

Monitoring Performance in the Treasury Function

1. Summary:

Measuring treasury function performance is a tricky business, and some people claim it is impossible. What should the performance measurement criteria (KPIs) be? What can realistically be put in place? How can a CFO measure the level of satisfaction with his treasury manager's work? These are the questions that this article is intended to answer. Let us disentangle the mysteries of performance indicators (Balanced Score Cards) in quest of value added metrics.

2. Key headlines:

The main difficulty with value added is measuring it

Never before have treasurers had to produce so much information or data for the annual report

Unfortunately, it is often the "benchmark" comparator that is lacking.

Setting you properly determined target increases accuracy

3. ARTICLE:

(see next page)

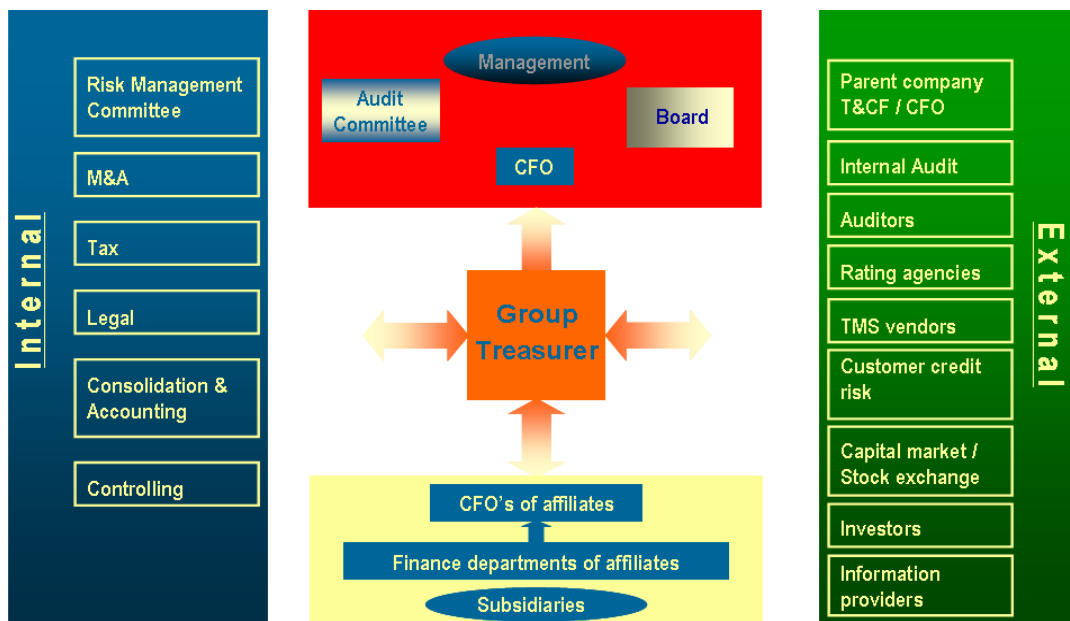
Performance, a synonym for profit?

When we start talking about treasury performance, plenty of people naïvely think that this can only be done providing we are operating in a purely speculative or trading context. Performance would then be easily measured and the total net savings achieved would be the key element for calculating the efficiency achieved by the treasurer, and at same time for calculating his annual bonus. Unfortunately, this view is far too narrow. Might it mean that treasurers operating in a "service" or "cost centre" environment could not measure performance, or even worse, could not achieve any performance?

Why measure performance?

The treasurer's job has changed fundamentally over the last few years. The role has become more technical and the scope of work broader than ever before. Treasurers have moved towards a role of partner to those around them. They have a central position. The target set for them by the CFO (Chief Financial Officer) is to add value to the company's financial activities. However, performance measurement in treasury management is somewhat nebulous. Plenty of people talk about it and claim to apply it; but in practice, very few truly apply it.

Treasury Stakeholders



But how are we to measure or assess this "(financial) value added" of which treasurers are an undisputed key architect? Few treasurers can give details of how they are assessed by their CFOs. Nevertheless, they are. But on what bases?

Performance enables you to:

1. compare cost effectiveness against the comprehensiveness of controls
2. transform a behaviour into a targeted performance indicator
3. measure decision-making cost/benefit advantages
4. report to the Board of Directors on the treasurer's activities and value added
5. Help give a better understanding of the treasurer's role within the group and the role of each team member within the treasury department.

KPI problems

The main difficulty with value added is measuring it. Behind the success factors (KSF – "Key Success Factors") or performance indicators (KPI – "Key Performance Indicators"), ideally we want to be able to measure this value added. Sometimes this is possible using "quite" quantitative elements. At other times, this is completely impossible and only qualitative elements can be used to identify the actual contribution. By means of such identification, the CFO can set the targets for treasury department and individual performance.

KPIs are one measure of performance and value added, and a necessary guide to the proper management of the department. In a three tier pyramid of types of treasurer role (1. *Operating*, 2. *analysis* and 3. *strategy*), KPIs belong to the second tier. To let treasurers see their jobs move up to the third tier of strategy, they have to move through the second, for which performance evaluation is an essential step.

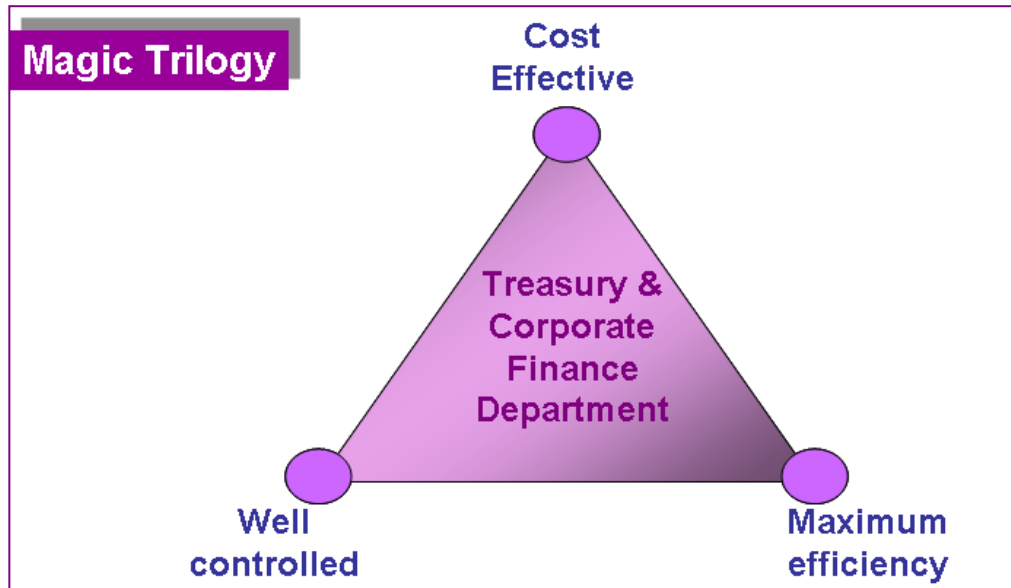
Environment of increasing supervision

Today's world of finance is currently governed by the all too well-known Sarbanes-Oxley Act, by corporate governance measures (the Lippens Code in Belgium, the Tabaksblad in the Netherlands, the LSF in France, etc.), by Basel II (and Basel III) and by the IFRS accounting standards. Unfortunately these are not "best practices" but laws or directives applicable to countries and their nationals. Never before have treasurers had to produce so much information or data for the annual report. With the application of IFRS 7, we estimate the treasurer's contribution to the financial section of the annual report to be between 15% and 18% (depending on the sophistication of the financial instruments being used). Against this background, it is vital to be efficient in quality and in the time taken to produce the required financial information.

A tricky balancing act

The difficulty is how to strike the right balance between on one hand low operating cost, limited resources, the need for automation, shortage of time, the world's dearest resource, and prevention and, on the other hand, value added

services, segregation of duties, detecting problems in good time and the fairness and accuracy of the figures produced. This balance is one of the most difficult to achieve. The magic triangle of minimum cost, maximum efficiency and extensive control is still a major target for all treasurers.



The impact of systems on treasury management

In the world of modern treasury, technology holds pride of place. To improve efficiency and control, you need to have coherent procedures, to save time, to cut down mistakes, to be less dependent on people, to improve controls qualitatively, to segregate everyone's tasks and duties, to have better safeguards and more effective audit. It is clear that Straight Through Processing (STP), pre-defining transaction flows and pre-coding accounting entries, web solutions, online transaction confirmations, online trading platforms, and tracing systems (audit trails) are all part of a toolbox that is essential for better management.

Moving to value added

Recent surveys show how the philosophy of treasury management centres has changed by moving to a value added approach. 70% now use value added against 10% using "profit centres" and 20% using "cost centres" according to a 2006 PwC survey. This is a proactive approach, no longer reactive. The idea is to make treasury management a structured decision-making support, providing information and specialist services. By setting KPIs, behaviour could change.

Targeted KPIs to change behaviour

A. Increasing control supports the business (by monitoring limits and observance of applicable policies, by centralising processes, by automating, and by identifying risks more quickly, etc. The support provided to business activities can be measured by indicators such as the number of limits exceeded, correction time, percentage treasury FTEs against total headquarters staff, number of documents checked, number of manual transactions, number of errors, compliance with internal policies, transaction speed, etc.

B. Seeking opportunities for creating value can lead to quicker risk identification, guard against market fluctuations, improve the accuracy of future provisions, result in using more appropriate instruments, etc. Factors that could be used to measure the quest for value are average hedging period, daily results of trading operations (where authorised), analysis according to various scenarios, etc.

C. Cost reduction through automation, netting, payment factories, shared service centres, a better credit rating and STP. KPIs might be cost per transaction, the number of external as opposed to internal transactions, the transfer error rate, or the cost of borrowing compared to a benchmark with a similar credit rating.

D. Reducing and managing risks by identifying them, real-time quantification, better communication of policies and procedures to be followed, improved sensitivity and stress scenarios, regular IFRS hedging effectiveness tests. KPIs might for example be changes in income statement volatility without using hedge accounting (simulated accounts), analysts' positions on the completeness of procedures, mitigation measures in place, the percentage of qualifying hedging relationships under IAS 39, etc.

E. Operating using "centres of excellence" by means of satisfaction surveys with the Business Units (BUs) or by improving reports and the time taken to produce them. Excellence can be measured by the affiliates' level of satisfaction, or the percentage of BUs using treasury services, by comparison with other treasury centres (via consultants), by comparison of bank costs, by distribution of bank transactions in compliance with the set banking policy, etc.

F. Building up a highly efficient staff by attracting and retaining "talents" by offering training and performance bonuses and career opportunities. Performance can then be measured by "rating" new employees, the link between salary or promotion and performance, personnel turnover, etc. Treasurers must "consolidate" staff expertise – this is the scarcest

resource in these times of a shortage of talented people and competent financial staff.

Treasury department performance table

People often say that in practice it is impossible or complicated to set benchmark criteria for you. Even if we cannot disprove this frequently encountered prejudice, we are not going to limit ourselves to things that are easy.

A performance table, also called a "balanced score card" should be based on four main features:

PERSONNEL
CUSTOMERS
FINANCE ASPECTS
PROCEDURES

For each of these parameters, a series of performance or procedure indicators should be set and followed, to provide the comparison needed for proper performance management.

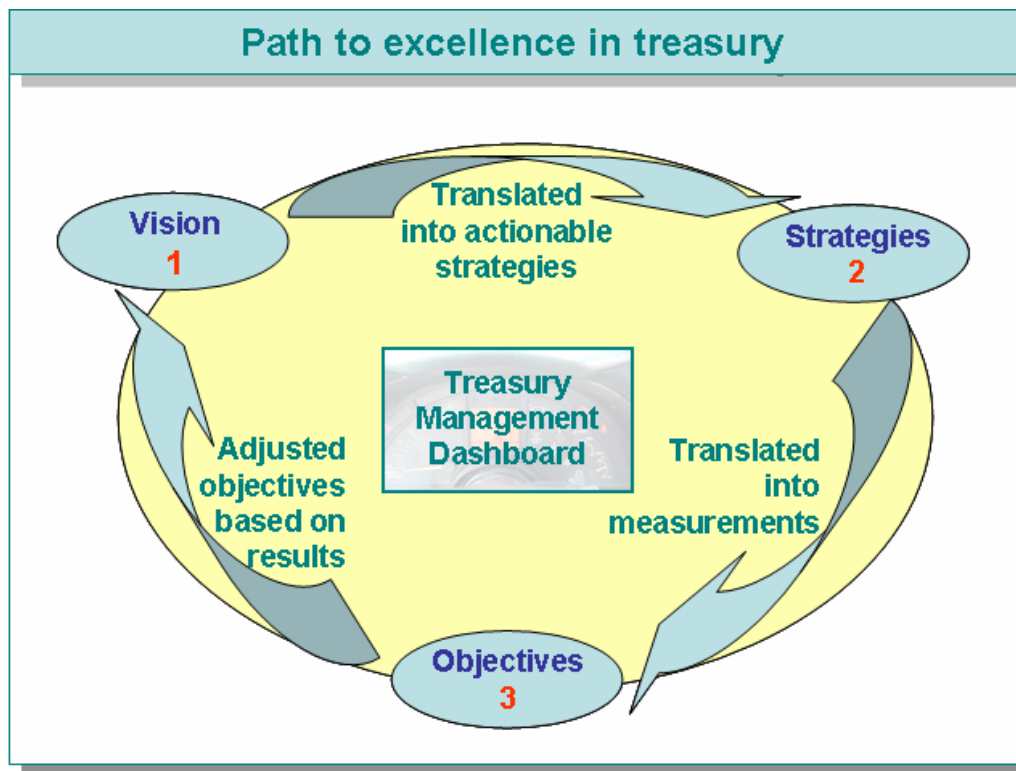
The criteria fall into two types:

QUALITATIVE
QUANTITATIVE

Different Types of Metrics & Indicators Reflecting the Strategic Performance of an Organisation						
Types of Indicators:	Categories of Indicators:	Non-Financial / Financial	Qualitative / Quantitative	Depending on Treasurer Action Non Directly Depending on Treasurer	Quantitative/Practical (*) Directional/Actionable	External / Internal purposes
KPI/KSF/GTI		NF / F	QUAN/QUAL	D on T / NON D on T	QUAN/PRAC/DIR/ACTIO	Ext/Int
KPI/KSF/GTI	STAFF	NF / F	QUAL QUAN	D on T NON D on T	QUAN/PRAC/ACTIO	Int
KPI/KSF/GTI	CUSTOMERS (**)	NF / F	QUAL QUAN	D on T	QUAN/PRAC/DIR/ACTIO	Internal
KPI/KSF/GTI	PROCESSES (**)	NF / F	QUAL QUAN	D on T	QUAN/PRAC/DIR/ACTIO	Int/Ext
KPI/KSF/GTI	FINANCIALS	F	QUAN	D on T NON D on T	QUAN/DIR/ACTIO	Ext/Int

* quantitative which can be presented as a number: practical that interface with existing company processes; directional specifying whether an organization is getting better or not; actionable sufficiently in an organisation's control to effect changes

** means in treasury only



We can talk not only about KPIs and KSFs, but also about General Treasury Indicators (GTIs). Some indicators can only assign a place to the treasury function as a whole, or compared with the whole of finance department. Some depend on treasurer action and management, while others are independent of treasurer action in isolation. Obviously, treasurers cannot act on all "shareholder value" parameters or levers, but they can contribute to the effort, for example through the cost of capital or the working capital requirement on sales.

The figures are only meaningful when compared to other similar or earlier figures. Figures have to be compared against themselves or against these comparators. You therefore have to build up a database and keep it up-to-date to make it meaningful and useful. Unfortunately, it is often the "benchmark" comparator that is lacking. Not much effort is made to build up comparators of this type, which would enable treasurers to compare their work with best practice. The *PwC European Survey* and *Annual Benchmark SLG* are two examples.

TREASURY MANAGEMENT DASHBOARD

The 4 main areas for KPIs; KSFs and GTIs (General Treasury Indicators):

PEOPLE	CUSTOMERS
<p style="text-align: center;">objectives:</p> <p style="text-align: center;"><i>team working, excellence, building of an organisation with high skills and expertises, vision, culture, treasury road mapping</i></p> <div style="border: 1px solid black; padding: 5px;"> <ol style="list-style-type: none"> 1 Attrition/retention rate, Turnover of staff 2 360 degrees appraisal 3 Employee surveys (treasury part) 4 Training days per FTE 5 Percentage of skill set on defined scale 6 Days of absenteeism per year 7 Average appraisal per capita of treasury department 8 Number of tasks backed-up and documented by procedures 9 Percentage of targets/objectives reached 10 Interoperability of staff by random turnover of tasks </div>	<p style="text-align: center;">objectives:</p> <p style="text-align: center;"><i>business focus, top management accountability, support to other HQ functions, bank, investors and rating agencies relationships</i></p> <div style="border: 1px solid black; padding: 5px;"> <ol style="list-style-type: none"> 1 Satisfaction of Bus (surveys) 2 Number of visit to affiliates 3 Timesheets and percentage time spent with Bus for advisory 4 Timeliness and quality of reporting delivered to affiliates 5 Number of reports produced per BU 6 In-house bank quality services rating 7 Benchmark of interco pricing versus external BU pricing 8 Working Capital management (DSO, DIO, DPO) 9 Revenue generated by treasury fees from Bus 10 Scope of master agreement in place with affiliates </div>
PROCESSES/PROCEDURES	FINANCE
<p style="text-align: center;">objectives:</p> <p style="text-align: center;"><i>improving productivity and efficiency, applying best practices, operational performance accountable, updated policies to match with business evolution and market environment</i></p> <div style="border: 1px solid black; padding: 5px;"> <ol style="list-style-type: none"> 1 Number of bank relationships and bank accounts 2 Respect of banking activity statistics (business sharing) 3 Bank charges/fees per account/ per flow (benchmark) 4 Treasury department budget costs (versus Y-1) 5 Number of netted transactions / natural hedges 6 Number of settlement errors / errors in transfers on total transfers 7 Compliance with policies' limits pre-defined 8 Maximum deposit with a single bank/on a single day/... 9 Total net risk of treasury risk matrix v. Y-1 10 Average time between 2 update of policies / procedures 11 Number of policies and procedures in place / benchmark of them 12 Bank balance score cards of service quality / performances </div>	<p style="text-align: center;">objectives:</p> <p style="text-align: center;"><i>improving overall value added, decreasing costs in general, costs of debt/interest charges, improving cash flow forecasting, while having sound risk management approach</i></p> <div style="border: 1px solid black; padding: 5px;"> <ol style="list-style-type: none"> 1 Average FX/IR hedging versus budget rates 2 Net total gains in case of trading activities 3 Cost of debt (benchmark v. similar ratings); % (un)-committed facilities 4 Return on assets (benchmark: e.g. EONIA or LIBOR 3M) 5 Idle cash upstreaming/tracking (percentage v. total cash) 6 Percentage of cash/debt centrally managed 7 Percentage of hedging v. total group exposure / volatility of P&L. 8 Total OCI/EHR (as result of hedging strategy) 9 Percentage of own guarantees v. bank guarantees issued 10 Basis Point Value (BPV); Net FX result/EBITA; n°HR/total exposure 11 Sensitivity analysis on B/S+P&L of market movements V@R 12 Estimate of margins made on treasury interco dealing (when tax optimised) </div>

non exhaustive list of KPIs / KSFs and other indicators of treasury service level and performances

Putting the treasury function into perspective

By using a few simple figures and outcomes, treasurers can give a clear picture of the transactions being processed and show the volumes being handled day-to-day. For example, the total of funds transferred in a year in EUR; the average transfer in EUR, the number of hedging contracts or "hedge relationships" in place; the number of transfers per day or even the same figures per person.

With these few figures, humble treasurers who are often poor communicators can give a snapshot of the transactions that they handle. Some of us would certainly be surprised by the volume being handled by our peers. But it might also be worthwhile measuring the number of articles published by treasurers promoting their companies, and their excellence or innovative nature.

Treasurers in the limelight – an opportunity?

Treasury departments have been the limelight for the last few years, although unwillingly. Now, however, they have the opportunity to demonstrate their "value

added", and to measure its scale, while providing yet more transparency. The number of pages contributed by treasurers to the annual report would be instructive in this context.

When treasurers reduce liquidity risk, they are working at creating value. When they make a non-taxable margin on the subsidiary's hedge, they are making a contribution. When they maintain optimal banking relationships by giving an appropriate slice of the cake to each bank, they are creating value.

In the past, treasurers have often been seen as expensive with no value added. We have to fight against these two preconceived ideas. Treasury support is essential in decision-making and for financial reports. That is why we need to take care in setting key performance indicators specific to the treasury function. From these indicators, its performance and that of its personnel can be assessed. From them, the CFO can set treasury department targets. Through a more innovative approach, different to that of other finance departments, treasury management can break out into the open. It can move closer to operational activities and to senior management, with a more strategic role than it had beforehand. With a modicum of rigour and by targeting its management objectives, treasurers can differentiate themselves positively. They are being offered a real opportunity to mark out their function and to be bold enough to assess it, by comparison to themselves, by comparison to their colleagues and peers, and by comparison to other finance personnel. Setting you properly determined target increases accuracy; and defining an identified centre, even though that may be difficult to achieve, can improve performance. Life is an ongoing challenge!

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