Treasury models are adapting for purpose

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A corporate treasury focused purely on executing transactional activities is a rare thing – if one still exists. The role of treasury has developed into a far broader function and phases such as strategic advisor are now thrown into the mix. But what does this mean and how does selecting the correct treasury structure enable an advisory function? Treasury Today Asia looks at how different treasury models, including hybrid centralisation, have evolved to fulfil the multiplying needs placed on different treasuries.

Whilst automation and cost reduction remain among the major aims when it comes to structuring the treasury function, full centralisation doesn't suit every business, nor is it possible for many. Certainly, emphasis on visibility and control is considered one of the drivers behind intensifying interest in centralisation. But the trend to note from recent years, suggests Craig Davis, Partner, Head of Financial Risk Management, Asia Pacific, KPMG, is the movement away from decentralisation – one which may not reach full centralisation in every case, but a journey that is particular to an individual company's criteria, and what works best for its operating model.

According to Norbert Braspenning, Clients & Products, Asia Pacific, Managing Director, ING Bank's wholly owned subsidiary Bank Mendes Gans, this trend can be compared to Charles Darwin's theory of natural selection. "In his scientific theory, the evolutionary process gives rise to diversity at every level. If you project that onto treasury, one of the definite takeaways is that there is more than one way forward." As companies evolve, "each business will find itself in a unique situation based on its size and scale, geographical footprint, organisational culture, technological sophistication and so on", and treasury will adapt more or less in line with these developments.

Without a doubt, though, in recent years, centralisation has been the hot topic. KPMG's Davis identifies three factors which have driven the preference for a move in this direction: "Firstly, from a cash management perspective, being able to pool your liquidity together is going to give you cost and efficiency benefits. In addition, from a risk management perspective, having a holistic view across the organisation is advantageous. A third key point is regarding infrastructure; rather than having multiple instances of TMSs, for instance, being able to build technology in one location and leverage that for increased risk analytics and cash management capabilities drives centralisation."

It is clearly not a new transition, but one which has been accelerated by the global financial crisis. Efforts to fortify internal controls, mobilise working capital and boost visibility intensified in the turbulence that followed this period. And now, Davis says, the current economic environment is further driving focus on such efficiencies, as well as technological advances making it easier and cheaper to centralise in varying degrees.

Drawing the right attention

As such, treasury models have received much attention in Asia Pacific (APAC). Richard Parkinson, Managing Director of the Treasury Today Group, facilitated a panel at the annual SIBOS conference in Singapore last year, which discussed the growing trend to centralise the treasury function in APAC but acknowledged the multiplicity of choices treasurers have when shaping the structure of their departments. Indeed, operating a centralised structure is not always straightforward and, as every business has individual requirements, it is important to determine (and periodically re-evaluate) the degree to which centralisation is beneficial and practical from a specific company's perspective.

This is particularly the case in Asia where infrastructure and regulatory frameworks diverge between markets, making achieving an optimal balance between global consistency and local flexibility of utmost importance. In fact, many treasuries form a hybrid between the two.

When deciding whether a company's treasury model needs adapting, the treasurer's knowledge of the company's business drivers, how funds are managed within regions and back to the parent company and desired levels of control, amongst other company-specific priorities, is key. "There are certain criteria that I think everybody needs to consider but depending on the type of industry they are in, some will be more important than others," says Davis. These priorities can then be matched with relevance to the two distinctions that treasuries find themselves between:

Decentralised.
Treasury policy-making, decisions and activities are conducted by individual subsidiaries. Typically, only a small team is retained at group level to provide advice and support. Subsidiaries may have their own local banking arrangements, will organise their own funding and handle cash management (including short-term borrowing and investments) locally but payments to and from the parent company will still occur.

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Fully centralised.

With a fully centralised structure, a global treasury centre or regional centres (on behalf of subsidiaries across a specific region or across the group) will undertake policy-making decisions and most, if not all, banking and financial activities. These centres may offer 24-hour services to ensure round-the-clock coverage for all subsidiaries.

Centralisation ensures group treasury has standardised operations, greater control across the company with streamlined bank accounts and improved transparency of cash flow. The natural hedge created by the matching of financial positions can also result in better margins. If basic processes of payments and collections are centralised, the cost of those processes decreases: it is a simple economy of scale. At the SIBOS panel facilitated by Treasury Today Asia, Finance Lead at British American Tobacco (BAT), Nicholas Soon, said how the cost savings from their centralisation project in treasury alone are $50m per annum.

Centralisation can, however, lead to a lack of local banking expertise and a loss of responsibility locally may create a lack of interest and build up resistance at that level. Technology developments can also be hampered by many Asian regulations so although full centralisation may be the ultimate goal for most multinational corporations, many companies end up with a partial or hybrid centralisation structure simply because it is too impractical for them to operate in any other way.

Indeed, it certainly isn't a case of one size fits all. Some responsibilities of the treasury department can benefit more obviously from centralisation – increased visibility of cash flows and information, for example.

But, in some instances, companies must question whether the process involved would be handled better locally – certain commodities hedging or transactions require reporting to central banks, for instance. "Historically, decentralised approaches were used for a number of reasons in terms of regulatory requirements and infrastructure challenges," Davis says. Whilst the majority of developed countries innovate, mature and advance, some countries remain stuck in the past somewhat and if companies want to operate there, they must follow the rules and deal with the consequences on treasury structure.

In fact, according to Braspenning, "the majority of corporates fall in the middle. There are a few that operate fully decentralised, but there are even less that can do everything centralised".

The best of both worlds?

Treasury models, of course, aren't fixed structures – they are meant to adapt for purpose. As such, over the years, other models taking influence from both ends of the spectrum have emerged. For example: global treasury centres with regional treasury centres and global treasury centres with decentralised treasury activities (see Chart 1). Both are part of a centralised treasury management function, but are legally structured as a separate group entity or branch.

Chart 1: Treasury centre operating models

Source: KPMG

Heralded as a 'best of both worlds' approach, hybrid centralised models typically involve individual subsidiaries following the treasury policy as outlined by group treasury, but given the responsibility for executing deals themselves via their local banking partners. Since the financial crisis, treasurers have been rethinking their approach to banking and funding and with an increasing number of banks withdrawing from once key markets, relying on just a few banks is no longer seen as a viable option.

This delivers more control while enabling subsidiaries to maintain a degree of autonomy within the front office function. It can also help to increase uniformity in treasury policies and procedures across the group and allows key decisions to be made at a global level with a comprehensive view of cash flow – whilst also retaining local expertise.

What you see with hybrid centralisation, Braspenning says, is that treasury can decide which parts it wants to outsource and what activities it wants to do locally. "For example, managing short-term cash using cash pools, whilst arranging long-term financing through an in-house bank (IHB)." In addition, keeping that local knowledge avoids an inevitable challenge of having all expertise at the centralised level. "Hybrid centralisation has already been around for a long time, but I think to a certain extent it has been rediscovered in Asia Pacific," says Braspenning.

However, trying to identify specific tasks that will be given to subsidiaries is somewhat difficult, as it will depend on their individual set-up and consequently can vary massively from company to company. Whilst, for example, subsidiaries could be tasked with identifying exposures related to their line of business and requesting head office operations to execute hedges, in other companies the specialised business unit may also execute the hedges. Over time though, Davis says, "treasury has evolved from being purely an execution centre to one that's driving a lot of decision making throughout the organisation" and it is this decision making treasury can use to drive forward a tailored set-up for the function.

What are the motivations?

Hybrid models can arguably be seen as "stepping stones to centralisation", says Davis. "Going straight from decentralised to fully centralised can be a significant leap for certain organisations. In some cases, such models are very much that stop gap." That isn't to say that it is every organisation's aim, however, to eventually move to a centralised structure. Some corporates like to keep a certain amount of control in the local businesses, so whilst there might be a group treasury helping them coordinate some activities, a lot of the on-the-ground decision making is still made within the local operation. "This links back to the culture of that particular organisation in terms of not wanting to give up authority within the local businesses," says Davis.

His colleague, Oliver Hsieh, Director, Advisory, KPMG Singapore, concurs. "I wouldn't say that a fully centralised treasury centre is the ultimate goal for every treasurer out there. Some companies' businesses naturally go towards a regional treasury model, especially where they have major pricing centres or major trading areas."

The tendency to stick to global treasury centres with decentralised treasury activities, Hsieh says, is often seen in Asian conglomerate companies that "like to have their fingers in a lot of different pies" – a result of which is that the group's businesses have limited connections to one another, so to try and force a centralised or even a regional treasury model onto that company might not necessarily work.

What's more, "in this day and age, corporates in multinationals or conglomerates can be conscious about having to sell off parts of businesses. To the extent that they would need certain assets to go with that specialised business, having a centralised treasury again may not actually work," says Davis.

Location push and pull factors

Whatever may be the motivation, when either a regional treasury centre or specialised business unit is encountered, decisions need to be made regarding location. Again, this choice will largely depend on a company's individual business model. A KPMG report, titled 'The Structure, Role and Location of Financial Treasury Centres: A Process of Evolution', cited the following consideration factors and the corresponding importance, as rated C-suite respondents representing MNCs from 12 industries:

- Banking factors (13.3%).
- Tax attractiveness (12.9%).
- Business environment (9.7%).
- Availability of skills and talent (9.4%).
- Government incentives (9.3%).
- Currency environment (9.1%).
- Access to capital markets (8%).
- Country credit ratings (7.4%).
- Infrastructure and accessibility (7.2%).
- Regulatory and reporting requirements (7.2%).
- Existence of other treasury centres (6.4%).

As Hsieh says: "It typically isn't one single factor that tips the balance, but a combination of multiple factors in multiple jurisdictions that they are weighing up." In sectors such as commodity energy trading, for example, tax effectiveness and governance incentives will be extremely important. Whereas, Hsieh continues, in electronics, the availability of talent and efficient infrastructure is likely to sway the balance.

Indeed, treasury centres are normally located in a tax-efficient environment, reducing the bill on transactions and profits associated with the entity. For example, between APAC's top choice for corporates for establishing a regional treasury centre (Singapore or Hong Kong), Hong Kong has lagged behind Singapore largely because of its poorer tax incentive programme. Recent developments have looked to change this: the Hong Kong Monetary Authority has new rules that tax payments on intercompany loans will no longer be larger than profit earned – thus bringing the territory's incentive package more in line with Singapore's Finance and Treasury Centre (FTC) award where qualifying corporates receive a concessionary tax rate of 8% on all fee income received from treasury activities and an exemption from withholding tax on interest payments.

But also of importance – and increasingly so – is the location's possession of a wealth of financial services expertise and talented future employees. According to Braspenning, as the tax landscape continues to change – the OECD's action plan on Base Erosion and Profit Shifting (BEPS), for example – it will, in fact, be "far more important to have capable people, in the right place, doing the right things". This is a factor, he adds, that treasury can influence, as opposed to a changing tax environment.

Typified by diversity

As has been explored, centralisation can take many forms; individual corporate objectives can be as varied as those pursing them. "Based on the corporate's DNA, the right (re)balance between centralised and decentralised needs to be found," says Braspenning. The days of understanding treasury centralisation as a project that has a finite end point are seemingly over. "Rather, the best idea is to see the change as multiple treasury evolutions because everyone will face different kinds of challenges, which need to be address in different ways."