



SECTION - 11

ROLE OF TREASURY FUNCTION

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- **Introduction**
- **Scope of Treasury Management Function**
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11.1 INTRODUCTION

- 11.1.1 For finance and treasury functions, the agenda is changing fast. Change is being forced with rapid economic developments, globalizing industries and competition, new technologies and revolutionary changes in the regulatory environment. As well as responding to these forces, finance and treasury functions are under pressure to add value to the organization through their operations and contribute to achieving strategic goals.
- 11.1.2 With significant developments that have taken place in the financial markets in the recent years affecting volatility in exchange rates and accentuating liquidity constraints, corporates have started paying closer attention to the treasury and foreign exchange (forex) management. Corporate treasury function is playing a pivotal role in financial risk management; exposure management and the use of hedging strategies are now all seen as essential requirements..
- 11.1.3 The concept of corporate treasury is defined through a comparison of traditional and emergent roles. The management accountants' main task in cementing the treasury's strategic role are:
- a. to facilitate communications and understanding of strategic possibilities;
 - b. to aid implementation through the use of diagnostics, and
 - c. the development of gap and sustaining strategies.
- 11.1.4 These emerging strategies are linked by one fundamental objective ie., to attract and retain competitively sought-after investor capital or, in other words, increase shareholder wealth. In a world where investor capital has more choice and mobility than ever before, the key to corporate survival and growth lies in organizational change initiatives that will contribute directly to the economic value of the firm and its ability to satisfy the financial return requirements of its investors. Increasingly, treasury and treasury management practices are being aligned with and integrated into, the business strategies of organizations. It should not be surprising to see corporate treasury and treasury strategies involved in organizational change.



11.1.5 Therefore, whilst ensuring the effective management of all forms of risks, treasury managers must also be able to use and apply financial products in order to maximize profit. With the ever-increasing range and complexity of financial instruments available, treasury managers must constantly update their skills in order to effectively undertake their crucial duties.

11.2 SCOPE OF TREASURY MANAGEMENT FUNCTION

11.2.1 In today's context, the scope of treasury management function is quite vast, and it continues to expand, as can be seen from the following listing. A treasury manager should be able to understand and appreciate the links between business strategy, organization and finance/treasury.

1. Cash and Liquidity Management:
 - a. Cash flow dynamics, cash flow forecasting , cash flow valuations
 - b. Short-term funding investment investments
 - c. Cash Management: transactions, pooling and netting
 - d. Working Capital Management
 - e. Using Debt Instruments
2. Foreign Exchange Risk Management
 - a. International Economics and International Finance
 - b. International Financial Markets and Instruments
 - c. Foreign Exchange: Swaps and Forwards
 - d. Vanilla and Exotic Foreign Exchange Options
3. Financial Risk Management:
 - a. Interest and Currency Risks
 - b. Interest Rates: Forwards, Futures and Options
 - c. Interest Rate Swaps and applications
 - d. Managing Currency Risks with Forward, Futures, Options and Swaps
4. Macroeconomic Policy Environment:
 - a. Understanding of macroeconomic policies
 - b. Understanding of how macroeconomic policies affect prices and costs in the economy
 - c. Current scenario and future outlook for India and globally
5. Other aspects in Treasury Management:
 - a. Role in accounting policy formation eg. Forex transactions, Mutual Fund Investments, etc.
 - b. Formation of Policies and Processes (Investment, Forex Management, Accounting, etc.)
 - c. Accounting Policies on recognition of Treasury Transactions



- d. Accounting Standards on various foreign Exchange techniques under US and Indian GAAP
- e. Taxation issues, eg. withholding tax on interest paid on overseas borrowings, treatment of capital gains/loss on investments, etc.

11.3 THE KEY TREASURY CHALLENGES

11.3.1 The world is increasingly global in level of connectivity and every day the pace of information moves faster than the one before. Treasury is at the heart of the organization and directly challenged by these external forces. The challenges include the following (extracted from Accenture's Brochure on Treasury management services):

Expanding risk coverage

The range of risks that the treasury function is now expected to cover has expanded. As well as traditional risks such as foreign exchange, funding, liquidity and counterparty risk, the treasury function is increasingly likely to manage commodity price risk, insurance and pension risks.

Ensuring the policy is still relevant

The treasury policy is the road map for the treasury function and it must keep pace with overall business strategy ensuring that the appropriate risks are identified, the right processes are in place for managing and mitigating those risks and that roles and responsibilities are clearly defined and communicated.

Performance reporting

Reporting and measuring performance is often seen as an additional burden on the overstretched treasury department. Well thought out metrics and indicators, along with a robust reporting framework, can not only be used to measure the performance of the function, but can also help drive high performance.

Reducing the risk of operational errors

The treasury function frequently manages complex, high-value transactions under tight time constraints, which can create the potential for operational errors leading to significant financial loss. An operational risk framework that captures, categorizes and analyzes loss events is pertinent to both the banking and corporate world.

Achieving a clear view of the global cash position

Organizations operate on a progressively global basis. As a result it becomes increasingly challenging to manage a central view of all banking arrangements. Depending on the relative autonomy of different business units, it may not always be practical simply to rationalize all global accounts. Other cash management methods—such as payment factories and in-house banking—may offer a more successful solution.

Enabling timely and accurate cash flow forecasts

Having an accurate and timely view of the global cash position is vital for effective cash flow planning, and requires effective communication between business units. The



treasurer may also provide valuable input into the longer term forecasting and budgeting processes and must work closely with the finance function.

Meeting strategic plans

Creating a funding program that is sufficiently flexible and responsive to achieve strategic objectives requires the corporate treasury function to make sure that its knowledge and understanding of the group business plans are consistent with the level, diversity, nature and maturity of the debt program it has in place.

Optimizing Return on Investment

With far more options available than simple bank deposits, the treasury function has to ensure that it is using the right instruments and investment methods that can fit both the risk profile and the required level of returns within the appropriate time frame.

- 11.3.2 High-performance treasury functions drive operational excellence throughout all levels of the organization. They are streamlined and flexible. They manage risk effectively, and they are able to contribute to the achievement of strategic business goals at the same time as ensuring that all statutory duties are met and compliance obligations are fulfilled.
- 11.4.0 The article titled “Treasury Organisation: Picking the Right Model”, published by HSBC’s Guide to Cash and Treasury Management in Asia Pacific 2004, appended at the end of chapter will further illustrate some of the concepts discussed in the chapter.

STRATEGIC DETERMINANTS OF THE CAPITAL STRUCTURE:

Main Aim: Maximising Market valuation of the firm.

- Asset Liability (ST/LT) mis-match should not be there;
- Nature of Industry: Funding of Seasonal needs may deviate from above theory;
- Degree of competition; More weightage on Equity if more volatile, low entry barriers, high degree of competition etc;
- Obsolescence: If high, Capital Structuring needs to be more conservative;
- Product Life Cycle; At venture stage, Equity is more preferred;
- Financial policy: Management policy on Maximum D/E, DSCR, Div Pay-out...etc
- Past and Current Capital Structure: It is not a day-to-day decision on the debt equity mix changes; it is altered not in Short term. It is only a Medium Term policy;
- Dilution of ownership by issuance of more equity exposes for take-over;
- Credit Rating;