The Financial Risk Management in Corporate Treasury of a Swiss Multinational Industry Group

Bachelorarbeit

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Executive Summary

Background

As an integrated component of the COSO Enterprise Risk Management Framework (ERM), Financial Risk Management (FRM) has become more and more important for company's management. While most books and papers focus on implementing FRM in financial institutions, there has been an increased need for a formal guidelines regarding FRM in industry corporations, especially in multinational enterprises (MNEs). Because of the growing opportunity in doing business globally and the increased number of financial products provided, MNEs are exposed to larger financial risk exposures with more complex character. In some cases, improper decisions regarding FRM may lead to substantial loss suffered by large industry corporations, as reported by Procter & Gamble in the 1990's[1]. The role of corporate treasury has also changed from mainly focusing on cash management to implementing risk management strategies covering all major financial risks in a company. This thesis aims to discuss some key aspects of corporate treasury's FRM process in a MNE by combining theory and practice.

Approach

The text part of the thesis consists of 5 chapters:

Introduction provides background information of the topic and explains the objective and the scope of analysis performed in this thesis, so that readers can get an overview of content covered here.

Chapter 2 is designed to build up a theoretical background about FRM in corporate treasury of MNEs. The characteristics of MNEs and corporate treasury are first examined. Section 2.3 focuses on the FRM in corporate treasury and consists of 3 parts: treasury related financial risks, arguments for FRM, and the FRM procedure. References from financial journals, books and economic theories are used for the analysis.

Chapter 3 forms the main part of the paper. The Group Treasury of a Swiss multinational industry Group ("the Group") is taken as an example. At the beginning of this part there is a brief introduction to overall business and financial situation of the Group, this part continues to introduce and implement a FRM model designed for the company. In the end the performance of the FRM model is examined by quantifying added value to the Group through FRM. As this is a practice oriented part, fewer references from economic literature are cited.

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[1] In 1994 an interest rate derivative contract has cost Procter & Gamble an estimated loss of USD 160 million.

As a matter of fact, many examples being used are taken from the Group's internal data. By communicating with the persons responsible for the FRM in the Group and from the author's own working field, more knowledge about the implementation of FRM in the Group is obtained.

Periodical treasury FRM report is produced to ensure that the compliance aspect is achieved in the overall FRM. Structure, users and important output in this report are discussed in Chapter 4. Examples shown in this part are partly based on the Group's monthly treasury report.

The last part, Chapter 5, gives an overview of the analysis done in this thesis and suggests improvements that should be made to increase the effectiveness of the FRM in the Group Treasury.

Result

FRM is and will remain a complex management issue for MNEs. Like any other risk management process within the ERM scope, the FRM follows a certain process, independent from the size of the company. The basis of all FRM measures is a thorough understanding of the business. The Treasury Policy is a must in a professional risk management process and provides guidelines for managing all treasury relevant financial risks. Besides, clear defined roles and responsibilities across treasury organization are also crucial for the success of FRM in MNEs. To obtain a complete picture of the company's underlying financial risk exposure, as well as to allocate resources in a most efficient way, creating a financial risk map and a risk matrix can help. The most important treasury relevant financial risks are but not limited to: liquidity risk, credit risk, interest rate risk and currency risk. Depends on the size, available resources, experience of the treasury team, risk culture and risk appetite of the company, different objectives for FRM are set and different approaches are chosen to manage the risks within pre-defined limits. By examining the savings through netting system, increase in share price, reduced costs of financial distress, and reduced earnings' volatility, it is believed that FRM do add value to the company. A periodical treasury FRM report should be produced to ensure the timely identification of risk exposures, compliance aspects are achieved and to provide information to senior management about FRM status.