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EiL

Excellence in leadership

Top finance and business insight in this issue

Olivier Bayzelon, of Volvo, on tightening cash management

Timon Drakesmith, of Hammerson, on managing the treasury function

Daniela Bas, of the UN, on the value of credit unions

Ian Armstrong, of Santander, on the role of banks in supply chain finance

Camille Van de Sande, of Rabobank, on balancing profit and social commitments

SUPPLY CHAIN FINANCE

Top industry chiefs share their views on getting the most from supply chain finance in the current economic climate

Excellence in leadership
Supply chain finance
ISSUE 1 2012

FOREWORD

Supply chain finance

Good businesses are like high performance engines: they are at their most efficient when properly maintained. As we move through another year of economic uncertainty, prudent business leaders are looking at ways of fine-tuning their operations to ensure maximum performance. This is especially important when it comes to the management of the financial supply chain.

In this issue, we aim to provide some practical, thought-provoking suggestions for getting the best possible value from working capital. Based around the themes of collaboration, risk management and new technology, some of the UK's leading experts look at different approaches to managing the financial supply chain and maximising cash flow.

We begin by asking the finance directors at Jones Lang LaSalle and Hammerson how their cash culture has changed since the start of the downturn, what the top priorities for the treasury function will be in the year ahead and how efficiency has been improved through technological developments, and services such as outsourcing (page 8).

And with outsourcing in mind, we look at how this service can help to make the treasury function more effective. Dr Anthony Hesketh, senior lecturer at Lancaster University Management School, addresses some of the scare stories in the financial media and underlines how careful preparation can avoid outsourcing difficulties later on. The key, he says, is to establish a strong partnership from the outset. This will ensure that there is a clear understanding of the firm's capital requirements and how these dovetail with its operations (page 32).

To illustrate some of the more innovative routes to working capital optimisation, Nick Wood, corporate director at NHS business support firm ASP, highlights how an online social network platform and the use of "apps" are helping to make his company greener and more efficient (page 18).

Another area to consider is the management of foreign exchange risk. Alex Canavezes, managing director of Quant Analytics, and Bruno Campana, director of economics at FTI Consulting, put forward some hedging and invoicing strategies for CFOs to mull over, as well as offering guidance on how to avoid some of the pitfalls (page 26).

Finally, in the wake of the scandal around structured products and toxic mortgages, credit ratings agencies have begun to recover their reputational standing. However, it seems that they are now facing new challenges in the form of calls from politicians and regulators for a more competitive ratings market in Europe. We look at the proposals being put forward by the European Securities and Markets Authority, and what investors – and the agencies themselves – have to say in response (page 21).

> 'In another year of economic uncertainty, business leaders are looking at ways of fine-tuning their operations'

Meanwhile, Georg Schroeder, a director at Deloitte, believes many companies could benefit from having more frequent engagement with credit rating agencies. Schroeder stresses the need for management teams to be clear about what information they should aim to disclose, and expands on some of the common misconceptions companies have on how corporate ratings are evaluated (page 24).

I very much hope that this issue of *Excellence in Leadership* provides you with some practical tools to re-evaluate the mechanics of your financial supply chain so that it can continue to function at optimum levels.

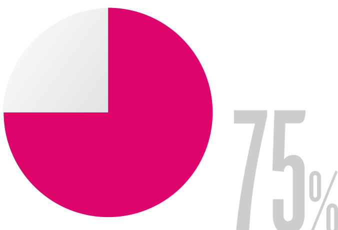
Charles Tilley, chief executive, CIMA

Cover photography: Georgina Hounsome. This page: Illustration: Masao Yamazaki/Dutch Uncle

CONTENTS

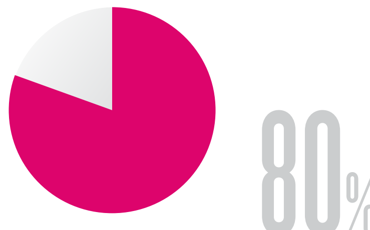
VITAL STATISTICS

Treasury statistics:



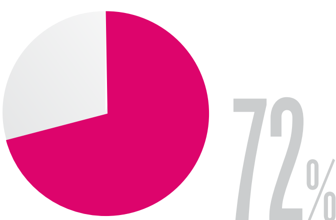
of top European banks still believe that the growth prospects for supply chain finance (SCF) remain "strong" or "very strong"

Source: Demica (2011)



More than 80% of respondent financiers said that their banks are putting "very significant" efforts into marketing and creating SCF products

Source: Demica (2011)



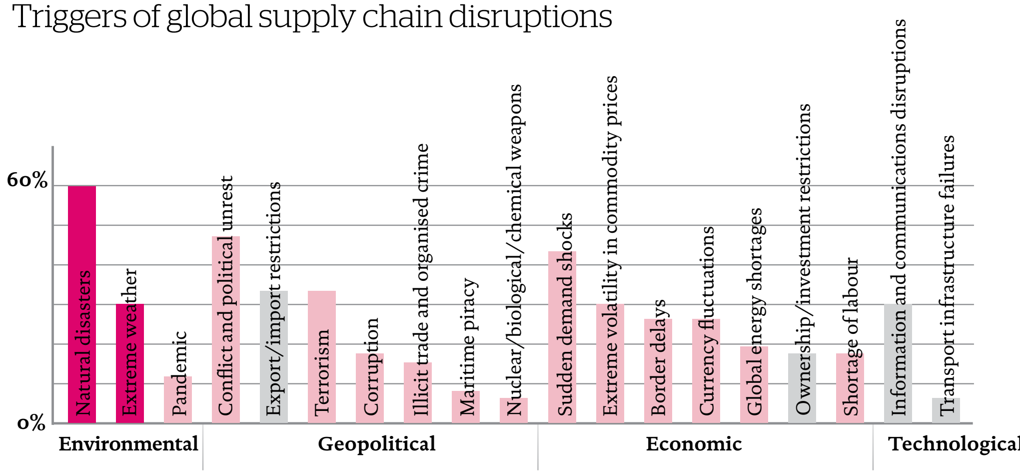
of CFOs report that SCF helped improve working capital efficiency in their organisation last year

Source: CFO Research Services (2011)

Most finance executives are focused on working capital management, with 81% stating it as a high priority

Source: CFO Research Services (2011)

Triggers of global supply chain disruptions



Source: World Economic Forum Supply Chain and Transport Risk Survey 2011

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Treasury in the spotlight

The global financial crisis has brought treasurers to the fore. Timon Drakesmith, CFO of property management firm Hammerson, and Joe Romenesko, global treasurer of financial provider to the property industry, Jones Lang LaSalle, explain how their strategies have changed...

The global financial crisis transformed corporate priorities, pushing financial risk management high up the list. In turn, this shift has raised the profile of the executive who is often responsible for managing that risk: the corporate treasurer.

Before the crisis, the prevailing treasury trend was to concentrate on benchmarking and on best-in-class systems, processes and controls.

In today's environment, it's all about access to liquidity, and there's a greater focus on debt covenants. Treasurers have also been working more closely with CFOs as risk and cash flow management have become greater corporate priorities.

To better manage risk, many treasurers have chosen to run a very conservative treasury operation in response to the economic crisis.

As the economy improves, however, many treasurers expect to spend the next few years focused on balance sheet repair. So what are the views of treasurers?

We asked two people responsible for their organisation's treasury function – Timon Drakesmith, CFO, Hammerson, and Joe Romenesko, global treasurer, Jones Lang LaSalle – to offer their views on the top priorities for the treasury function in the current economic climate, how the culture of their organisations has changed in the years since the financial crisis began, and their relationships with their banks, among other things.

Hammerson has been managing retail destinations and office buildings across Europe for more than 50 years. A FTSE 100 company with a real-estate portfolio in the UK and France of around £5.7bn, Hammerson has investments in 18 major shopping centres and 18 retail parks and owns six London office buildings.

Jones Lang LaSalleis a financial and professional services firm specialising in real estate services.

The company's services include capital markets, tenant representation, real estate investment banking, merchant banking, corporate finance, and consulting and investment management, among other things. »

Getty Images

‘The reduction in banks’ balance sheets has led borrowers to seek alternative forms of finance’

What are the top priorities for your treasury function in the current economic and financial environment, and why?
Timon Drakesmith, Hammerson: Our priorities are very clear. With deposit rates being so low and margins on borrowing increasing, it has become increasingly important to efficiently manage our cash to minimum levels to save interest costs. We also regularly review who our cash is held with for counterparty risk.

Liquidity is another priority – with banks restricting lending, maintaining access to funds from a variety of sources has become very important.

Foreign exchange exposure is the third priority – the eurozone crisis has led to a lot of volatility over the strength of the euro. We have therefore reviewed our hedging strategy for our French portfolio to ensure our assets are protected.

Joe Romenesko, Jones Lang LaSalle: We focus first and foremost on ensuring sufficient liquidity for our 200 offices in 70 countries to operate with confidence that we will always meet our financial obligations, and also have the ability to grow the firm. We manage a $1.1bn credit facility, with 18 banks participating in the facility. These banks have headquarters in seven different countries, so the group reflects the global nature of our business.

Can you give examples of how the cash culture at your business has changed in the past couple of years? Can you quantify the benefits?
Timon Drakesmith, Hammerson: To maintain minimal cash balances, we have sped up processes to pay cash out of subsidiary entities and pay down debt on our credit facilities. If we can reduce the average cash holding for the year by £10m, this will save us in the region of £100,000 in interest.

Joe Romenesko, Jones Lang LaSalle: We have been a net borrower for many years and, as a result, we have always been quite disciplined about using excess cash generated to repay our outstanding debt on our credit facility. Our employees understand that we are not a bank and, therefore, cannot extend long payment terms for our clients – although the typical payment terms vary greatly across the globe.

We partnered with our clients to minimise the impact of bad debt during the global financial crisis, but that period was a good reminder that we need to remain vigilant in collecting our fees for the good work we perform for clients.

To what extent are cash management and other treasury issues discussed at board level today and how does this compare with the typical situation pre-crisis?
Timon Drakesmith, Hammerson: The credit crisis of 2008 has changed the attitudes of everyone to the availability of funding and to how much interest and foreign exchange rates can move. Our board is committed to maintaining high liquidity levels and ensuring that our risk management strategies protect investors.

Joe Romenesko, Jones Lang LaSalle: We provide quarterly updates to our board on our balance sheet position, our contemplated spending plan and our sensitivities for downside scenarios. We maintain an investment grade rating from both Moody’s and Standard & Poor’s. Our ability to demonstrate this financial strength is important, not only to our banks and shareholders, but also to our clients who are choosing long-term partners and to our employees who want to work for a financially strong and stable firm.

In what ways have you improved the efficiency of the treasury function through the use of technology developments or outsourcing? Can you quantify the benefits?
Timon Drakesmith, Hammerson: We are fortunate to have a relatively simple treasury operation, but we have kept up to date with developments in information systems and internet banking systems. Having instant access to market information has become increasingly important and we have become closer to our banking group to keep in touch with the financial markets to evaluate our treasury strategy. »

Joe Romenesko, Jones Lang LaSalle: We have consolidated our European cash management to one banking partner and moved the payment processing into our in-house shared services organisation. Incorporating processing efficiencies has provided capacity for us to grow our European operations without the addition of significant infrastructure costs. With a regional banking platform, we utilise cash pooling to optimise the use of our cash balances across the region.

Which factors have had the greatest influence on how you manage your funding strategy and capital structure in recent times – volatility in financial markets, constraints on banks' balance sheets, shareholders attitudes to risk etc? Can you explain what the effects have been?
Timon Drakesmith, Hammerson: Volatility in the financial markets has led to borrowers having to take funding opportunistically when it is available. Hammerson has been able to maintain sufficient funding to not have to enter the markets at suboptimal times, but it can no longer be taken for granted that markets will be open. The reduction in banks' balance sheets has led borrowers to seek alternative forms of finance and increasingly companies are using overseas forms of funding. However, we have substantially deleveraged since 2008, so while banks' balance sheets have become constrained, our funding requirements have reduced.

Joe Romenesko, Jones Lang LaSalle: We increased the capacity of our credit facility in 2010 and amended it in 2011 to obtain more favourable pricing and terms. We benefit from excellent relationships with the banks in our syndicate, many of whom are important clients of the firm. Our banks were very supportive during the global financial crisis and continue to be supportive. We attempt to direct reciprocal business to these lenders wherever we can.

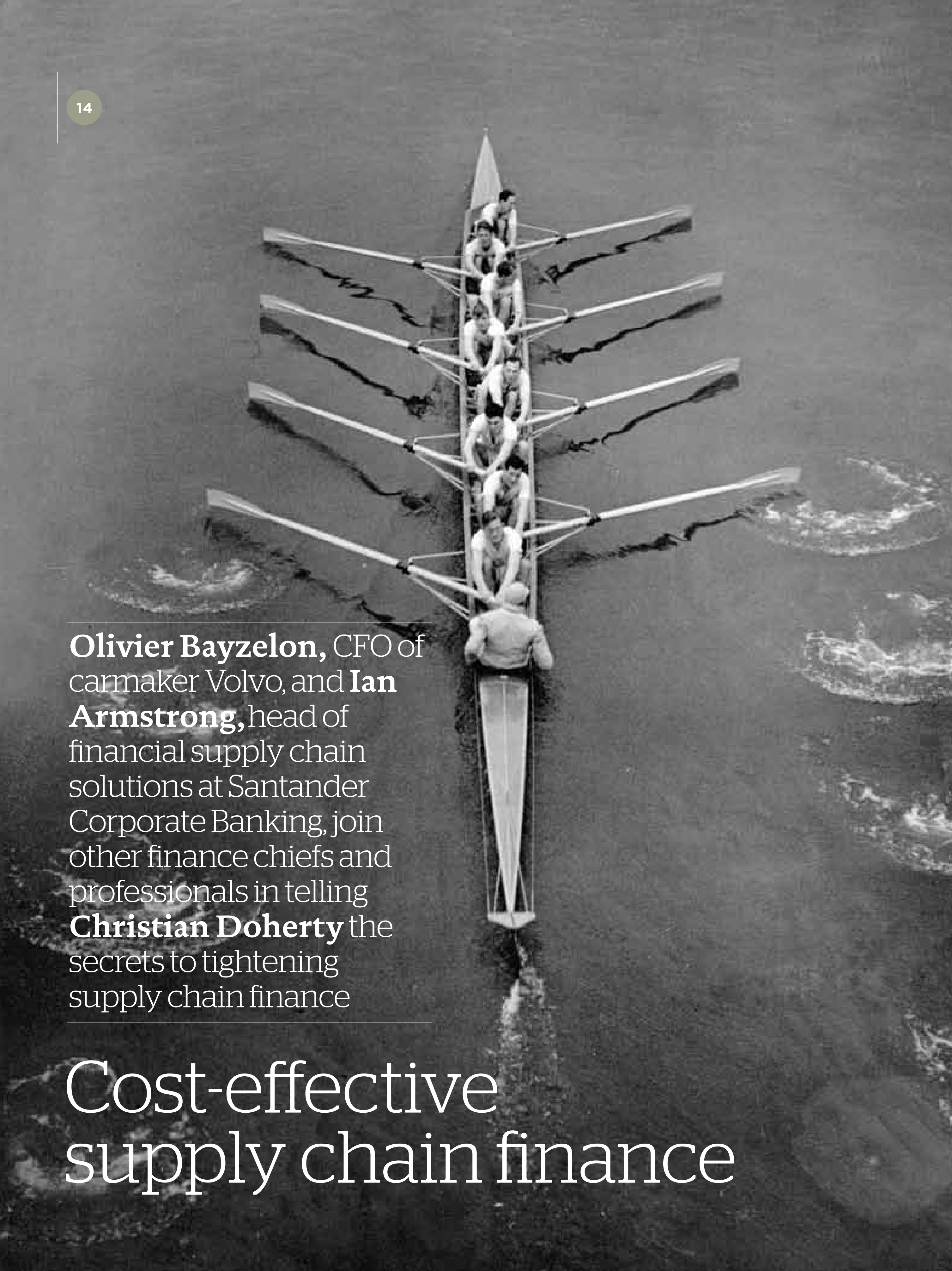
In what ways could the service you receive from your banking partners be improved in terms of global services, value for money, transparency?
Timon Drakesmith, Hammerson: Being a property company and having a large banking group, we are fortunate to have access to a wide range of bank advisory services. While increasing margins make life more difficult for everyone, it is understandable given the increase in bank funding costs and the changing regulatory environment.

How have your shareholders' attitudes to capital management and investment changed?
Timon Drakesmith, Hammerson: Since 2008, equity investors have become much more interested in the funding strategies of all companies. In our case, it means that we are questioned about the role and appropriate level of gearing, capital allocation in its broadest sense, and also what metrics we use to monitor the health of the balance sheet. I would say that this has informed rather than affected our corporate strategy.

Joe Romenesko, Jones Lang LaSalle: Our shareholders have a variety of opinions regarding capital management, with some advocating continued growth in our consolidating industry and others preferring increased dividends or share repurchases. We have chosen to invest in growth opportunities through both acquisitions and hiring while also increasing our dividend in the last year. We continuously evaluate our capital alternatives with our board considering the underlying market environment, our business prospects and the strength of our balance sheet. ■

Timon Drakesmith, CFO, Hammerson
Drakesmith, a chartered accountant, joined Hammerson as CFO in June 2011 from Great Portland Estates, where he had been finance director since 2005. Before this, Timon worked at Novar PLC as finance director of MK Electric and group director of financial operations. He was previously at Credit Suisse, Barclays, and Deloitte Haskins & Sells.

Joe Romenesko, global treasurer, Jones Lang LaSalle
Before joining the firm in 2000, Romenesko worked for eight years at Household International, where he held a number of positions. He has a Masters in management from the Kellogg School at Northwestern University and a BS from the University of Denver.



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Cost-effective supply chain finance

Olivier Bayzelon, CFO of carmaker Volvo, and **Ian Armstrong,** head of financial supply chain solutions at Santander Corporate Banking, join other finance chiefs and professionals in telling **Christian Doherty** the secrets to tightening supply chain finance

It is a simple fact that no business can thrive without a well managed supply chain. For many businesses, the emphasis is now falling on developing relationships with suppliers that go beyond merely driving the best price.

David Noble, chief executive of the Chartered Institute of Purchasing and Supply, believes there is little alternative but to bring suppliers closer. "The recession has been an interesting time for procurement," says Noble. "Supply chain professionals have been tempted to flex their muscles and drive their supplier prices down. During these difficult financial times the threat of business failures poses an increased risk to the supply chain.

"Employing a 'we're in this together' mentality encourages closer working relationships with suppliers based on shared risk and rewards, which makes supply chains stronger. It is these organisations that will emerge stronger when things are on the up as they will have invested in a robust supply chain.

"Perhaps the quickest and most sustainable win is therefore to develop a long-term, forward-thinking strategy for procurement and supply that is backed by senior management and integrated throughout the whole business."

The importance of protecting the integrity of a supply chain has been steadily climbing the CFO's list of things to do since the financial crisis hit. Logistically, the risks are obvious – as the past 12 months have shown, through the disasters that hit New Zealand and Japan, even the best-laid plans are never too far from collapse.

From a financial perspective, CFOs cannot afford to ignore the pressure of ensuring that their suppliers are committed to a long-term relationship, are happy with the terms offered and are able to respond to any changes in circumstances.

There are some clear trends emerging: there is no doubt that we are seeing the stratification of supplier management, which influences the attendant procurement strategies. On the one hand, "central suppliers" are now seen as more integral parts of the buying business, while non-core suppliers receive contrasting treatment.

Consider FTSE 250 building suppliers Travis Perkins. It recently announced a new "supplier colleague programme", under which representatives from key suppliers transferred to work full time in Travis Perkins' HQ in Milton Keynes "to look for efficiencies and ways to improve the working relationship between their companies".

While this is an extreme version, Travis Perkins is following in the footsteps of well-known retailers (supermarkets especially) that have been active in "on-boarding" suppliers for several years. For some businesses, this means involving suppliers in strategy consultation. For others, it takes on a more financial aspect. Long popular on the continent, supply chain finance offers a way to reduce working capital and maintain vital trading relationships. Simply put, supply chain finance involves the buying organisation extending credit to its suppliers via a third-party bank. The large buying organisation will almost always have a better credit rating than the smaller supplier, so using that to access bank finance makes sense.

The supplier invoices its customer, the invoice is quickly authorised and the bank takes over, playing an intermediate role by allowing the supplier to receive an early payment in settlement of their invoices, less a small finance charge, while the buyer pays the bank on the original invoice maturity date.

The lead bank usually runs the scheme for the buyer. "They do have a choice, but most of them have chosen for us to manage it for them because it saves them a resource," says Ian Armstrong, head of financial supply chain solutions at Santander Corporate Banking.

"There's no manual information, it's all automatic – the system will send the supplier a notification that an invoice has been approved, which virtually saves their credit control chasing the buyer."

Clear benefits

In principle, there are two overriding benefits – using the supplier offers the long-term flexibility of working capital and credit, while at the same time minimises the risk of losing key suppliers, and minimises competitive tension. The bank extends a credit line to the buyer and pays the supplier once the invoice is approved, allowing the buyer to pay on better terms – 60 days, say. That removes the biggest strain on trading relationships – late payment and a squeeze on working capital.

Alongside that, suppliers are naturally better disposed towards the buyers that use the scheme. Given the current strain many smaller suppliers are feeling from squeezed terms, large corporates offering a service such as this can make a great deal of difference. "Using supplier payments encourages suppliers to allow buyers a certain amount of orders on their books before repayment has to be made, meaning the supplier will effectively have a credit line from the buying organisation," explains Armstrong.

"With the bank paying them, it frees up their credit line from the buyer to be able to place further orders, so it allows that trading relationship to continue. And the buyer is still repaying the debt on day 90, which means they've looked after their working capital."

Initially, the scheme was largely confined to large » corporate buyers with many suppliers (think carmakers or supermarkets), but that has now been extended down the food chain. "Our risk is totally with the buyer so normal banking rules apply; so if the buyer is a good credit risk for the bank, we'll work with them," says Armstrong.

In France, Swedish carmaker Volvo has been using supply chain finance to protect its suppliers and de-risk the supply chain for five years. CFO Olivier Bayzelon pioneered the scheme and believes it goes a long way towards insulating the company from one of its biggest risks: losing key suppliers.

"That's a major worry for us," says Bayzelon. "We feel that even though there's an arm's length relationship with the bank, I do feel responsible for the suppliers and ensuring that they have access to credit in difficult times. So even through the credit crunch we are very pleased to have launched the programme because the people get a regular source of finance.

"And we've made a point that when we modify the terms we give the suppliers a chance to adapt. Even during the worst part of the credit crunch, the bank really played the game and placed no restrictions on the amount of credit available to suppliers. So it has been vital for these companies to have this financing in place."

And so far it has proved popular. "We've had different reactions, and of course all suppliers are different," Bayzelon explains. "But frankly it's been well accepted, apart from a couple we have a different relationship with anyway.

"We have just under 100 suppliers in the programme and they all seem to be satisfied – I don't hear any complaints. I think that is partly because they have transparency of payments. They can look at the system and decide which invoice they want to sell, so it's a kind of revolving facility for them."

Emerging trends

While large buyers can protect and tie in key suppliers through the financial supply chain, there is another trend emerging when dealing with non-core suppliers. Daniel Ball is the founder of supplier consultants Wax Digital. "We're seeing a trend with mid-size corporates that when they're dealing with their supply chains outside of their core, direct purchasing activities – for instance the purchasing of electrical equipment and facilities, maintenance and legal services – the contracts are subject to less close scrutiny," he says.

"So what tends to happen is that they get to the end of the contract period, or they don't have a contract in place at all, and it becomes freewheeling in terms of the way in which they manage it. They think: 'Our facilities maintenance contract is about to expire; quick, let's get the supplier in and a few others and talk to them, and see which one we like best and which one will give us the best deal'."

> 'One of the key drivers of this kind of supply chain management is getting more from internal resources'

Wax Digital – and other "supplier aggregators" – are now working with corporates to remove the burden of managing multiple supplier relationships by running the tender process. Using their platform, suppliers are put through qualifying questionnaires and asked to submit tenders for work into an auction process. The buying organisation then assesses each bid, not just on price, but also on the level of promised service, and so on.

The benefits, according to Ball, work both ways. "It allows suppliers to compete directly against one another, and that drives a completely different behaviour, as it does in any field where you're competing directly against somebody else, whether it is for business or on the football pitch, or whatever," he says. "It provides a different behaviour pattern to one where if you're competing remotely, where you don't see your opposition you don't know what they're doing.

"The buyer therefore gets a much better result, but equally, from a supplier's perspective, there are some fairly significant advantages too. They get to see very clearly what the market price of the goods or services are that they're selling. It can be quite instructive for a lot of suppliers."

Clearly, one of the key drivers of this type of supply chain management is the movement towards getting more from internal resources, which in some cases will have been whittled away during cost-cutting drives over the past few years. One CFO has tackled that challenge by empowering both the finance and procurement functions to work in a more joined up manner.

"You need to make sure procurement understand how what they do affects other parts of the business, such as logistics," says Julian Hodge, CFO at Tech Data. "They need to be asking questions, such as: 'Why are we ordering every day when they can send it once a week and remove the need to have guys in the warehouse every day when they could be doing something else?'"

"We're taking that 'cost of service' and applying it to the supply chain. From a finance point of view we're involved closely in driving that. People get used to working in silos – procurement does their little bit, finance does theirs – so it's up to the CFO and the finance team to bring all that together and set some targets on what we can achieve." »

Overhauling invoice processing in the NHS

The crisis in the global financial markets and corporate credit squeeze have focused financial managers' minds on working capital optimisation. **Nick Wood**, corporate director at NHS business support firm ASP, explains how ASP helped the NHS develop more cost-effective and efficient processing solutions

At ASP, we provide business support services across the east of England, managing everything from finance and payroll to property management and IT for 50 organisations, primarily within the NHS. With a turnover of £36m and more than 600 staff, we're a burgeoning business that forms the administrative backbone for many trusts and NHS organisations.

In the finance department, we have 42 staff processing more than 450,000 invoices a year from more than 10,000 individual suppliers.

That's a monumental task, and to cope we were using an electronic processing system. However, every invoice received was coming in by post and had to be added to the electronic system, often manually.

This was a highly resource-intensive process, as you can imagine. Paper invoices put an incredible strain on business. Not only do they have to be opened and logged, we then have to match them to purchase orders and input the data. Even if we use optical character recognition (OCR), this is a time-consuming process, and not as effective as e-invoicing.

We were eager to reduce transactional costs and make efficiency savings. Eliminating the burden of paper invoices offered a clear route to achieve this. We knew this would allow us to give our clients a better service and become even more efficient and competitive within our market.

Before choosing a supplier we looked at a number of solutions and carried out an extensive feasibility study to look at a number of leading products on the market. To ensure we could get as many of our suppliers on board as possible, we wanted something that was simple to use and didn't have any additional cost implications.

We chose a system from Tradeshift, an online platform that allows suppliers to exchange invoices for free. Through the online social network, companies and their suppliers can create and process electronic invoices, exchange business documents and communicate with each other in real-time to help smooth the entire payment process.

It also allows us to connect with existing finance and ERP systems to help improve internal business processes, and businesses can add other "apps" to enhance functionality. For example, a purchase order app helps extend and simplify standard business processes. Another problem we'd had in the past was communicating with suppliers once invoices were in the system. Our new system's online messaging and status update features allowed us to dramatically reduce the volume of phone calls we received from suppliers.

Once a new system is selected and in place, it can be a challenge to move suppliers across. However, we emailed them and within four weeks 29 per cent of them were on the new system.

In terms of results, it's still early days and our targets are fairly conservative. In the first year, we believe we can make a five per cent efficiency saving and up to 20 per cent at the end of year two. In three years we hope to put 70-80 per cent of all of our invoices through the system.

We've already seen a marked reduction in manual inputs and improved data accuracy. By communicating directly with suppliers through the system's "network" facility, we've also seen a reduction in the number of calls received. What's more, by reducing the use of OCR and manual input, we hope to reduce the cost per transaction. In the longer term, we also hope to see a reduction in our carbon footprint as a result of the decrease in the resources required to manage the process. ■

Improving your rating

Following huge criticism in the wake of the financial crisis, credit ratings agencies (CRAs) began to rebuild their reputations – only to face a new crisis in the eurozone. **Christian Doherty** offers some background to the issue, while **Georg Schroeder**, of Deloitte, sets out how to manage your relationship with the CRAs

'Eurozone leaders have demanded that the powers of ratings agencies be curbed'

Following the collapse of several major banks at the start of the financial crisis in 2007-08, the credit ratings agencies (CRAs) were heavily criticised. For some, the agencies were guilty of credulity over a new range of complicated financial instruments, while others accused them of collusion with issuers of toxic derivatives.

The criticism that the CRAs faced in the wake of the financial crisis focused largely on one area: structured products. These products – such as credit default swaps and collateralised debt obligations – had been growing at a rapid rate during the preceding five years, and the ratings agencies saw a growth area where they could diversify beyond rating simple corporate, municipal and sovereign debt.

At the same time, investment banks began to wake up to the possibilities of structured products derived from the US mortgage market. Therefore, banks sold these products, which were usually packaged with an AAA rating from Moody's or Standard & Poor's (S&P).

"It was a business line for the CRAs that was, crucially, repeatable – they weren't just going to one company and rating a single bond, they could repeat the business elsewhere," says Ann Rutledge, an analyst who worked for several large CRAs before starting her own consultancy, R&R Consulting. "And the banks who were issuing the products went to the agencies and asked, 'how would you rate it?'"

The rest is history – the role of such products in the collapse of the financial industry meant that the CRAs were castigated by analysts as lawmakers sifted through the ruins of the global economy.

Since then, however, the CRAs have gone some way to restoring their reputation, at least in the corporate and structured sectors. Liz Rae, of the Investment Management Association (IMA), believes that despite the seismic upheavals of recent years, CRAs have recovered.

"To an extent it's business as usual," she says. "Of course, to some degree they suffered some reputational damage, but our members have seen an improvement in the ratings agencies' analyses since then in both corporate and sovereign ratings. They appear to be more open about their assumptions and what's gone into the rating, so our members value their input. But of course it's just one of many elements that our members take on board when making investment decisions."

Having calmed institutional investors, however, the CRAs now face a new foe – European politicians and regulators. Suspicion and distrust continue to dog the agencies in Europe, where the febrile atmosphere of downgrades and bailouts has led to widespread calls for reform. Eurozone leaders – mainly those whose countries have suffered downgrades – have demanded that the powers of ratings agencies be curbed. France, in particular, reacted furiously to the S&P downgrade of its debt rating in January.

"Sub primes, wonderful savings products so warmly recommended by the wonderful ratings agencies, provoked the worst financial crisis the world had known since the thirties," commentator Alain Frachon wrote in *Le Monde*.

Getty Images

'ESMA proposals have been met with scepticism from both investors and agencies'

Another long-running criticism of the ratings agency landscape is that it suffers from a similar malaise as the audit market – lack of competition.

Between them, Moody's and Standard and Poor's enjoy a market share of around 80 per cent. Fitch, the French agency, comes in a distant third, despite its strength in Europe (where it has a 17 per cent share).

It is these criticisms, among others, that have compelled Europe to act. In April, the European Securities and Markets Authority (ESMA) is due to report the findings of its investigation into how CRAs operate.

Since assuming responsibility for the regulation of CRAs in June 2011, ESMA has suggested a number of reforms:

- Blackout periods enforced, where ratings on crisis-hit countries would be suspended while remedies were put in place. ESMA would be able to suspend the ratings of countries in bail-out programmes so that adverse ratings are not issued at "inappropriate moments".
- Ratings agencies should increase the level of transparency and disclosure over how ratings are arrived at. "CRAs should furthermore submit the proposed methodologies to ESMA for the assessment of their compliance with existing requirements," the proposals suggest. "The new methodologies may only be used once they have been approved by ESMA."
- CRAs should disclose to regulators the fees received for rating debt (the current model sees issuers of debt pay for ratings, creating potential for conflict of interest).
- Rating agencies should not issue credit ratings when their major shareholders have interests in the rated entity, or when the rated entities are major CRA shareholders themselves.
- CRA shareholders would also be limited in their ability to provide consultancy or advisory services to the rated entity.
- Ratings agencies would be subject to rotation, where the CRA may only rate ten issues from one issuer before the CRA must rotate, with a minimum time before rotation of one year.

However, these proposals have been met with scepticism from both investors and the agencies themselves. For instance, Fitch has criticised the rotation proposal, saying it would simply lead to greater entrenchment of the power of the "big two", while the issue of ESMA signing off on methodologies provoked predictable criticism from free marketeers.

Liz Rae of the IMA agrees that, in many ways, the proposals to curb the power of the agencies by bringing them under the tighter control of regulators would actually achieve the opposite effect. "The current regulation they work under, and indeed the proposals being put forward by the EU, gives the agencies more of a stature than they might otherwise deserve," she says.

"If you're a retail investor, for instance, and you understand that the ratings agencies are regulated, it gives you a comfort that may not be warranted."

Ultimately, the issue of sovereign ratings cannot be entirely divorced from politics. But there is a growing feeling that by lashing out at the CRAs, the eurozone governments might be looking in the wrong place for the source of their current woes. »

Tips for managing your ratings relationship

Georg Schroeder, director of advisory firm Deloitte, sets out what ratings agencies look for when assessing a company

Companies tend to have a certain view of how their businesses are performing. If investors and analysts don't share that view then they tend to be blamed for not properly understanding the business, its financials, or its strategy," says Georg Schroeder, director of advisory firm Deloitte.

"A lot of companies tend to only engage with credit rating agencies a month before their ratings come up for their annual review and are then surprised when they might not receive the rating they were hoping for."

Schroeder also believes that companies need to have more frequent engagement with the agencies so that they have a better understanding about the information they need in order to provide a rating.

"The agencies can only provide ratings based on the information they have to hand: if information is not disclosed or is deliberately withheld, they will tend to give a conservative rating. Regular face-to-face meetings with analysts will help management teams establish what information they should aim to disclose."

For example, he says, agencies are not just interested in the financial health of the company – they also want to know about "softer" issues such as corporate investment in new premises, equipment and IT infrastructure, staff retention levels, commitment to training, corporate governance and reputation management. Furthermore, agencies are looking for a broader management understanding of the sector and any macroeconomic trends that might affect the industry, as well as their procedures to identify and mitigate these risks.

"Companies tend to make the mistake that they are just being rated according to their own financial performance and the risks they face individually. This is not correct. Credit rating agencies also take into account the performance of the industry sector – a company is unlikely to score the highest investment rating if the sector in which it operates is in decline, despite the company's own financial performance and outlook," says Schroeder.

A closer, more communicative relationship can pay dividends, says Schroeder. For example, if a company is considering acquiring a competitor to increase its market share and service offering, it could ask a credit rating agency to carry out a "scenario assessment". This could involve, for example, analysing the price of the transaction; quantifying the value that the merger is forecast to create; examining the assets that are being bought; providing an appraisal of the new management team; looking at how the deal is being financed; and valuing staff redundancies and disposals.

"A company that is going to embark on such a major restructure will need to have an updated rating, and it might as well try to engage with a credit rating agency at the earliest opportunity," says Schroeder.

"By carrying out a scenario assessment, the management team will get a better view of how analysts will rate the transaction, as well as having an opportunity to address any concerns that the rating agency may have prior to the merger going live and the rating being awarded." ■

Georg Schroeder
Schroeder joined Deloitte in 2005, following 15 years in structured credit and corporate advice advisory roles. He now focuses on providing independent advice to financial institutions and investment grade companies through the debt capital markets.

FX challenges and opportunities for the CFO

Alex Canavezes, managing director of Quant Analytics, and **Bruno Campana**, director of FTI Financial Services, offer some tips for CFOs on managing FX risk amidst the eurozone crisis

The eurozone is threatened by the possibility of one or more of its members defaulting on their debt. This is a cruel and ironic reversal of fortunes. What was intended to eliminate foreign exchange (FX) risk within the eurozone has turned out to merely shift this risk into pure credit risk for the member states and euro currency holders. Moreover, a default by one eurozone member might dramatically affect the euro's standing against other currencies. Indeed, the FX risk has now become more difficult to manage because of political and other non-quantifiable risks.

That said, we have seen a change in market expectations on the euro. Recently, the European Central Bank's focus on helping banks through its refinancing operations interventions in the interbank market, coupled with the better than expected end of year cyclical economic data, generated a positive outlook for the banks that were able to recapitalise their balance sheets.

This has, in turn, reduced the potential for contagion from Greece's problems to other members of the eurozone, specifically Italy and Spain. This strengthened confidence to invest in euros and borrow in lower yielding currencies, reducing liquidity concerns in FX markets. However, stability is not yet restored. Even if street sentiment seems to be gradually improving, multinational CFOs remain concerned by the management of their FX risk. Post and pre-crisis, the question of how to efficiently protect "hedge" assets and liabilities against fluctuations in foreign exchanges and interest rates – especially between the euro and major currencies – remains the same, but the answer is now more complex.

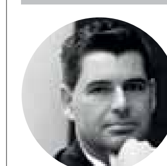
Banks have developed solutions for managing or transforming the FX risk affecting multinationals. Most of these products were designed to help treasury departments to better manage their funding costs and net FX risk exposure between assets and liabilities. Nevertheless, a number of corporates' hedges seem to be performing adversely during abnormal market conditions. Even though financial engineers might have cleverly designed structures that were suitable for corporate needs, some of these locked corporates into losses as liquidity dried, correlation increased and volatility spiked. These products are still offered, and are often referencing the more liquid currency pairs as well as the exotic ones. They can be structured at a cost or not, and can be tailored to the specific cash flows that need to be hedged – to the extent that the corporate has the ability to forecast future revenues or liabilities denominated in foreign currencies.

Nevertheless, the long list of acquired or bankrupted financial institutions since 2007 makes it very difficult today for corporates to trust banks as counterparties. CFOs are not willing to bear the credit risk of the financial institutions on their own balance sheet, and shareholders might as well not accept this downside risk. The trade-off between managing counterparty risk, as well as underlying extreme events, such as Greece's default, is a challenge for CFOs, and given that their risk aversion to the mechanics of complex structured solutions offered by banks has increased, few other solutions are available.

Recommendations for CFOs

Companies need to hedge FX risk because they do business with, or in, foreign countries, and receive cash flows or have liabilities denominated in foreign currencies. Not having control over the FX risk could potentially reduce the value of assets, or increase the value of a liability. If one accepts payment in a currency other than the domestic currency, then if that other currency depreciates against the domestic currency in »

Illustration: Mark Smith



Alex Canavezes
Canavezes is managing director of financial consultancy Quant Analytics. He previously worked in portfolio optimisation in the global solutions division at BNP Paribas.

the future the payment will translate into a lower value in the domestic currency and result in a loss.

The Swiss franc (CHF) has recently been showing negative overnight yields. This seems to suggest that the CHF is being used as a safe haven as investors (presumably euro currency holders) are prepared to pay a premium for the privilege of holding CHF overnight.

Eimear Daly, FX market analyst at Schneider Foreign Exchange, on how you can use foreign exchange to beat the economic downturn

While it may seem like currency markets are approaching apocalypse, FX is in fact one way in which businesses can make the most of the downturn.

For instance, if your company exports to the eurozone, warning bells may be ringing. The fact is, the 2008 financial crisis caused a shift in markets and devalued sterling. This means businesses are getting a better price than ever before. The same is true against the US dollar. The reality is that the financial crisis stopped persistent structural trends in currencies – dollar weakness before 2008 and sterling strength. Volatility has returned to markets.

To demonstrate the opportunities this volatility can create, take the example in October 2011, when a major exporter needed to convert €800,000 into sterling. At the time, European leaders announced the expansion of the European Financial Stability Facility fund – a European rescue fund whose expansion would stabilise the eurozone. The euro rallied and the pound value of the client's revenue was being withered away.

However, in these markets, rallies are often followed by sharp falls. The client placed a limit order at a lower euro-sterling rate. The following trading day the euro dropped, not 1p but 2p a pound. The client achieved a price below the limit he set and made a net saving of €16,000. Two pence per euro may seem like small change, but multiply it out and it becomes clear that effective FX hedging will make a real difference to your bottom line.

In this economic climate, all companies should be hedging currency. The euro crisis isn't just causing volatility to the euro – this is a global financial crisis. International trade means that market instability is viral. Though it is true that some markets will be less unstable than others, the main pairs will always be more volatile. The core principle is that the more currency you need to convert, the more you need to think about risk. Fluctuations in exchange rates make a difference when small changes are multiplied out.

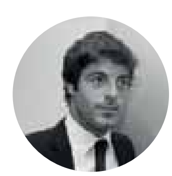
The Swiss National Bank is expected to defend the EUR/CHF floor vigorously, making use of negative interest rates if needed. Given the extension of QE2, GBP/USD seems stable. Events in Europe remain the main drivers of risk.

CFOs should consider the following hedging and invoicing strategies:

- Decreasing the vulnerability of its balance sheet to fluctuations in FX on its assets by creating liabilities denominated in the same currency and subject to the same future expected cash flows. This is referred to as hedging translation risk.
- Transferring the full FX risk to business counterparties: domestic-currency invoicing and hedging allow internationally active firms to reduce their exposure to exchange rate variations. This is referred to as hedging transaction risk.
- Sharing the risk of FX fluctuation with business counterparties: terms of agreement specifying that the payment can be made in a foreign currency as long as the FX rate trades within a range. This means hedging costs can be shared by fixing caps and floors (thresholds).
- Incorporating the full hedging costs into contracts with foreign counterparties, as long as it is clarified in the terms of the agreement.
- Hedging liabilities only if they could materially impact the gross profit.
- If liability or assets cash flows are predictable in advance, consider buying a hedge against FX risk on that revenue or cost stream.
- Consulting as many banks as possible to get the best advice and compare the fees and structuring costs.
- Hedging can sometimes be done by netting assets and liabilities cash flows, and might only require efficient reporting tools to isolate the net FX exposure, and then hedge only that portion if the risk is material.
- Trading directly in the FX derivatives market.

CFOs should be aware of wrong-way risk regarding hedging products sold by banks, and the embedded counterparty risk. This is the risk that arises from positive correlations between the exposure to a given counterparty and the credit quality of that same counterparty. There are structures that can be implemented for hedging wrong-way risk.

Uncertainty in the economy might adversely impact decisions made in the past, one way or another. Therefore, when an FX risk management framework is put in place it must be done by conservatively anticipating extreme scenarios that could adversely impact the balance sheet, both during normal conditions and in extreme market conditions. ■



Bruno Campana
Campana is director of economics at FTI Consulting. He previously worked for Deloitte Luxembourg, advising investment banks on FX.

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Choosing the right track

Many organisations are turning their process-driven treasury function over to outside providers to free up treasury time for higher value work. But how do you go about choosing a provider?

There is an old saying that although you can outsource the process, you can't outsource the risk. It's a sentiment that still holds true today. In an age when confidence in the banking industry has been shaken, increased focus on concentration, counterparty risk and squeezed resource, treasurers are faced with a thorny problem: how to retain control over critical systems and policies while also preventing treasury teams from becoming overloaded with process.

The answer to that conundrum in the past has been outsourcing. But the landscape has evolved, and the days of a simple "outsource or not" question are over. To put today's trends in context, it's necessary to understand the evolution of treasury outsourcing. From the late 70s and the 80s, in part thanks to the foundation of the International Financial Services Centre in Dublin, treasury outsourcing began to gain traction.

Following Ireland's success in attracting multinationals looking for European treasury capability to their shores, a number of banks developed treasury outsourcing businesses in Dublin.

"Initially, most of the businesses that outsourced treasury to those banks were lured by the attractive corporate tax rate," says Patrick Coleman, regional general manager, Central Europe, Middle East & Africa, at treasury software supplier IT2. "But as time went on the tax rate went up a little bit and we began to see other interesting tax incentives in other territories around Europe. As a result, treasury outsourcing then became more of a service, or a resource availability business, and a domain expertise business."

Many of the companies that were then outsourcing – and still are today – were North American corporations with European business activities that, while significant, were not big enough to justify a discrete treasury service (or they just simply had not yet established a European treasury function themselves).

Since then, the outsourcing model for treasury hasn't changed too radically.

"Head offices normally have small treasury teams, so it's the midsize companies that do most of the outsourcing," says Neil Fleming, director of client services at Capita International Financial Services in Dublin. "They have small teams and that will give you an indication of the activity they outsource. But of course, given the nature of the activity, they can't outsource too much because you can't entirely do away with an in-house treasury team."

In recent years, the type of treasury procedures and activities that have been outsourced have been primarily based around cash management and foreign exchange management.

Keith Strachan is a director in Ernst & Young's (E&Y) treasury advisory faculty. In his view, a typical treasury outsourcing arrangement will involve a business choosing discrete parts of the process to hive off. "Take an ordinary mid-market widget maker: typically, its prime concerns would be cash management and foreign exchange," he says. "And there will be some analysis, above and beyond the transactional elements, involved in that. And then there's the 'factory' element of treasury, which involves picking up the phone or going to the online dealing platform, doing the trade, concluding and recording it. It will then be settled, either straightaway or on the due date for settlement. And then it will need to be accounted for."

"So if you look at that end-to-end process, the element that would lend itself most obviously to an outsourced model will generally be from the point at which you decide on the deal that you need to do. After that, it's more a question of handle turning."

Recent E&Y research showed that treasurers are under pressure to do more on working capital, pensions and the rest, as well as getting closer to the business by playing a risk-advisory role. "So the only way they can deliver that is by minimising the time spent on processes," says Strachan.

Outsourcing one, two or three jobs isn't going to save the average treasurer at a midsize or large corporate much money. As a result, we are now seeing treasurers focusing more on technology – investing in their SAP systems, or using core online tools to try and compress the processes in order to free up one or two people to do what you'd call the higher skills.

Money market funds represent a form of outsourcing. So instead of putting £40m with eight different banks, the treasurer can place the cash with a money market fund, which will then split it among 50 different entities. As a result, the treasurer removes their concentration risk, gains access to expertise and frees up time for higher value work internally. The prevailing trend is now centring on treasurers analysing exactly what their processes and systems look like and deciding which parts can be separated. The smartest treasurers are now earmarking the "factory" elements of treasury for outsourcing.

"That is driven by a number of things," says Fleming. "But fundamentally, you do need to maintain a certain size of head office treasury capability, unless you go for the full 100 per cent outsourced model, which very few do."

Fleming – and other vendors – now work with clients to look at their treasury processes and spot easy wins and elements of the process that represent a drain on what is likely to be a small internal treasury resource.

However, there are clear pitfalls that can derail a treasury outsourcing project. "The mistakes that CFOs have made in the past have been centred on the expectation of what they could outsource, and that stemmed from a poor understanding of how treasury people spend their time," says Strachan.

"Contrary to what some CFOs think, treasurers don't spend all their time dreaming up new dealing ideas. What they actually do is try to get a clear picture of the risk the business faces."

Treasurers also spend time working out foreign exchange risk and how their processes can manage that. And that's in addition to working with banks on how to raise £100m in the next six months – deciding the best way to do that, where the market is, and whether they should do a private placement in the US or a straight bond in the UK. »

"That's the strategic thinking where a CFO needs help from treasury to get his head around," says Strachan. "So a lot of the time the mistake has been misguided enthusiasm over what you can outsource, but the cold reality turns out to show that the 'process' element is actually quite small."

As a result, for the most part vendors and consultancies have given up on pushing full outsourcing in the treasury space. In its place has grown a cottage industry of halfway-house solutions that aim to combine internal control with automation. These tools largely centre on providing software platforms that are either managed in-house or remotely via the vendor's servers.

What these type of the solutions offer is integrated treasury management in a controlled way. Consider the breadth of treasury's remit: cash, FX, funding, netting, commodities, leases, trade finance and so on.

"To meet that need, we aim to give the clients a tool that integrates all of that into one system so that they can have one set of management reporting across all of those domains," says IT2's Coleman. "And doing it in a controlled way is very important, because ultimately the purpose of treasury is to protect the business from financial risks."

Everyone in this space – CFOs, treasurers, vendors and consultants – accepts that certain core functions of treasury must remain in house. But by developing smarter ways of solving the eternal control versus efficiency debate, it does seem that for treasurers, a third way might exist after all. ■

Outsourcing dos and don'ts

Dr Anthony Hesketh, senior lecturer at Lancaster University Management School, discusses how treasury functions should be outsourced, and some of the risks that CFOs need to be aware of

No matter who is responsible for your corporate treasury function, you need to be vigilant and manage your working capital or you're in trouble. It's no accident that the world's largest organisations are holding some $3trn in cash on their balance sheets – they're worried about what's around the corner. It's also no surprise that, along with payables and receivables, procurement outsourcing is on the rise. Getting the balance of your working capital correct matters, but it's hard.

Some organisations are very good at managing this themselves, while others have no choice but to be. A good example would be airlines, where falling revenues and rising oil costs represent a financial "rock and a hard place"; you can't hedge/buy your future oil requirements if you've no cash beyond the cost of your operations to buy it with.

Companies that outsource their treasury functions do so because they value the expertise that these organisations devote to getting this right.

The C-suite determines what it wants its cost structure to look like. Its F&A provider delivers on this – or at least might look after certain processes that ultimately contribute to it.

Outsourcing providers that combine forces with CFOs and financial controllers to understand the short-, medium- and long-term capital requirements of the firm, and how these dovetail with its operations and longer-term goals, can prove to be an enormously effective partnership.

However, not everybody can see or necessarily understand all of the moving parts, which can end in outsourcing disasters, especially when key players from either side involved in the original deals move on.

The key risks of CFOs signing poor treasury outsourcing deals are that they don't know which services they want and why, and that makes it hard to know if the provider is actually delivering what the organisation needs, or whether it is capable of carrying out the work. The major foundations need to be in place and preserved from the start, or the whole arrangement will start to fall apart.

Companies need to decide what services they want delivered, and that service requirements are aligned with the capabilities of the provider.

CFOs also need to be clear about what success looks like, understand governance processes and be clear which service-level agreements really matter, and that once the deal has been signed off, that both parties stick to it. (If you try to change things once the project is up and running, you will be out of scope and your costs will increase, chomping your original business case.)

Good governance, clear targets and, above all else, smart clients who know and negotiate a contract for what they need, as opposed to what they would like, more than outstrip the scare stories we read about in the media. Bad executives sign bad outsourcing deals – period. ■

Outsourcing the corporate treasury function: What you need to know

By Sabimir Sabev, director, Novo Altum

1. Understanding what's involved

Although corporate treasury sits within the finance and accounting stack, it differs from the transactional F&A processes that most companies have outsourced to date (e.g. accounts payable, accounts receivable, general ledger). Whereas the transactional processes can be outsourced relatively easily, the corporate treasury function sits higher up in the F&A stack, incorporating as it does treasury risk management, banking relations, cash management, forecasting, divestments, debt management and foreign exchange. It must therefore be approached in a totally different way.

2. Identifying the right provider

It's vital that companies differentiate between suppliers who provide a transaction, process-centric service and those who have developed expertise in the judgement-intensive part of the F&A stack. They must ensure that the outsourcing provider they partner with has invested in developing a corporate treasury and risk management (CT&RM) centre of excellence. They must also satisfy themselves that the provider takes a long-term view, with continuous improvement a priority and an ongoing investment programme.

3. Deciding how much to outsource

The answer to this will depend on the nature of the organisations' business, as well as the objectives driving the project. For most businesses, a case can be made for a large chunk of their corporate treasury administration, cash and debt management or foreign exchange to be outsourced, whereas treasury risk, forecasting and bank relations may need to, at least initially, remain within the business. As a rule of thumb, around 70 to 80 per cent of the CT&RM activity set lends itself to centralisation.

4. Realising your return on investment

Outsourcing can bring cost savings, better business processes and performance improvements. However, as with any major organisational change, it's important to be aware of the risks. Clearly understanding your own specific requirements and finding the right supplier to meet them will help drive your business forward.

5. Question your potential suppliers

Ask the following questions:

- Who is the CT&RM lead within your (the providers) organisation?
- What investments have you made/are you planning to make in CT&RM?
- What governance model do you use?
- What account management model do you use?
- How is your delivery capability organised in terms of people, skills, systems, tools and locations?
- How are services priced? What pricing models do you use and what flexibility is there?
- How will you successfully manage the transition of our processes into your organisation?
- Who else is a client of your CT&RM practice? These should be of a similar size, complexity and geographic reach to the client organisation. Ask for reference names and make sure you speak to them.
- In what way do you strive to continuously improve the services provided by your organisation?

In the past decade, the liabilities of corporate pension schemes have reached unprecedentedly high levels, owing to substantial increases in life expectancy, low interest rates and the under-performance of underlying assets

De-risking strategies for pension schemes

Pension trustees have addressed the deterioration of funding levels in different ways, working on the asset or liability side, or both. On the asset side, there has been a stronger focus on asset-liability management, which has translated into de-risking strategies tilting asset allocations away from equities and toward liability hedging (liability-driven investment).

On the liability side, there have been closures of schemes to new members, as well as to new accruals to cap liabilities. The recent financial downturn has accelerated this process and led to a number of fund terminations. Even if liabilities are locked in at the closure date, there still remains the problem of meeting the pension payments as they fall due, which is a challenging task given the long duration of pension liabilities and their exposure to interest rate, inflation and longevity risks.

Some pension schemes have therefore opted for more radical solutions, such as the buyout of (part of) their liabilities, i.e. the transfer of their exposures to a counterparty, typically an insurer. The buyout market took off in the UK in 2006 when a new monoline insurer, Paternoster, sealed the first deal with the Cuthbert Heath Family Plan. The market has since grown strongly, with around £30bn of transactions to date, including £7bn of business written for FTSE100 companies and a host of deals involving smaller pension plans.

The global financial crisis dampened the buyout market in 2008-09 because of the impact on the corporate bond market (buyout firms are usually heavily invested in corporate bonds to earn a premium on treasuries and match the duration profile of the liabilities), but the recovery has been strong, with business volumes totalling £8.3bn in 2010, the highest annual level so far. Buyouts have been concentrated in the UK because the combination of stricter funding regulation and accounting transparency have acted as a formidable driver for changes in risk management and governance among pension trustees. Similar forces are now at play in other countries: the first $75m buyout deal was announced in the US this year, and transactions have taken place in Ireland and the Netherlands.

> 'With a buy-in, a pension plan is hedged against interest rate, inflation and longevity risks'

From the point of view of employers, buyouts are the most direct way to take liabilities off their balance sheet. Even if buyout costs are financed by borrowing, a regular loan replaces all the risks entailed by pension liabilities, and can be more comfortably managed. There are several advantages to a buyout: greater corporate flexibility, as there is no need to consult with trustees before any major business action; reduced exposure to regulatory risk and balance sheet volatility; and lower management expenses. Even so, buyout prices are perceived as being very expensive, and have prevented many schemes from adopting this solution.

Reasons for disconnect

There are several reasons for this disconnect between the buy and sell side. On the demand side, sponsors and pension trustees come from a tradition of lenient accounting and regulatory standards that have systematically downplayed the size and volatility of pension liabilities.

On the supply side, the market has quickly shown signs of capacity constraints, due to the strict solvency rules imposed on buyout firms, and the limited success of standardised solutions (such as longevity indices and population-based longevity derivatives). The reason why, until and after the credit crunch, buyouts attracted substantial capital from major investors is that insurers have superior expertise in forecasting and managing longevity-linked cash flows, can reap natural hedging benefits offered by their stock of exposures, and can use buyout premiums to support effective asset-liability management strategies while earning an attractive return on capital.

Still, the size of global pension liabilities is far too large for the capacity of reinsurance markets, and greater involvement by capital market investors is needed to improve market efficiency: a wide investor base (sovereign wealth, mutual/hedge funds etc) is interested in longevity exposures because they are largely uncorrelated with other asset classes, but is still waiting for them to be packaged in investible formats, delivering maximal diversification benefits.

There are three main ways to transfer part or all of the pension liabilities to a counterparty: through a pension buy-in, a pension buy-out, or a longevity swap. A buy-in involves buying a bulk annuity contract from an insurance company to insure some or all the liabilities of the pension plan while retaining responsibility for them. With a buy-in, a pension plan is hedged against interest rate, inflation and longevity risks, and can benefit from the strong guarantees offered by the regulatory framework for insurance.

More sophisticated buy-ins can be customised to meet the specific needs of the hedger. For example, by spreading premium payments over time, by allowing for exit/surrender options, or by reducing counterparty risk via collateralisation and the segregation of insurance premiums.

A buy-out takes the transfer to the next level, in that the responsibility for meeting the pension liabilities is transferred to the insurer: members receive their individual insurance policy and the pension plan can be wound up. Of course, this is the most expensive option, and it may require funding levels or generous sponsor top-ups well beyond the reach of the average pension plan. This is why buy-ins or partial buy-outs usually represent a first step in the direction of a full buy-out. Finally, longevity swaps are agreements between the pension plan and a hedge provider to exchange fixed payments against variable payments linked to the number of survivors in a reference population.

So far, transactions have mainly involved pension funds and annuity providers wanting to hedge their exposure to longevity risk, but without having to bear any basis risk (the risk of imperfect hedging associated with indexed instruments). The variable payments in such longevity swaps are designed to precisely match the mortality experience of each individual hedger: hence the name "bespoke longevity swaps".

This is essentially a form of longevity risk insurance, despite the fact that the transaction is typically collateralised and often arranged by an investment bank; the banks have worked with insurance companies (in some cases insurance company subsidiaries) in order to deliver a solution in a format familiar to the counterparty.

Phillip Toledano/Trunk Archive

Different solutions may appeal to different pension plans, depending on individual size, funding levels and objectives. For example, while a regular buy-in may be arranged for books worth less than £10m, the design and execution costs of customised buy-ins or longevity swaps are typically only justified for pension liabilities exceeding £250m. Similarly, larger pension funds may afford customised solutions, meeting individual needs or tailored to specific asset-liability configurations.

For example, in June 2010 British Airways arranged a £1.3bn synthetic buy-in with Rothesay Life, the pensions insurance unit of Goldman Sachs. The structure involved an asset swap, exchanging the proceeds from the pension plan's gilts portfolio (which was, at the time, very valuable relative to the swap market) for the expected pension payments, and a bespoke longevity swap, adjusting the payments in response to the actual mortality experience of the pension plan.

Similarly, in 2010 GlaxoSmithKline arranged a £900m customised buy-in with Prudential, with a strong focus on counterparty risk mitigation. The deal took the form of a regular buy-in transaction, but presented the important addition of a segregated collateral account legally owned by the pension plan containing the buyout premium, and an additional buffer contributed by Prudential to meet the pension payments as they fall due.

The affordability of pension de-risking solutions has improved considerably over the past few months, with the cost of regular buy-ins for pensioner liabilities converging to funding reserve levels. Still, there are several important steps that can be taken to obtain the best deal when preparing for a de-risking exercise.

First, it is essential to involve all the main stakeholders (sponsor, trustees, actuaries, lawyers and unions) to agree on the main financial and business objectives of the transaction, as well as to discuss the availability of extra funding. This allows the company to narrow down the range of solutions and identify suitable providers. Second, buyout costs can be substantially reduced by working on the asset side. For example, moving out of equities and into good-quality bonds can help stabilise funding levels and provide the insurer with a portfolio that can more easily match the liability profile. Good quality assets can also reduce the cost of longevity swap arrangements when posted as collateral. Lastly, proper data cleansing and management pave the way for very competitive deals.

Providers look favourably on any information that allows them to improve mortality forecasts and estimate pension payments as granularly as possible. Relevant information is represented by up-to-date records of plan members, including personal details and full addresses (postcode modelling is widely used in longevity analysis), as well as detailed information on spouses and dependants. Once all these steps have been taken, the de-risking exercise may still result in the pension plan's buyout basis diverging from the one offered by the provider. As buyout quotes change over time in response to market conditions, funding level and risk appetite, a valuable option is to set a price trigger and monitor the buyout basis on a regular basis so that a deal can be executed as soon as conditions in the buyout market become more favourable. ■

Enrico Biffis

Biffis is assistant professor in actuarial finance at Imperial College London. His main research interests are in the areas of insurance and risk management. He has written extensively on market-consistent accounting standards for insurers, longevity risk management and securitisation, counterparty risk modelling and mitigation. Before joining Imperial College London in 2007, he held positions at Bocconi Milan, the Association of British Insurers, and Cass Business School.

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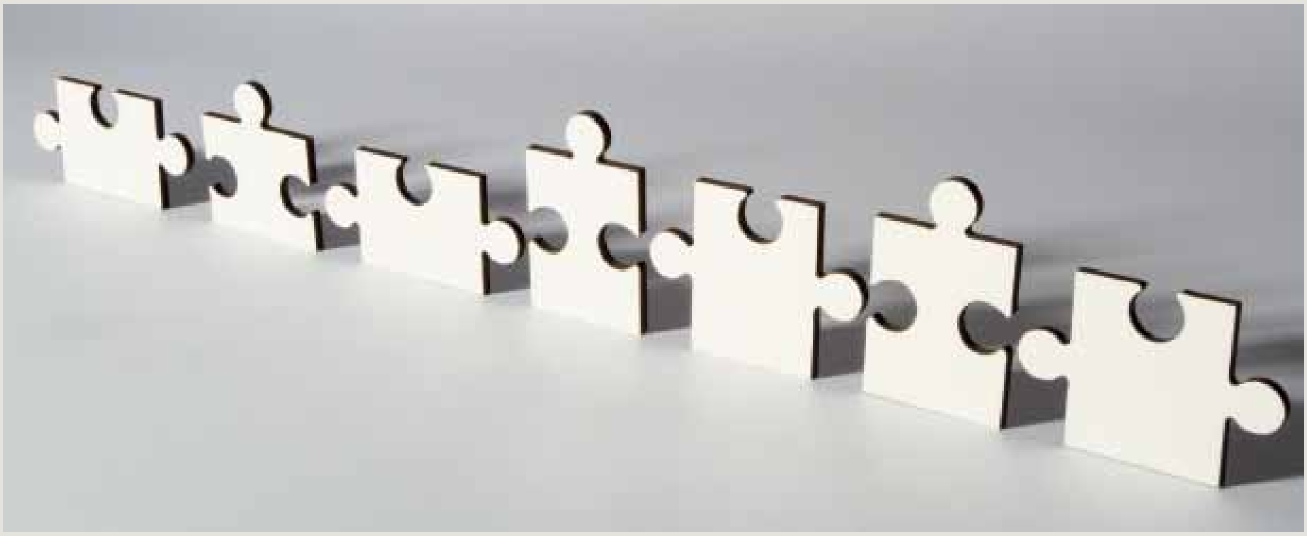

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Targeting the top

Phil Sheridan, managing director, Robert Half UK, on how ambitious young accountants should go about landing the job of finance director

The move from finance manager to finance director is a well recognised and clearly documented path. However, today's aspiring finance managers must recognise that they are now shooting at something of a moving target as the CFO role continues to evolve.

So what skills should CFOs-in-waiting acquire? The first thing to recognise is that the role of the CFO has changed dramatically in the past ten years. The stereotype of accountants as being mere bean counters or number crunchers has been eclipsed by more strategic descriptors, such as "business leader" or "performance manager".

The more stringent regulatory environment has highlighted the need for individuals who have it all: multi-disciplined professionals with strong technical knowledge, coupled with strategic, interpersonal and commercial skills.

In the most difficult economic years of recent times (2008-2010) the role of finance was very much centred on rebalancing the business, cost-cutting, where necessary, and helping to safeguard the future of the company. Now that this phase has been largely undertaken, the role is more nuanced, and finance has become far more involved in developing the business.

For that reason, developing effective communication skills and the ability to explain financial information to non-financial audiences is essential. For many accountants this can be a challenging task, and one that they may not have had to deal with previously.

Finance professionals are still required to guard the bottom line by managing expenditures and efficiencies. Yet increasingly, they are called upon to strike the right balance between risk and reward for future investment choices, as well as to ensure that the business has sufficient access to funding. Managing cash remains a critical issue.

This has led to increased business partnering. Finance teams now have to partner with IT on new software implementations, or with the sales team to manage credit as tightly as possible. Finance therefore plays a major role in contributing to the company's growth strategy.

The CFO also needs to take responsibility for the gathering and governance of financial and management reporting information. They must understand the company's financial reporting risks and focus on those controls that are particularly critical. Whether that's introducing IFRS-compliant processes and data at PLCs, or company-wide standards in privately-held companies, it's the responsibility of the CFO to ensure that there is a "single version of the truth" for all to follow.

Yet while it is essential for a CFO to improve efficiencies in any economic environment, now is the ideal time to come up with an exit strategy for programmes that don't deliver optimal value. In times of business uncertainty, senior executives are much more apt to welcome ideas for increasing efficiencies.

Regardless of the economy, it is essential to strengthen your pool of permanent employees. Nearly eight in ten (79 per cent) UK CFOs we surveyed reported talent shortages and were having difficulty in finding the accounting and finance staff they need.

Businesses are looking for finance leaders with big-picture vision, who are in tune with the company's goals and can see upcoming opportunities. This is particularly critical today, when firms are faced with many challenges to stay competitive and profitable. As a result, it's vital to stay up to date on the changes that are occurring within the accountancy and finance sector.

It's important to understand that extra knowledge and abilities will increase the chances of not just succeeding in a senior-level role, but will also allow managers to be considered for other interim opportunities, or possibly permanent roles.

Senior financial professionals hoping to assume a CFO or CEO role must demonstrate strategic vision, but will also build their experience in investor relations, operations, strategic planning and revenue enhancement projects.

However, they also need to demonstrate that they are capable of providing advice in these areas and be willing to share their vision – even if it goes against popular opinion, especially the opinions of other managers or directors. The best leaders are willing to take risks and make a persuasive case for their business decisions.

Indeed, people skills are a must at the senior or director level. It's one thing being brilliant with financial strategy, but managers who can't collaborate with others or motivate employees are unlikely to be very successful in the longer term.

It's also important to remember that part of being an effective leader is being a good manager. Individuals who have great reputations as executives are known for inspiring their employees. So, while it's vital to impress a company's leadership team, the perceptions of more junior members of the team is just as important.

Networking, both online and offline, is another important skill to master. Many financial and business groups hold breakfast or lunch meetings, or use social media.

Getty Images

Tools such as LinkedIn can facilitate an exchange of ideas and information. Something simple, such as a post about a new press release from one of the accountancy bodies, could lead to comments from other accounting and finance executives about how the announcement impacts companies in general, or their companies specifically.

Social media can also keep managers updated on the latest trends. Twitter is one of the best media tools for educational purposes. Many companies, organisations and industry experts use it to share information and generate discussion.

For example, most of the Big Four accounting firms are on Twitter and use it to announce webcasts or seminars they are hosting, comment on industry news or share job postings.

What makes a good CFO/FD?

Strong sense of commerciality	52%
Strong leadership skills	49%
Sound accountancy/finance skills	44%
Effective communication and interpersonal skills	33%
Experience in financial transformation initiatives	22%
Experience raising capital	21%
Experience managing costs and efficiencies	18%
Experience navigating an economic downturn	18%
An accountancy qualification	15%
Experience with mergers & acquisitions	12%
International work experience	8%

Source: Robert Half International (October 2011)

Simply following an expert in the finance and accounting industry on Twitter can be a good way to keep up to date on current conversations in your field of specialisation.

Showing a sincere interest in professional training and growth reinforces commitment, not to just succeeding in a current role, but also to taking that career further. For managers who are job seeking, training is particularly useful to improve weaknesses, update skill sets and increase marketability.

It's clear that the role of the CFO is in transition, but the good news is that there are a range of different steps that managers can take to make their way successfully to the next stage. ■

Top tips for reaching the summit

The position of FD is more complex and more influential than ever before, with today's FDs at the heart of driving organisations. We asked **John Gill** of HSS Hire Services, **Adam Haycock** of Svenska Cellulosa, and **John Gane** of GE to share their tips for making it to the top

John Gill, FD, HSS Hire Services

I never set out to become an FD. It was something that happened, and as my career developed and I gained experience across a broad range of finance roles – and some outside finance – I started to realise what impact financial leadership could have on the business, so when the opportunity came along to be an FD I had no hesitation in wanting to do it.

For me, the key to reaching the FD role was pursuing a broad range of financial and commercial skills. I think, in particular, it's about being able to understand the financial drivers of a business, and as I've gained experience it's become clear that that is more important for an FD than just the pure accounting side of the job. I came up through the financial planning and analysis (FP&A) route. In particular, I enjoy the forward looking and planning side of a finance role.

I spent much of my time doing mergers and acquisitions (M&A) work and that gave me a good insight into valuation, particularly how third parties arrive at business valuations. In the role of FD, that kind of experience can help you to think about what you can do to drive value. So it's good for finance people to get out of the traditional pure accounting roles – whether that's into M&A, commercial or functional roles – in order to get a better understanding of the business. I did, and I would encourage any career-focused finance person to do the same.

The role models who I looked up to and learned from were those who could use finance to understand what was going on in a business, how to plan, how to gain insight into a business and move it forward, rather than simply keeping the score.

As an FD you'll need to work across the company. The role isn't simply a functional one. I remember one of my MDs once said that the FD has to wear two hats – the functional accounting one and the cross-functional one, which requires you to help guide the whole business and build relationships with salespeople, commercial people and ops people, most of whom think differently from accounting people.

And even though you might be a very good, disciplined accountant, if you're too narrow in your focus then you won't be a board member who can contribute to the business on a wider level.

The increased automation of finance work now enables finance managers to get out into the business, and this is always something I encourage my team to do. To do that you have to understand what the key drivers of the business are, which means you have to be able to benchmark your business against your competition. Doing that ultimately helps you understand what the drivers of revenue and cost are.

When it comes to building and managing your team, never worry about recruiting people who are smarter than you. It is important to have people in the team who are capable and ambitious, and it works. Push your good people hard. In most cases they want to learn. I wanted to learn and progress when I was a finance analyst in FP&A and I expect that of my managers now. If you help your key people learn you'll get a lot more out of them, and so will the business. »

John Gill
Gill joined HSS as CFO in 2009. Before this he was the FD at Screwfix Direct, a subsidiary of Kingfisher plc, for nearly three years. Having joined Kingfisher in 2001 he rose through the ranks to become the head of corporate strategy. His early career was spent in strategy roles for Cable & Wireless and BP.

Adam Haycock FD, Svenska Cellulosa Ab Sca

From my very first days at work I quickly realised that if there was anything that needed to be done or changed, then it was the FD that made it happen, so that's where I aimed for. Having that ambition from the beginning made it easier because I always knew where I wanted to be.

Realising my ambition required some planning. I definitely knew I wanted to become an FD so I went about doing the expected, such as passing my exams, but I also tried to make sure I was put forward for internal training courses with people who were in a higher position than me. I didn't realise it at the time, but I was essentially networking at every opportunity I had.

Of course, over time I acquired a range of technical skills, accountancy qualifications first and foremost. I remember that my original boss, who was an FD at the time, hadn't passed all of his exams and always drilled into me that I had to get them out of the way and then start progressing in the business.

From there it was more about personal development. I was always lucky, in that the firms I worked for had excellent in-house training programmes that were designed to help you progress your career.

And that personal development was helped along the way by learning from those around me. Over the course of my career I have had several mentors – some chosen for me and some I chose myself. They weren't always people higher up in the organisation either. I would learn from people around me, not just people above me. And while there isn't one thing that stands out, I know I have learned a lot from all of them.

They gave me good advice, which helped my career. And now, my main pieces of advice to anyone aiming for the FD's job would be that, firstly, perception is reality – deal with it and move on. Second, always be willing to coach and be coached. Lastly, and perhaps most importantly, treat everybody with respect and they will always respect you for it.

I have been fortunate to have worked in varying parts of the business world on my way to becoming an FD and I have seen and learned along the way that people work better when they know what they need to do – it sounds simple, but you'd be surprised.

I was, and still am, happier when I know what is expected of me and I ensure that anybody that either works for me or with me knows what is expected of them. I am also a great believer in coaching people and bringing them on. I managed to get where I am at a relatively early age, so there is no reason why somebody that works for me shouldn't be capable of getting there sooner.

Adam Haycock
Haycock became FD, Scotland, of SCA in 2009, having previously been its southern region financial controller. He had left school at 16 on a YTS scheme with Bowater Containers, where he became finance controller in 1996, by which time the company had changed its name to Rexam Packaging.

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John Gane FD, General Electric

From the outset, I started with the ambition to get to FD level in an organisation, based on a belief that the more senior finance roles, and in particular FD roles, offer and require a strong understanding of how businesses work at all levels.

FDs are required to understand the operational and execution parts of a business to help operating teams to drive efficiency, implement cost discipline, partner with commercial teams to drive value from the customer portfolio, and act as custodians of a business from a corporate governance and financial regulatory perspective.

For most FDs, the typical route is to become qualified as an accountant and then work your way up through roles of increasing responsibility. In my experience, you can progress faster by taking a bit of a risk, which often means taking on those assignments that no-one else wants.

My advice is to take that difficult assignment at some point early in your career. That might mean an international opportunity, or a specific project that pushes you out of your comfort zone, and allows you to develop as a more rounded professional as you ascend the finance ranks.

Of course, taking a difficult assignment can be a double-edged sword, because if you don't perform it can be as career-limiting as career enhancing.

In addition, I think that any aspiring FD needs to get out into the wider business. I did my first commercial-facing finance role in Europe. The commercial function often thinks that finance exists in an ivory tower; the challenge is to show what value you can bring, both to their delivery and to the wider business as a whole.

Of course, the FD will ultimately end up leading a team; and that's a big challenge. For finance to be effective as a function it needs to have a good blend of experience, different and evolving skill sets and people who are at different stages of their career.

Creating opportunities for younger finance staff is a priority to bring fresh thinking and skill sets to a department, and opens the door to new ideas for yourself as FD and the department as a whole. However, continuing to develop more experienced staff is equally important to ensure that all members of your team operate as effectively as possible to deliver benefit to the business.

The three pieces of advice I would give any aspiring FDs are:

- Focus on getting well-rounded functional and business-facing finance experience in the early stages of your career. Plan your career; it invariably won't work out the way you plan it, but it will allow you to create a roadmap of the skills that you need in order to get to FD level.
- Take a risk. Be tenacious and take on the challenge that nobody wants! This will invariably give you great organisational exposure, which can accelerate your rise to FD-level roles. But be careful, it relies on performance and delivery.
- Be a change agent; constructively challenge the status quo and try to demonstrate a track record of continuous improvement within finance, and as a business partner. ■

John Gane
Gane became the FD of GE's Aviation Systems division in 2009. He was previously the FD with Zarlink Semiconductors and, before that, the finance and compliance director – Americas – at the Huntsman Chemical Corporation. He has worked in Singapore, Houston and Brussels.

This feature is part of the CFO Priorities programme, which includes articles, papers and interviews. Supported by Robert Half. www.cimaglobal.com/priorities.

The China syndrome

Simon Collinson, professor of International Business and Innovation, Henley Business School, University of Reading, outlines what policymakers and senior managers need to understand if they are to meet the "China challenge"

Since China began on the path towards economic liberalisation – of sorts, at least – Western companies have been trying to enter and tap into the world's most populous market. But over the past decade particularly, Chinese enterprises have also been increasingly investing in projects and companies overseas, primarily to meet three key criteria – to secure mineral resources, intellectual property and technological expertise.

China's investments, and its role in key infrastructure projects in Africa in return for mineral deposits, have been controversial, but also very successful. But the country's role in promoting outward foreign direct investment (FDI) to the US and EU member states, such as Germany and the UK, in return for gaining vital research in cutting-edge technologies and skills, is less well-known. Furthermore, it appears that such a strategy is likely to be developed more strongly as China seeks to grow its economy.

Within 60 years, China has transformed its economic outlook. In the 1950s its economy was the size of Sudan's; now it is the second largest economy in the world, with many experts believing that it will overtake the US over the next 20 years to become the world's largest.

In the past 25 years, with GDP growth averaging nine per cent per year, China has evolved from a closed, centrally-planned system towards an open, market-oriented economy. Economic reforms began in the late 1970s with the phasing out of collectivised agriculture, and expanded to include the gradual liberalisation of prices, increased autonomy for state enterprises, the foundation of a diversified banking system, the development of stock markets, the rapid growth of the non-state sector and opening up to foreign trade and investment.

The restructuring of the economy, and the resulting efficiency gains, have contributed to a more than tenfold increase in GDP since 1978. Increased trade and FDI, both inward and outward, have accompanied this economic growth as China has become integrated into the global economy.

China now ranks third and first respectively in the world in terms of total import and export volume. A growing share of China's economic growth has been generated in the private sector as the government has opened up industries to domestic and foreign competition, though the role of the state in ownership and planning remains extensive.

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Despite its large and growing domestic market, China exports a great deal more and across a wider range of industries than Japan did in its heyday. Although the country only opened its borders to trade and investment during the early 1980s, by 2007 China had surpassed Germany to become the third-largest trading nation in the world after the United States and Japan. By 2006, China's trade surplus more than tripled to boost foreign currency reserves to a point where they also exceeded those of Japan to become the largest in the world.

Current government industrial policy is directed at growing Chinese overseas direct investment under the epithet of "Going Global". In 2006, premier Wen Jiabao strengthened this approach, building on the initial impetus by premier Zhu Rongji in 2001 as part of the government push for the development of national industry champions and the procurement of natural resources abroad. Both underpin a broader agenda of economic nationalism, including energy security, geopolitical positioning and national competitiveness. The "Going Global" strategy has contributed to an increase in outward FDI from China as the programme relies on the active use of mergers and acquisitions (M&A) by Chinese firms to access Western markets, technologies and brands.

Another major policy objective in China is to boost high technology industry sectors. This was led by the National Development and Reform Commission as part of the country's 11th five-year plan, launched in June 2006 – now succeeded by the 12th five-year plan. The significance of the latest plan (2011-2016) should not be underestimated. It focuses on the promotion of consumer-led growth and "inclusive growth", and aims to promote further development of specific, high-technology industries (including energy, biotechnology and R&D intensive manufacturing), as well as the promotion of service industries in China. Given the role of government in China these initiatives will shape » the economy, Chinese business and the prospects for multinational firms.

Nor should anyone underestimate the significance of the growing opportunities to attract Chinese investment into markets, such as the US, EU and the UK.

FDI from China into Europe has increased rapidly in recent years, including a rise in Chinese M&A (up 35 per cent in the first six months of 2011). There are opportunities for Western businesses to attract funding and develop joint ventures that will give them access to the Chinese market.

However, such opportunities come with potentially serious caveats. Chinese government regulation and oversight can frustrate business strategies, and there is also the risk of losing technology and intellectual property to Chinese firms. Coupled with cheap labour costs and a strengthening economy, the competition could be stacked in Chinese firms' favour if Western companies are not careful. ■

China relaxes rules on inward and outward FDI

The UK's Foreign and Commonwealth Office (FCO) published a country update for businesses last year called "China Economy: Outward Foreign Direct Investment". Below are some of its key findings:

Last year, China's National Development and Reform Commission (NDRC) began to relax restrictions on Chinese foreign direct investment (FDI) abroad to gain access to resources, technology, brands and markets overseas – as well as to help relieve excess liquidity in the domestic economy.

Outbound investments of less than $300m in the natural resources sector no longer need NDRC approval. For non-resource sectors the limit is $100m. Any deals larger than that still need NDRC approval.

The Chinese authorities have taken a series of steps in recent years to boost outward FDI, including in 2009 when the Ministry of Commerce (MofCom) devolved responsibility for smaller outward FDI deals ($100m or less) to provincial MofCom branches. It is estimated 85 per cent of outward FDI deals fall into the $100m or less category.

In the same year the country's foreign exchange regulator, SAFE, revised regulations to make it easier for companies to access foreign currency to fund their expansion overseas. And at the beginning of 2011, the authorities announced that outward FDI could be made in renminbi, China's official currency, as part of a broader policy of increasing the international use of the "redback".

China's outbound FDI (in non-financial sectors) rose by more than 36 per cent in 2010, to $59bn (official statistics only refer to non-financial FDI). This figure excludes substantial "portfolio" investments in overseas financial markets by China's sovereign wealth funds and financial institutions. For comparison, FDI into China by foreign firms amounted to $106bn in 2010, up around 17 per cent on the previous year.

China's ever-increasing hunger for resources explains the looser restrictions on outward FDI. For example, overseas investments by Chinese oil firms in recent years have attracted much attention. But to put this in perspective, a recent report highlighted that the combined overseas assets of China's three major oil companies only amounted to less than seven per cent of oil giant Shell's. Other long-standing motivations for China's "going out" strategy include access to more advanced technology, brands, and markets.

The authorities believe increased outward investment can help boost domestic innovation and research capabilities, which is why moving to a higher-tech growth model is a key theme of the 12th five-year plan published this year. The authorities also believe that FDI overseas can help their corporations avoid what China sees as a raft of unfair restrictive trade measures being brought against its exports. Macroeconomic factors are also at play. The authorities' concern over inflation has also spurred faster reform on outward FDI. And as the renminbi gradually strengthens, overseas assets will become cheaper.

The authorities are simultaneously enthusiastic about Chinese firms investing overseas, while being somewhat sceptical of their ability to do so – and mindful of the considerable political and strategic implications of investment abroad.

FDI by Chinese firms overseas has not always been a seamless process – for a variety of political, corporate and cultural reasons – hence the paternalistic approach and the number of different government departments that are involved in supervising outward FDI.

The list grows longer for certain sectors: for example, in the financial sector approval by the relevant regulator (banking, securities or insurance) is also required. Any (central government) state-owned enterprise (SOE) that wishes to invest overseas also needs approval from the state-owned Assets Supervision and Administration Commission.

But although still closely supervised, Chinese outward FDI is rising sharply. According to minister of commerce Chen Deming, during the 11th five-year plan (2006-2010) China rose from being the 18th largest global supplier of FDI to the fifth, although the financial crisis may have dragged some Western countries temporarily down the rankings.

The bulk of mainland China's outward FDI goes elsewhere in the region, with 63 per cent going to Hong Kong alone in 2009. The next largest destination is Latin America (13 per cent in 2009), then Europe (six per cent). By the end of 2010, the stock of Chinese investment into the UK had reached $1.2bn.

According to MofCom, the UK is the second most popular destination for Chinese investment into the EU, after Germany.

Cooperating for a better future

United Nations director for social policy and development, Department for Economic and Social Affairs, **Daniela Bas,** talks about the contribution of cooperatives to socio-economic development, particularly their impact on poverty reduction and social integration. Meanwhile, **Camille Van de Sande**, from cooperative Rabobank, talks about juggling the need for profit and social expectations

With the theme of "Cooperative Enterprises Build a Better World", the UN International Year of Cooperatives seeks to encourage the growth and establishment of cooperatives all over the world. It also encourages individuals, communities and governments to recognise the agency of cooperatives in helping to achieve internationally agreed development goals, such as the Millennium Development Goals.

As business enterprises owned and controlled by the very members that they serve, decisions made in cooperatives are balanced by the pursuit of profit and the needs and interests of members and their communities. Cooperatives take many forms and operate in all sectors of society, but just how far have they come in recent years and what does the future hold for them?

The early cooperatives were born out of economic hardship in the UK and Germany, and were centred on the retail and financial sectors, but since then cooperatives have established themselves in almost all economic sectors and have a global presence – ranging from the small, village-based self-help cooperatives to large-scale producers and service providers. In 2008, the largest 300 cooperatives in the world, based on revenues, had a combined income of \$1.1trn. UN director for social policy and development Daniela Bas explains what the future holds for them. »

What is the potential impact of cooperatives on wider society?

The UN's Division for Social Policy and Development, DESA, has published a series of reports that outline the impacts of cooperatives on social development. These are available to the public at social.un.org. Here are a few of the findings:

The impact of cooperatives on employment and poverty are somewhat intertwined and is hinged on their capacity to empower individuals and groups to positively affect their life situations. Cooperatives employ an estimated 100 million people around the world. However, their contribution is not only in the numbers that they employ, but in the qualitative factors involved. The global cooperative movement, as embodied in the membership of the International Cooperative Alliance, adheres to the "decent work" agenda of the International Labour Organisation (ILO).

So cooperatives seek meaningful, dignified work for workers, embrace social responsibility and seek outcomes that support the wellbeing of the community.

Because they are, by definition, organisations based on collective action and serving the collective, cooperatives, or even "pre-cooperatives", can mobilise and protect members of the labour force that may be otherwise particularly vulnerable, such as informal workers. In applying these principles of self-help and collective action, cooperatives help to shape enterprises in which the poor can become active participants in the improvement of their own livelihoods and economic futures.

Is there strong evidence to substantiate the claim that cooperatives encourage further investment and income into communities?

There are many cases in which the work of cooperatives has improved the lives of their members and the wider community. In the latest report of the Division, published in 2011, we highlighted a few developing country examples, particularly within the agricultural sector, which have increased the real income of local farmers and led to greater investment in education and health. Having said this, it is important to mention the need for more robust and systematic research on cooperatives and their impacts, especially as compared to other business models.

> 'Cooperatives help the poor to become active participants in their own livelihoods'

What are the benefits for business, which must juggle the need for profit with the demands of members?

Because they are member-owned and member-driven, cooperative enterprises are always relevant to the needs of the clients they serve; this provides a measure of stability and sustainability for both the owners and the economies in which they are contained.

For the individual business person – for example, each producer member in an agricultural cooperative – the collective nature of the cooperative also makes doing business more cost-effective, providing deeper market reach than would otherwise be possible.

Why has the UN designated a Year of Cooperatives?

The onset and continued impacts of the recent global financial and economic crisis have made clear the importance of strengthening the real economy and of concentrating our development efforts on empowering people and building their capacity to secure sustainable livelihoods. Over the years, the effectively-run, principle-based cooperative has shown itself to be a viable and resilient business model that emphasises the needs of people and communities alongside – if not ahead of – the profit margin. Raising public awareness on this model can help fuel increased diversification of the way we do business in a way that can, hopefully, help to move our communities and economies forward in a more equitable and sustainable manner. »

The UN has long recognised that the people-centred values built into the effectively implemented cooperative model provides real and potential support to the people-centred development goals of the international community. This role was noted explicitly in the outcome of the 1995 World Summit for Social Development, which has influenced many of the more recent efforts at achieving balanced development, such as the Millennium Development Goals.

In 2001, the UN went on to develop guidelines for the promotion and advancement of cooperatives. Guidance on creating a supportive legal framework also came from the ILO in 2002, in Recommendation 193. However, since co-operatives function most effectively as autonomous entities, their development really requires greater knowledge of the model among the general public.

What is it hoped the UN Year of Cooperatives will achieve?

The central aim of the IYC is raising public awareness, but that hinges on three objectives: First, to increase public awareness about what cooperatives are, what they do and how they can and do contribute to socio-economic development from the individual to the national level. Second, the activities of the year will serve to promote the formation and growth of cooperatives. Third, through the activities of the year, we hope to encourage more governments and regulatory bodies to establish policies, laws and regulation conducive to cooperative formation and growth.

How will cooperatives evolve and what is the overall aim?

Where cooperatives go is really up to the members. What we hope to influence is the environment in which they operate. We hope that the IYC plants a seed that leads to a fairer operating environment for cooperatives in all sectors, and cements the option of the cooperative way of doing business as a viable option within current and future entrepreneurial minds.

One concrete outcome that we do foresee is the recognition of cooperatives as a distinctive business model, to be researched both for outcomes and impacts. This recognition will lead to more robust data collection on the model in the sectors within which it operates. In a nutshell, we aim to work with the model and the people it serves to truly ensure that "Cooperative enterprises build a better world!" ■

Rabobank's Camille Van de Sande on juggling business and social drivers

More than 100 years ago, the formation of cooperative banks was a hard economic necessity. It was the only way for its members to acquire the capital they needed for their operations. These founders didn't contribute capital and they never became shareholders, instead accepting joint liability for the debts of their cooperative bank. It was a commercial set-up that arose from a sense of enlightened self-interest.

Thanks to the accrual of annual profits, members nowadays no longer have personal liability. Despite this, at Rabobank we still don't have any individual shareholders. We are a commercial bank, but not one that is driven by shareholder value. This means we can focus on long-term continuity, the interests of our customers and the communities they operate in. Instead of paying dividends to shareholders, our annual profits are added to equity capital. This enables Rabobank to follow a conservative strategy with a modest objective for the return on equity and greater emphasis placed on controlled growth and a strong capital and liquidity position.

As a cooperative, we believe in contributing economically, socially and ecologically to building a sustainable society. One of the ways in which this is achieved is through the Rabobank Foundation, an independent organisation, funded by the Rabobank group, which donates a percentage of its annual profits. The Rabobank Foundation has been active in microfinance and the establishment of farmer-owned and credit cooperatives in developing countries for more than 35 years. Promoting economic participation and self-sufficiency are core values of the Rabobank Foundation. This is one of the ways we put cooperative banking into practice.

Another way is through our commitment to one of the most critical issues facing this generation and the generations to come: how to develop a safe and sustainable food supply. We foresee food supply lagging as demand for food increases and changes.

As a key player in the global food and agriculture chain, we are committed to playing our part in feeding the burgeoning world population.

Stepping stones to growth

Tim Bradshaw, head of enterprise and innovation at the CBI, sets out what's required to drive sustainable growth across the UK economy

The recent recession and ongoing sluggish recovery has highlighted just how unprecedented the period from 1993-2007 really was. The economy grew steadily, but became increasingly unbalanced towards debt-driven household and government consumption.

To achieve sustainable growth in the medium to long term, the economy has to become more driven by investment and exports, while allowing the burdens of both government and consumer debt to subside. Failing to rebalance alongside debt reduction will leave the economy struggling to grow sustainably in the future.

The CBI report, "A vision for rebalancing the economy", set out some of the challenges and opportunities for a new approach to growth .

There are no easy answers or quick fixes, and we have to rebalance while battling against headwinds from the eurozone crisis. Our most likely "base case" scenario for growth, modelled on a typical private sector recovery, would see the contributions of net trade (0.8 per cent) and investment (0.5 per cent) exceed household consumption (0.4 per cent). Tempered by a small contraction in government consumption, this should produce annual growth of around 1.6 per cent. This is below trend, but over five years it would provide a more robust basis for future economic stability, compared with what would be achieved with further unsustainable expansion in consumer spending.

To deliver rebalanced growth we must "swim with the tide" to take advantage of long-term domestic and global changes – particularly the rise of middle-class consumers in emerging markets, spurring a greater demand for our services and high-quality goods. The demand within the UK for significant investment to update our ailing infrastructure, digital growth and the diversification towards renewable energy will also provide significant business investment opportunities.

The government must concentrate on bringing the budget back into balance, which will require ongoing fiscal constraint, while also creating confidence with targeted measures that signal to investors that the UK is a profitable place in which to invest and grow a business.

To boost economic contributions from net trade we will need to reverse the historic trend of declining export performance; we also have to look beyond our normal export horizons. The UK's share of global exports has declined sharply over the past decade from 5.3 per cent in 2000 to 4.1 per cent in 2010, while Germany's grew from 8.9 per cent to 9.3 per cent. The main explanation has been our inability to break into and succeed in high-growth markets – in total we export less to Brazil, Russia, India and China (the BRICs) than we do to Ireland. In contrast, Germany has ridden the wave of demand for machinery, tools and equipment, fuelled by the expansion of manufacturing capability in the BRICs.

But the dynamics are shifting as living standards rise in these countries. There were around 430 million people falling into

the World Bank definition of middle class in the year 2000, but this is projected to increase to more than 1.1 billion by 2030. Demand from these middle class consumers will increasingly be channelled towards goods and services that mature economies such as the UK can provide. Our expertise in electrical and high-tech goods, construction services, financial services, communication services and high-value brands should provide the basis for an export renaissance to the BRICs and other high-growth economies.

Achieving the UK's export potential could be worth up to 1.5 per cent of GDP, or an injection of £20bn to the economy by 2020 if the UK focuses on high-growth markets. The government can help in a number of ways and, with Ernst & Young , we have developed a five-point plan to grow UK business overseas:

1. Government must set a high bar for export performance to be met through a 2020 national exports strategy.
2. Government must provide the right policy framework to boost businesses' export capability.
3. UKTI must inject greater commercial focus into its operations to better support UK business.
4. CBI will take the lead in supporting UK businesses entering new markets.
5. Business and the government must work together to increase the availability of export finance.

Boosting business investment will also require a turnaround in recent trends. From 1990-2010, general government investment grew by 5.1 per cent, compared to just 2.4 per cent annually for business investment. »

‘The challenge is to free up investment for infrastructure, and it is estimated that up to £200bn will be needed by 2015 to meet demand’

The potential for investment by the private sector is there, it just has to be unlocked. From 2012-2015 we estimate that £176bn could be unlocked from private sector balance sheets if UK businesses moved towards balance from their current record cash flow surplus. There is also significant potential to attract further direct foreign investment to the UK.

Creating certainty around the future so that businesses are assured that they will be able to gain from making investments now is critical. Having a competitive tax system lies at the heart of this and we support the government’s ambition for the UK to have the most competitive tax regime in the G20. Introduction of the Patent Box and improvements to the R&D tax credit will boost investment in innovation and manufacturing in the UK, while recent changes to the Enterprise Investment Scheme, Venture Capital Trusts and Entrepreneurs Relief will help to bolster funds available for investment in SMEs. Continued commitment to reduce the headline rate of corporation tax to 23 per cent by 2014 is also required.

The next challenge is to free up investment for infrastructure, which will be critical for our future growth. The World Economic Forum ranks the UK only 28th on the quality of its overall infrastructure and it is estimated that up to £200bn (70 per cent from the private sector) will be needed by 2015 to meet future demands. However, under the current capital allowances system a significant level of private sector spending on infrastructure (28 per cent, or £11bn annually) is ineligible for tax relief. We have proposed a new capital allowance scheme to the government on future spending that could reduce the effective cost of upgrading transport, energy, water and waste structures by up to 10 per cent, and hence stimulate investment decisions.

As well as looking specifically at exports and investment, we also need to recognise that growth can come from any part of the economy – from high-quality breweries to innovative waste recyclers and from medical devices to IT services and creative industries. The government needs to encourage this diversity and work with business to develop future value chains in the UK. Many of our future champions of growth are mid-sized businesses (typically with a turnover of £10-500m), and their needs have often been overlooked by the government. Yet these businesses are critical for growth in their own right, as well as being vital supply chain partners with both large and smaller businesses.

We are encouraging the government to look at how these mid-sized businesses could be better supported in breaking into export markets, how they could link up with others in their supply chains to develop the skills and ideas they need to grow, and how they might access alternative forms of finance. Mid-sized businesses already punch above their weight in the UK economy, but with the right support they could have a game-changing impact .

This year is not going to be easy, the economic recovery will be, at best, sluggish, and the ongoing eurozone uncertainty is sapping confidence. But by turning our exports focus to new high-growth economies, and encouraging business investment, particularly to update our ailing infrastructure, growth and jobs can be achieved. ■

Tim Bradshaw
Bradshaw’s remit includes small businesses, manufacturing, research, innovation and business-university collaboration.

Getty Images

Treasury – A Good Career Move

If you haven't already thought about your longer-term career, as a recent CIMA qualified management accountant you are probably now starting to consider what your next move could be. You may want to continue in an accounting focused role, whereas you might possibly be looking to experience other areas of finance. If this is the case, a career in Treasury is seriously worth considering.

The role

Treasury activity is an integral part of any finance function, although dedicated treasury departments will generally only be found in larger, more complex organisations. Recent economic conditions helped to demonstrate the importance of having a well-run treasury department, resulting in an increasing number of smaller companies looking to bring specialist treasury knowledge on board.

As a treasury professional, you will be working in what is effectively the company bank, and will be responsible for managing both the cash and debt within the organisation. It is a highly commercial environment offering a variety of different aspects, ranging from technical accounting and mathematical modelling to relationship management and strategic funding. You will be managing cash balances and currency flows to meet business needs, whether to pay monthly salaries or to fund acquisitions. You will be involved in cash flow forecasting and hedging strategies, potentially involving hundreds of millions of pounds. Your role will therefore have a huge impact on company performance.

The person

Competition for entry-level roles is high, and the increased spotlight on Treasury over the past few years has only made things more competitive. Although an accountancy qualification is not a pre-requisite for a successful career in treasury, as a CIMA qualified accountant the commercial understanding you have gained will certainly put you at an advantage when applying for jobs. Any treasury-related experience is advantageous but not essential, although a strong academic background is generally sought, with a particular preference for this to be mathematically orientated.

You will need:

- Strong commercial understanding and an interest in the financial markets, and the ability to discuss some of the challenges that may be involved;
- A high level of mathematical ability;
- Some understanding of treasury, along with a lot of enthusiasm for it;
- The ability to follow and apply processes, with strong attention to detail.

Attractions

You will have the chance to develop specialist expertise that can be used across different industry sectors. The role will be extremely varied, and will offer opportunities to get involved in more strategic areas of finance. Your work in treasury will also have a very direct short, medium and long-term impact on a company's financial performance, and as companies' treasury functions become increasingly sophisticated, this can make for some very interesting work.

Given that treasury is a specialist area requiring specific skills, your employer is also likely to sponsor you through your ACT (Association of Corporate Treasurers) exams, particularly if you show a high level of commitment to the company and your role. This is an invaluable qualification if you are planning either a long-term career in Treasury or a move into senior finance roles.

Where does it lead?

A move into treasury is frequently an entry point into a larger corporate, and a source of valuable experience on the way to a senior finance role. The Finance Directors of most FTSE 100 companies will have spent some time in treasury during their career. After completing a spell in treasury, it's possible to move into other finance-based positions within the company. Alternatively, you could continue in the treasury field and build a successful career, offering you the potential to move into more senior treasury positions.

goodman masson

Goodman Masson is the largest Independent Financial Recruiter in the UK and has been recruiting professionally qualified accountants and other finance professionals for almost 20 years.

With a team of over 140, Goodman Masson holds annual revenues exceeding £29 million and has obtained an impressive client portfolio ranging from small entrepreneurial start-ups and SME to 67 of the 100 FTSE corporations.

An award-winning recruitment firm, Goodman Masson has been named "*Best Small Company to Work For*" by The Sunday Times for two consecutive years and are recipients of numerous industry awards such as: *Recruitment Company of the Year* by APSco, *Best Professional Services Recruitment Company* by Recruiter Magazine and in 2010 was awarded *Growth Company of the Year* by Recruitment International.

If you are interested in a career within Treasury, or just wish to discuss your career options, please contact Guy Middleton on:

020 7324 0501
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www.goodmanmasson.com

EVENTS

Introduction to the Bribery Act and review of recent developments in money laundering

24 April
Nottingham

This presentation will review the key aspects of Proceeds of Crime Act legislation and money laundering regulations, with an examination of the latest developments. The session will examine the pitfalls for management accountants in business.

www.cimaglobal.com/EastMidlandsandEastAnglia

The Bank of England's outlook on the shape of the British economy for 2012

9 May
Peterborough

This event will review the Bank of England's latest economic forecasts from its recently published inflation report, and will cover the outlook for GDP growth, as well as CPI inflation.

www.cimaglobal.com/EastMidlandsandEastAnglia

CPD technical update: better decision-making in difficult economic times

16 May – Croydon
17 May – Milton Keynes

Bernard Marr, a leading global expert and bestselling author on organisational performance, will help you discover a range of tools to help you generate real competitive advantages for your organisation.

www.cimaglobal.com/Events-and-cpd-courses/CPD-technical-update-search

Further events

CPD Summer Academy
14-15 June, 25-26 June
This two-day event will cover a wide variety of topics that are relevant to your role and count towards, or even fulfil, your annual CPD requirements. It also incorporates a case study and time for networking.
www.cimaglobal.com/summer

LionHeart schools challenge
Get involved and share your knowledge and expertise with tomorrow's business leaders through the LionHeart challenge. CIMA members and students can act as finance business experts and judges. Taking part will contribute towards your CPD, and it's also an excellent opportunity to develop your coaching skills. CIMA is the national sponsor of the LionHeart challenge and is proud to be part of this valuable and rewarding schools programme. To find out more, or to get involved, visit **www.cimaglobal.com/en-gb/Members/Fees-benefits-and-career-support/Member-involvement/LionHeart-challenge**

IN THE NEXT ISSUE...

Strategic risk management

Q&A: Navigating today's business risks
Three leading finance chiefs discuss the risks facing their organisations and how they are navigating them, with a focus on the finance function.

Political risk
The current state of geopolitical uncertainty in many parts of the world is driving up demand for political risk insurance. A leading CFO talks about how their organisation manages the threat of political risk.

Reputational risk
From Tiger Woods and John Terry to BP, Toyota and BlackBerry – reputations can be shattered almost overnight. We ask the CFO of Toyota how his organisation responded to the damage to its reputation when the car manufacturer was forced into a series of product recalls.

Internet intelligence: social media risks and opportunities
Most organisations have social media strategies. But how can you effectively monitor what is being said about your organisation on the likes of Facebook and Twitter, and how can you turn this to your advantage?

The risks associated with the break-up of the eurozone
What exactly would happen if the eurozone broke up in 2012? And do risk managers have a hope of preparing for such a far-reaching forecast? By the end of this year, several observers think it's unlikely the eurozone will look the same as it does right now. We ask CFOs how they can prepare for such events.

Data risks
When outsourcing finance functions or moving into the cloud, many organisations have concerns about their data and IP. So what are the risks around data and what can organisations do to protect themselves?

Emerging markets
Deciding if, and when, you should enter new markets in search of growth can throw up all manner of risks. This article looks at those risks, and what companies can do to prepare for them.

Ethics and compliance
Leo Martin, director of responsible business advisors GoodCorporation, will be examining the role of ethics and compliance in global organisations.
In the light of recent failures within the financial services sector – with its very strong compliance culture – and the new emphasis on ethics in companies such as BP, the article will analyse the different roles of compliance and ethics.

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