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How Your Institution Can Use Treasury Functions for Strategic Value

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Every college and university has a portfolio of financial risks and resources which its leaders seek to deploy in a manner that balances the pursuit of growth against a set of guardrails that ensure financial health. Sustainable growth requires the prudent allocation of key financial resources, such as cash, credit, leverage, and invested assets. This process represents Treasury work and is the cornerstone of the institution's ability to assume appropriate risk in the pursuit of growth. Done well, Treasury can provide significant value to the overall institution.

Treasury Functions in Higher Education

Universities and colleges approach the Treasury functions in different ways. Many institutions use a dedicated Treasury model and have a Treasurer who manages liquidity as well as non-operating assets and liabilities. This model concentrates Treasury expertise, and can drive significant performance enhancement across all stages of financial resource management.

Figure 1. Four Core Treasury Functions

Source: Kaufman, Hall & Associates, LLC



Many more institutions distribute the core Treasury functions across multiple executives, perhaps with a Controller handling cash, and the Chief Financial Officer handling credit, debt, and investments. This model is typical for many smaller and less complex institutions. In larger, well-endowed institutions, a Chief Investment Officer assumes investment responsibilities. Each institution confronts different facts and circumstances, but the decision on Treasury structure typically focuses on cost and complexity.

Kaufman Hall can help your leadership team define the right approach for each of the four core Treasury areas described next: capital management, Treasury operations, external financing, and invested assets (Figure 1). Future articles in this series will address each area in more detail, and describe how to integrate these components within a strategic Treasury framework.

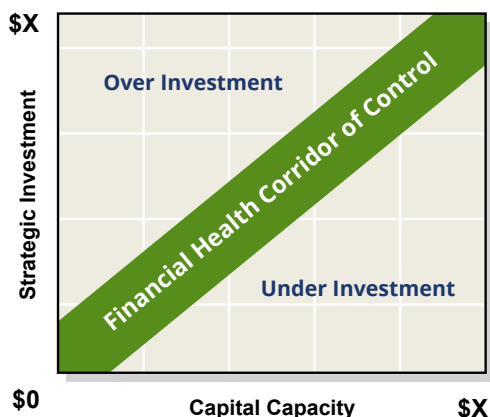
Function 1: Capital Management

Capital management activities focus on identifying, managing, and allocating capital and credit resources in order to stay within the "financial health corridor of control" (Figure 2). This corridor represents the equilibrium between strategic investment and financial capability. If an institution falls above the corridor of control in the area labeled "over-investment," its financial need or strategic capital appetite exceeds its financial capability.

Within the capital management function, credit positioning and monitoring ensure that the college or university achieves and maintains a credit rating that can support access to the required amounts of affordable external capital.

Figure 2. Financial Health Corridor of Control: Balancing Strategy and Financial Capability

Source: Kaufman, Hall & Associates, LLC



Rating and creditor coordination ensure timely and detailed communication of both negative and positive deviations from budgets and near-term forecasts.

The definition of capital capacity (debt capacity plus excess cash) determines the amount of capital—obtained through internal operations and external sources—that the institution can reasonably be sure to generate to support its development over a defined period of time. Capital resource allocation deploys these scarce capital resources to the mix of strategies or initiatives that will enable the institution to achieve the best-possible market strength and differentiation, and sustainable competitive financial performance.

All of this is defined by a set of financial targets/ratios that represent the institution's particular definition of its financial health corridor of control.

Function 2: Treasury Operations

Treasury operations focus on managing institutional liquidity, as well as building the infrastructure to support the seamless flow of credit/capital across the institution.

The core of this function is cash management and the maintenance of commercial banking accounts and products that facilitate receipt and payment of cash. Best practices include conducting periodic reviews of banking relationships to ensure that the institution uses the most innovative product offerings, and to the extent possible, aligns ancillary services across credit and non-credit banks. Specific areas that can provide value to the institution are streamlining the payment posting process in the bursar's office, and maximizing terms, discounts, and rebates through accounts payable and the supply chain.

In addition to liquidity management, the operating Treasury chassis looks to facilitate the free flow of credit and capital to wherever it is needed to defend operations or support growth initiatives. This might include a foundational master trust indenture, for example. With institutions with more than one component entity, the Treasury chassis should identify the right balance of centralized control versus autonomy with Treasury activities for each entity.

Function 3: External Financing

Activities related to external financing focus on building and maintaining an appropriate portfolio of comprehensive debt instruments.

This function controls access to outside capital, including markets, products, and relationships. Decision-support techniques and tools should focus on optimizing portfolio composition against risk objectives. An institutional point of view is established across funding channels (debt and leasing), funding partners, and financing products, including swaps and floating-rate instruments.

The financing portfolio is managed continuously across core—i.e., debt and swap—and comprehensive funding activities, including leasing and pension. Institutions are supported by relationships with external financing experts, such as financial advisory firms and investment banks.

Function 4: Invested Assets

Activities in the invested asset area focus on building and managing an invested asset chassis that drives returns while remaining within appropriate risk parameters codified under the institution's Investment Policy statement. Articulating a clear role for cash investment and its responsibilities to the operation is paramount for establishing appropriate expectations and guardrails.

Many institutions establish relationships with investment advisors and some are beginning to transition fiduciary responsibilities to external parties through an outsourced Chief Investment Officer model.

A Changing Operating and Treasury Environment

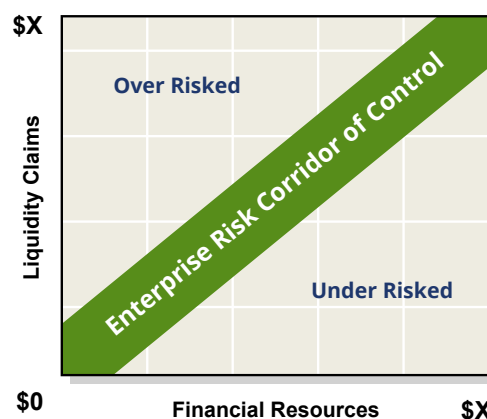
In many institutions, Treasury activities—and balance sheet resources—are built and managed with only an indirect relationship to operations and strategy. Of course, capital capacity and external capital access are integrated into the planning process, but debt and investment portfolios often are built in relative isolation. In times of business model stability, this fragmented management of the Treasury function can be tolerated. Each area can make its unique best contribution with less pressure on how each component works (or doesn't work) relative to the others.

The problem is that higher education has entered into what likely will be a sustained period of financial volatility. Market forces, enrollment pressures, uncertainty in public funding, and strategic investment requirements are forcing a business model change that is challenging the strategic, operational, and capital/credit position of most universities and colleges. Volatility within the investing and debt markets may create equal challenges related to the construction and management of portfolios of financial assets and liabilities.

These disruptive forces are challenging the definition of financial health; but they also are forcing a shift in the appropriate focus of the corridor of control from financial health as illustrated in Figure 2 to the balancing of risk against the resources available to offset or carry risk, as illustrated in Figure 3.

Figure 3. Enterprise Risk Corridor of Control

Source: Kaufman, Hall & Associates, LLC



A New-Era Enterprise Resource Allocation Framework

The imperative for today's universities and colleges is establishing a framework that integrates Treasury, operations, and strategy more tightly than ever before. If the prior imperative was Integrated Strategic and Financial Planning, the new imperative is Integrated Strategic, Financial, and Treasury Planning. Treasury's inclusion ensures that the management of operations, capital, liabilities, and invested assets is captured under a single decision-support and resource-allocation framework.

As depicted in Figure 4, Treasury sits at the center of this function—bringing together the credit and financial resources of the institution with a new focus on staying within the enterprise risk corridor of control.

Where to Go From Here

Figure 4. A Comprehensive Enterprise Resource Allocation Framework

Source: Kaufman, Hall & Associates, LLC



A truly integrated Treasury framework offers the opportunity for universities and colleges to prioritize a number of competing factors. For example, if a university is carrying excessive risk on the operational side due to federal and state funding uncertainty and competitive pressures impacting enrollment, it may be prudent to minimize the risks embedded in its debt or investment portfolios. Alternatively, if a university has minimal liability-side exposure, the institution may be positioned to leverage greater risk in its operations or in its investment portfolio to drive increased returns.

Every institution experiences tension between pursuit of strategic initiatives and pursuit of investment returns, but an integrated Treasury framework offers a differentiated level of decision support that can lead to a more informed allocation of resources against the realities of the prevailing business and risk environment.

University and college leadership teams can use the Treasury framework to drive decision making about how to best prioritize and deploy resources. The result is a balancing of resources and risks across operations, strategy, capital spending, invested assets, and liabilities that is more responsive to the current complex business/operating environment. This enhanced resource deployment defends the institution as a whole from outsized claims on liquidity and minimizes the tension between making investments in new capabilities (e.g., facilities, maintenance, faculty investments, online learning) and driving return on investment.

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