
Event Report

“Managing International Financial Risk”: A Presentation by Hans L. Pohlschroeder

FEBRUARY 24, 2009

On February 24, 2009, the Columbia Finance Organization (CFO) sponsored a talk by Hans L. Pohlschroeder, vice president, treasury, at Colgate-Palmolive Company, a global company with a strong international financial presence. Mr. Pohlschroeder drew on his extensive background in international markets to discuss how to successfully manage international financial risk at a large organization.

Although many people might think of Colgate-Palmolive as an American company, this is far from the case. Although Colgate-Palmolive is headquartered in New York, it operates in 218 countries. Colgate-Palmolive is perhaps one of the most international U.S.-based companies of its size, with approximately 80 percent of its sales outside the United States.

As Hans Pohlschroeder explained, Colgate-Palmolive has been an international company almost since inception. Originally, the company had full-scale manufacturing operations in many different countries around the world, because high tariffs made it more cost-effective to produce locally.

However, trade liberalization over the past few decades has lowered the barriers to trade and created an environment where it is more cost-effective to centralize manufacturing and production. This trend has been augmented by technological increases that make it easier to produce large quantities of product in one manufacturing location. As a result, Colgate-Palmolive has transformed itself into an integrated global manufacturing chain, which in turn has helped lower costs and keep Colgate-Palmolive competitive and profitable.

Globalization, however, has created a global product flow, which leaves the company open to new types of operational and financial risk. Mr. Pohlschroeder conveyed a good example of

operational risk by telling an entertaining story about the takeover of a Colgate-Palmolive plant in Italy by the mafia, who proceeded to steal the inventory of a newly developed product that was not yet on the shelves. The mafia moved the inventory at a speed far faster than Colgate-Palmolive could have done, prompting the company to reevaluate its distribution processes not only in Italy but also globally.

Mr. Pohlschroeder explained the basic objective of financial risk management, which is to minimize the cost of capital and the impact of currency, commodity and interest-rate fluctuations on the operating cash flow of a company. He credits the success that Colgate-Palmolive has had in managing this risk successfully to a few basic principles that have allowed the company to avoid many of the pitfalls of the recent recession.

First, Colgate-Palmolive maintains a high credit rating (AA-) and prefers to perform hedges, such as swaps, with companies that have a similar or better credit rating. Second, all hedges must relate to specific, identifiable exposures. Third, it is important to remember that the treasury is not a profit center. Fourth, because of the previous principle, speculative and leveraged transactions are prohibited. Fifth, once established, hedges should not be traded, and hedges should be diversified over time. Sixth, it is useful to structure natural hedges with currencies and interest rates, and to maximize netting by directing all settlements to one day to save the spread (multilateral netting). Finally, implement institutional oversight to ensure that these policies are followed and that they are in line with the overall objectives of the organization.

Mr. Pohlschroeder spoke specifically about strategies that help to manage international financial risk. These range from interest-rate swaps to currency contracts that can be used to hedge the foreign-exchange risk. In all of these strategies, it is important to remember that the goal is to manage risk, not to take on additional risk in an attempt to make a profit. This was a recurring theme during the discussion, and it seems to have served Colgate-Palmolive quite well in the recent economic downturn. The company is quite prudent about the risks it takes, remembering that the goal is to stabilize cash flows and not to take on speculative positions in an attempt to turn a profit.

Globalization is not new, yet the risks associated with it continue to evolve. Specifically, the globalization of the manufacturing chain and financial integration around the world have added risk factors to companies' balance sheets. Many of those risks involve financial speculation, the repercussions of which can be seen now in the global economy.

However, national financial policies also have become an important factor, such as in the case of Mexico in the late 1990s. The Mexican government instituted price controls as a method of dealing with inflation. The currency was devaluing at a rapid pace, and because prices were locked in, companies began to see margins decrease rapidly and to lose money. In response to this policy, Colgate-Palmolive shut down its main facility in Mexico. What followed was a standoff between the Mexican army and the Colgate factory, although the standoff was eventually resolved through a compromise.

This story, vividly recounted by Mr. Pohlschroeder, serves as a reminder that the globalization of companies is potentially profitable and decreases some risk, but it also increases exposure to factors that were not a consideration before today’s new globally integrated economy.

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