Cashflow is king

IN THE DRIVE FOR GREATER EFFICIENCY TO COMBAT THE EFFECTS OF RECESSION, TREASURERS ARE DEMANDING MORE OF THEIR BANKING PARTNERS. **MAURICE CLEAVES** TELLS **PETER WILLIAMS** WHY MAINTAINING A SUSTAINABLE CASHFLOW IS A KEY CONSIDERATION THAT CAN TEST THE EFFECTIVENESS OF THESE RELATIONSHIPS.

The issue of liquidity remains firmly on the corporate agenda because of the credit crisis and the economic downturn. A liquidity strategy is not just about the availability of cash but covers the wider question of the availability of credit. Underpinning every other activity that a business undertakes is the requirement for sustainable cashflow.

This is the key objective of management. It is also important for the reduction of liquidity risk. Treasurers – working with stakeholders in the business – need risk management strategies in place to ensure that if one source of cash falters or dries up then there are alternatives on which the company can quickly and comfortably rely.

SHORT-TERM VERSUS LONG-TERM CASH REQUIREMENTS
Maurice Cleaves, managing director and global head of cash management at Barclays Corporate, says: "Thinking about sustainable cashflow is to look at it in terms of intraday or intraweek liquidity for a corporate. Do you as a treasurer or CFO have the ability to service your short-term cash needs? All short-term planning becomes medium to long-term strategy and treasurers must ensure they have the right cash in the right place at the right time to service the needs of the business."

The exact sustainable cashflow requirement will differ from business to business. Some will have noticeable monthly spikes in their cashflow, others will have weekly demands on cash. Treasurers and CFOs have to create and sustain liquidity management practices that match and reflect the unique characteristics of their company.

THE ROLE OF THE TREASURER Cleaves suggests that while the CFO and the board have taken a much closer interest in the management of liquidity in the last few years, it is clear that the treasurer has the prime responsibility to make sure that the right amount of cash is available when needed. "Following the credit crisis, over the last two years the treasurer has had to cope with a change in the way funding is sourced and organised, as well as much more detailed attention from the board."

The work of treasurers and treasury departments has become more visible. Cleaves says: "Bankers know that treasurers are important in terms of the overall management of the business because they are the ones who are charged with ensuring the sustainable cashflow."

Treasurers and their work have been subject to greater scrutiny from the rest of the business, and many of the elements of their work have altered. Some of the traditional sources of funding which treasurers would have looked to in the past are not as readily available, while new sources and products have come on stream.

A parallel change is that treasurers are placing greater emphasis on the monitoring of the sources of funding and the inflow and outflow of funds. Cleaves adds: "Our experience is that the thinking of many treasurers has crystallised in the sense that they are clearly focused on the key sources of funds: their banks and working capital sources of funding, debtors and creditors.

"It is also fair to say that in the past treasurers would manage on a day-to-day or week-to-week basis, whereas the financial crisis made them manage intraday. They formed the habit of checking whether more uncertain items had actually arrived."

Sources of short-term funding in particular have changed. For instance, large corporates previously had access to the financial markets through issuing commercial paper (CP), as a regular means of securing short-term liquidity. Those opportunities have diminished, but innovative and alternative methods have been developed to ensure corporates' demand for liquidity can be satisfied.

THE NEW WORLD Under the old bank lending model, companies often relied on short-term bank cash, the classic overdraft, to provide the liquidity they needed at certain points in their business cycle. While such lending may still have its place, there is now a move towards products such as invoice discounting and factoring and asset finance, with the credit provided against measurable revenues or balance sheet items.

Recently these techniques and products have gained in popularity with both treasurers and banks, as they are seen as a realistic way of securing cash.

Corporates' management of cashflow occurs on a much tighter

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basis than had previously been thought necessary. In particular, a close watch on debtors, and the desire to collect funds within a certain timeframe, has encouraged renewed treasurers' interest in invoice discounting and supply chain finance.

Other products which have seen an upturn in their use by corporates are bank confirmations, guarantees and letters of credit, and open account trades. These can be used to provide greater assurance to treasurers on the receipt of funds, which also leads to payments being made in a timely fashion.

One welcome consequence of the financial environment of the last few years has been a greater investment by many companies in their treasury systems. This trend has not been universal, as some departments have shared in company-wide cutbacks in investment, which has slowed technology and system improvement.

What has been widespread is a determination by the treasury department to make the back office more efficient and a desire to see more clearly the funds flow of the business.

Treasurers have got a firm grip on cash to the extent that they want to see cash flowing into the business before they are prepared to see it exiting.

MULTIBANKING OPTIONS Another element of the treasurers' response has been a shift in the nature of bank relationships. A greater awareness among treasurers of liquidity risk and counterparty risk has highlighted the advantages of multibanking.

Multiple banking relationships widen the potential source of funding, decrease counterparty risk and, from a liquidity management perspective, allow treasurers access to a wide range of payment systems.

Barclays knows of clients that have established relationships with multiple banks in order to secure payments and collections systems as a means of contingency, in the event of unforeseen service disruption by the principal relationship bank.

The duplication of these channels may seem to run counter to the idea of greater efficiency for the treasury department, but that issue is outweighed by the comfort that such a multibank approach can provide.

It is interesting to note that such multibank relationships have been a standard feature of corporate life for treasurers in many parts of Europe for years. For instance, in France and Spain it is standard practice for a company to have between four and seven banking relationships. In contrast, before the financial crisis it was most logical for corporates in the UK to have a single bank relationship, or at most a dual one.

Cleaves believes that mono practice is drawing to a close, with UK companies looking to follow their European counterparts. He explains: "Having far more banking relationships than they ever had before allows companies to be a little more nimble than they were previously. Counterparty exposures are spread and new avenues are opened up for both funding and deposit taking in the short and long term."

This move also gives treasurers greater flexibility over how they manage their banking relationships.

Since late 2008/early 2009 the face of corporate banking has changed markedly through mergers: sometimes at the behest of regulators, and through some players voluntarily withdrawing from markets and others entering. Those changes mean treasurers have had to work hard to establish and maintain the banking relationships they require for their companies.

RECENT REGULATIONS Another factor pressing down on the corporate/bank relationship remains regulation. The Single Euro Payments Area (SEPA), Basel III, the liquidity buffer, even the bank levy, will all have implications. Regulation will take time to roll out and a debate is taking place that will shape the final result. But Cleaves says that, whatever the final outcome in these areas, regulation will tailor the way in which banks deliver products and services to corporates. For instance, the liquidity buffer – cash pools held to demonstrate strength/standalone cash reserves – could alter banks' offerings and the impact will inevitably be felt by corporates over time.

THE CASH PLANNING PROCESS Treasurers and bankers are used to discussing shared cashflow projections, looking at where the liquidity pinch points may occur and how to deal with those. However variable the quality and accuracy of the data that different companies produce, the objective of cashflow management and planning is, as Cleaves puts it, "a matched or long book – aligning incoming flows with your outgoing flows for the same time period, to minimise funding requirements". Banks can add value to the cash planning process by examining the contingencies that can be built into a plan: for instance:

- If certain debtors pay 30 days late, how can the impact of that late payment be mitigated?
- Is credit available if it is required?
- If collection performance is poor, can your bank help in speeding up the cycle?

Treasurers may require immediate access to funds, perhaps monies they have on deposit, if their cashflow forecasts are blown off target. At the same time, they also want to harness the best yield possible while not breaching risk policies.

The nature of the liquidity management undertaken and the help required from advisers such as Barclays Corporate will vary depending on the size and nature of the business.

For instance, business-to-business and business-to-consumer models place different demands on liquidity management and planning. A retail business will use trend analysis to perform cashflow forecasting, whereas utilities or companies in the oil and gas sector, for instance, have chunks of flows in and out, which they can determine with great accuracy in advance.

The main focus for capital-intensive companies will be how they fund their capital base, while trade or working capital-focused enterprises will have markedly different concerns. Those different pressures will lead to differing funding dynamics.

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The establishment of the treasury – centralised or decentralised – will also determine the nature of the conversations banks have with treasurers. The type of organisation will decide whether products such as pooling or sweeping could play a positive role in improving cash management practices.

It should be possible for corporates to gain greater visibility of what they have and to gain value and recognition from their banking partners for the funds they have in the system, without being obliged to move all funds into one pool. Credit accounts can be offset against debit accounts without, as Cleaves says, "the need for every last cent to be in one pocket". This should be so even in territories where "trapped cash" can pose problems.

STRIVING FOR GREATER EFFICIENCIES Companies are trying to manage and control their liquidity better. The introduction of more robust treasury systems and greater centralisation of treasury (even if local treasury hubs remain) mean that in many instances they are succeeding and cash positions are being consolidated.

Barclays Corporate is seeing that one result of this success is greater pressure on banking partners to provide better information in a more timely fashion.

It is sometimes difficult to discern trends in sectors such as cash management, but Cleaves says he is convinced that treasury departments are demonstrating greater efficiency and that in turn is causing the banks to improve their game, competing among themselves in terms of the deposit, lending and trade products that they offer to clients.

Efficiency can be measured in terms of information, rates, payment and collection and the physical movement of funds. Some improvements can be credited to treasurers and others to the financial services industry (such as the work of the Payment Services Directive).

In the context of liquidity management, it is clear from Cleaves' conversations with treasurers and CFOs that their relationship with banks is becoming ever more crucial.

Treasurers are seeking to place trust in their banks for advice and for help in times of crisis. Liquidity management is one area where that treasurer/banking model can really be tested – and proved.

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