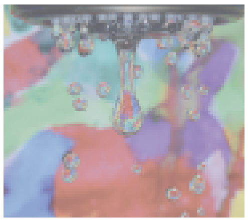


cash management

LIQUIDITY

Tap the world

IAN BLACKBURN SETS OUT THE GROWING LIQUIDITY MANAGEMENT CHALLENGE FOR TREASURERS.

Executive summary

No single liquidity management solution fits all corporates but cash pooling, cash concentration and zero-balance accounts can all help the treasurer reduce a company's borrowing costs and gain better control of its cash through enhanced access and visibility.

Shortage of liquidity remains a key driver for corporates, even for those companies that traditionally didn't have to focus on the issue. With credit much harder to come by and with margins on all types of lending rising, many large multinationals have seen that working on managing their cashflows is vital while markets are so challenging.

Every business is different, and so is every liquidity management solution. As in so many different areas, there is no one size that fits all. The right liquidity solution is dependent on the profile of the company, its overall business objectives, business lines and cashflows.

But while the solutions may differ, there are some questions that all treasurers should be asking on behalf of their companies. Even for those in the fortunate position of being cash-rich, the key issue is whether a treasury department can use liquidity management tools – pooling, cash concentration, zero-balance accounts – to reduce the corporate's borrowing costs and gain better control of its cash through enhanced access and visibility.

The challenges have increased notably over the last few years as the march of globalisation has seen larger businesses operating in all regions, often as a result of entering into mergers and acquisitions.

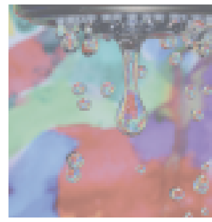
Such strategic moves have inevitably resulted in companies using the banking services of a host of providers. Such a situation is understandable but it does mean that many treasurers in these entities are struggling to get a simple answer to the questions of what money they have got and where it is. Given the current liquidity drought, the answers have become a must-know as companies want to understand their cash profile and work out the implications for the bottom line.

Treasurers and bankers know that liquidity management solutions and tools have been in use in varying degrees for a number of years. But as the business world has globalised, more companies now have significant operations outside their home markets and are therefore generating material cash inflows in a number of different currencies. While this may be good news for shareholders, it leaves treasury departments with the task of maximising the use of cash in different currencies, either improving interest earnings or saving on interest costs.

While challenging, dealing with this situation is not an impossible task. Using liquidity management tools such as multi-currency solutions, a company I recently worked with has managed to raise the amount of cash it holds in a notional pool from 60% to 96%. You can imagine how such a step change has transformed access to cashflows.

And this is not a short-term solution. Even once the current liquidity situation eases, by taking these steps companies will have strengthened their prospects by improving working capital, allowing them to finance their business themselves and to pay down debt. And while yields are low in the main currency, gaining visibility and access now will reap benefits when the yield curve rises again.

Any bank seeking to offer treasurers effective liquidity management solutions needs to take a consultative approach. Solutions are not applicable to every corporate and the various techniques are not universally appropriate. Treasurers must be comfortable that its bank understands the corporate objectives, where the company is today and where it wants to be in the future. Allied to the strategic picture, the bank has to understand the legal entities within



AS THE BUSINESS WORLD HAS GLOBALISED, MORE COMPANIES NOW HAVE SIGNIFICANT OPERATIONS OUTSIDE THEIR HOME MARKETS AND ARE GENERATING MATERIAL CASH INFLOWS IN A NUMBER OF DIFFERENT CURRENCIES.

the group as well as having a clear view of the locations and regions involved.

In the case of HSBC, the treasurer can also expect the liquidity management experts to come up with solutions demonstrable in the form of an interactive pricing model. This model uses the group's actual cashflows to portray accurately the likely benefit to be gained from using certain types of pooling structures. HSBC encourages the treasurer and others to use the model themselves so they can gain hands-on experience experimenting with various scenarios. This approach always seems to provoke a constructive dialogue between bank and treasury department.

While in my experience large multinationals have a good idea of where their cash is, the challenge often remains to obtain that information on a timely and/or automated basis. Many treasury departments are aware of the amount of overhead required to obtain cashflow information from subsidiaries. The extent of the problem depends on whether the company operates a centralised or decentralised treasury. Decentralised treasuries often face a legacy issue from M&A activity, raising cultural and technical obstacles for those in charge of trying to integrate the overall treasury function to improve cash visibility across the group.

One relatively simple starting point in tackling this issue is to look at the number of existing banking relationships within the group. If there is a substantial number, it's worth seriously considering whether they can be rationalised. It is a good rule of thumb that the more external banks in situ, then the less efficient the liquidity management. In other words, treasurers can expect a tough time obtaining the information they need for the main pooling. While there is always going to be an element of multibanking for large corporates, any treasurer who wishes to move to pooling or a zero-balance account needs to identify the main bank in each country or territory.

Once those first steps have been taken in improving visibility and control, it is possible to move towards online balance and transaction reporting.

While the treasurer is the natural choice to lead the liquidity management project, the treasury team and the bank need to recognise that others too should be involved as business practices must change if liquidity management is to improve. Treasurers and bank liquidity specialists will often make a joint presentation to the board, the chief financial officer or senior IT personnel, laying out the liquidity management vision along with the challenges and complexities that need to be addressed to realise the goal. A sensible approach includes a project implementation plan to guide the organisation through the key stages and involving appropriate technology specialists to help with integration (often on payments) and liquidity technology experts on the reporting of the balances.

Treasurers are well aware that implementing a sound liquidity management strategy involves dealing properly with legal, documentary and tax issues. Companies have their specialist legal and tax advisers for these issues and it is not an area where banks are authorised to give specific advice, although they should be able to offer their experience of similar situations.

A typical liquidity management project can take between six and nine months to complete. And while it would be unwise to underestimate the commitment required, a successful project sparked off by the desire for financial improvement can have very tangible results.

The ability for a corporate to combine different balances in different currencies in short and/or long-term positions can create interest efficiencies that deliver discernible bottom line results. Reduction in treasury department overheads are also realistically achievable by replacing treasury staff manually calculating balances with automated online reporting of the cash pooling. With cross-currency structures in place, the need to do daily foreign exchange (FX) swaps can be removed even though the funds remain in the original currency: the position is taken into account and applied across currencies.

It is fair to say that treasurers are hungry for anything that improves working capital management and enhances the ability to maximise interest earnings. Corporates are increasingly using some impressive liquidity management tools that are actively reducing borrowing costs and helping to offset multicurrency debit and credit positions. In particular, over the last few years, multicurrency solutions have come to the fore.

At the same time there has been a growing interest in what can be done in emerging markets, where varying degrees of regulation are in place. For instance, Asia Pacific has seen a growth in interest enhancement tools. This is not pooling in its truest sense but it applies relationship pricing for accounts held in different countries and hence across different regulatory regimes, where there can be difficulties in extracting funds. The outcome is higher interest receipts or lower borrowing costs.

Pressure on corporates to deliver returns to shareholders as the world economy improves suggests that treasurers will continue their search for enhanced liquidity tools as part of the bid to remain competitive.

Ian Blackburn is senior product manager for HSBC Global Transaction Banking.
Ianblackburn@hsbc.com
www.hsbc.com

HSBC
The world's local bank