The strategic edge

CASH AND THE BUSINESS ARE MORE STRONGLY ALIGNED THAN EVER AS STOCKPILES ATTRACT GREATER ATTENTION FROM SENIOR MANAGEMENT, WRITES BEN POOLE

For many corporates, stockpiling cash as a buffer against negative market movements has become a way of life since the financial crisis of 2008. "We are fortunate that, at the moment, we have a sizeable cash balance on the balance sheet," says Alison Wilson, treasurer at drinks company Innocent. "If you look back to the situation we faced in 2008, it was the reverse. We were running with very little spare cash and the business was largely debt-funded. In a reasonably short period of time, we have completely reversed our cash position."

With more companies stockpiling cash, the focus on cash has shifted from a cost and efficiency perspective to a value perspective. "Since the financial crisis, there has been much more urgency in finding out where the cash in a company is, and whether it is usable and therefore of value to the company," says Guy Pantall, head of cash management and payments at Lloyds Bank. "In a cash-rich business, the value is having the ability to understand where the cash is, and to be able to mobilise it. As a lot of companies today are in a cash-rich position, cash is driving strategic growth."

Looking at the entire working capital cycle, treasurers are focused on what they can do with their surplus liquidity to make best use of it. For Wilson, the benefits of having a cash pile are clear: "Having cash on the balance sheet means that we have cash available for any investment opportunities that may arise. This may manifest itself in incremental spending to promote our products, or should an opportunity for an acquisition or similar corporate finance deal come along, then we know the cash is there to make that happen. We are not actively looking for acquisitions, but our focus on cost control, smart 'spend' decisions and working capital optimisation means that we will have cash available should an opportunity arise."

While the disciplines of cash management and working capital management came under sharp focus immediately following the crisis, the prospect of growth returning to the UK and Europe offers the chance for treasurers to demonstrate their skills in a new environment. Cash management and working capital are equally as important in a growth environment as in a downturn since companies need to have visibility of their cash in order to make investment decisions.

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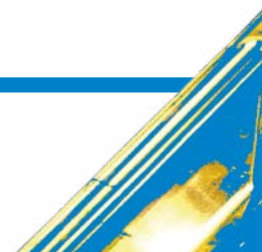
Cash and business strategy intertwined

High levels of cash need to be managed. Business strategy determines what treasurers can do with that cash, particularly in terms of the duration of any investments. "There is an ongoing debate on how long you should invest the cash, what sort of flexibility you need in order to respond to potentially short-term investment decisions, and what that does to the yield," says Michael Mueller, head of cash management at Barclays. "At the moment, some treasurers might opt for notice and premium products that give you the ability to have access to the cash if you need it, but still slightly more yield than if you hold the cash with the bank for a longer time."

Beyond investment policy, discipline around cash management can also influence business strategy. "We use our cash pile as more of a control check than you may anticipate," says Wilson. "We have a very clear commitment on what our profit and loss should look like. Just because we have cash in the bank does not mean that our discretionary spend is not linked to forecast and actual in-year performance. The shape of the profit and loss is agreed as part of the annual business planning cycle, and in-flight adjustments are made to discretionary spend decisions depending on actual performance. The discipline around cash is as much shaping the strategy as the availability of it. This is really encouraging since it demonstrates that senior management recognises the value of cash availability beyond its intrinsic value."

The view of corporate cash has gone beyond purely looking at how a business is being funded on a day-to-day basis. There is a far greater strategic view on how capital is being acquired and deployed, and how the collection of funds is supporting the bigger strategic objectives of the business. "Capital was previously seen as purely the treasurer's domain



and part of the plumbing of the business," says Paul Taylor, head of GTS sales, EMEA, Bank of America Merrill Lynch. "Now, at a time of cash stockpiling and corporates making very strategic decisions about whether to go to the capital markets to seek funding for specific projects, this cash pool is very much part of that conversation. Corporates are seeing that, by improving their cash management, they could be self-funding some of their market activity. It is a strategic and commercial benefit."

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Challenges

Ensuring cash is available in the right place, at the right time, is a key focus for treasurers. This is particularly the case for expanding businesses such as Innocent, a well-established company in the UK that is also rapidly growing in many countries across Europe. "We are spending a lot in our European countries to support a significant growth in sales," says Wilson. "We have to make sure that liquidity in each of the overseas countries is adequate to support that growth. Even though we have a pot of cash, when you divide that into six or seven different pots, managing that liquidity individually in those countries can be challenging. We have a concentration of euros, but also Danish krone and Swiss francs to manage, to ensure that we have the right amount of the right currency in the right place at the right time."

The low-interest-rate environment is another challenge. "Many treasurers are almost resigned to the fact that, at the moment, yield isn't great," says Mueller. "Depending on the currency, the duration and the type of instrument, sometimes you are talking about single-digit basis points that you can get from your investment."

"Yield is definitely our third priority, behind security and liquidity," explains Wilson. "In the current low-interest-rate environment the chance to enhance the yield is pretty limited unless you are prepared to either take some tenor risks or some fund market risks, neither of which we are interested in doing at the moment."

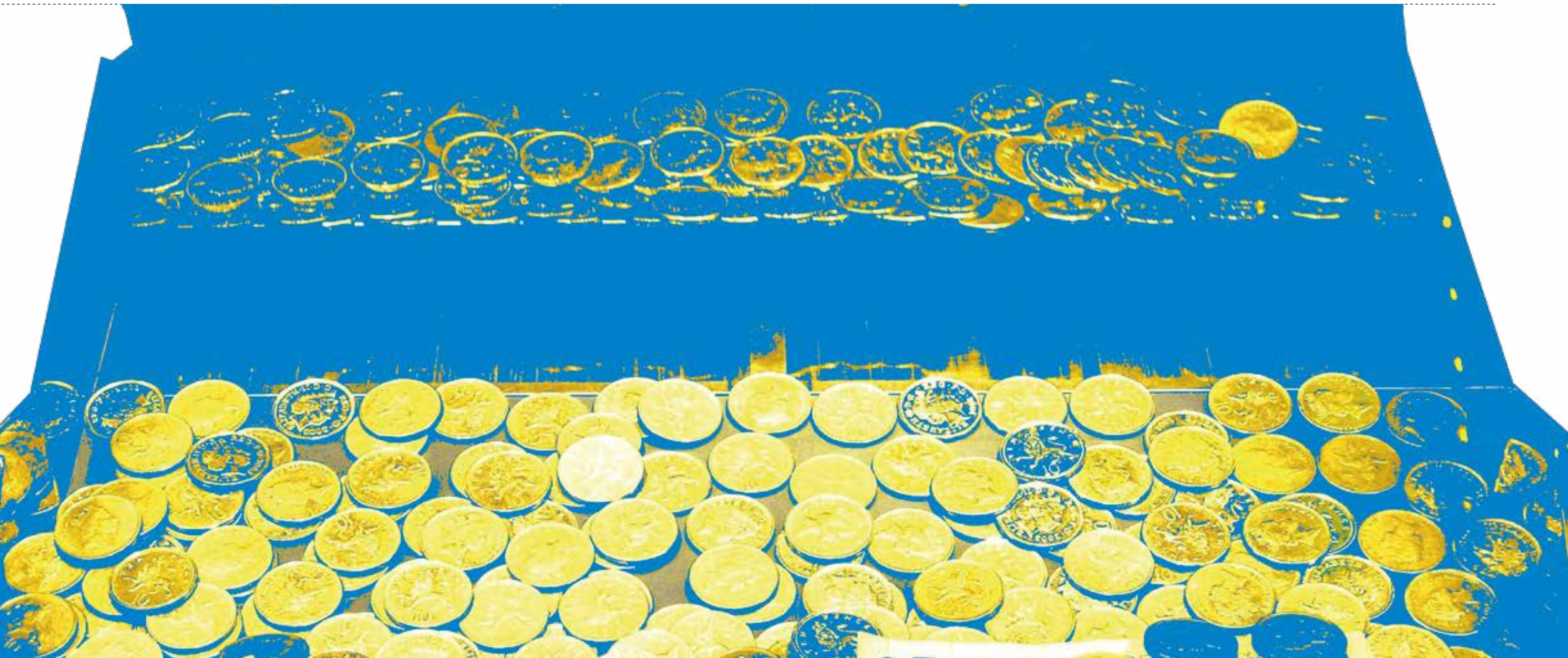
Many corporates are exploring how they can tap into growth in emerging markets, but this brings its own challenges. "Hypothetically, a corporation may take a strategic decision to go into an emerging market where double-digit growth looks achievable," says Carl Sharman, head of the treasury consulting practice at PwC UK. "Later down the line, the potential sales figures could have been achieved, but the cash value is restricted – perhaps there were issues around exchange controls, volatile FX rates or the high cost of withholding tax, for example. This is not a problem for the sales team, who could well have hit their bonus targets, but rather for the treasurer who has to find ways to get the money out without losing value."

Finally, the challenge of risk management looms large over corporate cash management. At Innocent, there is a focus on credit risk, in particular. "We have a reasonable concentration of credit risk, given that we don't have a plethora of banking relationships," explains Wilson. "To ensure that we have the most effective and efficient oversight of our cash, we only use a handful of banks. As our cash balance has grown, the amount of credit risk we are taking with each of those banks has grown. We spend more time monitoring what is going on with them, to make sure we can justify that concentration of credit risk."

Board scrutiny

It is important for the treasurer to have the ear of the board when strategic decisions are being made regarding growth or investment opportunities. Fortunately, today the board is usually proactive in wanting to hear from the treasurer. "The board wants to know that its cash is safe, and about value preservation and the accessibility of that cash," says Pantall.

There is also a major focus on risk at board level. "The board is very interested in what the company is exposed to, be it counterparty risk, country and sovereign risk, reputational risk or the availability of funds and how that impacts on finance risk," says Taylor. "Risk is another factor that has brought cash management to the board table in a way that, pre-crisis, was not a consideration."



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THE OTHER SIDE OF THE COIN

Companies with a level of debt also have a heightened focus on cash management. Graeme Hancock, group treasurer at Electrocomponents, explains his key cash management challenges.

"We are not a company with a cash pile. We have a level of debt, but our net debt/EBITDA is only just over 1x, so it is a relatively low gearing. One of our objectives, in fact, is to try and make sure that we don't have any cash balances at all, if possible. If you look at our balance sheet on the reporting dates, there is very little cash sitting there. The gross debt position of our business is very close to the net debt position. This demonstrates the level of control we are achieving over cash.

"As a treasury function, we are keen to ensure we have access to all cash on a daily basis around the world. For the companies that we have in freely tradable currencies – across Europe, North America and parts of Asia – we have cross-currency cash pools in place. We sweep out and net all their cash and overdrafts on a daily basis into just two locations: London and Singapore. This is optimal control. But as a business we are going much more into emerging markets, where it can sometimes be significantly harder to get hold of cash. As a treasury function, we now spend a lot of time putting processes and structures into these markets to make sure that there is no trapped cash and that cash balances are kept as low as possible while, at the same time, ensuring these businesses still always have access to adequate local liquidity.

"Managing working capital is also very important. As a treasury function, we get very involved in managing debtors, creditors and stock, and trying to ensure that cash isn't unnecessarily tied up in any of these assets. We also review when cash is used for capital expenditure or other parts of business strategy, to ensure it is properly costed and used wisely.

"Finally, of course, the other piece to all this is that we always make sure that we have plenty of debt finance available and committed from our relationship banks. This ensures there is sufficient cash available for the business's development and strategy at all times."

Conclusion

The focus on cash is becoming more strategic and broadening out into the wider working capital cycle. "The treasury function is becoming much more responsible for macro-level balance sheet management," says Sharman.

"Treasurers are the guardians of the balance sheet in terms of financial stewardship," says Wilson. "I can point to lots of colleagues sitting around me in the office who are very focused on the company's profit and loss – and quite rightly so, because that is the engine of profitability and growth. But all of that activity has to be supported by a robust balance sheet. It is really important that I focus on that and cash is a key element of balance sheet strength."

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