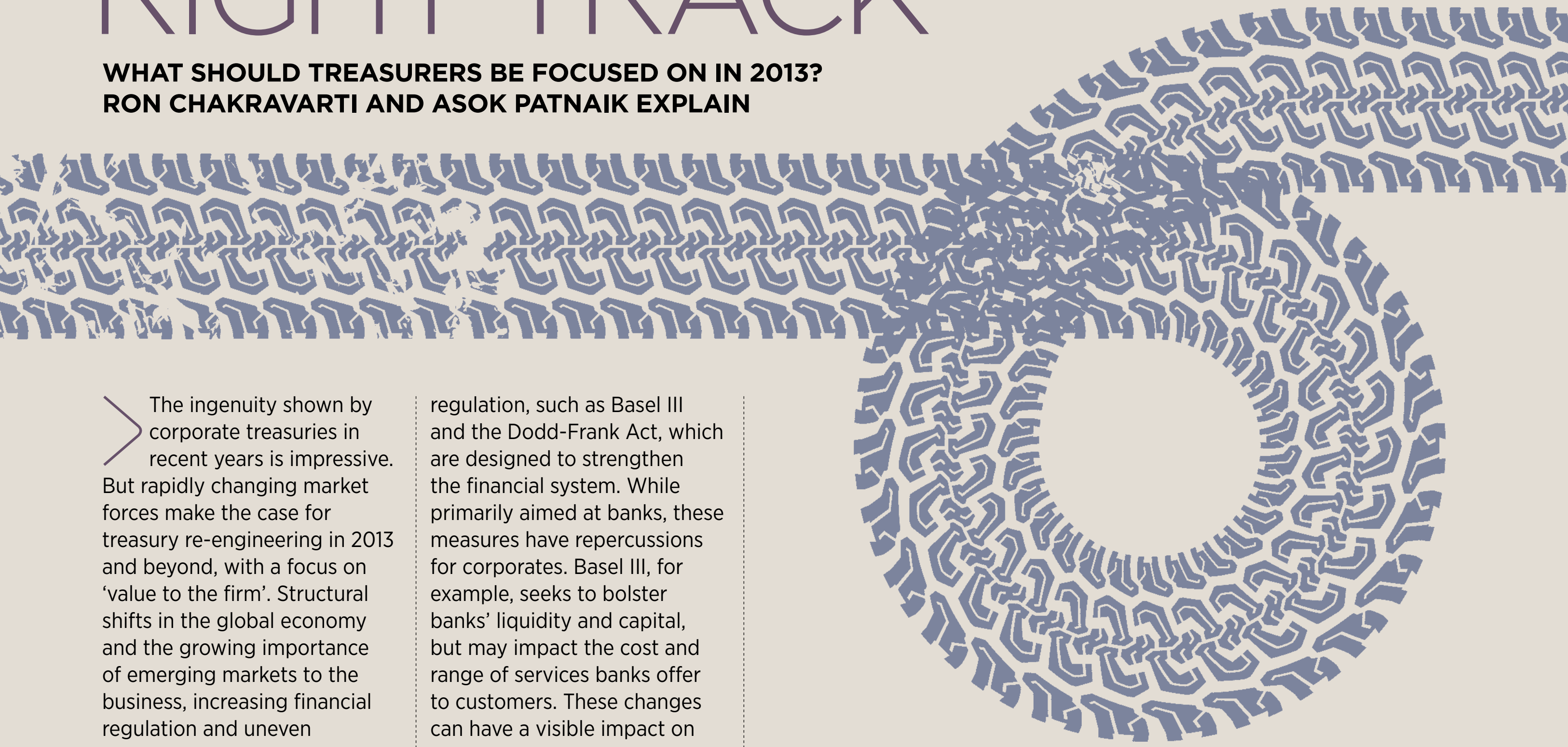
ON THE RIGHT TRACK

WHAT SHOULD TREASURERS BE FOCUSED ON IN 2013? RON CHAKRAVARTI AND ASOK PATNAIK EXPLAIN



The ingenuity shown by corporate treasuries in recent years is impressive. But rapidly changing market forces make the case for treasury re-engineering in 2013 and beyond, with a focus on 'value to the firm'. Structural shifts in the global economy and the growing importance of emerging markets to the business, increasing financial regulation and uneven economic growth are some of the catalysts of change. Consequently, many treasurers are taking a fresh look at their priorities and goals.

Fortunately, this confluence of factors is taking place at a time when treasury has never had a more important role in many companies, given the central importance of risk management in the post-crisis period. As firms restructure to meet the needs of the changing global marketplace, treasurers have the opportunity to partner with the business and re-engineer their departments to create more value for their organisation.

Drivers of change

Regulatory upheaval

The post-crisis period has been dominated by financial industry regulation, such as Basel III and the Dodd-Frank Act, which are designed to strengthen the financial system. While primarily aimed at banks, these measures have repercussions for corporates. Basel III, for example, seeks to bolster banks' liquidity and capital, but may impact the cost and range of services banks offer to customers. These changes can have a visible impact on companies' supply chains and working capital, and thus require close monitoring.

Meanwhile, national regulators are increasingly introducing measures to protect local taxpayers and depositors, which may lead to the balkanisation of the global banking system and limit banks' ability to provide financial services efficiently to multinationals. Given that credit market conditions are likely to be tougher in the future, companies must seek to understand the impact of these changes on the servicing of their financial needs.

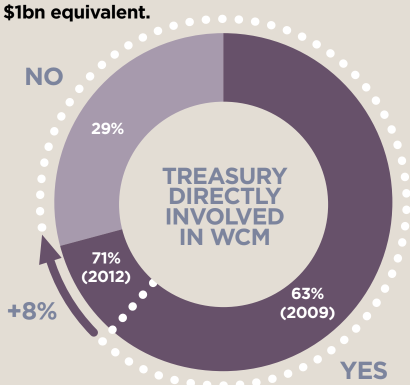
Evolving global supply chains

The globalisation of supply chains and shift of both supply and demand from developed to emerging markets is prompting companies to reorganise their operating models. Corporate structures are being fine-tuned to meet evolving market needs and to better manage economic exposures, while remaining financially efficient. The result is strategic re-engineering of the trading model, including legal entity structures, sourcing, manufacturing and distribution across the enterprise.

This has a profound impact on the treasury function: ownership, location and movement of cash change, as do funding requirements globally. A key difference from past business cycles is the focus on growth in emerging markets. Regulated markets create greater

FIGURE 1: MANAGEMENT OF TREASURY AND COMMERCIAL FLOW IS CONVERGING

Results of ongoing treasury operations benchmarking survey programme (2012). Participants are multinational companies headquartered around the world with the majority having turnover in excess of $1bn equivalent.



SOURCE: CITI TREASURY DIAGNOSTICS

The shift in supply chains towards emerging markets affects how liquidity is generated, managed and invested, and may make it necessary to refine banking structures that may no longer be current

complexity for treasury in managing group liquidity, trapped cash, counterparty risks and FX exposures.

Improving financial conditions

Citi projects global economic growth of 2.6% this year, rising to 3.1% in 2014. The improvement in the global economic outlook underpinned by loose monetary policy and reinforced by other factors, such as strong corporate balance sheets, has fed through to the financial markets. Equity and debt markets have both performed strongly, and debt capital in particular is cheaply available. But it would be over-optimistic to expect this to be a permanent feature. Further, the evolving financial regulations may make financing harder and dearer, at least for specific segments. All this calls for careful reassessment of financing needs and capitalising on opportunities while they last.

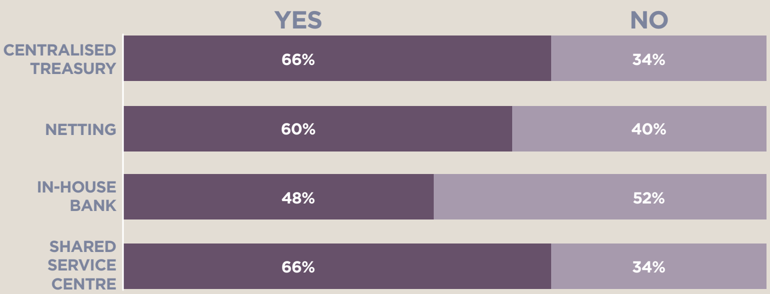
Priorities for 2013

Having carefully balanced regulatory, operating and macroeconomic short- and long-term factors, what may be the most important objectives for treasurers in 2013?

1. Convergence of treasury and working capital management

FIGURE 2: INCREASING ADOPTION OF CENTRALISATION AND WORKING CAPITAL STRUCTURES

Results of ongoing treasury operations benchmarking survey programme (2012).



SOURCE: CITI TREASURY DIAGNOSTICS

Central to the shifts in global supply chains is change in operating legal entity structures, redefining companies' sourcing, manufacturing and distribution. These activities are reorganised to ensure more efficient allocation of capital, reduction in costs, seamless movement of goods and services worldwide, and financially efficient trading results.

It is imperative that treasury strategy is recalibrated so that it optimally meets the needs of the evolving supply chain. Departmental resources – people, processes and infrastructure – must be aligned with this new operating model and the company's strategic objectives. Treasury centralisation is no longer defined as (ideally) placing all people and processes in a single location, but, instead, ensuring that a 'functionally centralised, globally distributed' treasury organisation is close to the business and to evolving conditions in key operating markets.

Meanwhile, in support of the evolving operating model, many companies are establishing or extending efficient treasury models, such as in-house banks and principal trading companies. These umbrella entities can support restructured commercial and financing flows in a more efficient manner, and become especially relevant in managing liquidity and risks as business volumes tilt eastwards and southwards. At its core, an in-house bank allows a company to centralise intercompany activity to improve self-funding and management of FX risks. Principal trading companies consolidate cross-border intercompany procurement and distribution flows. Further enhancements of scope can include re-invoicing and sourcing.

2. Re-engineering banking structures

The shift in supply chains towards emerging markets affects how liquidity is generated, managed and invested, and may make it necessary to refine banking structures that may no longer be current. Regulatory changes reinforce the need to review structures. For example, in the eurozone, the mandatory move from national payment instruments to SEPA instruments, coupled with 'payment on behalf of' structures (where an entity is authorised to pay on behalf of other entities within the group), will mean that companies no longer need to maintain legacy accounts in many European countries. Similarly, changing regulations in emerging markets mean that it is now easier to move both liquidity and commercial

flows out of these countries, necessitating a rethinking of existing arrangements.

3. Improving commercial risk management practices

The globalisation – and stretching – of supply chains and increasing demand in emerging markets are changing companies' commercial risks. Strategies to mitigate the risk of supply chain disruptions and counterparty default should be a corporate priority. Treasury can use its corporate finance skills to broaden understanding of the risks embedded in practices and also enable improvements in working capital and risk management.

Sales growth in new markets requires closer monitoring of credit terms and commercial counterparty quality to mitigate default risks. Where the commercial counterparty risk or sovereign risk is less than desirable, treasury could sell accounts receivables after comparing the financing costs to the underlying risk. Receivables can be bundled across different risk categories to diversify the portfolio and attract investors, and can be insurance-wrapped to enhance credit quality if necessary.

4. Investing in technology

Technology remains central to successful treasury re-engineering. By consolidating instances of enterprise resource planning (ERP) systems and deploying treasury workstations (or ERP treasury modules) globally, treasuries can facilitate strategies, such as extension of in-house banks and 'on behalf of' structures. Similarly, deployment of credit analytics tools and global data sets can help companies to manage their commercial credit portfolio effectively. Treasurers must make the case for technology investment based on the material improvements in risk and working capital management (WCM) it can deliver for the company.

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Treasury transformation

Treasury is changing from being an enabler to being a strategic partner to the business. As companies' operating models evolve, the treasurer is a key stakeholder in identifying optimal strategies that consider risks more holistically. The higher profile of treasury within many companies gives treasurers an opportunity to present a compelling case for change, identify investments that support the company's strategic objectives and create a solid business case for funding these. By doing so, treasury can drive change and contribute greater value to the firm.

FIGURE 3: KEY OBJECTIVES IN IMPLEMENTING PAYMENTS ON BEHALF OF (POBO) STRUCTURES

Results of ongoing treasury operations benchmarking survey programme (2012).

SOURCE: CITI TREASURY DIAGNOSTICS


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