JOINED-UP THINKING

TREASURERS NEED TO TAKE A STRATEGIC APPROACH TO FX AND CASH MANAGEMENT, SAY JENNIFER BOUSSUGE AND GLENN CROTTY

This year, we've seen corporates focus on four main FX market trends. The first of these comes under the broad heading of 'emerging markets'. Large multinationals continue to look to these for growth and, as a result, their global footprint and FX risk profile has changed due to the higher volatility of emerging-market currencies. Corporates are using measurement tools, such as value at risk and cash-flow risk, as opposed to notional measurement.

Four major trends

Due to the recent turmoil in Argentina, Ukraine and Venezuela, treasurers are investigating how they can hedge earnings translation risk in emerging markets and hedge 'high-carry' currencies linked to net assets and cash-flow hedging. The balance between managing risk and hedging costs is a constant challenge in a world where emerging-market FX weakness is of great concern.

China has again risen to the forefront because the recent volatility of its currency has generated more questions related to hedging. Given official comments on band widening and volatility, corporates are now reconsidering their approach to CNY balance sheet hedging. Traditionally, corporates have not hedged because the CNY has been strengthening for many years. This year, the Chinese renminbi entered the list of top 10 most traded currencies, and turnover is soaring. We expect this trend to continue.

A second key trend is that more companies are centralising their corporate FX functions in order to ensure coordination and realise netting exposure where possible. Not only has there been greater centralisation of the management of G10 currencies, but, also, head offices have taken more control of the oversight and deal execution of onshore emerging-market currencies.

The push for greater efficiency and development of integrated treasury management systems has led to electronic trading

MAKING THE SMART CHOICE

To truly manage FX and cash strategically, corporates need to work with banks that share their holistic view of FX trading and payments, and offer integrated systems for managing both FX and payments end to end. This comes down to more than just technology; the advisory services that some banks offer treasurers bring additional value. They can provide corporates with economic commentary, exchange- and interest-rate forecasts, trade ideas, quantitative risk analysis and option guidance.

Treasurers are increasingly being asked to demonstrate local knowledge while thinking on a global scale. This is where working with a large global bank can bring real benefits and enable corporates to reduce their overall pool of banks. These financial service providers can offer support through risk management, global solutions and streamlining working capital cycles, not just through pricing FX deals. When selecting a bank that can support growth, corporates should look for treasury management services that are integrated into online cash management platforms, offering multi-currency payments and electronic access to the bank's international payment network.

Over the coming months, those companies that openly discuss their business strategy with their bank, and are transparent in how business will be allocated, will ultimately get the best value from their bank. Your bank should bring to you the best services it can, tailored to your needs, and do this using its networks. On top of this, it should offer ownership and accountability for ongoing services and support – both of which are the real measures of a quality provider.

rising in the past few years. As a result, companies have sought out customised and integrated e-commerce solutions to meet their FX requirements and treasury needs.

Thirdly, many companies have been extending the average tenor of their hedges, probably for two reasons. G10 volatility is at an all-time low, so option users have taken advantage of this dynamic by purchasing longer-term structures. Additionally, it seems that many corporates agree with our outlook that the US dollar is poised for a long-term bull run and, as a result, they are extending the length of hedges for their short-term US dollar exposures.

The final market trend, and the trend with possibly the most significant impact on treasury in the past year, has been increased regulation. With the implementation of Dodd-Frank and European Market Infrastructure Regulation, companies have dedicated significant resources to meeting the new reporting rules.

Despite the increased burden on treasury, however, companies have not fundamentally changed their hedging behaviour as a result of these new rules. In fact, the new regulatory environment has caused numerous corporates to rethink their organisational structure. For example, rather than have a number of subsidiaries executing hedges, many businesses switched to executing at the parent level, relying on internal transactions between companies. As a result, banks and companies have been working together for a smooth implementation.

A strategic approach

Given these market trends, it is important for companies to not think of FX in isolation. Many corporates have separate functions for FX and cash, but they can achieve significant benefits by consolidating these into one value chain. FX management in isolation potentially misses out on the processing and cost efficiencies and the rate-transparency benefits that can be achieved by integrated management of FX and overall working capital.

This is important in the payments space, but it also affects liquidity in terms of the type of multi-currency, notional-pooling accounts corporates can set up, for example. How a corporate manages FX is a direct consequence of its financial and business operating model and it is important that its strategies are aligned with the objectives of the treasury department.

Furthermore, an integrated approach to FX management brings advantages for corporate risk mitigation and management. The task for treasury in managing FX risk – and associated counterparty, economic and country risks – is becoming increasingly complex. By selecting the right tools and working closely with a trusted adviser, however, companies have an opportunity to achieve their FX risk-management objectives and safeguard their bottom line and future growth.

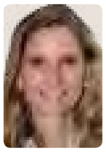
Risk management becomes even more important when your business is growing abroad and expanding into the emerging markets. As the world's economies and payment systems rapidly integrate, understanding how to transact across borders and currencies is becoming a critical part of a company's international strategy. Corporates can use FX instruments to gain a competitive advantage by managing international business risks, making and receiving secure cross-border payments, improving efficiency through a faster transaction speed, and gaining greater and deeper visibility into their cash.

The quest for visibility also drives change within the organisational structure of treasury departments for both large and mid-cap corporates. With critical mass, treasury centralisation can be advantageous since it provides a holistic view of overall positions.

FX is an important activity that can be improved by centralising treasury. Rather than business units converting currency locally to meet their needs, creating potentially significant and hard-to-quantify FX risks across the organisation, the business can benefit from improved rates and mitigate its risks. FX positions can also be offset, reducing the cost of spreads and ensuring the company has a global view of FX risk.

The case for integration

The integration of FX and cash management strategies makes clear sense for treasurers. It provides greater visibility and control over treasury operations and offers efficiency savings compared with a 'siloed' approach. In addition, taking a strategic view of FX gives corporates a solid base for growth since it provides an efficient approach to risk management. Choosing the right bank to support this holistic advice can help to deliver value across a corporate's entire working capital value chain.



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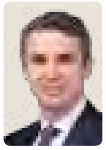

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