Ask the experts:

Under a bright light

FORMER TESCO GROUP TREASURER NICK MOURANT CONSIDERS THE EVOLVING ROLE OF TREASURY IN THE UK FOLLOWING THE CREDIT CRISIS AND WHAT THE FUTURE MAY HOLD FOR TREASURERS.

The credit crisis has meant that the perception of the treasury profession has shifted: it is no longer seen as a specialist role within corporates, but part of the mainstream of the finance functions. Treasury is now more important and enjoys greater senior management focus than at any other time.

From talking to my treasury peers it is clear that in many cases finance directors who used to be happy to let treasury run along on its own have spent a lot more time over the last 18 months with their treasurer to understand the work the treasury department does, the risks it manages and the relationships it has, particularly with banks, rating agencies and other providers of funding.

In short, a bright light has been shone on treasury and in particular the light has been shone on three areas: liquidity, cash management, and relationships with banks and the capital markets. The credit crisis has broken down many of the traditional assumptions and parameters, as has been apparent in the market volatility and the unforeseen changes in the credit quality and risk appetite of some banks.

This volatility and uncertainty has proved a mixed blessing for treasurers. It put the treasury function under considerable scrutiny at a time when the markets were enduring their greatest volatility. At one point after the Lehman bankruptcy it was all but impossible to know where the next problem would spring up. In particular, as rumours spread and press speculation grew, some of the banking relationships that you felt you could have always relied on as a treasurer looked like they could end in disaster. In the end there was no widespread banking collapse but the experience has taught this generation of treasurers to really understand where their credit exposures were.

When Lehman went under, a number of banks were caught with secondary exposures because they were dealing with counterparties who had exposure to Lehman that it was just impossible to know about. Another example of this was selected landesbanks (state-owned banks unique to Germany) with exposure to the sub-prime market. As such, the impact of the Lehman collapse, sub-prime and the contagion effect on non-financial corporates would have been difficult to foretell.

It is not unreasonable to believe that prior to the market disruption many boards did not appreciate the increasingly complex role of the treasurer. As a result of recent events, this role is now much better understood and treasurers have had to spend an increasing amount of time internally communicating what they do and why they are doing it. At the height of the financial disruption many non-executive directors wanted a deeper understanding of what was happening in their companies and that translated into a significant amount of additional work for treasurers dealing with requests for extra information.

While this extra scrutiny may have been time-consuming, the greater understanding that resulted has been good for the treasury profession. Treasury should be able to play its part in setting company strategy and should be seen as a key player in determining the health of the business.

Although we are beginning to see some sort of normality return to the markets, it's going to be a long time before treasurers forget the volatility and disruption to the credit markets. Treasurers will always have in the back of their minds how the traditional assumptions broke down. For example, in 2008 we saw occasions where the commercial paper market dried up even for quality investment names. We also saw the dollar bond market dry up for a period and that has simply never happened before.

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As a result treasurers saw a breakdown in the traditional assumptions about the sources of finance. The market disruption has seen corporates having to place much more reliance on their bank relationships. Treasurers who spent time with their banks developing the relationship in the good years saw that investment pay off handsomely when they were able to come through the problems in reasonable order.

But no corporate has escaped unscathed from recent market conditions. The banks are constraining their balance sheets and they are more aggressive in looking to use their capital for the best return and payback. Before the market crash, corporates knew that there was significant competition among banks for their business. Now corporates have to prove what ancillary business they actually have to offer and suggest what the long-term bank/corporate relationship is really going to be.

For example in late October 2008, Tesco raised a £1bn facility with eight core banks. The reason that we were able to do that was because we had spent time and effort showing those banks what the add-on ancillary business was going to be for them and we had a strong track record of delivering on those promises.

Since the start of the year there has been a significant improvement in capital markets, particularly in bond market spreads, which have come right back to almost pre-Lehman levels for many investment-grade issuers. Absolute pricing yields (in other words, coupons) have also decreased as a result of quantitative easing.

In the coming year it is likely that treasurers will spend more time on liability management. We can already see this in a couple of ways: treasurers are concerned about refinancing risk (we have seen this with the rise of the forward-start loan transactions), and in the capital markets new issues are being coupled with tender offers or exchange offers for existing deals that are due to mature in the next 12-24 months, allowing corporates effectively to roll them forward.

While the bull rally of the last six months has put treasurers in a good place compared to where they were, there is bound to be continued nervousness among boards and treasurers that the market could retrench. The risk for the treasurer is that the market could wobble and return to the conditions of late 2008 or early 2009, so it is sensible to look at the downside risk when looking for funding. That is why I would expect to see more corporates leaving their new debt at fixed rates. While that is quite a painful decision in the short term given current higher spreads, in two or three years it may look like a sensible move.

At the same time treasurers can be expected to continue to diversify funding sources (such as looking to the dollar market) and look to source new pockets of funding. We are now at the stage where there is not a significant new issue premium and some issues are pricing through an issuer's existing secondary curve. The loan market is showing some signs of activity in mergers and acquisitions (Kraft's bid for Cadbury is one example), but banks are being careful where they are putting their lines. For example, some of the state-owned banks will have an incentive to lend domestically but presumably they want to lend where it is safe and that will tend to be to the larger companies, where the banks can see the opportunities for ancillary business and run limited credit risk.

We also have to deal with quantitative easing. The risk here is one of timing. If the tap is turned off too quickly, we could slide back into recession and credit could dry up; if we leave the tap on too long, there is a risk of higher inflation. While we are unlikely to return to the conditions of October 2008, the risk is still on the downside.

As for the key task for treasurers in 2010 these are likely to be around pensions and foreign exchange. Pension deficits will keep jumping back to the top of the agenda. This is no surprise if you look at IAS 19: the volatility in defined benefit deficits is as a result of movement in spreads, inflation and gilts. We have seen commercial reactions such as the closure of defined benefit schemes, moving to defined contribution schemes or using career salary averages as a way of taking out volatility.

The outlook for sterling is difficult. It is a relatively weak currency, which will have knock-on implications for treasurers of companies with sterling exposures, and they will need to evaluate where the resultant economic exposures lie.

Recent business conditions are unprecedented in our working lives: there is simply no point of reference. One of the key lessons from the Lehman collapse and the subsequent effects is just how interconnected everything is in today's global markets. This is a new phenomenon and one that we will have to learn to live and deal with.