Liquidity versus yield

ANDY RANSOM LOOKS AT THE CHANGING CHALLENGES FOR TREASURERS LOOKING TO INVEST CORPORATES' DEPOSITS AS PART OF THEIR FINANCIAL MANAGEMENT STRATEGY.

"Treasurers may need to become more sophisticated in terms of cashflow planning and cash management to cope with the changed liquidity management environment. With the imminent arrival of new regulations – such as Basel III and the FSA's liquidity requirements – banks are becoming more interested in long-term cash than ever before. Volatile money is less valuable to them in offsetting their loan books. In essence it is becoming more expensive for banks to hold short-term cash. And they are pricing accordingly.

On the other hand, corporates will be seeing banks offering quite attractive terms on longer-term sticky products, say over the period of six to 12 months. If banks can attract money at that tenor, then it helps with the longstanding problem of trying to close the gap between maturing assets and liabilities.

So will treasurers need to think about revising the old saying – security, liquidity, yield? Is it time to change the running order and go for security, yield, liquidity? What is certain is that security is firmly entrenched as the number one requirement for liquidity management. Ever since the banking crisis, it is noticeable that all types of organisations, across both public and private sector, are taking a much more analytical approach to counterparty risk.

Relationships still matter, but assessing the financial strength of who has your money has definitely moved centre-stage. Testing out counterparty risk is part of a flight to safety and it is hard to see this emphasis on security diminishing in the near term. The result is much more of a two-way street, with banks being thoroughly tested by credit assessment teams, as thoroughly as they check corporates looking for credit. As well as a reliance on traditional methods such as credit ratings, tools such as credit default swaps (CDS) are increasingly being used in the assessment of risk.

Understandably, when the banking crisis first broke, corporates were prepared to sacrifice yield for complete security. However, a couple of years on and the search for yield is moving back up the agenda. In reality this means that treasurers are facing a stark choice: they are under pressure to secure both liquidity and improved yields. But if you can't have both, which wins?

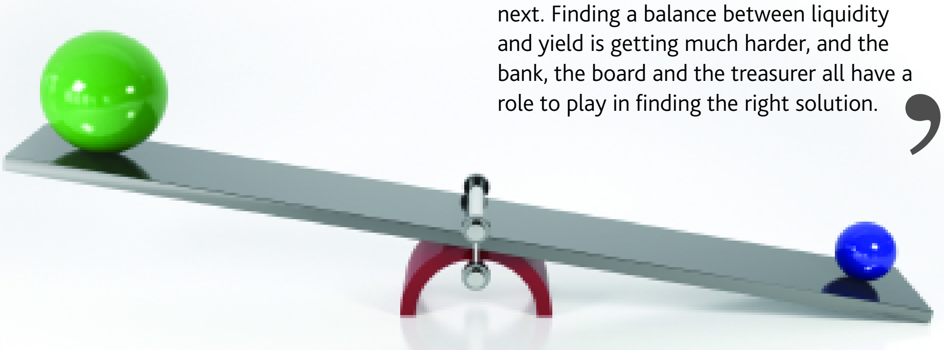
In some ways companies and public sector institutions have got round the problem in the last couple of years by finding more productive ways of using their surplus cash: debts have been paid down and acquisitions have been funded through internally generated cash. But that still leaves the question of what to do with surplus cash on the balance sheet.

If in the new environment there is a clear distinction between a poor yield on short-term money and more attractive rates for locking away funds for longer periods, treasurers will surely need to look at how they can adjust to the new reality. Even if treasurers decide they don't want to engage with the issue, finance directors and other board members will be asking some awkward questions.

And this brings us back to the question of liquidity management and cashflow planning. No one is suggesting you lock away every last penny but treasurers need to think carefully about how much cash they need to hand. Is it for a specific purpose, for a rainy day, or is it the just in case fund? Hence the need for treasurers to look again at the tools and techniques they currently employ for cashflow forecasting over the 12-month horizon. Are the results as accurate as you'd like, and, if not, can you improve?

Treasurers are not alone: bankers too are going to have to up their game in terms of knowing more about the future likely liquidity needs of their customers than was ever the case in the past. Santander Corporate Banking has a range of products and solutions which suits the varying needs of corporates and institutions in today's environment. The days of all a corporate's eggs being in one basket are over.

Both treasurers and bankers will need to engage with the board in a two-way dialogue. Boards can't demand treasurers secure greater yield one moment and then urgently ask for substantial liquidity the next. Finding a balance between liquidity and yield is getting much harder, and the bank, the board and the treasurer all have a role to play in finding the right solution."



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