cash management
LIQUIDITY

After the storm

ROBERT EWING, **STEVE ELLIS**, **JOANNE SUGDEN** AND **LIZ WILLIAMS** OF SANTANDER CORPORATE BANKING DISCUSS THE CASH MANAGEMENT CHALLENGES FACING TREASURERS.

Since the financial crisis broke in 2007 corporates have focused on liquidity to ensure survival. Joanne Sudgen, head of cash management at Santander, says: "In the current crisis cashflow is the main concern for most companies. In any downturn liquidity is essential."

Key strategic tasks for treasurers have been to look at the security of their funding and assess the strength of their banking group.

Robert Ewing, director at the large corporate group at Santander, says the bank scene has altered significantly over the last three years: "A lot of European banks have walked away and gone back to their domestic markets as a result of capital constraints and domestic political pressures. However, there are lenders still keen to lend and the disappearance of some lenders from the market presents a significant opportunity for those remaining."

The shake-up has forced corporates to improve their supply chain management and to find alternative forms of working capital finance. The dramatic reshaping of the traditional bank lending sector, combined with the resulting credit squeeze, has made corporates acutely aware of financing risk.

Liz Williams, head of loan markets at Santander, points out that the sensible response to the credit crunch was to accelerate refinancing and seek alternative sources of finance. She says: "This time last year corporates were accelerating refinancing and as a result forward-starts became all the vogue in the last quarter of 2008 and the first half of 2009."

The forward-start reflected concern among corporates as to whether all members of their banking group would be around in 2011 or 2012.

Ewing says liquidity has improved, so forward-starts are seen less frequently. Especially as large corporates also found the bond market a welcome source of funding. "Treasurers and finance directors concluded that refinancing was possible," he says.

While treasurers may have fixed their financing issues in the short term, Williams suggests they need to keep a careful eye on longer-term issues: "The question for treasurers is who do they want in their banking group? Banks like Santander are pulling their weight but it is particularly noticeable that the state-supported banks, such as RBS and LTSB, are frequently happy to take up the slack left by other banks."

Should treasurers rely on a small banking group when recent experience tells them that this may not be a wise course of action? And question marks may hang over what happens to the lending commitment of these entities when state support is reduced. The treasurers working for those companies that refinanced during the credit crisis, when tenors were restricted to three years, will need to be thinking about refinancing within 24 months of signing the deal.

All these issues have led treasurers to take a long-term view and realise that they need to maintain a broader banking group.

LONGER TENORS. The last few months have seen an easing of one of the main corporate liquidity risks. At the height of the financial crisis it was hard to find lending beyond three years. Now, says Williams, the tenor of bank lending is increasing: "Five-year lending is definitely back for more highly rated corporates, but resistance remains for crossover credit where compromise structures are more likely to be agreed such as 3–4 year maturities or 3+1+1."

Banks are re-opening for business and Santander is seeing a lot more activity as it raises its market profile. Santander's objective is to form broad banking and business relationships with creditworthy UK corporates. And as liquidity returns, so pricing is easing.

Williams says: "Margins have fallen a lot and in our view

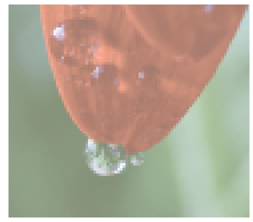
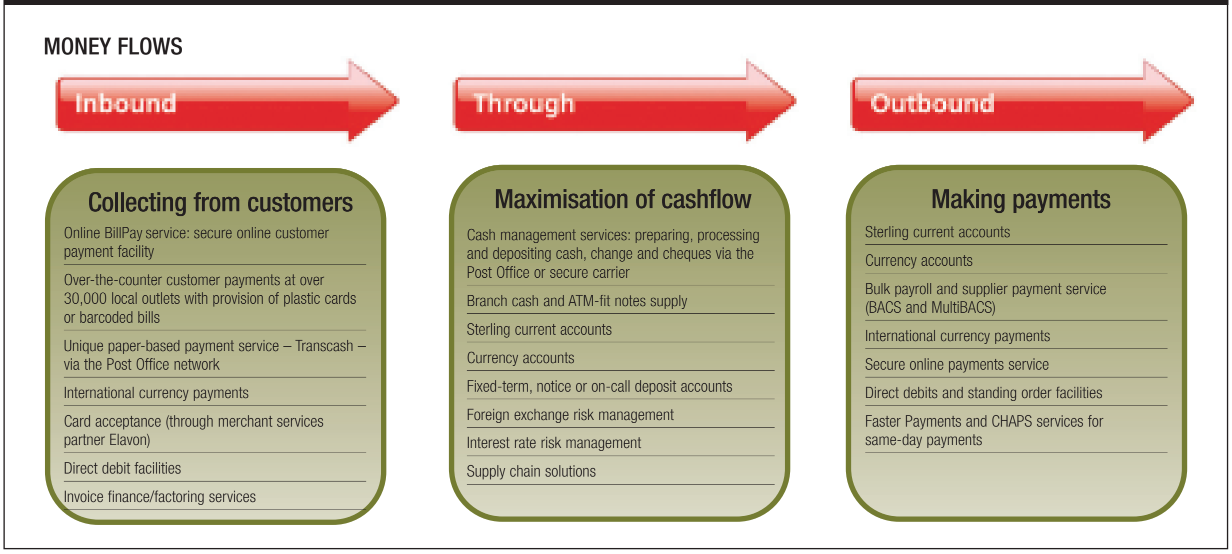


Figure 1: Santander Corporate Banking solutions in corporate money management



will continue to fall, albeit at a slower rate during 2010. Covenant packages have altered since 2007 and levels of leverage which were considered 'on market' then are rarely acceptable now."

Ewing says many treasurers will see lending packages returning largely to their pre-crisis look. However, corporates will find themselves questioned more closely over the amount of headroom they are seeking. Another trend Santander has noticed is that treasurers are more often working with debt advisers, who provide a link between bank and corporate, acting as a general sounding board as a company completes its refinancings.

Over the last two years as companies battened down the hatches to avoid the worst of the recession, merger and acquisition activity has been at a low ebb. With the economy on the mend, M&A activity is expected to grow. Treasurers will be central to the corporate's quest to raise the funds for takeovers and mergers, but Ewing suggests that a premium will have to be paid for M&A financing.

In 2009 the markets demonstrated that the great majority of borrowers managed to source finance through loans and/or bonds. Williams suggests that the company strategy should continue to focus on both markets to secure appropriate working capital and longer-term funding: "A bond is a drawn funding instrument, so there will always be a need for a loan market which supplies a revolving facility to meet corporates' cyclical cashflow requirements and for standby purposes."

While bonds were attractive for corporates during the past year, this will not always be the case as other factors come into play, such as the government's need to sell gilts and possible inflationary pressures.

INTERNAL AFFAIRS. The crisis may be over, but most treasurers realise that difficult times still lie ahead. Sudgen is well placed to see how corporates have sought to take matters into their own hands: "Companies are now forced to look for new efficiencies within their business to free up cash.

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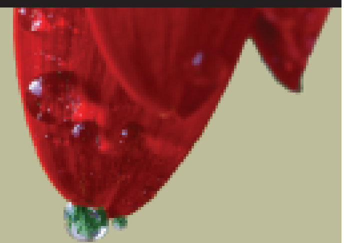
Over the last 12 months particular effort has been invested in financial supply chain management to leverage greater value without damaging long-standing relationships."

Treasurers are juggling the dual demands of cultivating alternative routes to secure finance and the need for more assurance that finance will be available. They don't want to see the finance tap suddenly turned off. One of the key ways to meet these dual demands is through leveraging greater added value through banking relationships. The requirement to use diverse funding is now back in a big way and companies will be looking at other sources of funding, such as factoring and finance leasing and supply chain finance (see box on page 10).

Before the financial crisis treasurers would have used cashflow or cash reserves to buy capital assets. Now, the goal is to preserve cash, so they are seeking to leverage their assets instead, which is why techniques such as asset-backed lending are coming to the fore.

Sudgen says: "Most companies are focusing on internal affairs. The demand for alternative sources of financing is sparking a shift in the nature of the bank-customer relationship, offering genuine opportunities for mutual wins. We are talking to many corporates that up to 18 months/two

Supply chain finance



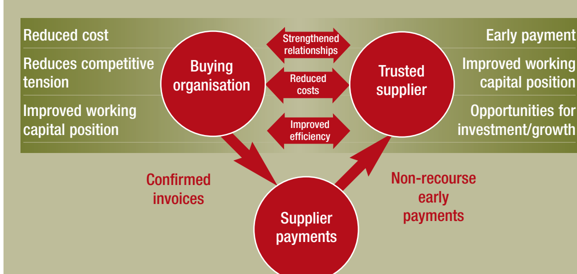
Supply chain finance is a familiar term, but until the credit crunch there was more talk than action. Steve Ellis, director of corporate sales, supply chain finance, at Santander, says the urgent need to improve working capital management has changed all that. Treasurers are now working with supply chain colleagues to decide the best course of action.

Many corporates have simply looked to extend payment terms to suppliers. But such a move is often counter productive, as it could force out of business those suppliers already in financial difficulty as a result of the economic slowdown. Extending terms of trade could also result in a price hike.

On the other hand Ellis has also seen accounts payable teams automatically take early payment terms when it was not beneficial for the company to do so. Rather than trying to improve working capital in arbitrary ways, supply chain finance solutions can make sure suppliers are paid early, on a non-recourse basis, while the buyer can benefit from an increase in working capital, strengthened collaborative relationships and a possible reduction in costs.

Ellis says: "A supplier payment service lets a company use its financial strength to provide finance to suppliers at a much cheaper cost than they could negotiate with their own banks." This credit arbitrage can work across borders: a UK corporate sourcing in Russia, Turkey, China or Brazil, where it is expensive to borrow, could work with its supplier partners to reduce finance costs and secure supply. Dealing with the legal and regulatory issues across borders is never easy but Santander's presence in over 40 countries means it offers a global solution, using its local knowledge to guide its customers.

Ellis says: "In terms of supply chain finance, companies need to look at the profit and loss impact as well as the cashflow. We are now working with treasurers and accounts payable teams to see what works best. Treasurers are playing a much more active role in day-to-day management of the business in this area and this has to be a good move."



years ago would not have entertained discussions with any bank other than their main bank."

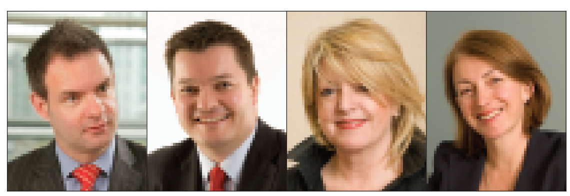
Cost savings are a priority and companies are looking for a renewed engagement with their bankers to explore how to free up cash within the organisation. Relationship banking is key here, rather than particular products or services. A bank such as Santander can work with treasurers to improve cash revenue management. Figure 1 on page 9 shows how cash can be processed and banked more efficiently and how other payments can be collected more quickly.

The relationship manager needs to identify the management challenge with the treasurer and then liaise with the cash, payment collection and supplier payment specialists. All of these specialist products and services are different and cannot be bundled into one place and handled by one general team. The relationship manager is a trusted adviser, guiding the treasurer to the right solutions via the right specialists.

Sugden says: "The depth of that process at Santander is not reflected anywhere else in the market place at the moment."

We are in an era of responsible banking. Businesses need to ensure they remain effectively leveraged and they need, in Sugden's words, to "keep an eye on the horizon". She adds: "All businesses – and young businesses in particular, where this is their first experience of a recession – need to ensure that they retain a suitable cushion to accommodate downturns within their sector, and reputable lenders have their part to play in this. It's been too easy to over-extend for too long and the banks need to make sure that they stick to a lending level and structuring format that meets the needs of their customers." And that only reinforces the message of the need to take specialist advice.

Liquidity and cash management are still top of the agenda in 2010. But as the credit crunch starts to fade and the economy moves out of recession, treasurers have to move their focus away from merely staying afloat in a downturn to using better cash and liquidity management systems for competitive advantage.



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