THE MANY ROUTES TO LIQUIDITY

Treasurers should make use of the good times to diversify their company's funding sources, advises Neil Jones

The worst fears concerning how the tide of post-crisis banking regulation would affect corporate borrowing have failed to materialise. There are a number of reasons for this and, from a corporate treasurer's perspective, it is interesting to assess whether these risks have disappeared or simply been delayed.

Many believed that the financial markets would change for ever following the crisis, and initial expectations after the 2008 crash were that the new rules and regulations imposing more stringent controls on bank balance sheets would feed through directly to the corporate market.

For example, it was felt that Basel III would result in corporate borrowers facing the prospect of limited liquidity, higher prices and shorter tenors. In the short term, there was an element of truth in this alarmist view as banks repaired their balance sheets and reviewed their strategies. Financial markets now feel buoyant, however, and liquidity, pricing and tenors have all returned.

The Middle East has a considerable appetite for a combination of tenor and pricing that would have been difficult to envisage back in 2009. In the year to date, regional corporates have signed more than $16bn of syndicated loans, a figure that is expected to increase markedly as we move into 2014.

Rather than passing on the financial consequences of regulatory change to clients, banks have adjusted their own internal models. In part, this was driven by global markets remaining more competitive than expected. Liquidity continued to be easily available in regions less affected by the crisis. Among them were Asia and the Middle East.

In 2011, the Arab Spring gave an unexpected liquidity impetus to countries such as the United Arab Emirates and Qatar, supplementing their already-strong GDP. Quantitative easing also played a role in stabilising the markets. It introduced significant liquidity into certain developed Western markets, ensuring a greater geographical equilibrium. These factors have contributed to banks deciding which countries and products they want to be in.

Variants in timing of implementation of the Basel III rules on capital adequacy and an inability to pass on higher costs means many international banks have been forced to reset their ambitions on returns. Cost reduction and efficiency drives have become the norm.

It is largely the banks themselves that have absorbed the tsunami of change within the financial markets. To a certain degree, this has been reflected in their valuations. The experience of their corporate customers, on the other hand, remains somewhat unchanged.

Today, liquidity is as strong as it has been since 2008. Supply outstrips demand. But it is not entirely straightforward for treasurers. Broadening and diversifying liquidity remains key to ensuring corporate robustness through any future financial crisis.

WHAT LIES AHEAD IN 2014?

As we head towards 2014, the financial markets – and corporate access to those markets – appear as strong as they have been for some time.

The regulatory 'big bang' that occurred after the crisis has largely been absorbed by the financial markets. While implementing regulation may take time, its impact has been generally well understood. Should we prepare ourselves for further regulatory change that might have a more marked impact at the corporate level from 2014 onwards?

Rather than headline-grabbing new regulations, greater adherence to, and tightening of, existing rules might have a more significant impact.

One area that may have an indirect impact on liquidity relates to sanctions and know your customer requirements.

These requirements may not have received the same headline status as Basel III and Dodd-Frank, yet they may bring more challenges over time, particularly as banks with a full international presence have to comply with Office of Foreign Assets Control (OFAC), EU, UN and local sanctions requirements.

At present, the need for local banks to just comply with UN sanctions means that they have more flexibility compared with an international bank governed by OFAC guidelines. The way in which guidelines are interpreted generally means different banks may have different approaches to their application.

We believe the sanctions environment will continue to tighten, however. So corporate planning should ideally take this into account, for example, with appropriate ring-fencing, segregation of accounts and non-mingling of funds.

A strong and open dialogue between banks and corporates, coupled with an understanding of sanctions regulations and related planning, should mean liquidity levels remain strong and geographic, and instrument diversification remains achievable.

Future strategies for the corporate treasurer

Some countries in the Middle East have remained strong through the crisis as liquidity generated from natural energy resources was bolstered by the regional Arab Spring-related cash inflows.

This buoyant liquidity is, on the whole, good for corporates and other organisations operating in the Middle East. But with it comes challenges.

Abundant liquidity, often at attractive pricing, relatively light documentation and longer tenors than were previously available, mean many regional CFOs and treasurers face difficult decisions around long-term strategic funding.

There is the temptation to rely extensively on the bank market. But it may be better to diversify into different types of liquidity and tenors. This will result in a solid strategy to withstand the unexpected.

Diversifying across banks globally brings further protection against downturns in different parts of the world.

While there is no obvious macroeconomic indicator that suggests any tightening of regional liquidity, there is a sense that uncertainty still persists. Individual economies remain vulnerable to single large economic or political events.

A company setting out to be robust and cost-efficient has to look at every aspect of the capital curve. It should remember the principles of good balance sheet management and ensure debt maturities are staggered through the range to avoid the need to refinance too much, and too quickly, when a shock hits. Extension of debt maturity has always been seen as important and a number of corporates have successfully tapped new areas such as the project bond market, which is increasingly seen as a viable alternative to more classic project finance structures.

More recently, the market has started to assess the benefits of diversification through the full tenor curve. In particular, at the shorter end of the curve, both banks and corporates can see the advantages of supply chain financing (SCF). SCF can achieve much more than simply providing a cheaper price and greater variety of shorter tenors for a large company.

By exploiting its own credit quality, and the lower pricing associated with that, a corporate's SCF programme can help its small- to medium-sized suppliers by giving them access to better liquidity and cheaper debt. Usually, this would be in return for a longer payable period to the corporate buyer or some other benefit.

This could be a win-win situation for both buyer and supplier. Potentially, it also strengthens the broader economic fundamentals of a local economy.

The adoption of a diversified funding strategy should eventually drive an optimal long-term model, as the stronger the balance sheet, the broader the investor appetite to support the business.

The financial markets have been through a period of significant regulatory upheaval. Issues such as global terrorism result in further layers of regulation that also directly affect financial markets.

From a corporate perspective, the availability and diversity of financing remains as strong as it has been for some time.

Embracing that diversity, putting in place a strong financial structure and ensuring adequate disclosure creates a solid foundation for businesses. This also enhances the corporate's attractiveness to a broader investor base, thereby creating the virtuous circle.

It is not entirely straightforward for treasurers. Broadening and diversifying liquidity remains key to ensuring corporate robustness through any future financial crisis

Neil Jones is head of international banking – MEA at RBS