TURNAROUND TREASURY
Keeping a cool head when all around are losing theirs

MAKING IT TO THE TOP
Former treasurers share their tips for career advancement

STRONG CREDIT CULTURES
Efficient cash conversion relies on good supplier relationships

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ APRIL 2017

The regulation issue – are you up to speed?

PLUS

CAROLINE STOCKMANN
The ACT's new chief executive on strength through diversity

www.treasurers.org/thetreasurer

HANSE ORGA GROUP
FINANCE PROCESS AUTOMATION

SAP Silver Partner

BOOST PAYMENTS EFFICIENCY AND TRANSPARENCY!

Companies today are challenged by issues like fraud and fragmented, inefficient processes. Discover our award-winning FS² payment solutions and benefit from secure, reliable and audit-proof processes. Directly embedded in your central SAP® ERP environment!

tmi AWARDS 2016
FOR INNOVATION & EXCELLENCE

Contact us now for a free demo:

+1 (312) 620 1200

efficientpayments@hanseorga-group.com
www.hanseorga-group.com/fs2payments

ACT

LEADING TREASURY PROFESSIONALS

Editor's letter

By the time this issue of *The Treasurer* reaches you, prime minister Theresa May will have triggered Article 50 and the UK will be on its way towards negotiating an exit from the European Union.

It has not been lost on anyone that the measure came just a few short days after the EU reached an auspicious anniversary, with its leaders gathering in Italy's capital to celebrate 60 years since the Treaty of Rome. It also comes at a point when some of Europe's problems, although still undeniably grave, start to look a degree or two less pivotal.

Economic indicators suggest a more encouraging outlook for trade and growth. The defeat of Geert Wilders in the Netherlands' general election can't be said to mark the end of European populist nationalism, which persists in the eastern half of the bloc and in the figurehead of France's Marine Le Pen, but it does at least settle the question of who will lead one of the key economies, and makes continuing political upheaval seem a little less inevitable.

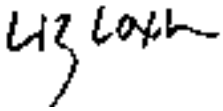
So, given the EU's journey from six founding states to 28 (soon to be 27), can this 60-year-long experiment in shared sovereignty be said to be at an end?

In this issue, we present two pieces on Europe from commentators with starkly different views. On page 15, Kallum Pickering, chief economist at Berenberg Bank, argues that with the severest geopolitical risks abating, Europe is set fair for economic recovery and greater stability in terms of its political outlook. On page 26, meanwhile, Roland Hinterkoerner, consultant at Expertise Asia and a long-standing observer of the minutiae of European realpolitik, argues that Brexit heralds the end of the single currency experiment.

One thing we can be sure of is the interaction between the UK with Europe and the regulatory frameworks that corporates must abide by is, if anything, set to grow more complex, since Brexit does not mean that UK-based corporates can opt out of key measures and regimes. We explore the plethora of regulation and untangle the terminology in our update on page 22.

Elsewhere in this issue, we mark the arrival of the ACT's new chief executive, Caroline Stockmann, who brings verve, openness and a commitment to promoting the standing of treasurers to her new role. Our profile of her begins on page 18.

I hope you enjoy the issue.



editor@treasurers.org
Follow us on Twitter @thetreasurermag

THIS MONTH'S CONTRIBUTORS

Eleanor Hill is a freelance corporate treasury writer who has been covering developments in the industry for almost a decade. She has written several best practice handbooks for treasury practitioners, including a guide to supply chain finance. Her feature on regulation is on **page 22**

Gary Slawther is founding director of Corporate Advisory Resources in UAE, which advises companies on, and provides interim management services to implement, treasury and bank relationship solutions in pressured situations, including corporate turnaround. He writes about this subject on **page 30**

Brian Shanahan is founder of Informita, a consultancy that assists companies in the areas of working capital and procurement. He has 19 years' experience in management consultancy and five years in financial accounting. His article on promoting a good cash culture appears on **page 32**

The Treasurer
is the official magazine of
The Association of Corporate Treasurers
68 King William Street, London EC4N 7DZ
United Kingdom
◆ +44 (0)20 7847 2540
◆ www.treasurers.org

Policy and technical Steve Baseby, Sarah Boyce, Michelle Price
Sponsorship director Denis Murphy
Technical review Ian Chisholm, Alison Stevens, Neil Wadey, Peter Walker-Smith

ADVERTISE WITH US
For all enquiries, contact:
Tom Fountain
◆ +44 (0)20 3771 7250
◆ tom.fountain@thinkpublishing.co.uk
Dan Gallagher
◆ +44 (0)20 3771 7244
◆ dan.gallagher@thinkpublishing.co.uk

THE TREASURER ©2017
Published on behalf of the ACT by
Think, Capital House,
25 Chapel Street, London NW1 5DH
◆ +44 (0)20 3771 7200
◆ www.thinkpublishing.co.uk

Editor Liz Loxton
Managing editor Rica Dearman
Design John Pender
Cover Chris Piascik
Group account director Ruth Lake
Managing director Polly Arnold
SUBSCRIPTIONS
Europe, incl. UK (per annum)
1 year £260 | 2 years £370 | 3 years £480
Rest of world
1 year £295 | 2 years £455 | 3 years £600
Members, students and IGTA/ EACT members
[Self-certified members of national treasury associations, including the AFP in the US]
1 year £135 – UK and Europe (MUKEU)
1 year £175 – rest of world (MRoW)
For information, visit www.treasurers.org/thetreasurer/subscription

MIX Paper from responsible sources FSC® C004116

Printed by Pensord
ISSN: 0264-0937

Events and Publishing Forum
Members of the Events and Publishing Forum (EPF) provide the ACT with strategic and consultative support **a)** developing relevant issues with a medium-term horizon; **b)** apprising the ACT team of competitor developments; **c)** broadening the speaker and contributor network; and **d)** underpinning the ACT's overall aims (in education, membership growth, international development). If you are interested in participating in the EPF, please contact dmurphy@treasurers.org

ACT LEARNING ACADEMY

WHERE DO BEES KEEP ALL THEIR MONEY?

IN A HONEY BOX

#dadjokes

Ok, we don't tell the greatest jokes, but we do have the best cash management learning solutions!

Create a buzz with practical new skills that can be immediately applied in the workplace.

Qualifications

- Award in Cash Management Fundamentals
- Certificate in International Cash Management

eLearning

- Corporate finance: finding money, spending money
- Cash management

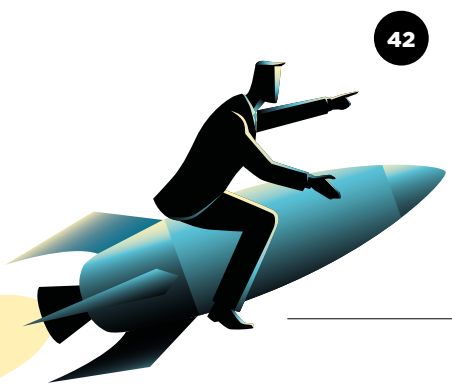
Training

- The nuts and bolts of cash management
- Cash forecasting fundamentals
- Advanced cash management

academy.treasurers.org

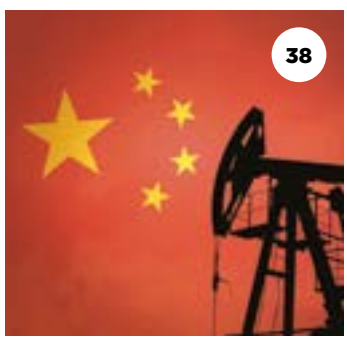
What do you think of this issue of *The Treasurer*? Please write to **editor@treasurers.org** or tweet **@thetreasurermag**

CONTENTS



18 "One of the most important things for anyone in finance is to first of all try and understand the business"

Caroline Stockmann, chief executive, ACT



Agenda

For the latest news and comment in the treasury world, follow us on Twitter **@thetreasurermag**

{ CORPORATE FINANCE }

UK TECH SECTOR LEADS ON EUROPEAN DIGITAL INVESTMENT

UK-based technology firms raised £6.8bn in venture capital and private equity funding last year, more than 50% more than any other European country, according to business accelerator Tech City UK.

According to a study from the accelerator 'Tech Nation 2017', the UK has seen robust capital investment amounting to £28bn over the past five years in the digital technology sector.

London attracted greater amounts of technology investment over that period than Amsterdam, Berlin and Paris combined. France's technology sector attracted the next largest amount over the past year, according to the report. However, at £2.4bn, the investment amounted to considerably less than the UK's total for the year.

Tech City UK said the UK's success in securing funding has been achieved against a backdrop of falling investment. Investment in digital technology for 2016 was 34% down on 2015, said the report's authors, who argued that the dip is part of a global correction and may also reflect increasing caution among investors.

The report put the combined turnover of UK digital technology companies at £170bn for 2016, with a growth rate of 22% over five years.

Over the same period, the number of UK digital technology companies grew by 28%, providing 1.64 million jobs.

{ CONTEXT OF TREASURY }

Global indicators point to across-the-board recovery

With a collection of positive growth indicators for the last quarter of 2016 becoming available combined with improved figures in confidence barometers for early 2017, economists and commentators are cautiously heralding a recovery in both mature and emerging markets.

In Asia, for instance, export activity in Singapore, widely taken as a barometer of global demand, has reached a two-year high, while South Korea's export growth for February rose 20%. Manufacturers in Taiwan have reported month-on-month growth for a 12-month period.

Fears around overcapacity and currency devaluation in China have receded, and in Japan, figures for capital expenditure for the last quarter of 2016 saw growth at its fastest rate for three years. Brazil and Russia are also likely to add to the growth picture in 2017, according to commentators.

In Europe, Germany's Ifo Institute in Berlin published increases on its business climate index, with German business sentiment at its highest levels for three years. In the UK, manufacturing companies reported increasing optimism also.

In the US, growth in rail freight volumes suggest growing demand, as do measures such as JPMorgan Chase's index of capital goods shipments, which shows worldwide equipment spending growing at an annualised rate of 5.25% for the last quarter of 2016.

While across-the-board growth is welcome news, the pace of recovery is still slower than pre-financial-crisis levels. "Global growth is running around 80% of its pre-crisis levels," said Ian Stewart, chief economist at accountancy firm Deloitte. "This so-so performance has been called the new normal." Improvements on that picture will require a recovery in productivity growth, said Stewart.

WORDS

"Austerity is out and secular stagnation has disappeared."

Peter Praet, the European Central Bank's chief economist, acknowledges a raft of positive economic data for Europe, while being cautious about remaining problems, such as non-performing loans.

SOURCE: *FINANCIAL TIMES*, 15 MARCH 2017

"You don't need a piece of paper with numbers on it to have an economic assessment."

David Davis, Brexit secretary (pictured above), prevaricates in front of the Brexit Committee when asked to quantify the impact of leaving the EU without a comprehensive trade deal.

SOURCE: *BUSINESS INSIDER*, 15 MARCH 2017

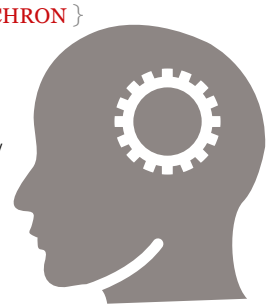
WIKIMEDIA

{ KEY FINDINGS FROM TOP FINANCIAL SERVICES TRENDS SURVEY BY DIGITAL CONSULTANCY SYNECHRON }

38%
the proportion of respondents who place regulation as their top priority for 2017

42.6%
the proportion who said MiFID II would be their top regulatory priority

29.6%
the proportion who put Dodd-Frank first



29.2%
the proportion who said regulations around blockchain and artificial intelligence would be a top focus

{ BREXIT }

UK BUSINESSES LOOK TO DUBAI AND EMERGING MARKETS FOR EXPANSION

Emerging markets are becoming increasingly attractive to UK businesses looking to expand, with the Middle East a favoured potential base for establishing themselves overseas.

According to a report from the Dubai Multi Commodities Centre (DMCC), 42% of UK businesses reported that they were more inclined to expand their operations abroad following the Brexit vote last year and in the wake of the US election results.

Out of those businesses looking to expand, 63% say emerging markets are becoming more attractive, with 75% citing Dubai as a potential market. Out of the UK businesses that said they were undecided, 40% said they would consider the Middle East as an option for overseas expansion.

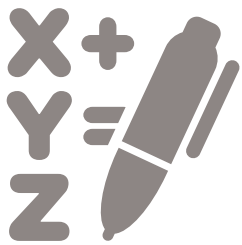
Reasons respondents gave included the need for a global presence (47%); availability and wealth of overseas talent (44%); and uncertainty in the UK market (36%).

Of those respondents hesitant about growth into markets overseas, 43% said tax incentives would strengthen arguments in favour of making moves into other markets. Twenty-nine per cent cited easier company formation and business support.

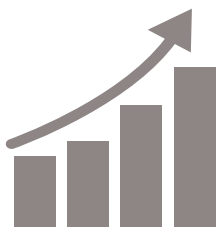
£240m
the investment Toyota will make in the UK factory that makes Auris and Avensis models

€50m
the fines within proposed German legislation that may be levied against social networks that fail to promptly take down hate speech, false news and other undesirable content

$4.6 trillion
the amount the American Society of Engineers says the US needs to spend to fix its infrastructure



£1bn
annual sales of gin in the UK, ensuring the spirit regains its place in the inflation basket of goods, after a 13-year absence



$152bn
China's new defence budget, representing a 7% increase

0.4%
the household-saving ratio in the UK for the second half of 2016, excluding pension equity, according to the Money Charity

What do you say?
Tweet us
@thetreasurermag

"We are working to strengthen the contribution of trade to our economies. We will strive to reduce excessive global imbalances, promote greater inclusiveness and fairness, and reduce inequality in our pursuit of economic growth."

G20 finance ministers at their meeting in Baden-Baden, Germany, confirm the importance of balanced trade to the world economy, but drop the former tough language to resist protectionism.

SOURCE: *FINANCIAL TIMES*, 18 MARCH 2017

{ AROUND THE WORLD IN 30 DAYS }

INTEREST RATE HIKE, EUROPE ATTRACTIVENESS, ICELAND

Snæfellsjökull National Park, Iceland

RICA DEARMAN

Central bankers increase rates

Positive employment data in the US helped the Federal Reserve towards a hike in its interest rate, a move that it had previously flagged. The Fed lifted its benchmark interest rate by one quarter of a percentage point from 0.75% to 1%, only the third interest rate rise at the US central bank since the global financial crisis began.

Announcing the rate increase, Federal Reserve chair Janet Yellen said: "The simple message is, the economy is doing well, the unemployment rate has moved way down and many more people are feeling more optimistic about their labour prospects."

China's central bank followed suit, in a move designed to limit capital flight to the US, while president of the European Central Bank (ECB) Mario Draghi maintained rates at 0%, but said that the ECB no longer had a sense of urgency in terms of taking more action on stimulus.

Europe's powers of attraction

A survey into Europe's attractiveness to outside investors in the wake of the UK's decision to leave the EU has found that investors remain committed to Europe. The *2017 European attractiveness survey – Plan B for Brexit* from accountants EY found that 56% of global investors plan to grow their presence in Europe, compared with 36% last May.

However, more than 70% reported an impact following the UK referendum vote, with currency, commodity and capital markets scoring as high-risk factors.

Iceland lifts restrictions

Iceland lifted capital controls imposed during the 2008 collapse of its banking industry, signalling a return to financial normality and international financial markets. The country's GDP rose 11.3% for the last quarter of 2016.

The controls were put into effect to stabilise a volatile krona after the country's three biggest banks – with assets three times the size of its economy – collapsed. One of the successors to those banks, Arion, is due to list on its stock exchange. Finance minister Benedikt Johannesson told the *Financial Times* that the government would now examine whether the currency should be stabilised by pegging it to the euro.

Concerns remain as to whether Iceland is at the top of its current tourism-led boom and whether the economy may be on the point of overheating.

{ CORPORATE FINANCE }

INDUSTRY GROUP CALLS FOR ACTION ON RISK CAPITAL

A report from the Association for Financial Markets in Europe (AFME) has identified a shortage of risk capital available for high-growth enterprises and significant structural barriers to expansion.

The report's authors said factors, including a fragmented start-up market across Europe, a lack of awareness of risk capital benefits among ambitious high-growth companies, insufficient venture capital funding and sluggish primary markets combine to limit European firms with high-growth potential. They also said there was an unfavourable environment in terms of businesses accessing public markets. Improving access would help growth companies access the information needed to initiate long-term growth-financing strategies.

Director-general at the European Commission's department for financial stability and capital markets Olivier Guersent said the inadequate supply of risk capital has been a long-standing constraint on ambitious European firms. "Under CMU, the Commission has tabled several initiatives to improve the functioning of these markets. However, there is no quick fix. European policymakers need to stay focused on this structural challenge in the years ahead."

Simon Lewis, chief executive of AFME, said: "Europe's shortage of risk capital for high-growth businesses is a pressing issue, particularly given the enduring low-growth environment."

THE STATS

{ KEY FINDINGS FROM THE ASSOCIATION FOR FINANCIAL MARKETS IN EUROPE'S REPORT ON RISK CAPITAL FOR HIGH-GROWTH FIRMS }

€1.3m – average venture capital (VC) investment received by European companies compared with €6.4m in the US

5% – amount of VC-backed EU companies that also obtain venture debt capital

€4.1bn – amount that VC funds invested in European high-growth companies between 2007-15 compared with €26.4bn in the US

44% – proportion of EU VC investments that went to later-stage businesses compared with almost two-thirds of all VC investments in the US

MAKING THE NEWS

The new £1 coin is now in circulation

12-sided £1 coin ready to go
With security features including micro-lettering around the rim, a distinctive shape and use of a hologram-type latent image, the new £1 coin goes into circulation this month. Retailers, including vending machine operators, have spent millions on staff training and adaptations to equipment.

Most are fully prepared. However, the UK Automatic Vending Association, which predicts the changes will cost its industry £100m, says there may be a short period when some machines will still accept only the old coin. However, most retailers have welcomed the new issue due to the high numbers of counterfeit old-style coins in circulation. According to the Royal Mint, around one in 30 are fakes, although some commentators suggest the real figure is closer to one in 10.

Kenya's mobile bond
Kenya, a pioneer in the use of mobile phones for payments, has become the first country to exclusively sell government bonds via mobile phones. Kenyans can buy government bonds for around 3,000 Kenyan shillings (around £23), according to the central bank, which is using the country's track record in mobile transactions to reinforce this new means of raising funds.

In Kenya, the main provider of mobile transactions, M-Pesa, has around 20 million users, and M-Pesa kiosks outnumber ATMs by 100 times. Finance minister Henry Rotich says the initial offer will be limited to 150 million shillings. If successful, a second bigger issue will take place in June. The bond, M-Akiba, can be bought by phone users without the need for a bank account and will pay an estimated 10% in interest. Kenya's bond market backs an ambitious infrastructure programme.

Trade policy debate
Economic officials from Germany hit back at US criticisms of its trade policy in the wake of the G20 meeting of finance leaders that took place in Baden-Baden last month. A group of top economists, advisers to Germany's federal government, rejected criticism that the country's foreign surpluses were too big and mounted a counter-attack, suggesting America's trade deficits were too large.

"Problems can arise on both sides – surpluses and deficits," said Jochen Andritzky, secretary general at Germany's Council of Economic Experts.

SHUTTERSTOCK

{ CONTEXT OF TREASURY }

LACK OF CYBER AWARENESS A GROWING PROBLEM IN THE FACE OF CYBERATTACKS

In spite of mounting evidence to the contrary, global corporates are failing to grasp the level of threat posed by CEO frauds or 'whaling' attacks carried out by cybercriminals, according to a recent report.

Cybersecurity specialists Trend Micro surveyed more than 2,400 enterprise IT decision-makers in Europe and the US, and found that just 12% of respondents consider this kind of attack a threat. However, this lack of awareness is at odds with increasing accounts of their prevalence.

Findings published by cybersecurity firm Proofpoint indicate that in the final quarter of 2016, CEO frauds and similar business email compromise (BEC) attacks jumped by 45% among companies in the US, UK, Canada, Germany, France and Australia.

Sophisticated social engineering is a characteristic of these attacks, which come in the form of emails from cybercriminals purporting to be CEOs or other senior executives requesting the release or transfer of significant sums. To be successful, the emails have to be highly plausible, and cybercriminals often manipulate recipients by suggesting the matter is sensitive and confidential.

The steep rise demonstrates that BEC presents a very real risk to global corporates, which are losing an average $140,000 per incident, the report found.

SHUTTERSTOCK

THIS MONTH

CHANGE THROUGH BREXIT

By the time you read this, I will have retired, and so it feels appropriate to review the bigger picture as I close the door. We've had Trump and Brexit. European elections approach. Political change may appear remarkable to those brought up in the Age of Entitlement, but pale against the changes in technology and population.

If you have views you'd like to share with the ACT policy and technical team or have your own submission you are willing to share, please email us at technical@treasurers.org

Steve Baseby is ACT associate policy and technical director @BasebyStephen

{ IN DEPTH }

"Nine meals away from anarchy"

Maurice Cleaves, CEO of Payments UK, opens its *Changing Payments Landscape* report noting that the smartphone and its interaction with the internet has led to change unforeseeable as little as 10 years ago.*

Over four decades, the financial world grasped the potential of the relational database and then the internet. Now corporates and individuals often communicate with their banks almost exclusively through internet portals and smartphone apps. Cash can be obtained at an ATM, which is as likely to be in your local supermarket as at a bank branch. We are anyway shifting to non-cash solutions, such as a swiped debit card. Now distributed databases (blockchain) loom as the next great efficiency step forward for financial services, government, corporates and individuals.

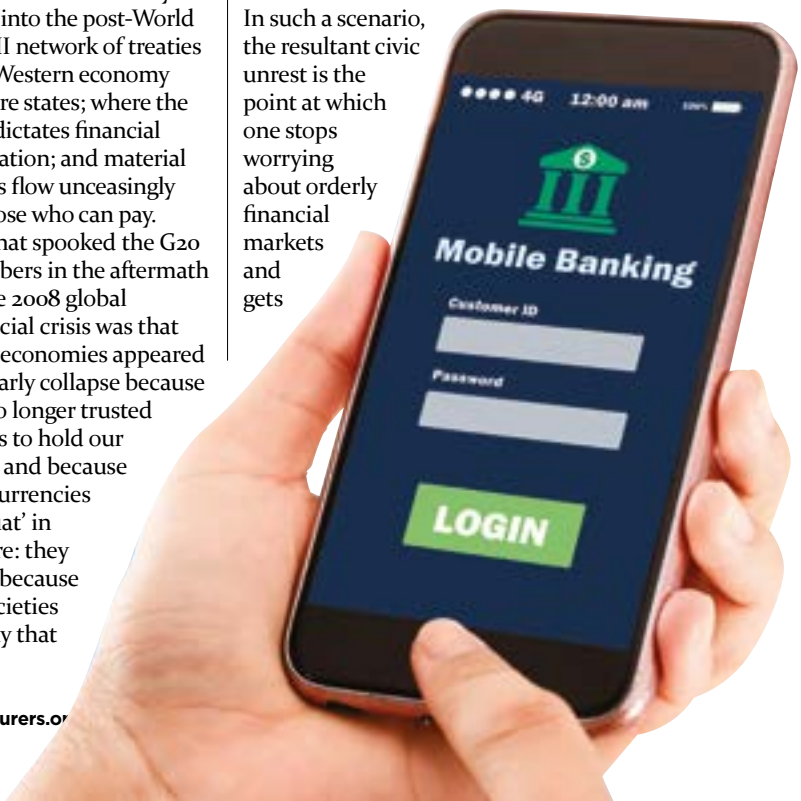
The real world is also changing. Population is rising with pressure on resources. China is investing in African agriculture and transport infrastructure as no colonial master ever did. Energy supply has become more complex as oil and gas become harder to extract. LPG cargoes are bid for as they travel the world. The UK now relies on pipes from Norway for gas the Norwegians do not require because they have hydro-electricity. Continental Europe relies on gas pipelines that start in Russia.

The science world wants to rename our time the Anthropocene Era, with a suggested start date of the first atomic bomb, to recognise the irreversible change humans have made. I propose to add to that the more local human subset of the Age of Entitlement: society born into the post-World War II network of treaties and Western economy welfare states; where the G20 dictates financial regulation; and material goods flow unceasingly to those who can pay.

What spooked the G20 members in the aftermath of the 2008 global financial crisis was that their economies appeared to nearly collapse because we no longer trusted banks to hold our cash, and because our currencies are 'fiat' in nature: they exist because as societies we say that they do, and not because they comprise lumps of precious metal for which value is universally recognised. We have yet to panic to the stage where we no longer value the currency, although some have started to become choosier about the currency held.

As corporate treasurers, who daily manage the shrinking credit creation of banks, and the increasing burden of reporting, it is easy to lose focus on the core driver of the G20's increase in regulation, which is to try and avoid another run on their domestic banks. In such a scenario, the resultant civic unrest is the point at which one stops worrying about orderly financial markets and gets out on the street to start hunting food. In 2007, Lord Cameron of Dillington echoed the 1906 statement of Alfred Henry Lewis that civilisation is only "nine meals away from anarchy". But in a modern world just in time food supply chains are reliant on efficient financial infrastructure.

Financial services and financial markets are only a subset of modern society, and they rely on infrastructure, which requires reliable energy supplies, which also enables production of the biochemicals we use to produce and then transport food. All these things that we believe we are entitled to are interdependent.



The thought I will leave with you is that failure to decide between nuclear, fracking and mining for energy, between housing estates and national parks or agriculture, is the point at which we start to consider our entitlement to turn on the light switch, hop into our chosen form of transport, tap into an endless source of food at the supermarket, and log on to the internet for pleasure and commerce.

The failure to match financial regulation to the financial enablement of other parts of the same society puts that sense of entitlement at risk. Hoping that the world of fintech will alleviate the capital constraints of post-2008 regulation may be akin to oil-free Germany and Japan pushing electricity and its by-product, hydrogen for transport, while shutting down their nuclear energy plants.

*(See www.paymentsuk.org.uk/sites/default/files/Changing-Payments-Landscape%20January%202017.pdf)

View briefing notes, technical updates and policy submissions at www.treasurers.org/technical. UK members can find our library of Brexit-related resources at www.treasurers.org/brexit

For more immediate responses to events as they occur, the policy and technical team continues to write various blogs at https://blogs.treasurers.org

Please get in touch if you have something you'd like us to post as a blog on our website.

{ INTERNATIONAL }

THE INFLUENCE OF THE US

What does the somewhat different style of US president Trump to his predecessors mean from a practical standpoint for treasurers? This may well be a thread that runs and runs, but a couple of things spring to mind that a treasurer may want to keep a watching brief on.

First, the reform of US taxes, which may result in the repatriation of billions of dollars currently held outside the US in the form of bonds and cash investments.

For example, Apple Inc owns around $120bn of corporate bonds, twice the holdings of the European Central Bank – imagine the impact if they chose to unwind this position.

Second, Trump's determination to roll back what some see as the restrictive regulation of the financial markets with the much talked about repeal of some or all of the Dodd-Frank regulations will certainly have consequences for corporates, depending on what gets reversed.

So far, this is all theoretical, but it never hurts to be prepared and keep a close eye on what's happening across the Atlantic.

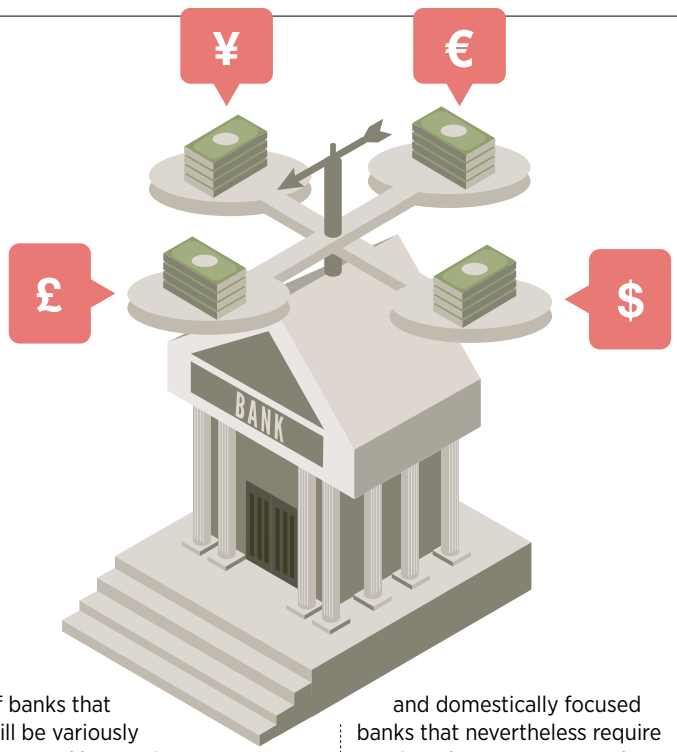
{ WATCH THIS SPACE }

Know your bank – at home and away

It's time to start to make sure that you understand the intricacies of the banks that are your counterparties following all the changes made as a result of 2008 (and now Brexit).

The ring-fencing regulations in the UK will start to bite during 2017, and your UK bank should now be in a position to start talking about exactly which part of the bank your business will sit in – and what this means in practice for the corporate. There is a raft of information on the Bank of England Prudential Regulation Authority website pages.

Slightly further afield, banks need to identify and address the challenges that Brexit poses to the provision of banking services in the EU. The Association for Financial Markets in Europe has commissioned a report from PwC, which has identified three categories of banks that will be variously impacted by Brexit.



The three categories are: banks predominantly using a hub (frequently based in the UK) as a basis to serve clients across the EU; banks with pan-European structures (activities and staff spread across legal entities located around the UK and the EU-27); and domestically focused banks that nevertheless require continued access to UK and EU-27 markets. Each category will face different challenges, and corporates should consider which category their various banking partners belong to so that they can start to explore just what Brexit might mean in practical terms for their bank group.

{ TECHNICAL ROUND-UP }

EU variation margin deadline

The imposition of margin on NFC+ corporates has an initial margin required as from 1 March 2017. We have argued that this is the conversion of counterparty risk to liquidity risk, but the EU remains keen on initial and variation margining for those corporates that do not fall within the European Market Infrastructure Regulation (EMIR) thresholds.

A timely reminder, as the Financial Conduct Authority recognises that implementation is not proceeding immaculately and it may need to use some judgement on enforcement. See www.fca.org.uk/news/news-stories/fca-statement-emir-1-march-2017-variation-margin-deadline

Repos, collateral and EMIR

The International Capital Market Association (ICMA) has issued its *European Repo Market Survey*, available at www.icmagroup.org

The repo market is used by banks and other financial services entities to raise short-term cash by offering financial securities as collateral. Some corporates are using the other side of that market to invest short-term cash.

Financial securities are also used as collateral for margining and by stock lending by natural holders, such as pension and insurance funds.

The ICMA report shows that the repo market is growing slowly. Market observers have expected the collateralised markets to increase as parties seek more physical security to support their cash transactions. The slow growth in repos, and the preference to collateralise margin with cash, is generally attributed to low liquidity in financial securities.

The reason for this is not yet apparent; we will probably require some form of market crisis to ever know.

TIM CANTY

MANAGING DIRECTOR, CANTY TREASURY MANAGEMENT LTD

How did you get into treasury?
My first job after university was on the foreign staff of an international bank, in Asia. I decided I wanted to switch sides and a customer suggested a good way in would be corporate treasury.

What do you like about treasury?
Being the interface between the company and the finance providers means you are able to guide and influence others. To do this, you have to pay attention to the detail, but understand the wider business. Being an interim means that I can help growing companies who need support with their increasingly complex risk management and financing requirements.

What's the best thing about being a treasurer?
Because 'cash is king', you have to get to know all aspects of the company and the people in it. This gives you a great overview of the business, making it dynamic and exciting.

What's the best thing about being a member of the ACT?
The networking opportunities, attending conferences and access to technical updates.

What's the most unusual responsibility that you have as a treasurer?
My current client is a regulated financial services business, so quite different to most other corporates I have dealt with. There is a steep learning curve, both culturally and technically.

What's the most important lesson that you've learned during your career?
Be a good listener, building up the trust and confidence to be able to delegate appropriately.

What's your ultimate career goal?
Continuing to help my clients in my interim business through my knowledge and experience, and mentoring those entering the profession.

Who is your greatest inspiration and why?
Abraham Lincoln. For his humility, thoughtfulness and carefully crafted speeches.

If you weren't a corporate treasurer, what would you be and why?
A travel writer, recording my unusual and amusing experiences for others to share.

If you would like to star in our 60-second interview slot, email editor@treasurers.org. Please provide a photo of yourself, your email address and telephone number. We won't publish your details – it's just so we can contact you in the event of queries.

ACT DIARY DATES

TRAINING, EVENTS & WEBINARS

2017 TRAINING COURSE DATES

25 April, London
The nuts and bolts of cash management
Develop an in-depth understanding of the basic principles and practices of cash and liquidity management, its importance to the business and to the treasury function at this one-day introduction to cash management. The programme examines the basic building blocks of cash management from the domestic perspective and, through a series of case studies, extends these basic principles to tackling the complexities of international cash management.

26-27 April, London
Advanced cash management
The cash management marketplace is morphing: global banks are 'deglobalising' and corporates will increasingly be multi-banked. New (and recycled) techniques are being introduced: Partner Banking, SWIFT Corporate Access, ISO 20022. At the same time, the regulators – whether via SEPA or Basel III – are moving the goalposts and enabling new types of competition to traditional banks. This two-day course will arm you with the knowledge to prepare for this rapidly changing environment.

2-3 May, London
Treasury security, control and audit
Develop an all-round understanding of how to create a secure environment in which treasury transactions can be managed and carried out with minimum risk of fraud or error. Learn about assurance practices to effectively plan and execute a risk-based treasury audit.

4 May, London
Foreign exchange
Learn about the different types of FX risk and develop an ability to advise both commercial operations and senior management about these risks. Find out about some of the instruments used to manage FX risks, how they are traded and some of the risks around this, together with the controls that should be used to deal with those risks.

5 May, London
Interest rate risk
Gain a deeper understanding of the many aspects of interest rate risk, how it affects different firms and its inevitability. This course will teach you the concepts for evaluating the different components of interest rate risk.

To view more courses or to book online, visit academy.treasurers.org/training. For more information, contact Radmila Trkulja at rtrkulja@treasurers.org or call +44 (0)20 7847 2573

ACT EVENTS 2017

8 May, Dubai
Middle East Breakfast Briefing
In a bite-sized breakfast format, network, debate and be informed at our popular annual morning event, alongside senior corporate treasurers from the region.
www.treasurers.org/mebreakfast

16-17 May, Manchester
ACT Annual Conference
The most powerful treasury and finance debate returns to Manchester. Our new two-day format delivers unrivalled content and networking opportunities, only in a smarter, more compact set-up that means less time out of the office.
www.treasurers.org/annualconference

27 September, Hong Kong
ACT Asia Treasury Leaders' Forum
Join more than 200 treasury and finance professionals from across Asia for the Asia Treasury Leaders' Forum to discover the latest developments in treasury tools, tactics and strategy. It is the perfect meeting place to share knowledge, experience and best practice, and build your professional network.
www.treasurers.org/asia2017

8 November, London
ACT Treasury Forum
This invitation-only event is the perfect platform for leading treasury professionals to come together – sharing and debating the key issues of the day in an informal and interactive setting.
www.treasurers.org/treasuryforum

8 November, London
ACT Annual Dinner
Taking place in the elegant surroundings of the Great Room at the Grosvenor House Hotel, this event provides you with a fantastic opportunity to network with your peers while enjoying a superb three-course meal, fine wine and entertainment in one of the most prestigious venues in London.
www.treasurers.org/annualdinner

21-22 November, Dubai
Middle East Annual Summit
Join us at the largest and most popular treasury event in the Gulf Cooperation Council. Bringing together the region's leading corporates, expect to meet more than 500 treasury and finance professionals, and hear thought-provoking insights and best practice from over 50 speakers, all under one roof.
www.treasurers.org/middleeastannualsummit

ACT WEBINARS

Join in the discussion and debate from the comfort of your desk
Led by the ACT's policy and technical experts, ACT webinars give direction on regulatory change and key treasury concerns direct to you, wherever you are in the world.

For details of our webinar programme, visit www.treasurers.org/webinars

To attend an ACT webinar, book online at www.treasurers.org/events. For more information, email events@treasurers.org or call +44 (0)20 7847 2589

{ FUND MANAGEMENT }

JEREMY WARNER

Smart beta testing is the latest buzz term in the fund management sector, but does it net results?

When Aberdeen Asset Management recently announced an £11bn merger with Scotland's largest insurer, Standard Life, it was more out of necessity than starry-eyed vision of boundless opportunities for the future.

With decent investment returns ever harder to come by in today's low interest rate, low growth world, active fund management is in ragged retreat; rather, it is passive investment that makes the weather. To thrive in this wafer-thin margin, business requires both ultra-low costs and cutting-edge IT. The two companies calculate that together they can make a better go of these requirements.

Credit Suisse estimates that, in the US alone, more than $1 trillion has flowed out of active fund management and into passive funds since the financial crisis in 2008. Many hedge funds have been particularly badly hit; 'normal' pricing signals have been all but wiped out by massive central bank money printing, and many of them now struggle to outperform.

But it is not just because investors are increasingly sceptical about the ability of actively managed funds to add value. It's also because passive fund management has become more sophisticated, taking on some of the attributes of active investment, but at a lower cost.

The buzz term is 'smart beta', or so-called factor investing. A recent survey of major investors cited in the latest *Credit Suisse Investment Returns Yearbook* found that three-quarters of asset owners are already using or actively evaluating smart beta, and of those with an existing exposure, nearly two-thirds are evaluating additional allocations. The proportion of asset owners using at least five smart beta strategies rose from 2% in 2014 to 20% last year. It's the latest thing, but does it work?

SHUTTERSTOCK

Smart beta refers to the supposedly superior returns that can be extracted

First, let's disentangle the terminology. The return delivered by the market overall is known as 'beta'. Smart beta refers to the supposedly superior returns that can be extracted using particular, usually algorithmically driven, passive strategies. Traditional passive investment merely tracks the market; smart beta tracks indices that have been constructed to have built-in biases. These biases typically include momentum, value and income investing. Or the 'exchange-traded funds' may have a bias to investing in larger companies and, sometimes, smaller companies. Some will apply a mixture of different factors. In all, researchers have identified at least 316 separately applied factors.

This type of investing has of course been around for decades, but smart beta aims to go the extra mile and systematically apply modern computing power to the various investment strategies.

So, does smart beta succeed in delivering superior returns? Research by Credit Suisse in conjunction with the London Business School comes to a not altogether surprising conclusion: sometimes it does, and sometimes it doesn't. As ever with stock market investment, much depends on timing. Momentum works well in certain kinds of markets, value investing better in others, and so on.

The researchers tracked five of the most commonly used forms of factor investing – low volume, income, momentum, size and value – and found that in all cases performance is variable, doing very well one year, and badly the next. If you bought a basket of all the different factors, you would probably end up with something pretty close to the market anyway.

With traditional active fund management on the wane, money managers are desperate to find strategies that might justify higher charges. It's hard to reach any definitive conclusions; some smart beta providers are better than others. But in the round, it seems unlikely that these relatively new forms of investment are going to prove any better at beating the market than the older ones.

Jeremy Warner is assistant editor of *The Daily Telegraph* and one of Britain's leading business and economics commentators

ACT

LEADING TREASURY PROFESSIONALS

HOW CAN WE HELP YOU?

Educating through professional qualifications

Networking through events and conferences

Shaping careers through treasury training

Guiding through policy & technical updates

Supporting through membership services

Informing through publications and webinars

Connect with us at **act@treasurers.org**

TREASURERS.ORG

Reasons to be cheerful

Is Europe broken? Economic indicators and the balance of geopolitical risk suggest not

The wheels of history are turning. If political risks materialise this year, the European project as we know it could be brought to an end. If it all goes wrong with the elections in France, and possibly Italy, the EU could unravel. Such risks cannot be taken too lightly. But they are no more than tail risks. Underlying economic fundamentals are healthy. There are a few good reasons to be optimistic about Europe's medium-term growth prospects.

First, the recovery is entrenched. It would take a major shock to throw it off course. Lest we forget, the initial eurozone recovery after the financial crisis kept pace with the US and UK. It was disrupted when the European Central Bank (ECB) failed in its duty as lender of last resort to prevent contagion spreading from tiny Greece to the rest of the vulnerable eurozone periphery. It took ECB president Mario Draghi's 'do whatever it takes' speech in 2012 to finally calm the panic. While the pace of the post-euro crisis recovery has remained modest, the economy has expanded at its 1.6% trend rate for the past two years now. All components of demand are contributing to growth. Survey measures show that economic participants' confidence and expectations for future growth are rising.

Second, Europe is currently benefiting from the rebound in world demand that began in mid-2016. Generating around 30% of their GDP from exports, European economies are sensitive to fluctuations in global demand. The spending appetite of households in the US, the largest economy in the world, remains the keystone of global demand. As long as the solidly responsible Republican Congress reins in a somewhat unpredictable president Trump on his anti-trade rhetoric, Europe should see a further gain in external demand stemming from an acceleration in US growth in late-2017 as the US fiscal stimulus and tax reforms begin to take effect.

SHUTTERSTOCK

Third, all elements of economic policy are supporting growth. Through its aggressive asset-purchase programme – likely to last until mid-2018 – monetary policymakers at the ECB are helping to keep long-term borrowing costs low and the euro exchange rate competitive. That supports a rise in demand from home and abroad. Since underlying inflation remains well below the ECB's target of 'close to, but below 2%', the central bank is not under pressure to withdraw stimulus any time soon. Meanwhile, austerity has been over across almost the entire eurozone since 2015. Fiscal policy is no longer a drag on growth. Instead, governments' decisions on spending and taxation can add 0.1-0.2 percentage points to annual growth over the coming years.

Fourth, political risks probably will not materialise. After the upsets of Brexit and Trump last year, markets will keep a close eye on elections this year in Germany and France, and possibly Italy. But even if Angela Merkel loses the German election in September, German politics does not pose a serious threat to the European project. All key parties in Germany are solidly pro-EU. If anything, the challenger to current chancellor Merkel, ex-president of the European Parliament Martin Schulz, is even more pro-Europe than she is.

France presents more opportunity than risk. Both the centre-left reformer Emmanuel Macron and the more Thatcherite François Fillon enjoy comfortable leads over ultra-right Marine Le Pen in a second round run-off vote, according to opinion polls. Like Thatcher's Britain and Schröder's Germany, France could be the next major economy to switch from 'sick-man of Europe' to one of its main growth engines if it puts a reformer at its steering wheel.

While Italy is unlikely to actually opt for the chaos of a euro exit, it tops the list of tail risks in Europe. After ex-Italian prime minister Matteo Renzi stepped down following the referendum defeat on constitutional reform late last year, the risk that an anti-euro party, or coalition, could come to power in Italy is greater than almost anywhere else. But even then, Italy would probably shy away from the costly turmoil of an Italexit.

Touch wood, the political risks will not materialise. If so, the stage is set for Europe to enjoy its best economic performance since the stalled post-Lehman rebound with stable growth and steady gains in employment. For once, risks are even skewed to the upside. With luck, the Brexit divorce will not affect the large European economy very much, Italian politics will remain too fragmented for any serious threat to emerge and the newly elected French president may reform Europe's biggest growth laggard, France. With just a little luck, 2017 could even see a new air of optimism return to Europe.

While Italy is unlikely to opt for a euro exit, it tops the list of tail risks in Europe

Kallum Pickering is senior UK economist at Berenberg Bank

ACT LEARNING ACADEMY

Develop practical new skills and treasury expertise that you can apply immediately in the workplace

Qualifications

- Certificate in Treasury Fundamentals
- Certificate in Treasury
- Diploma in Treasury Management
- MCT Advanced Diploma

In-company solutions

We offer in-company solutions and can adapt any of our off-the-shelf courses to create completely bespoke programmes for your organisation.

Training

- The A-Z of corporate treasury
- Treasury security, control and audit
- Corporate tax for treasurers
- Treasury in a day

eLearning

- First steps in treasury series - 7 short online courses

academy.treasurers.org

{ ACT EVENTS }

PETER MATZA

The speakers' chair for the ACT on how treasurers continue to add value to organisations

What is it I need to know? It's a question many of us in our busy, day-to-day professional lives don't take much time to stop and consider. From keeping up to date with the latest technologies to taking a step back and re-evaluating how treasury is adding value to our businesses, we are all often guilty of not reflecting on where we stand as a profession and what we could do differently to be more efficient or value-creative.

Answering these questions is made even more difficult by the prevalence of uncertainty: geopolitical events, the variability of economic growth and market volatility all muddy the waters. Concurrently, the pace of technological advancement, social trends and ways of working are providing numerous opportunities and challenges to how treasury operates.

In short, there's a duopoly at play, which is redefining the treasurer's role. We'll get some measure of the extent of this when we publish findings of this year's *Contemporary Treasurer* – the ACT's comprehensive annual survey tracking treasurers' views on their role in corporate financial strategy and business growth; how they are spending their time compared with five years ago; and how far they have come in strategic engagement terms.

SHUTTERSTOCK

Of course, change is inevitable in the treasury world – some might argue it's just all part of the day job – but with new risks and challenges, and also opportunities around every corner, when do we get to stop and take a moment to debate these questions?

The ACT Smart Cash Conference in February provided an opportunity for delegates to share their best practice approach to treasury structures, such as cross-currency notional pooling and in-house banking. The programme also covered supply chain issues, shifts in the regulatory environment and a fascinating debate around the role of corporate treasury in relation to cybercrime. Don't miss your copy of the full conference report available with this issue.

On 16-17 May in Manchester, the ACT Annual Conference will bring the treasury community together on a much larger scale to hear about the issues affecting it and impacting business – and what the treasury world is thinking and doing in response. Justifying time out of the office is becoming increasingly difficult, so this year we've developed a new, time-efficient, concentrated two-day format that's full of practical takeaways. The conference will also provide thought-provoking external perspectives on international business and trade, UK plc post-Article 50, and ethical hacking – a live demonstration that will offer a fascinating insight into the sophistication of the cybercriminal and the measures you need to take to prevent an attack. Be sure to check out the brochure included with this issue, featuring the latest content updates.

Certain themes appear year after year – diversity, sustainability, regulation. This year, the ACT's new chief executive, Caroline Stockmann, will lead a session on embracing diversity for real business benefit, a cause she has been committed to throughout her career, as she discusses in our profile of her on page 18.

In regulatory terms, treasurers often find themselves between a rock and a hard place, with business objectives pitted against the practicalities of regulation. The regulation feature on page 22 of this issue, 'Piecing together the regulatory puzzle', will go some way to helping make sense of the latest developments. Delegates at the conference will have further opportunity to hear about regulatory change, such as money market fund reforms – particularly the low volatility net asset value fund, as well as to hear from representatives from the Bank of England on Financial Markets Codes of Practice, their relevance for corporates and what is expected of all market participants.

With so much going on, it's a good job we've got the conference app again this year to help us all keep track! I look forward to welcoming you to Manchester, and to engaging with as many of you as possible, professionally and socially, throughout the conference.

Change is inevitable in the treasury world – some might argue it's just part of the day job

Peter Matza is the speakers' chair for the ACT

CAROLINE'S CV

Present
Chief executive, ACT
2014-2016
CFO, the British Council
2010-2014
CFO, Save the Children International
2010
Interim international director, Sue Ryder Care
2007-2009
Financial and commercial director, the Southbank Centre
2006-2007
Head of global business planning, Novartis Group
2000-2006
Various roles at Unilever, including two years as CFO and CIO, Unilever Thailand
1997-2001
Various roles at Bestfoods, including FD and CFO, Bestfoods Benelux from 1999
1996-1997
Financial controller, Granada
1994-1995
Senior auditor, Cadbury Schweppes
1990-1994
Assistant manager, KPMG

A SENSE OF PURPOSE

The ACT's new chief executive, Caroline Stockmann, combines financial leadership with a deep interest in people and what they can contribute to their organisation

Words: **Liz Loxton** / Photos: **Will Amlot**

Caroline Stockmann is a musician, a linguist, a chartered accountant (FCA) and a seasoned executive whose experience includes senior roles in both blue chips and charities.

She is a classically trained flautist who is just as happy at a Massive Attack concert as a Daniel Barenboim one. And she is well travelled, having worked in the Netherlands and Thailand, to name just two overseas assignments.

Openness about who she is as a person fundamentally informs her leadership style. "My belief is people need to know you're human," she says.

It's central to the way she operates. Compared with many other chief executives and senior leaders, Stockmann is strongly people-oriented and believes in embracing communication between herself and the people she leads. Teams contribute more to their organisations and to their customers, or indeed members, if they are allowed to play to their strengths. Fulfilled, motivated people perform better, she believes, so throughout her career she has encouraged respectful two-way communication and sought to promote diversity and interaction with and between the individuals she has led. "We all want to make a difference to people's lives and to our organisations," she says.

Early moves

That desire to make a difference began early for her. As a young graduate, Stockmann wanted to put her skills to use in one of the world's most deprived corners. "I wanted to go to Ethiopia to teach blind children music, because I wanted to help make a difference," she says. "As it happened, they wouldn't let me in the country because of immigration policy at the time, so I did some fundraising to buy musical instruments and the local police band taught the children.

> "We all want to make a difference to people's lives and to our organisations"

I ended up working with young people in the north of England, designing and running school-leaver courses. It was probably where I first started developing thoughts around diversity."

With that formative experience behind her, she began looking for a role that would play to her skills and take her onwards into her career. Stockmann's move into the world of finance began with KPMG, and it was her love of languages and of learning that got her through the door. Her family had an engineering business built up by her grandfather, and her mother had ended up as chairman, a role her mother hated. "She particularly disliked it when the auditors came in, and I thought I could help out with that. So that's why I ended up at KPMG. They wanted linguists and I thought I would learn something new."

After KPMG, she took the classic route into business, taking up a role as a senior internal auditor at Cadbury Schweppes. Her work there took her via secondments to Germany and Poland, where she set up the financial systems at a new Cadbury factory, after which she moved into a financial controller position at Granada.

Stockmann then moved on to Bestfoods, a company she stayed with for four years, during its takeover by Unilever in 2000, with whom she stayed a further six years. Surviving the takeover turned out to be quite a feat, but Stockmann had already won her place in Bestfoods by dint of determination. When the role of Benelux regional CFO in the Netherlands originally came up, her soon-to-be boss dismissed her as too young for this senior and Dutch-speaking role. Stockmann's response was to learn basic Dutch on a week-long crash course. Securing the job, she duly moved her young family to the Netherlands.

In the wake of the Unilever deal, she was one of only a handful of Bestfoods finance executives to retain their role. "I was one of the few Bestfoods people who survived. Unilever's finance team was very strong and dominant in the merged organisation," she says. Vice president of finance at Unilever Foods Europe turned out to be a fascinating position and one that confirmed her presence in the Unilever network. It was also the largest subregion within the group, and Stockmann was able to take advantage of training opportunities, becoming a coach and reviving her earlier interest in diversity work. Then came the move to Unilever Thailand, one of the group's high-growth locations where, as CFO and CIO, she managed the finances of the €600m entity.

In 2006, she moved to Switzerland to take up the role of head of global business planning at Novartis Group, looking after $23bn in pharma financials. After that she changed tack, returning to the UK to become financial and commercial director at the Southbank Centre.

This role marked the beginning of nearly a decade of senior roles in UK charities. As financial and commercial director, she managed 14 franchises, set up the annual Christmas market, established the riverside outdoor bars and secured lifeline funding for the centre at a time when small theatres were closing and arts funding was being cut to the bone. "I put together a strategy for the organisation, something they'd never had before – none of the arts organisations had."

With that strategic framework, Stockmann was able to win her case when she told the Arts Council that investing in the Southbank over the short term would enable it to become self-sustaining, an argument that netted the organisation an extra £16.5m.

A leadership change at the Southbank Centre prompted another move. In 2010, Stockmann became interim international director at Sue Ryder Care. Then came four years as CFO of Save the Children International, a role that involved considerable restructuring of the operation. In 2014, she was headhunted by the British Council, the UK's largest charity, with a £1bn turnover.

FIVE THINGS TO KNOW ABOUT CAROLINE STOCKMANN

1. **She is a classically trained musician who once had a work commissioned for her by Northern Arts.**
2. **She speaks seven languages.**
3. **She is a trained coach, a qualification she attained while at Unilever.**
4. **As commercial director for the Southbank Centre she set up the annual outdoor Christmas market.**
5. **While working at Save the Children International, she fulfilled a long-standing desire to visit Ethiopia.**

Both of these roles gave her an opportunity to bring some hallmark financial and professional rigour into organisations that badly needed change. She joined Save the Children International at its inception, with a brief to integrate and streamline its operations. "It was a $1bn start-up, taking on all the programmes from Save the Childrens around the world and merging them, for instance, in one location, where you had seven country directors, seven HR directors and seven finance directors, most of them not only on the same road, but operating out of the same building." The work also involved rolling out a new financial system. In all she worked with 30 member organisations to deliver $10m a year in savings to be reinvested in the charity's work with children.

Stockmann came up against comparable levels of complexity and challenge at the British Council, which needed a better-functioning finance operation. "That was about including people, filling the gaps, building new teams where needed and developing existing teams," she says. The foundational work also helped inject a strong financial management ethic at the heart of the organisation, something that enabled her to roll out a new finance strategy, as well as global procurement and estate management programmes. "This was an organisation that had grown rapidly over the years, but hadn't grown its professional services," she says.

Recognition

Making sure there is a professional work ethic within finance functions is a recurring theme in her career, but getting a financial mindset more widely recognised and accepted within charitable organisations is not a given. It's broadly the case that charity CEOs tend to make their way up via operational roles rather than through finance, a fact that might inform finance's lack of standing in the sector. "I believe that in the FTSE 100, around 80% of chief executives have a finance background. In the charitable sector, it's less than 10%," she says. But she believes having a financial and professional qualification

"In the FTSE 100, around 80% of chief executives have a finance background. In the charitable sector, it's less than 10%"

has given her a great deal. "It gives you an insight into the whole organisation, which is invaluable. Through my roles in all these organisations, I've seen everything that goes on."

In turn, the mix of charity and private sector work she has experienced has paid dividends in career terms. "I do believe wholeheartedly that you can apply these skills and lessons in any organisation. One of the most important things for anyone in finance is to first of all try and understand the business."

Clearly, the next step for Stockmann was to become a CEO, a long-standing ambition. And she intends to carry her commitment to diversity and encouragement of others with her into the top job at the ACT. For her, the primary role of the CEO is leadership and empowerment. "It's interesting to see how some people take that next step up, but are fearful. And that manifests itself in trying to control things. They stifle everything around them. People around them have to check everything with the boss. The boss's ideas are always responded to with a yes and you get that 'yes culture'. That's not healthy for an organisation."

The ACT's value, as a people-facing organisation committed to helping and promoting its membership, is strongly evident to her. The ACT has a great deal to offer – high-quality people working at the hub with council members and the advisory board contributing a wealth of expertise and experience. The events she has encountered so far, this year's Smart Cash Conference and Deals of the Year Awards, have shown the membership and professional body's commitment to applauding its high achievers and sharing its wealth of good practice, and demonstrated that service ethic abundantly, she says.

> "I believe that you can apply these skills in any organisation. One of the most important things for anyone in finance is to first of all try and understand the business"

The main thread through all this is professionalism, she says. Professional membership groups have so much to offer because they provide that assurance about the solidness of an individual's qualification as well as their qualities and integrity. The implications of a person going into a treasury function without a solid qualification or adequate preparation are, she points out, pretty stark. "It is possible without those for someone to bring down a whole business. This is about professional integrity, making sure that's in place in business, encouraging that and helping people understand treasury and its role in society."

She would like to see the ACT grow and increase its membership – although not at the expense of quality. And the task of ensuring that commercial organisations appreciate the centrality of the treasury discipline will also be paramount. Colin Tyler's work to reach chartered status for the ACT was work well achieved, she says, and Stockmann would like to see the ACT be able to confer individual chartered status on its members in due course.

For now, what's important is ensuring the ACT and its members can build on these solid foundations, leverage the expertise that already exists within the body and its membership, and forge fruitful relationships with membership bodies with similar concerns and outlooks. She looks set to bring considerable energy to that undertaking.

Liz Loxton is editor of *The Treasurer*

Piecing Together the Regulatory Puzzle

WHETHER IT'S TALK OF DEREGULATION IN THE US, OR THE EU'S REVISED PROSPECTUS DIRECTIVE, THE REGULATORY LANDSCAPE IS CONSTANTLY EVOLVING. *THE TREASURER* EXAMINES THE LATEST DEVELOPMENTS IN FINANCIAL REGULATION, ASSESSING THE DIRECT AND INDIRECT IMPACT ON CORPORATE TREASURY ACTIVITIES

Words: **Eleanor Hill** / Illustrations: **Chris Piascik**

€EMIR Basel III

The phrase 'unintended consequences' perfectly encapsulates the frustrations of many treasurers dealing with the fallout of financial regulation. Not only are they having to rethink aspects of cash and liquidity management, but they are also adjusting their funding strategy accordingly.

Europe's CRD IV package, which implements Basel III across the continent, is a case in point. As the liquidity coverage ratio (LCR), net stable funding ratio (NSFR) and leverage ratio become entrenched in Europe's banks, financial institutions' appetite for taking short-dated deposits is waning.

"A combination of regulation and the ratings environment has led to many banks losing interest in very short-term deposits," confirms Pedro Madeira, treasurer at Thames Tideway Tunnel. "While one or two banks are still happy to accept deposits, others only accept them as a gesture of goodwill and as part of an ongoing relationship with the company," he notes.

The impact of CRD IV on deposit-taking is being exacerbated by quantitative easing, which has flooded the banking system with liquidity, combined with the extremely low interest rate environment. Many treasurers are therefore seeking alternative solutions for their short-dated cash. But regulatory initiatives like money market fund (MMF) reform in Europe are further narrowing the field.

SPOTLIGHT ON MMFs

While the US has already enacted MMF reforms, a political agreement on new European rules was only reached in December 2016. Full implementation is therefore more than 18 months away, but one of the more significant changes is the introduction of a new type of MMF, the low volatility net asset value (LVNAV) fund.

Although the experience for end users will be relatively unchanged from that of constant net asset value (CNAV) funds, a few factors will be very different. In certain scenarios, LVNAV funds may be forced to move away from a stable unit value pricing to a variable unit value pricing. They will also have potential liquidity fees or redemption gates applied to them in extreme stress scenarios.

As a result, some treasurers are starting to rethink their use of MMFs. However, Alastair Sewell, head of the EMEA and APAC FAM group at Fitch Ratings, believes that while there are new features of LVNAV funds that treasurers will need to get used to, European MMFs will remain fairly robust. "Indeed, investors we have surveyed see LVNAV funds as a workable alternative to the existing product range," he notes.

> LVNAV funds may be forced to move away from a stable unit value pricing to a variable unit value pricing

EMBRACING CHANGE

Robert Scriven, group treasurer and planning manager at Cairn Energy, falls into that camp. "Although I was concerned about the introduction of LVNAV funds originally, I feel more relaxed now about the changes," he says.

"Some of the main concerns, such as the impact on ratings, have dropped away and the nuances of the new rules are now becoming much clearer. As long as we get appropriate accounting guidance, we should still be able to count these funds as cash or cash equivalents and we will still continue to use them."

Alongside MMFs, Scriven also uses repos as an alternative to bank deposits. "Our experience of using triparty repos is that you can achieve at least as good as, if not better, rates than you'll get on deposits and you get security – so it's a no-brainer from our perspective," he says.

For those smaller corporates who are unable to access repos, short-dated securities such as treasury bills may be a viable alternative to bank deposits and MMFs. The challenge is that they yield very little, or in the case of Europe, have a negative yield.

STRUCTURES AND PROCESSES

Aside from narrowing treasurers' short-term investment options, the structures and technologies that corporates use to manage their cash

and liquidity are also under threat from financial regulation.

One of the main consequences of the CRD IV leverage ratio, for example, is that banks must effectively attribute capital against the gross positions in notional pooling structures. Ian Tyler, MD at Alvarez & Marsal Financial Industry Advisory Services, comments that, "We have therefore seen some banks aggressively exiting that business, and others have looked to significantly reprice these arrangements, which is encouraging the move to physical netting of balances."

In addition, MiFID II, effective January 2018, means that some corporates are not only finding themselves impacted by increased transaction reporting requirements, but must also trade through automated systems – which, while second nature to larger treasury functions, may be painful for smaller companies.

GLOSSARY

CRD IV – The Capital Requirements Directive IV is an EU legislative package applying to banks, building societies and investment firms (FIs). Intended to implement the Basel III agreement in the EU, it covers the quality and quantity of capital FIs must hold, rules on counterparty risk management, a base for new liquidity and leverage requirements, among other things.

CMU – The EU's flagship Capital Markets Union is intended to widen access to a range of funding sources for business.

MMF reform – With more than $2.7 trillion invested in money market funds, regulations changing the way MMFs are structured will affect their risk profile and yields with wide implications for investors.

MiFID II – The Markets in Financial Instruments Directive is the EU legal framework regulating investment firms that provide services linked to financial instruments – shares, bonds and derivatives, etc. MiFID II is intended to improve transparency, and the main impact for treasurers is expected to be increased use of trading platforms.

EMIR – The objective of European Market Infrastructure Regulations is to reduce the risks posed to financial systems from derivative transactions. The principle requirements include: central clearing and margining of standardised OTC derivatives (with certain exemptions for non-financial counterparties), and reporting of all derivative transactions to a trade repository.

KYC – The know your customer regime – designed initially to combat money laundering and financial crime – is a global regulation to give banks greater visibility of their customers. This adds considerable complexity to bank relationship management.

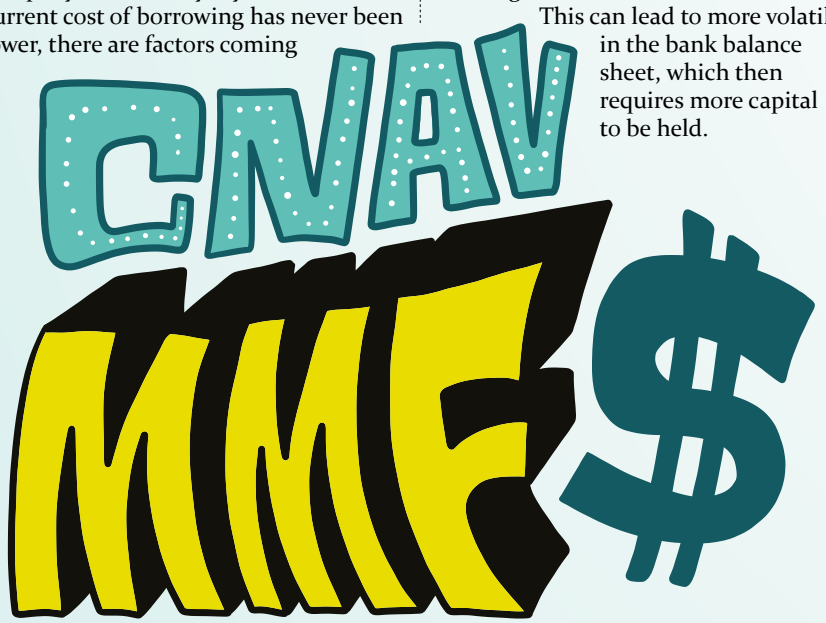
FUNDING STRATEGIES

Corporates' funding mix is also changing because of financial regulation. As Nick Burge, MD, head of strategic liquidity, at Lloyds Bank explains: "Under CRD IV, the amount of capital that banks must hold against credit risk is now 2-2.5x higher than it was pre-crisis. Given this increase in the raw material cost of manufacturing loans, lending has naturally become a more expensive process."

And although the average corporate treasurer of an investment-grade company would likely say that the current cost of borrowing has never been lower, there are factors coming down the line that may cause treasurers to think again about bank borrowing.

> "EMIR is an ongoing frustration We self-report and it has become a bit more complicated of late, but we're fortunate not to have too many reportable trades"

IFRS 9, *Financial Instruments*, the new IAS 39, is a prime example. In simplified terms, IFRS 9 requires banking books to be mark-to-market. This can lead to more volatility in the bank balance sheet, which then requires more capital to be held.



Burge believes it is too early to make a direct read across to the impact that IFRS 9 is having on banks' capacity to lend and the cost of borrowing, largely because banks are still modelling IFRS 9 and aren't implementing it yet. Tyler, however, cautions that the way the regulators respond to this new accounting development in terms of core tier 1 thresholds "could yet have a significant impact on banks' risk appetite for term lending".

A JOINT EFFORT

An initiative intended to provide greater access to alternative sources of funding is the EU's Capital Markets Union (CMU) plan. Despite suffering some setbacks, the CMU is still a significant focus for Brussels. The plan introduces a raft of different measures aimed at developing and deepening the market, but may not be straightforward to implement.

One such initiative for treasurers to be aware of, for example, is the revision of the Prospectus Directive. Shortening a prospectus summary to six sides of A4 paper, yet making the content

more prescriptive, will be tough for even the most seasoned professionals.

ADDITIONAL HEADACHES

Elsewhere, EMIR continues to dog many treasurers. The rules governing the mandatory posting of collateral for uncleared derivatives came into force on 4 January 2017 and, as of 1 March 2017, all in-scope counterparties must post variation margin. There is a phased-in implementation for initial margin from 1 September 2017-2020. While this change will only impact the largest non-financial corporates, it is widely seen as an inconvenience – and a step that the market simply isn't ready for.

"EMIR is an ongoing frustration," confirms Scriven. "We self-report and it has become a bit more complicated of late, but we're fortunate not to have too many reportable trades."

Madeira, meanwhile, always has an eye on derivatives regulation because of the impact it may have on the banks' ability to offer long-dated derivatives in an affordable way. "We are already seeing that some long-dated derivatives are becoming more expensive," he says. "The challenge is that too much regulation on the banks might end up leaving corporates unable to afford hedging solutions and sitting on the risk, which surely cannot be what the regulators truly intend."

Another concern, he says, is the ring-fencing of UK banks. "We wonder whether derivatives might end up in the so-called 'bad bank' and what impact that will have on charges."

Despite the clear rationale, banks' ever-more detailed KYC requirements are yet another headache for treasurers, who frequently provide the same detailed information to different banks, or different departments within the same bank. One ray of light is the emergence of KYC utilities, which essentially act as a secure repository for corporate KYC information that only authorised banks can access. This means, in theory, that treasurers need to upload and update just one set of KYC information.

"We have been asked by one bank to use Markit's KYC.com and we could see, if more widely adopted, that this would help us all. It does seem to be a way forward for the industry, but it is early days," says Scriven.

PIECES OF THE PUZZLE

Finally, while individual regulations may put additional strain on treasury resources, the real challenge is managing the combined impact of these regulations and staying one step ahead of future changes. To that end, the ACT will continue to keep members updated on the latest regulatory developments – including potential deregulation in the US. Although, for now, that falls squarely under the heading 'watch this space'.

Eleanor Hill is a freelance corporate treasury writer

GLOBAL FX AND UK MONEY MARKETS CODES

Alongside financial regulation, treasurers should also be aware of two new market codes due to be published shortly: the Global FX Code and the UK Money Markets Code

Both are voluntary codes of conduct designed to 'improve' behaviour in unregulated financial markets. The codes set out best practice principles for users of these markets covering: ethics, governance, risk management, information sharing, execution, confirmation and settlement, and as such are helpful to corporates looking to understand how they and their counterparties should act when transacting in these markets.

The Foreign Exchange Working Group of the Bank for International Settlements released the first phase of the Global FX Code in May 2016, together with principles for adherence to the new standards. The complete global code and the adherence mechanisms will be released in May 2017 and will replace the FX component of the current Non-Investment Products (NIPs) Code in the UK.

The UK Money Markets Code, which is due to be published on 26 April 2017, will cover the executions of transactions in the UK in unsecured deposits, repos and securities lending markets. It was developed by a joint subcommittee of the Bank of England's Money Market Liaison Committee and the Securities Lending and Repo Committee. It will incorporate revised relevant sections of the NIPs Code, as well as revisions and updates to the Gilt Repo Code and Securities Borrowing and Lending Code. It is expected to come into force as of 1 January 2018.

While the Global FX Code is expected to apply to all market participants who are active in the market as a regular part of their business, the UK Money Markets Code only applies to those corporates defined as professional eligible counterparties by the Financial Conduct Authority (which broadly means firms with net assets above £5m), and who are regularly active in the wholesale unsecured deposit market. From a corporate perspective, while the codes provide best practice guidance, the ACT, among others, lobbied to ensure that proportionality is a fundamental principle in both codes in recognition of the differing level of exposure and complexity among the various market participants.

To help treasurers better understand the impact of these codes, the ACT will shortly publish guidance for corporates. "Once the codes are issued, treasurers should familiarise themselves with the details of each code, determine the extent to which it applies to them and make a judgement call as to whether they adhere to the suggested policies and procedures on a proportional basis," advises ACT associate policy and technical director Michelle Price.

UNDER PRESSURE

With the UK set to exit the EU, certainties about its future are thin on the ground. Roland Hinterkoerner explores the implications of further economic fractures in Europe

We must not forget that, despite historic efforts on the part of the founding fathers of the EU to make utopia into reality, Europe has never been one in its history and probably never will be. Ethnicity aside, the peoples of Europe have been too different in heritage, tradition and culture to meld them into one big federation.

Why would it not work, like in the US, to establish the United Nations of Europe? The answer is simple: the US is not a nation. It is a concept adhered to by the people living in and migrating to it. The US emerged from exactly the frustrations that plagued the Old Continent.

It's not that Europe didn't have its chance to find its own cohesion. However, previous attempts during the past thousand years to unify the continent have failed miserably. The likes of the Habsburgs attempted it under the banner of the Church. Napoleon had his misperceived notion that Europe could only be led through the nation of France. And Hitler failed for obvious reasons.

Why is that? Hilaire Belloc once created the phrase: 'The Church is Europe, and Europe is the Church', but his claim had fundamental flaws. To be sure, the Church brought the barbaric tribes out of the Dark Ages and tried to assemble them under the Catholic ecclesia, but made the fatal compromise of leaving the peoples to their pagan roots and rituals. These are the origins of national states in Europe.

A CURRENCY ECCLESIA

I have, in the past, likened all this to what the currency union now resembles. This modern-day ecclesia was intended to bring the nations together by introducing a common currency. The diabolical trade was to leave finance ministers to their countries' pagan devices – hanging on to their own fiscal policies, a situation that prevented further economic integration and triggered the crisis we have now.

Speaking in financial terms, Europe has two very different camps in terms of saving patterns. The likes of Austrians, Dutch, Germans and Scandinavians have always believed in virtuous economic behaviour. They have entrusted mostly the Bundesbank with the stability of their money, and consequently saved in deposits and paper, and they rented their homes.

On the flip side you find the French, Greeks, Italians, Portuguese and Spaniards, who have historically lived with the much looser monetary policies of their respective central banks and an ensuing inflationary trend. They have been used to owning real assets, such as homes, and justifiably have not shied away from taking maximum leverage. Those two opposing paradigms have been rubbing against each other for the past 17 years of monetary union.

Grave imbalances were only a matter of time. Having adopted one currency, the periphery kept spending as they used to, but had forfeited the one instrument that allowed them to do it, namely the sovereignty over their own fiat money. Germany had innocently traded its Deutschmark for the adoption of Teutonic values within the European Central Bank's (ECB's) monetary policy. It has been a train wreck waiting to happen ever since.

OLD HABITS

Maastricht was well meant, but an illusion to begin with. Deficit spending may have been constrained at first, but not for long. Then the crisis hit, and it transpired that the numbers weren't what everybody thought they were. Most of the old habits had successfully been concealed from Brussels. Berlin still went along, however, as it saw its own political fate as an inalienable part of the larger construct.

Look at debt levels. Germany cast it in constitutional law not to raise its national debt level any further from 2016. On the contrary, budget surpluses are being produced left, right and centre, and government debt has been reduced. Peripheral countries have somewhere between doubled and tripled their debt since the commencement of the currency union, and the trend is just short of going vertical.

SHUTTERSTOCK

Italy and Germany, for example, sport roughly the same government debt, around €2.2 trillion each. Italy's GDP, however, is almost half the size of Germany's. Italy is on track to become the next Greece, only the implications for the eurozone will be much different. All the peripherals have slipped into utterly unsustainable debt-to-GDP territory, anywhere between 130% and 180% in the case of Greece.

Instead of being a unifier of Europe and bringing harmony to the financial conduct of the eurozone nations, as was initially intended, the ECB has been relegated to plugging holes in the ship and a rescuer of last resort.

Its monetary activity ever since the crisis constitutes a prolonged lifeline for incurable cases among its members. ECB president Mario Draghi has thrown every principle of the founding fathers overboard to keep the ship from sinking.

> Instead of bringing harmony to the financial conduct of the eurozone nations, the ECB has been relegated to plugging holes in the ship

INBUILT IMBALANCE

The term 'TARGET2' has been unknown by the wider public and dismissed as a technicality until recently. It is an expression of the balance of payments between a country in the eurozone and the rest of the eurozone. As accounts always have to balance within the eurosystem, or else the entire currency union would collapse, TARGET2 money flows that are being entirely facilitated by the ECB, have the function of adjusting surplus and deficit countries.

Germany's receivables are essentially other eurozone countries' liabilities. Its surpluses are being migrated via the ECB, from the Bundesbank to the likes of Banca d'Italia, leaving the German central bank with implicit government bond collateral on the asset side of its balance sheet. What this means, however, is that Germany is stealthily lending to the periphery in excess of €800bn via the eurosystem, in addition to all other credit exposure.

The interesting part here is that, despite the fact that both Italy and Spain have recently even been sporting

small current account surpluses, their negative TARGET2 balance has been increasingly unchecked, to a level of between €350bn and €380bn each. The ugly truth is that private funds continue to leave the periphery for Germany, by way of capital flight. Bundesbank money needs to replace them at the origin country, at an accelerating path.

The pundits say there is no problem... as long as the eurozone sticks together. To be sure, as long as surplus funds get reshuffled into deficit countries, the system will theoretically function. The questions are: firstly, whether there is a natural breaking point of imbalance magnitudes; secondly, whether political shifts will trigger a disintegration of the eurozone; and thirdly, how long it will take the German electorate to finally figure out the risks and eventually panic.

It is not as easy to point the finger as one thinks. It takes two to tango, and while one side would blame the periphery's overspending and lack of competitiveness, the other might take grievance with Germany's surplus madness, and rightfully so. Currently, enforced Teutonic virtues and policies have Germans relentlessly building up public and private surpluses, and seeing their savings recycled down south.

There, combined with Draghi's quantitative easing (QE), the funds find no productive home in the respective economies and flee back up north again. The more this happens, the more the eurosystem needs to make sure the surplus excesses are sent back to the periphery, and so the wheel keeps turning. The result is that TARGET2 imbalances mushroom, and the Bundesbank sits on ever more worthless collateral.

The dangers for the eurozone keep multiplying. On the one hand, there is an onslaught of national elections that started with the Dutch last month, followed by the French in May, the Germans in September and possibly the Italians some time in between. Imagine for a moment that one of those shifts the balance of political power towards that reactionary populism that could potentially end the union. The consequences would be horrific.

The Dutch have been lucky to keep the ascent of Geert Wilders in check. The sitting prime minister had an aggressively outspoken Recep Erdoğan deliver on a silver platter the perfect excuse to help himself to a public posture that attracted the many undecided who would have likely voted for Wilders onto his side, two days before the polls. However, in the process, he used some of the populist language the establishment has been demonising.

CAPITAL FLIGHT

People do not realise what it would mean if Italy, for example, voted in a government that decided to hold a referendum to exit the eurozone. Just the viability of a referendum would accelerate existing capital flight and increase the TARGET2 imbalances dramatically. One would theoretically have to impose capital controls on the eve of the election result to prevent the system from melting down.

Draghi recently fired a long overdue warning shot, stating that countries would have to settle their TARGET2 liabilities before exiting the eurozone. But it was too little, and much too late. In such a case, Italy would be instantly insolvent, a fact that would only be amplified by the redenomination of its currency and immediate depreciation of it by, say, 50%. We'd enter the mother of all debt restructurings and write-downs in history.

Even Germany, implicitly owed €800bn by the periphery via the eurosystem, and much, much more when the going gets tough, could be rendered insolvent. You do wonder why people think they are hedging themselves against a eurozone break-up when they pay almost 1% as a quasi-insurance premium for parking their money in two-year Bunds. They don't seem to realise that there is no hedge. You can run, but you can't hide.

And now, the US new administration is after the eurozone, and Germany in particular, claiming its export industry is benefiting from an artificially low euro, tempting the Berlin government to cowardly agree and drive another wedge into the ever more fragile union. Also, inflation is picking up, leaving Draghi with fewer and fewer arguments to keep his QE measures going, the only lifeline for the weakest links.

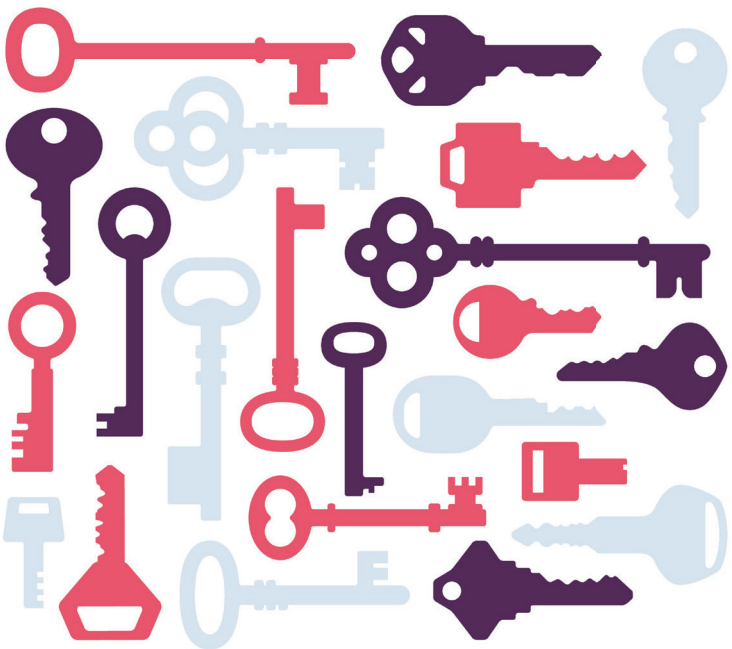
The water in the pressure cooker is boiling hard. It is only a matter of time before the lid flies off.

The pundits say there is no problem... as long as the eurozone sticks together

Roland Hinterkoerner is founder of consulting and online financial publishing business Expertise Asia www.expertise-asia.com

ACT

LEADING TREASURY PROFESSIONALS



UNLOCK YOUR POTENTIAL

ACT Career Hub: Develop the skills to succeed

Did you know that as an ACT member, whether you're in the early stages of your career or an experienced practitioner, you have free access to a wealth of articles, podcasts, videos and eLearning courses to help you develop your professional skills?

Packed with advice for a successful career, you'll also find insights, tips and job vacancies. You can use the hub to build key employability skills and make the most of your own career development opportunities.

Not a member? You can gain access to the ACT Career Hub by signing up for digital membership and becoming an eAffiliate. Find out more at **treasurers.org/eaffiliate**

treasurers.org/careerhub

TREASURY IN EXTREMIS

TURNAROUND SITUATIONS MAY NOT BE DESIRABLE, BUT TREASURERS ARE UNIQUELY WELL PLACED TO OFFER SUPPORT TO COLLEAGUES, COUNSEL TO THE BOARD AND TRUSTWORTHY COMMENTARY TO BANKS. GARY SLAWTHER EXPLAINS

I always sum up treasury in six words: the efficient management of financial risk. As treasurers we spend our lives trying to avoid or mitigate risk to ensure the worst doesn't happen. But what if it does? What if we run out of liquidity or a government nationalises our major overseas investment?

We treasurers can put in place systems and processes and purchase instruments to manage FX exposures and interest rate risks. We can ensure liquidity through reporting and forecasting, and putting in place facilities. But what happens if the forecasting is wrong or omits a risk, or there's just a risk that we can't forecast? What happens to our liquidity and funding if the forecast profitable trading just doesn't happen?

Every so often mismanagement or adverse conditions can start a cycle of losses, and the business hits a downward spiral. Contracts are lost, key people leave, customers go elsewhere, suppliers smell risk and their prices go up and terms reduce. Lenders, working capital providers and equity investors get twitchy – the business needs to be turned around.

The treasurer's position now depends on two things: were you there when the problems occurred or are you a new treasurer just brought in? If you're the incumbent, this can be a good or a bad position: and it's entirely up to you which one. Did you see the crisis coming? What were you doing about it? What were your forecasts and risk management activities based on? Why didn't you highlight problems to management and, if you did, were you forceful or persistent enough?

The absolute essence of being a treasurer is ethics; it is our *sine qua non*. If you're not comfortable with the direction of the business, you are duty-bound to critically appraise plans and strategies, and not just go along with management.

The ACT's ethical code is clear and unequivocal – our duty is to the company, not to individuals or the board, or any class of creditor, but to the entity as a whole. If the company does well, all do well. A successful company has satisfied customers, keen suppliers, motivated staff, banks doing good business and being repaid, and contented shareholders.

IKON IMAGES

The ACT's ethical code is clear and unequivocal – our duty is to the company... the entity as a whole

Disclosure and confidentiality

So the business is in turnaround. If you've been seen to be flagging the issues; if you've been sending out clear messages to the business and the decision-makers, warning lenders of risks, then people will see you were right all along and you will be seen as part of the solution.

However, if you haven't been absolutely straight with the lenders; if you've toed the management's improbable line just for a quiet life; if your integrity is in question, then at the very least your reputation will be damaged, if not totally lain waste.

Of course, openness has to also be balanced with another core element of our ethics, which is confidentiality. We cannot breach a confidence and make disclosures that could harm the entity that employs us. This, again, is a non-negotiable. So how do we balance honesty with confidentiality? What if we feel we have to disclose something, but to do so could jeopardise the business, and what if our concerns and reason for disclosing are wrong?

The balance between disclosure and confidentiality is often a matter of judgement – one of the core qualities a treasurer must have. Identify risks and act appropriately, which may mean seeking advice from colleagues, peers, lawyers or the Archbishop of Canterbury. Taking advice isn't a sign of weakness – it's a sign of good judgement.

So, you're in one of three positions:

- incumbent saviour;
- incumbent problem; or
- brand-new party.

The guiding principles for action are as follows:

Rule one – get control of the cash. Those cash reports and forecasts that subsidiaries used to send in if they could be bothered are now the lifeblood of the business. Invoicing forecasts and statements of payment terms by individual customer and supplier are all needed. And if you don't have the CFO fully behind this effort, shout and shout again.

Rule two – you have to have full control over how much cash you need, when you need it, where you need it and in what form you need it – cash, letters of credit, construction

bond or receivable sale. This is all much easier said than done, and will require hard work and persistence. You won't be able to take these forecasts or requirements at face value; you will need to check and recheck them, validate them, confirm them and challenge them. This will consume time you don't have.

This means long days and longer nights. You'll be in the office before 7am and leaving before 10pm will feel like sloping off early. If you're an interim, make sure your day rate reflects this or quote for an eight-hour day and pro-rata for anything longer.

Rule three – communicate, communicate, communicate (always referring back to 'confidentiality'). The banks will likely have been in the dark for some period, as may the board and shareholders. The board and shareholders may even be new. You have to establish your credibility and that means remedying what will invariably have been a past failing. (If you're new and untainted by the past, you will be granted a honeymoon period. The standard for this, in my experience, is around two hours.)

Rule four – don't forget to be keenly aware of the longer-term goals and strategies of the company. Is the business being streamlined for a trade sale or a further equity raise, or stabilised to resume growth later? Decisions made now will impact on the future. A long-term, committed leasing line may look great now, but could look costly and short-sighted in the future.

Rule five – show leadership towards others – upwards, downwards and sideways. Your staff will be having a torrid time and they're probably getting paid a good chunk less than you; so give them the benefit of the doubt. Assume they know what they're doing and make them believe you know what you're doing. Take some of the pressure yourself; keep the team motivated.

Your peers will probably be a bit shell-shocked and likewise the board. Show them that there's a plan, a route ahead.

Rule six – you're the guardian of the cash, *everything* has to come through you. All decisions that can affect any financial risk have to be approved by you, even at board level. This can feel like an onerous responsibility. What if you get it wrong? What if everyone hates you for it and thinks you're an idiot? Welcome to senior management.

Rule seven – know and understand the business. Learn the commercial operations and how they work. Communicate with your operational and support colleagues. Get to know the legal counsel very well. Without that understanding, you don't stand a chance of knowing the true risks in the business or being able to manage them to the extent that they affect you. You won't know what the business needs – is it trade finance instruments for raw materials, leasing for equipment or credit insurance for receivables financing?

This approach will also build up your network around the business, your early-warning system, as well as generate some goodwill from operational colleagues.

So, are you now equipped for a turnaround? Well, not by anything I write. You have been equipped by the ACT training, its ethical code and your own common sense. Taking on a business in turnaround is undoubtedly stretching and it's a time during which you'll need to hold on to a strong sense of your capabilities.

Good luck.

Gary Slawther is director of Corporate Advisory Resources FZE

GOOD FOR YOU GOOD FOR ME

AN EFFICIENT CASH CONVERSION CYCLE DEPENDS ON PROMOTING A CASH CULTURE – ONE THAT IS FULLY UNDERSTOOD BY ALL PARTIES, INCLUDING SUPPLIERS. BRIAN SHANAHAN SETS OUT THE BASICS OF A STRONG FRAMEWORK

It is very likely that a company that is good at working capital management (WCM) will have effective internal processes. This is usually the case because to be good at WCM requires effective processes. For example, in order to collect cash from a customer, we need a clear customer order, a clean invoice, a good collections process, an efficient dispute process for when things go wrong and a good cash-allocations process for when the cash is collected. Fail on one of these points and it is very likely that you will not be collecting invoices on time and the cost of process will escalate substantially.

Being effective at WCM is a much better way of helping your supply base for a number of very good reasons

It may seem obvious that the faster we can turn our initial cash investment into a product, sell it to a customer and collect the cash from that customer, that we will make more profit simply by churning the same cash investment faster and faster. But many companies do not see the strategic significance of this cycle and find they have high levels of working capital and falling levels of profitability.

Managing this cash cycle well opens up all sorts of strategic opportunities and gives your company a competitive edge on a number of fronts. There is an old saying that the man with cash always has options. In business, this might be the opportunity to fund capital investment and research. It may be the opportunity to acquire new businesses in new markets. It may be that by being more effective in WCM, you are better able to serve your customer base and can take advantage of organic sales growth. And most of all, you can take advantage of funding these growth opportunities without

any of the funding costs that come with borrowings, or share or bond placements. Done badly, your company is unlikely to be operating at optimum performance and will miss out on the kinds of opportunities described above. In a worst-case scenario you may run out of cash and, as Professor Roland Smith used to say, "You only run out of cash once". We have many modern examples of this, such as Woolworths and BHS, so this is not just a theoretical statement.

Putting suppliers first

There are those who would suggest that there may be a need to sacrifice good WCM in order to protect your supply chain. Going down this route can be dangerous, since it will involve your company behaving like an informal bank with suppliers who may not be stable themselves. On top of that, you will be limiting your own opportunities to invest, since working capital will be soaking up valuable cash that is protecting suppliers.

Being effective at WCM is a much better way of helping your supply base for a number of very good reasons. Firstly, if you are the lead in the chain and you are financially secure and efficient in WCM, it makes the entire supply chain more robust, since its lead player has more liquidity. This will probably mean that you will pay your suppliers on time, given that you have no reason to artificially or systematically delay payment. It makes it more likely that suppliers might even be paid more quickly, since you will probably have some kind of supply chain finance facility that suppliers can take advantage of in order to minimise their own working capital exposure. And if all of this is true, then your suppliers will feel more secure to invest in the future, meaning that your company should be able to reap the benefits of your suppliers' efficiencies in the future through better-quality supplies at more competitive prices.

Managing this cash cycle well opens up all sorts of strategic opportunities

One common sign that there might be a problem is if your suppliers continually complain about late payment. For your company, this could be caused by poor invoice-capture processes, slow sign-off procedures for invoices, agreeing short payment terms with suppliers than cannot be fulfilled or slow dispute-management processes. In these cases, the answer is to automate processing as much as possible and to ensure there is proper and timely compliance with authorisation workflows.

But these solutions will only work if it was your company and not the supplier that was at fault. In many cases, late payment is caused by the supplier. Examples would be sending invoices in weekly or monthly batches, issuing inaccurate invoices or sending invoices to the wrong location. The supplier will still complain about late payment, but assume that it is your company that was the cause. This is an even greater reason that you need to have efficient and transparent processes, so that supplier process errors can be highlighted and communicated.

Continuous improvement

One of the biggest issues in recent years is companies that have completed successful working capital programmes that did not sustain themselves. The first thing that should be acknowledged is that fewer than 10 of the world's largest 3,000 companies have improved working capital every year since 1998. There are many reasons behind that. Over time, there will be changes in personnel. This can mean that the experience of the working capital programme is lost. The best companies, in working capital management terms, all have either a working capital director or champion, and possibly a team that is dedicated to sustaining and improving working capital performance.

Another big issue is measurement. You cannot manage those things that you do not measure – and working capital is no exception. Most companies are able to measure working capital at a high level with day sales outstanding, overdues, days payable outstanding and days inventory outstanding, but very few have a drill-down capability to understand what is really driving the numbers every month. The last big thing that can throw the ship off course is events. These could be mergers, acquisitions, changes of senior management or bad publicity for the company. These are all things that can push a company into emergency mode.

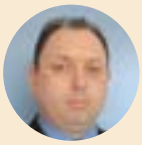
In emergency mode it is common that all the good things about WCM are forgotten about until the emergency is over and then it might be too difficult to return to the pre-emergency norm. This is why people will sometimes talk about a cash culture where senior leaders need to practice what they preach. Working capital performance must be properly incentivised and everyone in the company must understand how their actions impact working capital.

All this is important for suppliers, too. If they have agreed to longer payment terms with the promise of on-time payment or have entered into a supply chain finance arrangement, the continuity of those agreements and your company's capability of fulfilling them is vital. All treasurers understand that the continuity of stable liquidity is vital to the effective WCM of a business. If suppliers are relying on that liquidity from their customer relationships, it is vital that your company lives up to its promises. If not, suppliers will seek deeper relationships elsewhere. That will mean that future price decreases will go to competitors; when a product is in short supply it will go to the opposition and there is very little likelihood of suppliers engaging with R&D activity.

Good WCM is not just about dressing up your balance sheet and sticking it to the supply base. Good WCM is about maximising the opportunities for investment and cooperation across the supply chain, not for just one company in the chain. There have been many studies over the years showing that supply chains that work together are far more profitable than those that behave in adversarial mode. In a well-oiled working capital machine, everyone gets a share.

SHUTTERSTOCK

Brian Shanahan is founder of working capital and procurement consultancy Informita and was a speaker at the ACT's Smart Cash Conference

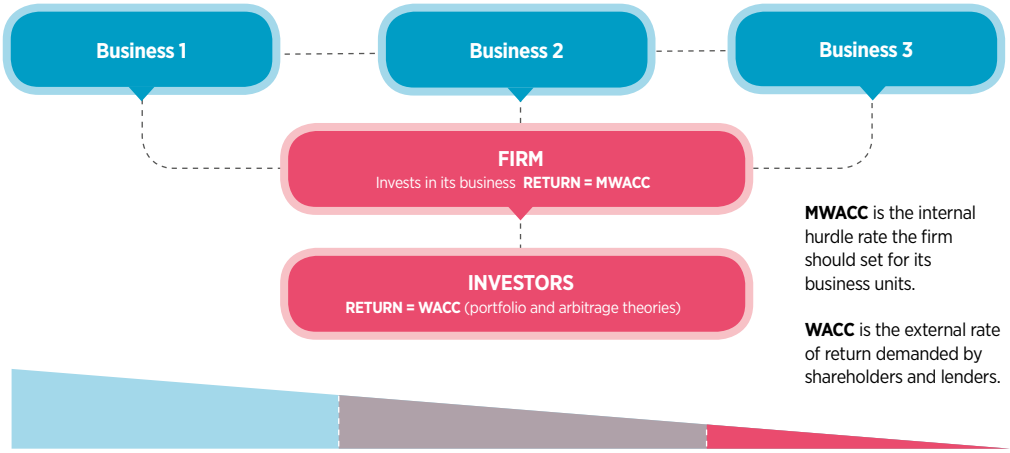


THE LURE OF **RETURNS**

CORPORATE FINANCE PRINCIPLES ARE POORLY UNDERSTOOD IN THE CORPORATE WORLD, TO THE DETRIMENT OF VALUE CREATION. IN PART ONE OF A THREE-PART SERIES, BEN WALTERS ELABORATES

FIGURE 1 HOW MWACC IS THE CORRECT HURDLE RATE FOR THE FIRM'S INTERNAL INVESTMENT DECISION

- Shows external investors passing the firm the message through their valuation that the business opportunity has the ability to produce an internal rate of return (IRR) of just under 15% on the 100 of capital available to it.
- By discounting this return at the WACC of 7.5%, investors arrive back at the firm's valuation of £17.5. If the business only produced an IRR of 11% on its capital, the firm's valuation would fall to £8.59 and the investors would have lost value, even while the business had produced a WACC-beating return.
- Investors would have overestimated the strategic position of the business and the returns it can make. Lastly, an IRR of 3% destroys both the investors' and the business's value despite still producing an accounting profit.
- A positive return above WACC on the business assets will of course still create value, but unless this beats MWACC, it will not create enough value to justify the external market's assessment of the level of return the business should be able to produce from its strategic position.



Return > MWACC	MWACC > Return > WACC	Return < WACC
Business creates value	Business creates value	Business destroys value
Firm creates value	Firm loses value	Firm loses value

	CASH FLOW	P&L	CASH FLOW	P&L	CASH FLOW	P&L
Investment (T0)	**(100)**		**(100)**		**(100)**	
t1	30	10	27	7	22	2
t2	30	10	27	7	22	2
t3	30	10	27	7	22	2
t4	30	10	27	7	22	2
t5	30	10	27	7	22	2
IRR	**15%**		**11%**		**3%**	
NPV	**£18.00**		**£8.59**		**£10.22**	
Investors gain/(loss)	**£0.50**		**(£8.91)**		**(£27.72)**	
Cumm acc profit		**48**		**35**		**10**

MKT VALUE OF FIRM	**£17.50**
WACC	**7.50%**
MWACC	**15%**

It is a strange paradox that corporate finance can be surprisingly irrelevant in the corporate world. One reason for this is the concept of risk-weighted returns stretching off into the future, which isn't the most natural concept to grasp. Earnings in a discrete period are intellectually manageable, far easier to measure and, therefore, reward.

There are other reasons. The academic side of corporate finance has an unsatisfactory tendency to have no 'right answer'. What's more, in practice, discounted cash flow (DCF) evaluations inevitably involve the heavy use of assumptions; layered on top of each other, the result can feel unrealistic and superficial. It is very easy to arrive at the result you want to with just small tweaks to assumptions and the hurdle rate (how many DCF evaluations ultimately disagree with the CEO's opinion?). 'Value creation' is trotted out by all and sundry as the corporate holy grail, but it is incredibly difficult to measure and reward it.

Returns required from the capital the firm invests back into its business are often not linked to the value the market assigns to the firm's strategic position, and therefore expects the firm to achieve[1]. Additionally, there's a natural conflict in most DCF analysis; sponsors always present a winning case to decision-makers who mark up the discount rate in retaliation. The process often loses credibility under pressure from these influences.

The result has been the slow uptake of DCF in the corporate environment[2], and even today it is poorly understood and unimaginatively applied in many firms. Corporate finance should be at the heart of how firms think, report and incentivise. It is a genuine failure to date that the business world has not been able to bridge the gap between theory and application in a manner that makes corporate finance the driver and ethos of the firm's financial strategy.

IKON IMAGES

The aim of this article, the first in a series of three, is to suggest a way forward, provoke a debate about the role of corporate finance in the commercial environment and open up the black box to genuine commercial applications.

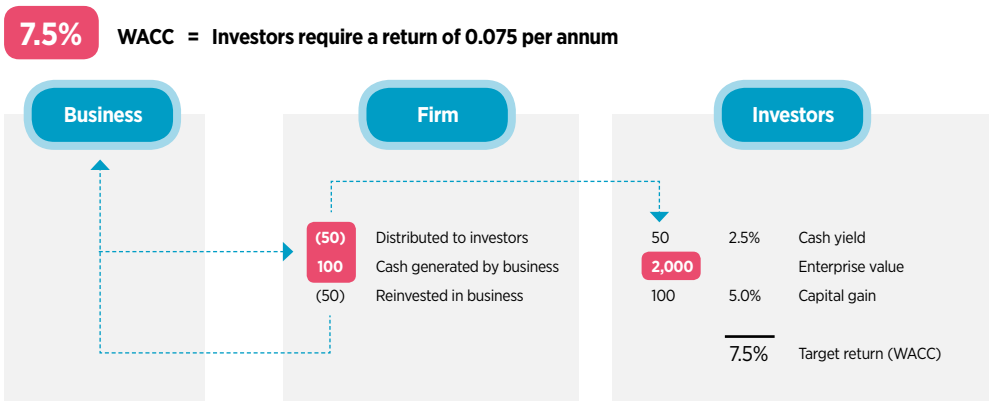
Let's start with something a little controversial...

The hurdle rate = WACC?

Wrong! I strongly believe that the weighted average cost of capital (WACC) is not the right hurdle rate to use for investment decision-making *within* the firm for two reasons:

FIGURE 2 MWACC IN VERY SIMPLE FORM CAN BE DERIVED FROM THE EASILY AVAILABLE INPUTS (HIGHLIGHTED IN MAGENTA)

- The firm is committed to return 50 to investors (dividends and interest), has a current enterprise value (EV) of 2,000 and measures WACC at 7.5%. The business generates 100 of cash before any reinvestment.
- So, after returning cash of 50 to investors, the firm has 50 to invest in the business.
- It must create a capital gain (increase in EV) of 5% from this investment in order to return 7.5% to investors overall.
- The capitalisation rate on 7.5% (the risk-adjusted rate of return for this business's assets) of 13.3 and dividing the target capital gain of 100 by this gives an annual cash-flow target of 7.5. This is the annual return the firm must demand from its investment in the business in order to justify its EV today.
- The target return as a percentage then is 7.5 over the capital reinvested of 50, which gives a result of 15%. This is the firm's MWACC™.



Reinvested cash into business	50
Target positive NPV from investment	50
Target capital gain	100
Annual return required from investment	7.5

(This is equivalent to a 100 of cash today expressed as a perpetuity @ 7.5%)

Return % $\frac{7.5}{50.0}$ = **15.0%**

SEVERN TRENT WATER AND THE WACC

Allowed revenues = Totex (opex and capex) + Return of capital (depreciation) + Tax + Return to capital

Severn Trent Water (STW) is a FTSE 100 water and sewerage company serving around 4.3 million customers in the English Midlands and parts of Wales. The company is a regulated monopoly provider and is subject to five-yearly price reviews that determine the revenues we can collect from customers. The current price control period (called AMP6/PR14) runs from 2015-2020.

At each price review, Ofwat, the industry regulator, calculates our allowed revenues using a building block approach. This involves calculating the revenues an efficient company needs to operate its assets and finance its operations.

One key component is the return on capital, which is calculated by applying a weighted average cost of capital (WACC) against the regulatory asset base (known as the RCV in the water sector).

The WACC is a core element influencing the financial strategy in the water industry. Ofwat uses a traditional capital asset pricing model to set the WACC. Ofwat sets a vanilla real WACC of 3.6% per annum for AMP6 based upon an assumed gearing for a notional water company of 62.5%. This is significantly lower than the 5.1% per annum allowed return in the previous price control period (notional gearing of 57.5%).

The WACC plays an important role in the development of our financing and business strategy. At the time of the last price review, detailed financial modelling was undertaken that considered various scenarios, sensitised for changes in inflation (a key element of the company's revenue and costs) and interest rates. The focus of the modelling was to assess the impact of the business plan upon key metrics, including earnings, dividend cover, credit metrics and debt covenants.

The modelling allowed STW to set an appropriate financial strategy commensurate with a sustainable investment grade rating and to communicate its dividend policy for a five-year period to 2020.

Once the business plan has been set, the focus of the company is to outperform the WACC and other assumptions. This allows STW to generate returns above the WACC. In AMP6, there are three sources of outperformance (or underperformance):

1. **Total expenditure (TOTEX) outperformance** – this involves achieving efficiencies through a focus on the cost structures, for example, through savings in the supply chain and identifying more innovative ways to deliver services.
2. **Financing outperformance** – this is achieved through financing the business efficiently and sustainably. Since 2015, STW has taken advantage of low interest rates and secured new funding from the European Investment Bank, the bank market, US private placement and the sterling bond market.
3. **Output delivery incentive outperformance** – this is a new incentive regime introduced by Ofwat where the company is rewarded or penalised if it achieves or fails to achieve certain key operational targets. For example, reducing the number of incidents of internal sewer flooding.

Outperformance enables STW to generate additional returns, which it can invest in its networks to improve its service to customers and which it can return to shareholders.

***Nick Corker** is assistant treasurer and **Shane Anderson** is head of regulation, Severn Trent Water*

1. Part of the firm's value derives from its strategic position; and
2. The capital available to any firm is, in reality, limited.

Strategic position creates or destroys value. Finding a niche, a product, a market, a place in the supply chain that gives you an advantage and creating the tools to defend that for as long as possible creates a nebulous thing called value. It's sometimes a tenuous process, but markets look at the cash flows they expect a firm to be able to generate over a long period of time from this strategic position. They then discount them at WACC to arrive at a fair value for the firm. This is almost never the value of the firm's existing cash flows valued as a perpetuity.[3] The difference, the gap, is the value of the firm's strategy. So a firm's value is both today's cash flow as a perpetuity *and* future value from opportunities the firm hasn't even invested in yet, but which will derive from the strategic position the firm occupies.

Capital availability is not a controversial subject at all. For most firms, the supply of capital is a mixture of retained cash flow after shareholder returns and any change in levels of debt. As treasurers, we are well aware that debt capacity is finite with covenants, management time and credit ratings, all limiting its availability. Very few firms go out and raise equity unless they are start-ups or in financial difficulty. Capital for reinvestment in the business is limited to all intents and purposes.

Now combine the value assigned by the market to the firm's strategic position with the limitation placed on capital for reinvestment and there is a logical outcome: the firm has to reinvest its limited sources of capital at a certain rate of return to realise this value. This rate of return is the true hurdle rate for the firm, and I am going to call it MWACC[4]. A return at less than MWACC will destroy the value of the firm (ie its current worth), even though it is perfectly possible that it creates value in absolute terms (ie when compared to WACC). Returns greater than MWACC increase the firm's worth and create value for shareholders. MWACC is always higher than WACC where investors view the firm as having some strategic value. Figure 1 shows this graphically (see page 35).

MWACC

But is the MWACC secret out of the bag already? Is it just that the academic and corporate worlds haven't identified it or come up with a way of measuring it until now?

WACC is very rarely the internal hurdle rate set by the firm because:

1. Statistical and complex adjustments such as coefficients to emerging markets, oil, small firm bias and so on adjust basic equity and WACC on the grounds that this gets closer to a theoretically true position of the cost of capital.[5]
2. A lot of corporates simply add a few % to adjust for 'risk' (such as knowing that project sponsors will have inflated the cash flows).
3. Corporates also know they cannot take on every net present value (NPV) positive project because capital and management time is limited, so they adjust the hurdle rate to cherry-pick the best projects.

Embracing the concept of MWACC into the corporate environment builds trust with the business because everyone can see where the hurdle rate is coming from. Intuitively, the drivers for the gap between MWACC and WACC, such as strategic position and available capital, make perfect sense. This meshes instinctively with the views of many people tasked with the actual job of making investment decisions. Furthermore, this situation reflects the reality of business; if you are in a better position than your rivals, the market will expect the firm to make better returns on its invested capital compared with those rivals. The better a firm's strategic position, the greater value placed on it by the market, the higher the MWACC will be. There is no such thing as a free lunch.

Having identified here the correct hurdle rate to use within the firm, in future articles we look at MWACC's implications for the firm's payout decision, and how it sets and appraises management's performance in creating value. Both areas, with the addition of MWACC-style thinking, can substantially increase the firm's value.

1 Who has sat through teachings on DCF where there has been anything more than little or no connection to a firm's strategy?
2 'Evolution of Financial Indicators', p532, *Corporate Finance Theory and Practice* (3rd edition), Vernimmen et al.
3 Even growing the perpetuity at inflation rarely gets close to the value placed on many firms. However, many industries may not even be considered perpetuities.
4 The term MWACC is trademarked to the author, Ben Walters.
5 In the author's humble opinion, no one has the right answer, and the myriad and confusing array of adjustments bandied about is a distraction from the real job of analysing the investment itself.

Ben Walters is deputy treasurer at Compass Group

CHINA'S **ENERGY** QUEST

WITH CONTINUING INTEREST IN CHINA'S GROWTH PROSPECTS, FLORENCE EID-OAKDEN EXPLORES ITS INCREASING RELIANCE ON IMPORTS FROM THE MIDDLE EAST AND NORTH AFRICA

SHUTTERSTOCK

Since 2000, China's dependency on imported oil almost doubled from 30% to 57% and its reliance on imported crude will continue to grow. Since 2013, China has become the world's largest net oil importer, overtaking the US by as much as 1 million barrels per day (bpd) in 2014. And since China imports more than 50% of its crude from the Organization of the Petroleum Exporting Countries (OPEC), its oil dependence is enough to become a cause for concern on national security grounds.

China has sought to diversify its energy portfolio across geographical regions. Crude imports from Iraq, Oman and Russia have surged relative to those from Saudi Arabia and Iran, while China's use of loan-for-oil deals has strengthened its hand vis-à-vis OPEC producers.

China has started paying in renminbi for crude imports from two key suppliers: Russia and Iran. But it will take time before the petroyuan is accepted by the entire MENA region.

Diversification

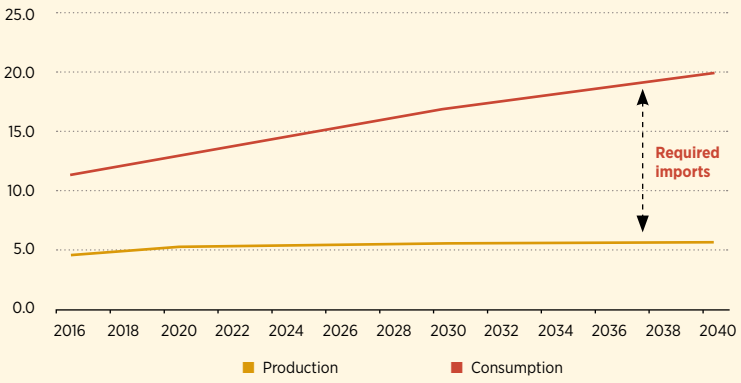
China is projected to import 8 million bpd by 2020 and 11.4 million bpd by 2030, compared with 7.6 million bpd in May 2016 (see figure 1, below).

In October 2015, OPEC's share of Chinese oil imports stood at 55%, down from 68% in mid-2012, with Saudi Arabia's share falling from 20% to 16%, and Iran's from 9% to 6% respectively. The relative decline is partly checked by the rise in imports from Iraq and Oman, which accounted for 10% and 12% of China's imported oil in October 2015, respectively. China is already the largest foreign investor in the Iraqi oil industry, holding substantial stakes in an oilfield in Kurdistan and in Al-Ahdab, Rumaila, Halfaya and West Qurna 1 in the south. In a move to further secure energy supply, China is also actively expanding Port Tripoli, Lebanon, as well as Port Said, Egypt. Port Tripoli is on the receiving end of the Mosul-Haifa oil pipeline (now defunct), whereas Port Said hosts the Damietta-Port Said gas pipeline, which is operational.

In South Sudan, Beijing has also committed diplomatic capital, including more than 700 Chinese troops as UN peacekeepers, to mediate the country's civil war, and protect its 120,000 bpd of crude supplies. China's growing interests in MENA will result in a gradual expansion of its political involvement there, but not in ways that constitute major departures from its non-interference policies, which have been the cornerstone of Chinese foreign policy.

Another noteworthy development is the dramatic rise in Russia's market share vis-à-vis Saudi Arabia and Iran. China's Russian oil imports grew 3% annually to about 810,000 bpd in the first nine months of 2015. Loan-for-oil deals are a key driver

FIGURE 1 China's projected oil demand and supply (m, bpd)



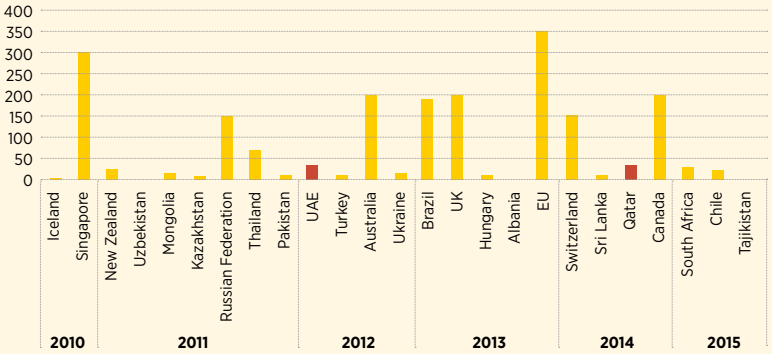
of the oil trade growth between China and non-MENA producers. From 2009, China's loan-for-oil deals with Angola, Russia, Venezuela and other producers amounted to $45bn, contributing to 30 million tonnes of crude reaching China annually.

As the oil price remains sluggish, loan-recipient countries are required to export more crude to China in order to repay the given amounts of loans. Nonetheless, MENA oil producers can take comfort from the fact that Chinese enthusiasm for loan-for-oil deals has been somewhat dented, as credit risks loom large for its loans to Venezuela and Angola.

China's strategic petroleum reserve boasted 400 million barrels in total in June 2016, still 200 million barrels short of its 2020 target. While Chinese diversification will remain a potent force in the oil market, we expect the Middle East to remain China's top choice in the short to medium term at a time when the pie of Chinese demand is growing. In May 2016, Saudi Arabia, Iran and Iraq's crude exports to China soared by 33.6%, 19.5% and 56.6% year-on-year respectively, albeit against Russia's 52.4%.

One major factor is that Beijing has been actively substituting coal with oil and gas as part of its environmental drive to cap coal use at 62% of total energy consumption by 2020. In addition, Chinese refineries' preferences for the Gulf Cooperation Council's medium to heavy grade, to which their production lines are catered, will mean China's demand for Saudi oil will remain inelastic for some time to come. More broadly, Chinese diversification will not imply its absence in the Middle East and North Africa. Combined, the two regions are home to half of Chinese companies' overseas oil production, a showcase of the country's continued interest in oil trades with these regions.[1]

FIGURE 2 Bilateral swap agreements (renminbi, bn)



Crude to China, yuan to MENA

Being the world's largest trading nation and net importer of crude oil, China would also naturally desire to make at least part of its oil payments in renminbi. Beijing hopes that the rise of the petroyuan will provide a stable anchor to the value of the renminbi, thereby establishing the renminbi as a global reserve currency. China has already been paying part of its purchase of Iranian oil in renminbi as early as 2012, as Iran sought to get around Western financial sanctions.

In 2015, Qatar became MENA's first hub for clearing transactions in renminbi, following a $5.7bn currency swap with the People's Bank of China in 2014 (see figure 2, above). Concurrently, China and the United Arab Emirates (UAE) renewed their currency swap agreement in December 2015, leading to a swap line totalling $5.2bn. The petroyuan would not be aided by Qatar and the UAE, however, as evidence suggests; renminbi clearing is likely to first start with non-oil trades.

In the wake of Western sanctions, Russia has also accepted selling oil to China in renminbi. While sanctions only target individuals and businesses, Russian officials are vigilant to the risk that they could one day be shut out of the dollar-based international financial system. Gazprom Neft, Russia's third-largest oil producer, has reached the stage of selling all of its China-bound crude in renminbi from mid-2015, whereas Rosneft, the largest producer, has received renminbi credit from Russian state banks. Russian embrace of the renminbi largely contributed to its capture of Chinese oil market share at the expense of Saudi Arabia for the second time, in the first five months of 2016. However, Saudi Arabia retook the top spot in June, as it intensified price competition and, for the first time, sold a spot crude cargo of 730,000 barrels to an independent Chinese refiner.

The fight for market shares on the currency front will continue, although Russia would not wholeheartedly underwrite the rise of the petroyuan should Western sanctions be relaxed.

Far from being content with making oil payments in renminbi, China also wants to launch its own crude futures benchmark later this year in the Shanghai International Energy Exchange, in its bid to rival Brent and West Texas Intermediate. China has long complained about the so-called 'Asia premium' caused by the Middle East's formula-based pricing, which results in Asian countries paying on average $1.20 per barrel more than Europe and the US since 1988.[2]

Currently, the price of Asia-bound crude is determined by the average of Platts Dubai Crude and Oman Crude benchmarks, which do not accurately reflect Asian crude supply and demand.[3]

With limited convertibility, renminbi-denominated crude futures contracts are unlikely to be popular among oil traders, although perceptions might change upon further financial liberalisation of China. Overall, although China's thirst for imported crude continues to grow on the back of rapid economic growth, the ascent of renminbi-denominated oil will take time unless renminbi develops sufficient appeal as a global reserve currency.

In the short to medium term, Beijing envisages the renminbi as a regional currency in Southeast Asia and Central Asia, knowing full well that the petroyuan will not have enough allure among MENA countries at this stage. Looking into the future, Beijing aims to establish the renminbi not against the dollar, but alongside it as part of a global multi-currency regime. This implies that China will be content to pay MENA countries in both the petroyuan and the petrodollar in the long term.

1 US Energy Information Administration
2 Arabia Monitor; People's Bank of China
3 S&P Global

Russia has also accepted selling oil to China in renminbi

Florence Eid-Oakden is chief economist at Arabia Monitor, a research and strategy advice firm with a focus on the Middle East and North Africa

A CLEARER FOCUS

THE IMPORTANCE OF AN EFFECTIVE FX RISK MANAGEMENT POLICY IN TODAY'S PARTICULARLY VOLATILE ECONOMIC LANDSCAPE REQUIRES A BROAD PERSPECTIVE AND CLOSE COMMUNICATION WITH THE BOARD. YURI POLYAKOV AND ASHLEY GARVIN EXPLAIN A REFOCUSED APPROACH TO HEDGING

SHUTTERSTOCK

Right now, many businesses are facing a new kind of financial risk. While currency volatility is an age-old concern for treasurers, unusually sharp fluctuations in the valuations of formerly dependable G10 currencies are proving challenging.

Driven largely by political events such as the EU referendum result in the UK and the election of Donald Trump in the US, such movements are interwoven with and influence other factors, such as commodity, inflation and credit risk. Indeed, these seismic geopolitical events make it increasingly important for treasurers to be able to assess the full scope of risk when managing FX or even seeking to optimise working capital.

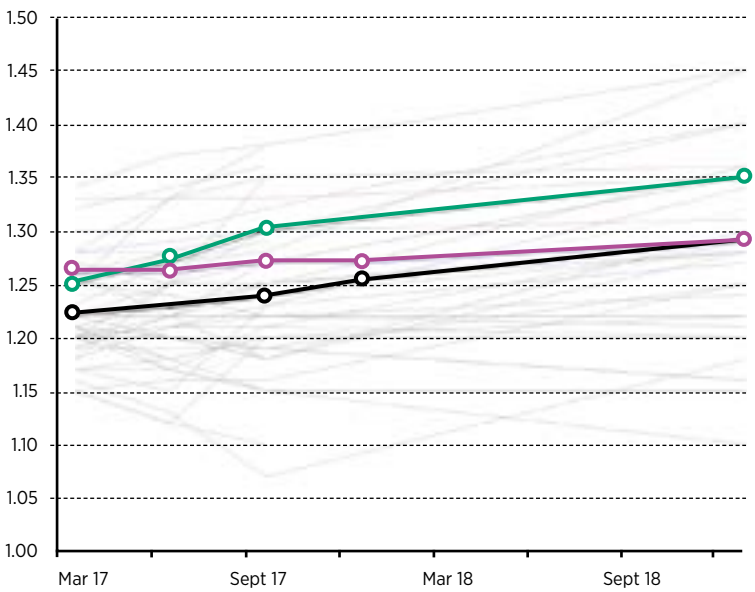
While UK net exporters may express a positive view of sterling's relative lack of strength, net importers are feeling the pressure. Many retailers, for example, are witnessing heavy margin compression under such conditions (amplified by increasing competition and changing consumer behaviour, for instance).

Moreover, calmer waters are not expected to return any time soon. With the triggering of Article 50, and the forthcoming election in Germany potentially throwing markets another curveball, the headlines throughout 2017, and beyond, will almost certainly be dominated by increasing market volatility. Managing risk caused by these 'known unknowns' is becoming more important than ever.

The changing risk landscape

Corporates are exposed to a range of different event risks that can impact performance, including strategic, compliance, operational, reputational and financial. The ability to respond to increased risks in these is typically slow and requires broader organisational changes. Nonetheless, not all is lost as financial risks stand out as a class of risk that can be managed with more speed and less organisational friction than the other. As a result, corporates may wish to review and apply a new risk-tolerance threshold against the way that they currently manage a broader set of financial risks, such as FX, interest rates and credit.

FIGURE 1: PROJECTED GBP/USD



Please note: for illustration purposes only. Forecasts may not be achieved
Source: Bloomberg data as of 1 March 2017

Existing hedging book, new challenges

They may also wish to revisit their current hedging practices, even if they have been successful in mitigating downsides throughout previous bouts of volatility.

For example, given the economic responses to recent variables, such as geopolitical, regulatory, macroeconomic and market competition risks, there has been a move away from stable hedging rates for GBP/USD of the past few years to new levels.

Corporates that had been using longer-term hedging strategies (so those adopting a rolling layered approach that saw them hedge incrementally lower percentages over consecutive quarters) were able to achieve stable levels over 2014/2015*.

*SOURCE: LLOYDS BANK ANALYTICS AS OF FEBRUARY 2017

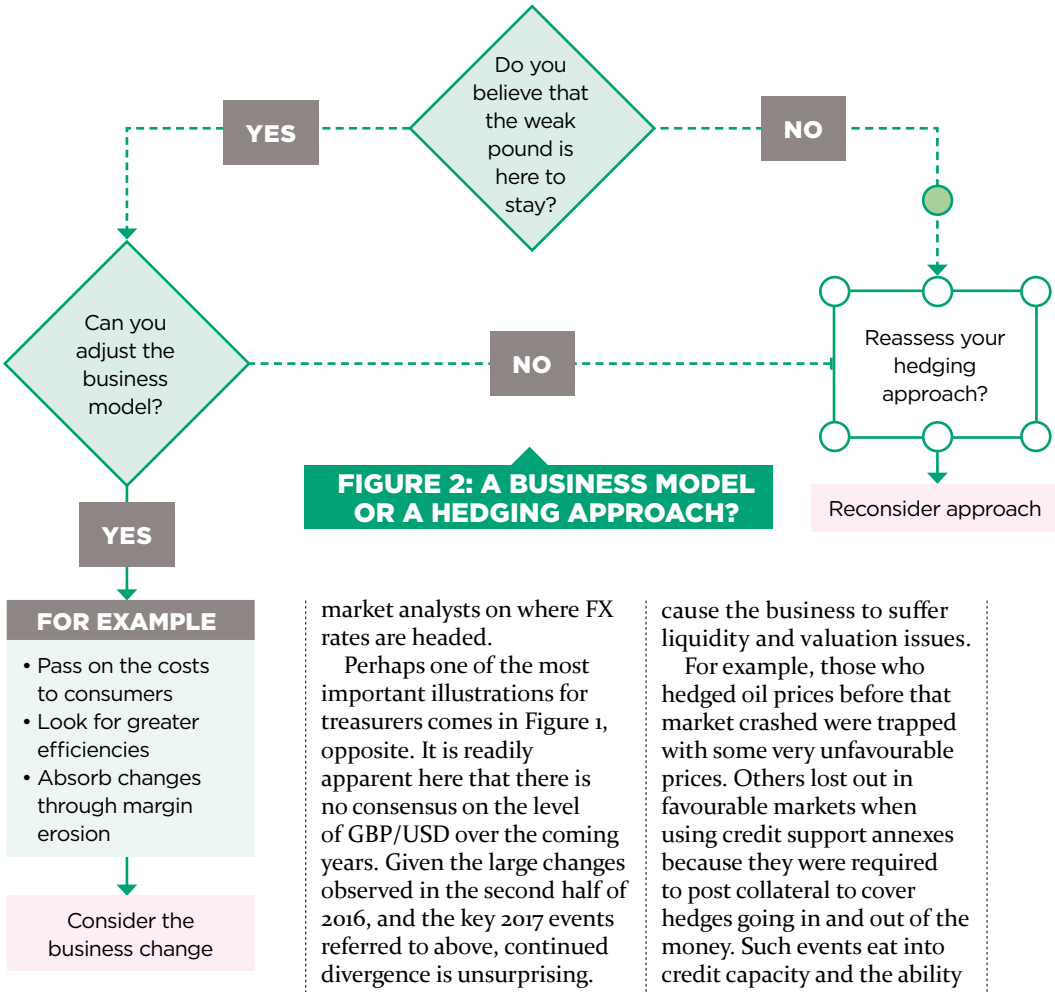


FIGURE 2: A BUSINESS MODEL OR A HEDGING APPROACH?

However, since the UK referendum result, unidirectional volatility has been progressively pulling hedges lower. So, while that layered strategy may have slowed the impact of falling rates on these businesses, hedging levels are now starting to affect them. In addition to this, the nature of this type of strategy would lock the company into adverse rates if sterling were to recover substantially.

No agreement

Yet building out that new strategy comes with certain challenges. For those who are not immersed in the research, there may not be full appreciation of the degree of disagreement among market analysts on where FX rates are headed.

Perhaps one of the most important illustrations for treasurers comes in Figure 1, opposite. It is readily apparent here that there is no consensus on the level of GBP/USD over the coming years. Given the large changes observed in the second half of 2016, and the key 2017 events referred to above, continued divergence is unsurprising. Although the forecasts show an expectation of general recovery in GBP/USD, there continues to be a sizable range of outcomes from the 53-strong bank panel (1.45-1.10) up to 2019.

It is difficult to avoid taking a view of where markets may head, but whatever their strategy, treasurers need to be clear about the impact of their chosen path, especially if it ends up veering off course.

In other words, the chosen strategy may be very effective in protecting the business if the market behaves as expected. If it takes an unexpected turn in the direction of something the company did not initially need to be protected against, however, a rigid strategy could cause the business to suffer liquidity and valuation issues.

For example, those who hedged oil prices before that market crashed were trapped with some very unfavourable prices. Others lost out in favourable markets when using credit support annexes because they were required to post collateral to cover hedges going in and out of the money. Such events eat into credit capacity and the ability to re-hedge.

The next step

The question of how to respond, with sterling at historical lows, could find an answer in the flow chart of Figure 2, above, where planning for either business model or hedging approach adjustments could suggest a course of action.

An action plan

Above all, corporates need to take a flexible approach to risk strategy so that when the market reality changes, strategy keeps pace. Treasurers must therefore step up the level of communication so that C-suite and board-level stakeholders are fully cognisant, not only of a broad sweep of specific risks faced by the business, but also of the strategy applied to help mitigate such risks.

But it also means treasurers should seek the approval of senior executives when confirming new strategies, or reaffirming existing ones, in the light of expected continued turbulence. Furthermore, it is essential to communicate the approved risk strategy and its expected outcomes to investors and other stakeholders. Informing and educating in this way helps to manage their expectations. It does this by demonstrating that there will likely be controlled impact rather than complete mitigation of any risk, should the market behave in a certain way.

In the current volatile economic and geopolitical environment, it is apparent that in order to manage against a weak pound, corporates may need to re-evaluate and at times change their approach to managing FX and other financial risks. The measures taken may be achieved either within policy or by gaining a temporary policy exception, granted under extraordinary circumstances.

Treasurers now have a duty to bring their knowledge and expertise to bear on a wide range of issues and know that their role now includes communicating these issues to senior executives and the board to gain the highest level of approval; a case of when there's trouble on the bridge, be sure to call the captain.

Treasurers should seek the approval of senior executives when confirming new strategies

Yuri Polyakov is head of financial risk advisory and **Ashley Garvin** is director, financial risk advisory, Lloyds Bank

LLOYDS BANK

A crash course in making CFO

HOW CAN TREASURERS BOOST THEIR CHANCES OF CLIMBING TO THE TOP OF THE FINANCE TREE? SALLY PERCY SPILLS THE SECRETS OF SUCCESSFUL FINANCE LEADERS

Not every treasurer hankers after the CFO's job, but many wouldn't rule it out. And neither should they. After all, the route from treasury to the executive suite is relatively well trodden.

Former treasurers who went on to hold the top finance job include Nick Luff, CFO of information provider RELX, Teri List-Stoll, CFO of clothing company Gap, and Keith Nichols, former CFO of chemicals giant AkzoNobel. Other finance leaders may not have had the title of treasurer, but still held treasury responsibilities, such as Paul Edwards, group FD at transport operator The Go-Ahead Group.

Commit to personal growth

Ronan Dunne, executive vice president and group president at US telecommunications giant Verizon Wireless, held treasury roles early in his career. When I interviewed him for my book, *Reach the Top in Finance: The Ambitious Accountant's Guide to Career Success*, he explained that he initially studied treasury qualifications while he was working in banking because he saw them as a way to build knowledge and network with corporate treasurers.

Little did he know then that those qualifications would be a crucial step in a journey to the very top of the British business world. Following a stint in treasury, Dunne was head of strategic finance at logistics operator Exel before working his way up to become CFO, then CEO of Telefónica UK, part of the Spanish multinational communications group Telefónica.

Dunne explains his success like this: "I always had the mindset in my career that I am on a journey," he says. "So I am looking for interesting things that stretch me and help me to develop my knowledge. I have seen every role as a developmental opportunity and a learning opportunity, not just as a job, and I was always very open-minded about where I might find myself."

Ultimately, the more open-minded you are, the more likely you are to be receptive to new experiences that enhance your knowledge base and enable you to grow as an individual.

> The more open-minded you are, the more likely you are to be receptive to new experiences

Tear up the career plan

Julie Brown, now chief operating and financial officer of luxury fashion house Burberry, believes that what she calls the 'ABC of success' has been instrumental in helping her get to where she is today.

"The 'A' stands for ability – your own ability to learn so that you're knowledgeable in your area of responsibility," she explains. "The 'B' stands for bravery – being willing to take opportunities when they present themselves and willing to take the risks associated with those opportunities. The 'C' stands for chance – senior positions are often about being in the right place, at the right time, and seizing the opportunity."

In her own career, Brown has applied the ABC of success principles over and over again. After qualifying as both a chartered accountant and a chartered tax adviser with KPMG, she did a secondment as an interim FD that gave her a taste for life in industry. She then joined ICI as the finance head for R&D and ended up staying with the company (which later became Zeneca, then AstraZeneca) for 25 years.

During that time, she held 11 different roles, in four different countries, and she gained experience in both finance and general management, albeit not specifically in treasury. She puts the breadth of expertise she gained down to her managers being prepared to take risks on her and she herself being prepared to take risks and seize the opportunities that came with them.

Brown's big break came when she was made AstraZeneca's interim CFO during a period of transition for the management team. This role put her firmly onto the headhunters' radars and she moved to medical equipment manufacturer Smith & Nephew as CFO in 2013, then to Burberry earlier this year. Interestingly, she says she "never had a plan to become a FTSE CFO". Instead, her plan "was to broaden my experience base and learn from the best".

SHUTTERSTOCK

Take the rough with the smooth

Resilience is another important attribute for would-be CFOs, as Andrew Bonfield, group FD of National Grid, knows only too well. He was appointed CFO of FTSE 100 pharmaceutical company SmithKline at the age of 36, but lost the job soon after when the business merged with rival Glaxo.

"I had to go through a set of merger discussions where I was not going to be part of the new company," he recalls. "That was hard and it was a learning experience having to go through it. After the merger discussions, senior bankers from the other side came up to me and said: 'You did a great job.' That stuck with me."

Later in his career, the arrival of a new CEO resulted in him leaving his job as CFO of US pharmaceutical company Bristol-Myers Squibb. He was also CFO of confectionary group Cadbury when it was taken over by US food giant Kraft.

It seems that being philosophical about moving on is the only way to survive the brutal uncertainty that comes with holding a senior finance role – that and not falling into the trap of taking the position for granted. "You know it's going to happen," says Bonfield. "It's part of your job."

The value of treasury

Not all the finance leaders that I interviewed held treasury qualifications. But those who did, or who had some experience of practising treasury, believed that it was a very valuable skill for a would-be CFO to have. For example, David Tilston, interim CFO of drug manufacturer Consort Medical, says that his MCT gave him an "extremely good toolbox of techniques and skills, plus experience in the classroom of dealing with ambiguity and complex situations".

So if you're a treasurer who wants to reach the top in finance, take heart from the fact that your skills and experience will certainly stand you in very good stead. But don't forget that what you do with those skills, and how far you get them to take you, is entirely down to you.

HOW TO REACH THE TOP IN FINANCE

What should you do to increase your chances of career success? Read our tips from leading CFOs:

"As you move through your career, it is important to take on different roles and build up your all-round experience."
David Tilston, interim CFO, Consort Medical

"People invest so little time in their own careers. They expect their employer, or HR, or somebody else, to manage their career. But the only person responsible for your career is *you*. My career has not been a straight line of always successful, but I have always put myself in a position to be lucky."
Ronan Dunne, executive vice president and group president, Verizon Wireless

"International experience is a must. The world is increasingly mobile, open and transparent, and most large companies compete on a global scale."
Julie Brown, chief operating and financial officer, Burberry

"Complacency is your biggest enemy. If you assume that everything that goes well is down to you doing a good job, and you're not aware of what could go wrong, then potentially you are setting yourself up for failure."
Andrew Bonfield, group FD, National Grid

Sally Percy is a freelance financial journalist and author of *Reach the Top in Finance: The Ambitious Accountant's Guide to Career Success*

Readers of The Treasurer *can get a 30% discount on the book if they order it from www.bloomsbury.com and quote FINANCE at the checkout*

TOO MUCH CHOCOLATE?

UNDERSTANDING AND MANAGING THE CASH CONVERSION CYCLE IS VITAL FOR ALL ORGANISATIONS, AND AN ESSENTIAL SKILL FOR TREASURERS. DOUG WILLIAMSON SHOWS HOW EFFECTIVE MANAGEMENT CAN RELEASE MUCH-NEEDED CASH AND BOOST LIQUIDITY

As a treasurer you are not only responsible for investing cash safely. You also need to understand the cash conversion cycle (CCC), and its fundamentally important role in operations. In simple terms, the CCC reflects our efficiency in managing inventory (stock), receivables and payables. We'll start with inventory, as it's the easiest to visualise.

LISTEN TO THIS FREE WEBINAR RECORDING

Managing working capital in a rapidly changing environment – challenges and opportunities in 2017. www.treasurers.org/manageworkingcapital

Chox Group

Let's take a simple example. Say we all work for Chox Group. Our business is buying and selling chocolate. We also hold inventories of chocolate.

We'll have to pay for the chocolate, of course. The more cash we invest into chocolate, the larger our inventories, and the smaller our cash balances.

Good management includes holding appropriate levels of working capital, not too much and not too little. To develop this idea further, let's define some key concepts.

Successful working capital management (WCM) includes identifying an appropriate safe level of inventory to minimise stock outs, as well as managing supplier, customer and internal operational relationships.

To do that, we need some key numbers to compare and discuss. First, let's quantify inventory days for Chox Group.

Inventory management terms

Inventory days
How long would our inventory last if we didn't replace it? This is our investment in inventory, measured in days.
Stock out
A situation in which levels of inventory (stock) are too low to meet demand. Stock outs can lead to delays, loss of revenue, additional costs and loss of goodwill. Clearly, we want to avoid stock outs.

Financial data

We have the following information from Chox Group's management accounts:

Profit and loss account extracts (£m)	
Revenue	180
Cost of sales	100

Balance sheet extracts (£m)	
Inventory	35
Receivables	9
Payables	11

Inventory days

A simple formula for inventory days is:

Inventory / cost of sales x 365
= 35 / 100 x 365
= 128 days

This seems a very high level of inventory, likely to be too high. We will return to this.

Continuing to focus on key numbers for now, let's extend our understanding into the broader operating cycle.

Operating cycle terms

Receivables days
The credit period we're giving our customers. Our investment in receivables, in days.
Operating cycle
Our total investment in inventory and receivables, in days.

Now let's quantify receivables days and the operating cycle for Chox Group.

Receivables days
A formula for receivables days is:
Receivables / revenue x 365
= 9 / 180 x 365
= 18 days

Operating cycle
A simple formula for the operating cycle is:
Inventory days + receivables days
= 128 + 18
= 146 days

The operating cycle quantifies our total investment in inventory and receivables, which we need to fund. The good news is, the operating cycle is offset, and partly funded by, our suppliers. Our net position is measured by the CCC.

Cash conversion cycle terms

Payables days
The credit period we're taking from our suppliers. Offsets and funds part of our investment in the operating cycle.
Cash conversion cycle
This is the number of days it takes us to convert cash outflows into cash inflows. It is also the amount of liquidity, measured in days, to which we need access.

Let's quantify the payables days and CCC for Chox Group.

Payables days
A formula for payables days is:
Payables / cost of sales x 365
= 11 / 100 x 365
= 40 days

Cash conversion cycle
A formula for the CCC is:
Inventory days + receivables days *less* payables days
= 128 + 18 - 40
= 106 days

Limited information health warning

These calculations are a simple starting point for WCM.

In practice, as we will see shortly, we would go into the figures and operational dimensions in much more detail, and refine our analysis. Areas for further detailed investigation will depend on the sector and business model we're working with, and the findings of our initial review.

But in the absence of more information, we need to work with whatever we've got, suitably qualifying our recommendations based on the amount and quality of available data. Exams, by definition, will always present you with limited simplified information.

Too much inventory?

Returning to Chox Group briefly, in theory, it should consider reducing its inventory levels.

Before we do that, let's turn to a real-life case study.

£21m cash release

As a student you learn a lot of theory. When you get to the workplace, you can spend a lot of time working out how to put that theory into practice. This is another set of skills.

Putting theory into practice occurred in a European subsidiary group of a global fast-moving consumer goods brand. The group's finance team had not been questioned on its working capital practices and, in particular, its inventory management system.

Asking operational teams questions to understand what was happening at a detailed level revealed a potential huge cash-generation opportunity. The inventory levels needed were analysed on a product-by-product basis against forecast demand. This confirmed a large overinvestment in inventory.

The management team was persuaded there was a cash opportunity and that stock outs would not result from careful reduction in a number of, but not all, product lines. Coordination with sales, marketing and inventory management teams to reduce inventory levels step by step demonstrated that it was 'safe' to do so.

A more active and joined-up inventory management process, aligned more closely to the sales forecast, was put in place.

The result was more than £21m in cash from working capital that year for a £180m turnover group. There were no stock outs. A fantastic result for the business.

Jess Coles FCA AMCT, director, Emerson Nash

Your turn now

Remember we previously calculated Chox Group's CCC as 106 days, and believed inventory levels might be too high. Let's assume we've investigated, and concluded that it would be safe and appropriate to reduce inventory by £21m.

(a) Assuming we've now successfully reduced inventory by £21m, and all other amounts are unchanged, recalculate the CCC.
(b) Is the CCC better or worse now?

(a) New cash conversion cycle
Inventory is now £14m (35 – 21).
Inventory days:
= 14 / 100 x 365
= 51 days

CCC:
= 51 + 18 - 40
= 29 days

(b) Is this better?
Yes. In this simplified situation we've also investigated and identified that the reduction in inventory appears safe and appropriate.

Based on this information, the reduction in CCC is indeed a good thing.

For more on WCM, turn to page 32

With thanks to Jess Coles, Michèle Allman-Ward and John Mardle for their valued suggestions and guidance.

Doug Williamson is a finance and treasury coach

THE 360-DEGREE APPRAISAL

Mr Treasurer thinks about life in the round

Dear Mr Sales Director,
As you will know, we are now completing our 360-degree appraisal process. Mr Treasurer has asked that you provide feedback of his performance over the past year in respect of his working relationship with you. Please kindly complete the attached questionnaire and return to HR.

Kind regards,
Human Resources

PS: Please use black ink and not crayon, like you did last year.

1. Which of these phrases best describes the added value that Mr Treasurer brings to your role and department:

- ❒ Only sales adds value. Everyone else is overheads.
- ❒ Treasury controls the cash and pays the salaries. Therefore, Mr Treasurer adds considerable value.
- ❒ I couldn't do my job without him – or so he tells me.

2. Which of these phrases best describes Mr Treasurer's communication skills:

- ❒ Can't understand a bleedin' word he says, but he seems to go away happy.
- ❒ Mr Treasurer always makes sure I completely understand what he's trying to tell me.
- ❒ His PowerPoint presentations to the team give me the opportunity to catch up on my expenses.

3. In what ways could Mr Treasurer improve his communication skills with you *[tick all that apply]:*

- ❒ Use less-complicated PowerPoint slides.
- ❒ Use PowerPoint less often.
- ❒ Use littler words.

4. Which of these phrases best describes the frequency of communication between you and Mr Treasurer:

- ❒ He's never out of here. Constantly asking for information and telling me things.
- ❒ He communicates as often as necessary and I can approach him any time I want.
- ❒ Please send me a photograph of him so I recognise him next time I see him.

5. Would you prefer to have more frequent communication with Mr Treasurer:

- ❒ Yes.
- ❒ You're kidding, right?

SHUTTERSTOCK

6. Thinking about Mr Treasurer in relation to the other functions that you engage with, which of these statements most closely reflects your view:

- ❒ Mr Treasurer is more helpful than procurement, but less helpful than marketing or operations.
- ❒ Mr Treasurer is more helpful than finance and HR, but less helpful than logistics and facilities management.
- ❒ Mr Treasurer is less helpful than facilities management, but more helpful than marketing – except when operations are more helpful than HR.
- ❒ HR, logistics, operations procurement and finance are more helpful than Mr Treasurer, except when they're not.
- ❒ Please, can we just skip this question?

7. In what ways does Mr Treasurer help you *[tick all that apply]:*

- ❒ Helps me keep my department focused on cash.
- ❒ Helps me keep my department focused on working capital.
- ❒ Tries repeatedly to explain what working capital actually is.
- ❒ Explains why negotiating a €130,000 sale is a good idea, but allowing the customer to pay in 90 days in Albanian leks possibly isn't such a good idea.
- ❒ Helps me keep my department focused on sales forecasting.
- ❒ Hides his disappointment well when our forecasts blow up.
- ❒ Suggests innovative ways we can help fund our distributors.
- ❒ Hides his disappointment well when I file expenses in 12 different currencies.
- ❒ Explains our corporate strategy to me, even though I thought our strategy was just to sell as much stuff as possible.

Andrew Sawers is a freelance business and financial journalist. He is a former editor of *Financial Director* and has worked on *Accountancy Age*, *Business Age* and *Commercial Lawyer*. He tweets as @Mr_Numbers

IN THIS ISSUE:

The highlights of the April 2017 issue of *The Treasurer* include: The ACT's new CEO, Caroline Stockmann, talks about what she plans to bring to the Association, on page 18. What are the latest developments on the constantly evolving financial regulatory landscape? Find out on page 22. How treasurers can help their organisations in turnaround situations, on page 30. Corporate finance principles and their place in the corporate world, on page 34

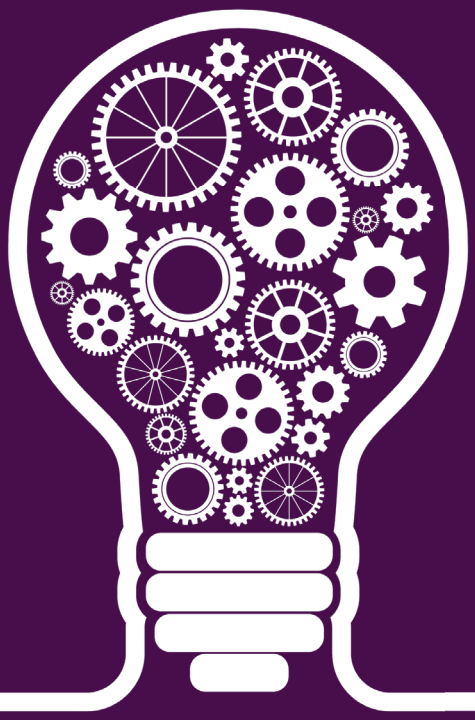
ACT LEADING TREASURY PROFESSIONALS

eAFFILIATE MEMBERSHIP

A wealth of resources at your fingertips

Your perfect introduction into the ACT and the treasury profession.

eAffiliate membership gives you access to exclusive online resources. As part of this international network you'll have support from some of the greatest minds and expertise in treasury and finance.



- Gain international credibility by joining the UK chartered body for treasury
- Stay current on latest industry issues
- Get access to The Treasurer magazine online
- Make the most of excellent networking opportunities
- Use our career resources and jobs board
- Benefit from the personal mentoring service

treasurers.org/eaffiliate