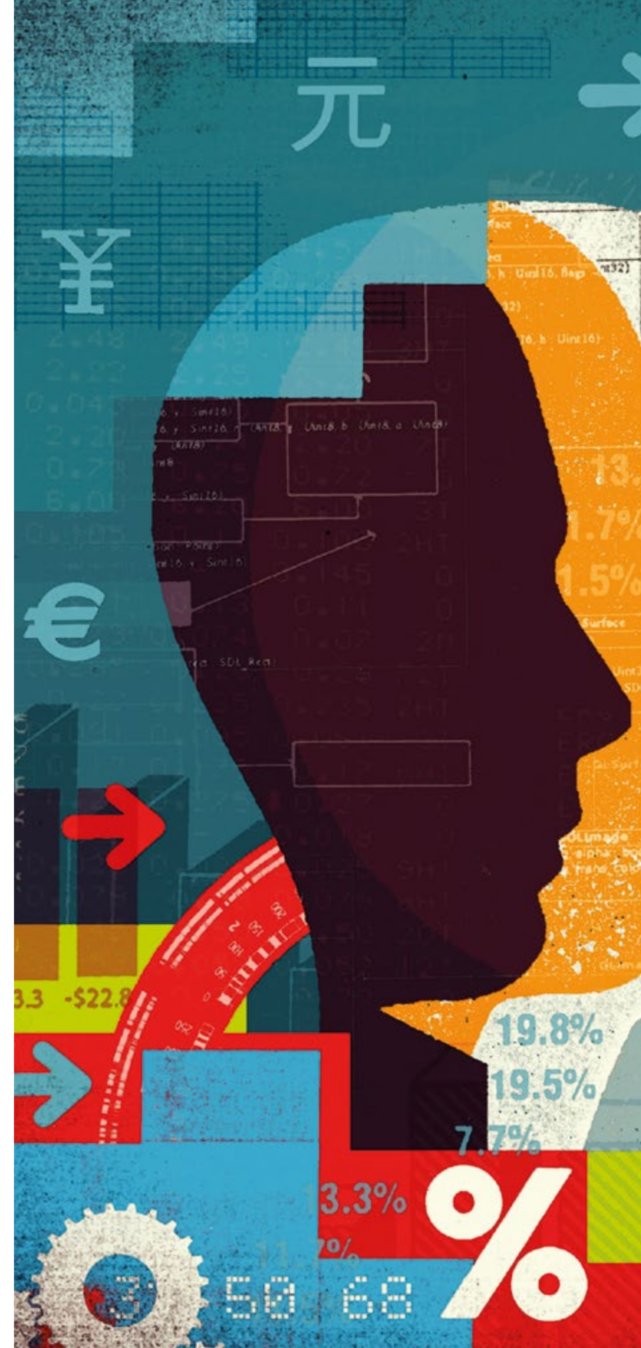
The hunt for liquidity

TOUGH ECONOMIC CONDITIONS AND CAPITAL REQUIREMENTS UNDER BASEL III RESTRICT THE AVAILABILITY OF CORPORATE FUNDING. BUT THERE ARE WAYS FOR TREASURY DEPARTMENTS TO BOLSTER THEIR ACCESS TO LIQUIDITY, SUNIL VEETIL REPORTS



ALEX WILLIAMSON/IKON IMAGES

Corporations across the Middle East and North Africa (MENA) region increasingly have found themselves needing to reconsider how they approach liquidity management. As falling oil prices drain revenues in MENA, and preapproved state infrastructure projects suck up existing deposits, previously cash-rich companies now have to make an effort to reduce their borrowing costs and search for internal sources of funding.

In addition, the region's central banks have largely been following the Basel Committee on Banking Supervision's guidelines towards implementing Basel III's liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) requirements. This means that the banks based in MENA will have to be fully compliant by 2019.

We've already seen short- and medium-term borrowing costs beginning to climb in the region as banks, now carefully examining their risk-weighted assets and allocation of capital, make changes to their balance sheets. At the same time, advancing benchmark interest rates in the wake of the US Federal Reserve rate increase at the end of last year will also put upward pressure on loan costs.

Another factor strangling available liquidity for some treasury departments is the difficulty in moving funds from some parts of the region elsewhere. For example, the shortage of foreign currencies in Egypt prevents multinational corporations (MNC) with a presence there from repatriating revenues earned in the country.

Mapping strategy

Despite the tough operating environment for many corporates, we have seen increasing sophistication and a willingness to adapt. Five years ago, the larger local corporates outside of the state sector began looking at developing longer-term strategic roles for their treasury departments, rather than just fulfilling the transaction processing and cost-centre function.

This is a key development because, if the CFO is absolutely clear about what the department needs to achieve – be it a long-term investment target or a policy on which currencies the company can afford exposure against – it means the bank can work closely with the firm towards those aims.

Indeed, as corporation boards increasingly realise the potential of their treasury departments beyond merely dealing with outgoings and receivables, so treasuries see that deep relationships with banks can offer far more than just basic transactional benefits.

In the United Arab Emirates and Egypt in particular, the large local corporates are sophisticated enough to seek liquidity solutions from the banking sector. Before, demand for these services mostly came from global MNCs operating in the region looking to move funds to their headquarters.

In the first instance, companies that develop strong banking relationships will have an advantage as they look to work with banks to help them meet their LCR and NSFR requirements. This is going to put them at the front of the queue for available funding at the most competitive rates.

Consolidation of activities

One straightforward example of a helpful symbiotic relationship between a corporation and a bank would be choosing to route consolidated payments and collections through one institution.

Historically, local corporations developed as many as 25 banking relationships, because they shopped at an individual transaction level. They

For companies struggling for liquidity, the ability to finance operations internally can be critical

picked one bank for having the cheapest automated clearing house costs, a different bank for having the cheapest high-value transaction costs, etc. Having collections spread across 25 banks and payments across multiple banks both splits liquidity up into inefficient pockets and results in lack of visibility, inaccurate cash-flow projections and increased fund transfer costs between the banks.

By consolidating payments with one bank, the company increases liquidity efficiency and gains far more visibility over the flow of funds.

At the same time, the bank can help the firm have more control over liquidity management through better payment cycle planning. Rather than making payments every day, it could perhaps work with the company to concentrate payments into two runs a month, thus leaving them with more credit available against the cash outflow and enabling them to plan their liquidity movement far more efficiently.

Consolidation can also make the process of cash concentration easier, both domestically and across borders. For companies struggling for liquidity, the ability to finance operations internally can be critical. Although moving funds throughout MENA will depend on country-specific regulations, working with a regional or international financial institution could help you free up funds. A secondary benefit is that greater visibility and cash control at the headquarters level can be achieved.

A deeper relationship with fewer banks will also be useful for corporations in the region indirectly affected by the reduction in credit extended to SMEs. The problem arising from local banks under liquidity pressure choosing to cut lending to SMEs is that many of these SMEs are part of the supply chain for larger companies.

However, if a firm has a good banking relationship and a good credit rating, it can access alternative funding such as purchase finance, and improve relationships with the SMEs in its supply chain.

Speed through transparency

There are significant benefits also for companies subject to anti-money laundering or economic sanctions-based regulation.

The last thing a firm wants is a critical payment needed to release cargo, for instance, being delayed for 15 days because a lack of communication resulted in inadequate explanation of the business context for the payment. A good relationship means the bank will understand the context and know who to approach at the company to obtain clarifications necessary to clear the payment.

While these are all practical benefits that provide solutions for short-term problems, there are also large-scale services that will fit into a company's longer-term liquidity management strategy that come with a more thorough banking relationship.

Because many of the local corporates have complex ownership structures – whether through joint ventures, partial state-ownership, having domestic and foreign stakeholders – using notional cash pooling to calculate group-wide interest rather than physical pooling makes a lot of sense in the region. But this is not a solution suitable for everyone.

One structure similar to notional pooling that is becoming increasing popular is enhanced interest on credit balances or price of overdrafts in one location based on the credit wealth held elsewhere without moving the funds. This, in particular, is helping companies that have significant amounts of cash trapped in countries such as Egypt with its FX limits, and Oman, which has restrictions on the automated movement of cash. The solution is far more scalable than a multi-currency notional pool because there is no need to pull in funds from various markets.

Ultimately, those who are looking to develop the capabilities of their treasury function, increase the sophistication of their operations and build strong relationships with a few key banks are going to be the companies best-placed to minimise inefficiencies and secure necessary funding even as liquidity levels across MENA fall.

Sunil Veetil is regional head of payments and cash management for Middle East and North Africa