

# The Treasurer's “Maximization” Challenge

In a challenging and increasingly competitive global economy, treasurers are under pressure to manage treasury more efficiently and achieve maximum returns on capital while minimizing costs. As treasurers adopt a broader, more global view to optimize their cash positions, discussions of “working capital management” and “global liquidity management” are becoming increasingly focused. Meanwhile, maximizing returns on cash – especially when managing a global array of funds flows – is becoming more complex. Treasurers would do well to remember that effective treasury, liquidity, and working capital management begins with good cash management, and a careful, accurate analysis of how to best use the many cash products and services now available. This article provides treasurers with guidelines for developing effective strategies to maximize return on capital – whether they wish to do so locally, regionally or globally.

## INDUSTRY TRENDS SHAPING THE ENVIRONMENT Two Global Currencies and Local Currency Loops

For the most part, treasurers now deal with two global currencies: the US dollar and the euro. Currencies other than US dollar and euro are primarily leveraged in self-contained working capital loops to pay suppliers, electric bills, rent, and insurance on facilities. Corporations may hold any excess (not needed to cover local working capital needs) in reserve in the local currency, but more typically seek to leverage the excess in one of the primary currency bands, as permitted by the prevailing regulatory and tax environment. Regardless of their

strategy, corporations need access to a flexible array of local, regional and global capabilities to maximize both local and global currencies.

## Regionalization and a Trend Toward Global Liquidity Management

Corporations that do business on a global basis are increasingly moving towards a regionalized or centralized treasury operation, particularly for their dollar and euro currency bands.

In liquidity management, corporations have for many years concentrated and notionally pooled cash balances domestically to maximize returns on balances and minimize expense. Globalization and the euro prompted an increase in cross-border concentration. Now, treasurers can leverage target balancing, notional pooling and automated investment products to benefit from a more streamlined electronic solution. These liquidity management solutions can be linked to other core cash capabilities – such as payables and receivables – enabling corporations to optimize their funds flows end-to-end, free up working capital, and maximize investment returns while minimizing overdraft expense.

## Real-time Information Integration

With today's technology, treasurers can view and manage their cash positions globally on a real-time or close to real time basis. They know what their positions are earlier in the day and earlier in their cash cycle. Bank reporting systems, as well as accounts receivable and ERP systems all establish real-time positions over the course of the day and provide improved forecasting accuracy. Treasurers can project what their net positions are going to be and make earlier more

precise investments of excess funds (and realize better returns) or manage a least cost method of acquiring funds if their net position is going to be short. By virtue of earlier, better information, they



can decide whether to draw down their working capital line, use a credit line, or redeem some of their invested positions.

## CONTRASTING APPROACHES TO MAXIMIZING LIQUIDITY

We often encounter corporations that keep millions or hundreds of millions of dollars in time deposits earning minimal interest. We encourage them to realize higher returns by, for example, concentrating dollars globally and investing them in vehicles such as money market mutual funds. When using an interest maxi-

mization approach, treasurers should establish core vs. non-core funds flows – preferably, three bands of capital.

For the first band, covering ongoing day-to-day working capital requirements, corporations need an overnight investment that offers the earliest real-time intraday information possible so the treasurer can best decide how to fund

Leaving cash in time deposits is certainly easier than establishing different investment scenarios for three bands of capital, but increasingly the treasurer's challenge will be to realize a higher return.

### DEVELOPING A STRATEGY FOR MAXIMIZING RETURNS ON CAPITAL

#### The Building Blocks

Developing a strategy to achieve the highest returns possible on capital is a complex and critical task and involves deciding when to use various building blocks – concentration, netting, notional and physical pooling, active and passive investments, and foreign exchange (FX).

Questions for treasurers to consider might include:

- What combination of concentration, netting, pooling and target balancing provide the most efficient liquidity structure?
- Do I maximize returns on excess cash through investment and use that to fund other activities?
- How far out on the yield/risk curve do I go with my investments?

• How do I want to approach the FX challenges or opportunities that are part of my basic business infrastructure?

#### Internal Strategic Objectives

Ultimately a company's internal strategic objectives relating to investments or working capital management drive decisions regarding how and when to use various building blocks. Corporations must be able to articulate their primary objectives which may be to:

- Realize maximum investment returns

as long positions are invested on an active or passive basis

- Meet working capital imperatives for predictability of cash flows.
- Manage intercompany flows between head office and subsidiaries
- Utilize technology most efficiently to free up staff
- Minimize bank costs and exposure to overdraft fees

Increasingly, the primary objective of many corporations is to "maximize efficiencies globally" and manage liquidity on a regional or global basis.

#### Complex Legal, Regulatory and Accounting Issues

Once a treasurer has defined the corporation's internal strategic objectives and considered options for achieving those objectives, the real work in developing a maximization strategy – particularly a regional or global one – begins. Developing a regional or global liquidity management solution involves understanding complex legal, regulatory, and accounting issues pertaining to that corporation and the countries where their subsidiaries are located. When establishing such a solution, it is important to take into account:

- The structure of the company – whether a single entity or multiple entities.
- Where the company is incorporated and where subsidiaries are located. Some countries have regulations that restrict use of liquidity solutions such as notional pooling. Different regulations may exist for resident vs. non-resident accounts.
- Where the bulk of funds are coming from and where they are going. Also, how payments are received (wires vs. checks, money orders, etc.) and in which currencies (dollars and euro or other currencies). How many accounts and where they are located.
- The central location where funds



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shortfalls or invest the excess shown on any given day.

For the middle band, which covers volatility in working capital, corporations should sacrifice a little bit of return in order to have access to cash when needed rather than draw on credit lines. A vehicle with shorter-term maturity that provides full liquidity is a good choice.

The third band, a pool of excess cash, can be invested long-term for a higher return. Liquidity is sacrificed since the cash is not needed to meet working capital requirements.

will be managed (i.e. where "header account" will be located) – at an international treasury facility or at the parent company.

- Issues regarding intercompany lending. Proper accounting of intercompany transactions, and of allocated

These liquidity management solutions, which typically hook one or more of the fundamental building blocks – concentration, netting and pooling capabilities – to the ideal investment vehicle, must be tailored to meet the corporation's individual requirements.

### Not Only Thinking Globally, But More Broadly Within the Organization

To develop a strategy that fully maximizes a corporation's cash position, treasurers must look at areas outside of the traditional scope of treasury. For example, the treasurer can be an advocate for changes that will speed the collection and availability of cash. The sooner cash is available, the greater the maximization potential.

Corporations should look at optimizing collections with products such as lockbox and electronic invoice presentment and payment (EIPP), which greatly accelerate the in-flow of funds. EIPP improves predictability of cash flows and accelerates receivables by 2, 5, 7 (or in one client case, 20) days ensuring cash can be invested sooner.

It might also be useful to review and optimize payment terms and policies typically set by sales and marketing. As corporations offer 30, 60, 90-day pay-

ment terms and agree to take payment via mailed checks vs. wire payments, their Days Sales Outstanding (DSO) increases. Corporations need to evaluate whether it pays to offer discounts to accelerate payments. Since some buyers will do business under some terms and not others, sophisticated modeling may be required to determine how a particular company's payment terms and policies can be optimized.

### IMPLICATIONS FOR THE CORPORATE BOTTOM LINE

In the year 2003, as corporations struggle to compensate for shrinking profit margins, low interest rates, and a difficult debt market, an effective maximization strategy can be a valuable 'working capital management' tool – delivering a greater return on capital while reducing the use of credit.

Corporations should, like a handful of treasury innovators, take a global view and conduct an enterprise-wide rationalization of their liquidity management needs and opportunities. After doing so, they will be better positioned to determine when and how to use the liquidity management tools available. In this rapidly evolving liquidity management space, there is one thing we can be certain of – to address one area of opportunity and not the others, or to look at liquidity management needs and opportunities locally rather than regionally or even globally – is leaving money on the table.



interest among participants of the structure, must be ensured.

- The corporate strategy and policies for achieving funding efficiencies and for investing excess liquidity.

- The kinds of systems in place as well as reporting requirements. Also, the challenges of properly integrating bank and ERP systems to ensure the availability of actionable information and data.

Corporations, with the help of their global bank partners, must approach the process of developing a regional or global liquidity management solution or any type of maximization strategy with a high degree of discipline and rigor.



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