Preservation to Growth in Global Liquidity Management

After a period of retrenchment and consolidation, the business sector is now beginning to shift its focus from survival towards controlled growth. Corporates are developing cautiously optimistic business strategies that involve a need for an efficient utilisation of their global liquidity. Supply chains are being lubricated and financial capacities expanded in anticipation of new growth opportunities. That said, with globalisation, emerging market growth and ever-increasing competition, working capital efficiency remains the key to success.

Certainly, at Citi’s 2014 Global Liquidity Management Forum, the discussion pivoted on the dramatic market changes in recent years and how they have led to an expectation for banks to be at the head (if not ahead) of the curve as providers of liquidity management solutions and, more importantly, as advisers. Indeed, advisory services now form an integral part of the value-add banks can offer corporate clients.

While centralisation, deregulation and emerging-market development have all contributed to more efficient and cohesive liquidity management structures, challenges persist. It is up to banks to address these challenges and to advise their clients on the best strategies for managing them. The solutions they devise must be all-encompassing, bespoke to the client and as flexible as possible. Only then can banks help drive clients towards a new era of development characterised by — albeit fragile — optimism.

Of course, this fragile environment is a marked improvement on the broken post-financial crisis landscape, in which corporate access to capital became increasingly difficult. Many corporates adopted strategies that maximised the availability of internal sources of liquidity — learning or relearning efficiencies that the pre-crisis abundance had allowed many corporates to forget. With this realisation, however, came the need for greater creativity with regard to the optimisation of corporate reserves and fragmented positions.

One of the many examples highlighted at the Citi Liquidity Management Forum was TUI Travel PLC: a leisure travel company with the inevitable highly seasonal cash flows associated with the sector. “The nature of our business is such that we require a scalable liquidity solution that can ensure year-round liquidity regardless of the fact that we only have large balances during the summer months every year,” said Stuart Case, director of group treasury at TUI Travel PLC.
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For TUI Travel, cash flow visibility across the company became vital for liquidity management. For instance, “SWIFT bank balance reporting has provided us with a solid and transparent fact base; something that, for us, has proved invaluable,” said Case. The combination of seamless connectivity and a customised liquidity structure have generated working capital, operational and economic efficiencies for the company.

Moving towards a centralised future

Centralisation is key to global efficiency and to sustainable growth. A general trend towards centralised corporate structures – brought about in part by the need for visibility and pooling available liquidity on a company-wide basis – has been observed in many multinational companies recently. Most now acknowledge the efficiencies available from a more unified internal structure, although initiatives such as SEPA have hastened such thinking, at least in Europe, observed Amit Agarwal, Citi’s regional head of Liquidity Management Solutions for EMEA.

Another trend supporting this centralisation is the growth of shared service centres (SSCs). SSCs have been a catalyst, said Sandip Patil, Citi’s regional head of Global Liquidity Management Services for Asia-Pacific: “The centralisation model is going from decentralised-centralisation towards centralised-centralisation,” said Patil, “which is to say that corporates with seven or so treasury centres, and 10 or so SSCs, are now realising that a single treasury centre and a single SSC could actually perform the same function, with the same, if not improved, efficiency”.

There is no doubt that the change is being driven, in part, by technology. Corporates are now so well connected internally that a single centralised facility headquartered in one region can provide the same, equally efficient service to their branches domiciled elsewhere. Furthermore, technology has revolutionised liquidity management in its capacity to rapidly and efficiently centralise and aggregate data.

Steven Elms, sector head of EMEA Industrials in Citi’s Treasury and Trade Solutions business, showcased Citi’s next-generation “Interactive Solutions” programme during the Forum; a proprietary application which, with incredible ease, develops bespoke liquidity structures and working capital solutions for clients via data provided from them or gathered from Citi’s expansive global network and regulatory information that is constantly updated by Citi’s local experts in over 100 branches globally.

Emerging market opportunities

“When corporates look for growth, they look to the emerging markets,” said Sandip Patil.

Almost unscathed by the fallout from the 2008 financial crisis, the emerging markets have undergone rapid economic development, and are increasingly being taken into account in corporates’ liquidity structures. Quantitative easing – executed in the US and the UK to refloat otherwise illiquid economies – has also had a major impact in the emerging markets (due to the search for yield), which has directly aided development. In addition to this, the reduced price of oil has given the emerging markets a boost – in particular, India, China, Brazil and South Africa – supporting monetary expansion and injecting liquidity into the global system.

Nowhere is development more apparent than in the Asian market and, specifically, in China. Although a slight slowdown in Chinese economic growth has been observed in recent months, China still stands as the world’s largest trading nation, and its economy continues to grow at 7%. The Chinese currency, the renminbi (RMB), has also experienced rapid growth. And the international adoption for such a young currency over such a short time period has been impressive.

Just two years ago, the regulation of the RMB was extremely tight and China was a country full of trapped (and thus illiquid) cash reserves. Now the currency is the seventh most traded in the world (from 20th two years ago), and its adoption as a treasury currency is becoming increasingly common. The wider market is also recognising the benefits of RMB adoption, both as a trade currency and as a lucrative asset in corporate business structures – a move augmented by the gradual yet progressive liberalisation of the RMB.

Pentair, a Swiss industrial machinery company, was the first of Citi’s clients to go live with RMB adoption, using the Shanghai Free Trade Zone (the first zone for RMB convertibility) to facilitate cash movement into its multicurrency notional pool in London. Citi was the first international bank to set up a branch in the Zone.

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“Since making the move, Pentair has enjoyed the benefits of increased treasury efficiency,” said Alison Tosh, from Citi’s EMEA Liquidity Management Services, “and has had sufficient funds to cover its working capital needs in RMB in China, while also gaining greater control and visibility over the management of those funds.”
With regard to RMB development and the role that the currency could play in global treasury structures, there are challenges that might delay what could otherwise be an exponential increase in RMB adoption worldwide, as a trade, treasury and perhaps even reserve currency. Understanding these challenges requires an understanding of the RMB itself.

In fact, the currency is currently managed by the Chinese regulators as two currencies: CNY (the local Chinese currency) and CNH (the offshore Chinese currency). Restrictions remain preventing their comingling, a complication that must be managed by banks and impedes its adoption. In addition to this substantial impediment, the RMB also lacks a “lender of last resort”, meaning that a shortage of CNH in a foreign market can result in a dramatic rise in interest rates across the interbank market.

Due to the lack of a standard against which RMB rates are measured, positioning is vital: a deficit in RMB can mean significant losses for the bank involved, which are not even compensated for by gains of a similar margin in the event of a surplus. Lastly, complications around RMB clearance and geographical handicaps hinder the currency’s development and push many banks and corporates to adopt a more conservative approach towards the accrualment of assets in RMB.

But the RMB is a young currency, and these challenges will dissipate as the currency matures, especially given the currency’s potential for treasurers globally.

Regulatory and tax issues are not only confined to the emerging markets. Graham Robinson, tax partner at PwC, said: “Global regulation and tax are pushing back against other phenomena such as globalisation, trade and the increasing ease of international cash concentration. Regional variations on tax laws impact significantly on liquidity management, and therefore tax should still be a key factor to consider when restucturing your treasury float”.

Indeed, cash concentration structures are frequently complicated by contentment over the distribution of transfer pricing pay-outs to the various tax authorities involved. Moreover, in territories such as the US, tax rules dictate that subsidiaries of a firm headed by a US corporation must pay tax on all transactions, regardless of where the transaction takes place. Corporates must be aware of this when devising a liquidity solution – something that Citi’s Interactive Solutions accounts for as it provides a visual representation of both regulatory and tax laws on a per-country basis, based on client data and local expertise provided by Citi’s unparalleled network.

Regulatory changes must also be taken into account. The Money Market Fund reform, for example, already introduced in the US and awaiting an outcome in Europe, will have an impact on the institutional money market and thus on liquidity modelling. However, Britta Hion, the managing director and head of the International Corporate Cash Sales team at BlackRock, when speaking at Citi’s event on the reform, assured attendants that, while its introduction in Europe would certainly present a challenge for investors, “many policymakers have understood the reasons why investors use CNAV and want to find a solution that will preserve a range of solutions with these features. The legislation may bring about some considerable changes, but we are confident that we will be able to provide the best possible solutions to clients”.

In conclusion, from an event shedding significant light on several areas of liquidity for corporate treasurers, capital preservation continues to be the most important criterion from a treasury perspective. Yet corporates are now opening up to the idea of incorporating both preservation and growth strategies into their business plans. Faith in the financial system has, to an extent, been restored, and clients are looking for creative liquidity solutions. This is something that banks with their on-the-ground insight, global network and technological expertise are perfectly positioned to deliver.

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Challenges and complexities
Despite such success stories, challenges to global liquidity management persist. The emerging markets – while presenting an abundance of opportunity – carry with them a number of risks. In 2014 alone, the market has witnessed significant geopolitical turbulence, with the Russia-Ukraine conflict, war in the Middle East and the Ebola crisis in West Africa being three of the most significant. What’s more, the actions of central banks in developed markets have a direct impact on liquidity levels, and thus the risk profile, of the emerging markets. In order to overcome regional nuances related to tax, regulation and culture, corporates therefore require a banking partner physically embedded within their target regions or regions of operation. Insight and advice based on local knowledge is vital.
Other speakers at Citi’s Liquidity Management Forum:

**Mark Tweedie**
EMEA Head of Corporate and Public Sector Sales, Treasury and Trade Solutions, Citi, gave the opening remarks.

**Amit Agarwal**
EMEA Head of Liquidity Management Services, Treasury and Trade Solutions, Citi engaged in the panel discussion on liquidity management in emerging and volatile markets.

**Michael Berkowitz**
North America Head of Liquidity Management Services, Treasury and Trade Solutions, Citi, engaged in the panel discussion on liquidity management in emerging and volatile markets.

**Cindy Gerhard**
Liquidity Management Services, Global Head of Project Management, Treasury and Trade Solutions, Citi, acted as the facilitator for the panel discussion.

**Dimitrios Raptis**
EMEA Head of Market Management, Liquidity Management Services, Treasury and Trade Solutions, Citi, gave the introduction to all sessions and prologueed Graham Robinson (PwC).

**Bert Heirbaut**
Treasury Manager at IHG, engaged in the panel discussion on driving cost, working capital and operational efficiencies through a global liquidity structure, giving insight from an IHG perspective.

**John Murray**
EMEA Head of Corporate and Public sector Cash Sales, Treasury and Trade Solutions, Citi, acted as facilitator for the panel discussion.

**Fernando Almansa**
EMEA Liquidity Management Services, Treasury and Trade Solutions, Citi, joined Steven Elms in showcasing Citi’s digital solutions and innovative tools for liquidity management.

**Rajesh Mehta**
Europe and Middle East and Africa Treasury and Trade Solutions Head at Citi, gave the closing remarks.