



Liquidity Management - Plotting Progress in a Turbulent Market

by Chrystal Pozin, Principal, Treasury Strategies



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The global credit crunch has forced companies to rebalance their liquidity portfolios and reevaluate cash management processes and providers. Corporate treasurers are reducing credit exposures in their cash portfolios and reviewing and enhancing processes to 'bullet-proof' treasury operations so that they can safeguard every dollar that flows through the financial value chain. By strengthening controls, treasurers will also ensure that they can continue to focus on emerging strategic responsibilities and not be distracted by 'the crisis of the week.'

As corporations look to automate and strengthen basic liquidity functions and focus on opportunities to create value, banks have unprecedented opportunities to deepen relationships. Banks are assuming a greater role in helping companies consolidate, monitor and invest liquidity through new information services and enhanced sweep and investment offerings. By helping their treasury clients automate and safeguard liquidity activities, banks are laying a foundation to support the development and delivery of the next generation of treasury service products that meet the emerging strategic needs of corporate treasurers.



Throughout this article we have drawn upon findings gathered from Treasury Strategies' 2008 Global Corporate Treasury Research Program. This research is undertaken to

help our corporate treasurer and financial services provider clients understand key market trends. Our corporate treasury clients use the insights from this to optimise their treasury functions and stay abreast of key market issues. Our financial services clients leverage the research to understand and respond to the needs of corporate treasurers and the dynamics of the market. The 2008 Global Corporate Treasury Research Program surveys over 970 senior corporate treasury leaders in North America, Europe and, for the first time this year, the Asia-Pacific region.

Liquidity - the flight to quality

In our research, we've seen that treasurers have not only rebalanced their portfolios in response to market conditions, but that they have also continued to develop their internal liquidity practices to better monitor, aggregate and manage liquidity. Going forward, treasurers note that they will be further rebalancing their portfolio, presenting opportunities and threats to financial services providers.

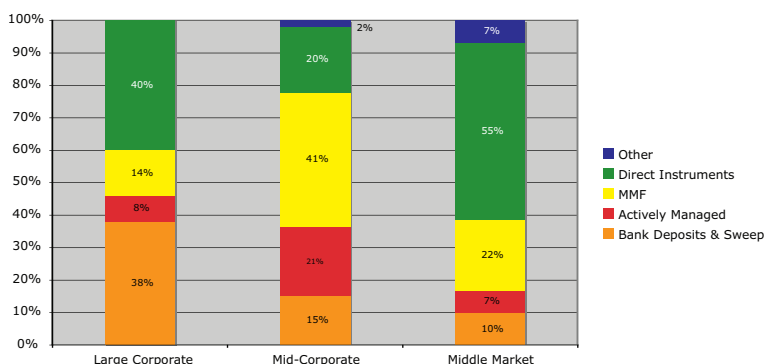
The composition of cash portfolios varies widely by region and is driven by differences in regulatory environments and traditional market practices. While bank deposits dominate Asia and some countries in the European market, direct instruments are the most popular category of short-term investment instruments in North America.

Corporations in the Asia-Pacific region proportionally

summary

This article is based on findings from Treasury Strategies' 2008 Global Corporate Treasury Research Program. It reveals how, in response to financial instability, treasurers in North America, Europe and Asia are rebalancing their cash portfolios and restructuring their banking relationships, with the intention of relying more heavily in future on banking providers. Europe and North America are also increasingly turning to technological solutions, while in Asia the focus is on business development. The author examines the implications of the research findings for the providers of services: in brief, "deliver enhanced banking solutions that optimise liquidity and manage risk".

Fig 1. US Portfolio Mix by Segment





invest the greatest amount in bank deposits, reflecting strong relationships with their banks, less developed secondary markets for fixed income instruments, and the lack of penetration in money market funds.

Long a mainstay of the cash portfolios of French corporations, money market funds have gained an increasing share of corporate cash throughout Europe and the US, particularly in the UK. In most cases, where money funds have been adopted, they have dis-

placed direct instruments. Money market funds are now emerging in the Asia-Pacific region, but currently comprise a relatively small share of corporate cash.

The reasons for the growing adoption of money funds by corporate treasury are multiple - first, money funds, due to their scale, can aggregate multiple investments into a large portfolio and thus diversify credit and other risk. Secondly, the largest and most competitive money funds can



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offer attractive yields as management and distribution fees for institutional share classes are generally quite low. Lastly, money funds are a convenient investment option - many money funds are now easily accessible through both proprietary and non-proprietary online portals and most offer corporations the ability to make purchases and redemptions later in the day, when they have greater certainty as to their cash position.

Liquidity - portfolio rebalancing

Corporate treasurers are planning to shift the compositions of their cash portfolios in response to market conditions. To understand how portfolios might shift, we isolated the planned increases of firms looking to increase liquidity balances by 20% or more and the planned decreases of those firms looking to decrease liquidity balances by 20% or more. We found that firms are generally reducing risk while looking to enhance yield - primarily via shifts into interest-bearing vehicles such as Term Deposits and Money Funds. Table 1 shows the primary instruments into which treasurers are going to invest additional liquidity.



Consistent with historical investing behavior, Asian firms that project a 20% or more increase in liquidity balances plan to direct these funds into bank deposits. A small number of middle market firms noted an intention to invest increased liquidity in repurchase agreements - essentially a collateralised deposit. Across the middle market and mid-corporate segments, a material number of firms noted a plan to increase holdings in foreign currency term deposits, reflecting the global nature of these firms' treasury activities. In the Asia-Pacific region, banks have an opportunity to stress the safety of their

Table 1 - Targeted instruments for incremental investments in Asia

Middle market	Mid-corporate	Large corporate
1. Foreign currency term deposits 2. Interest-bearing current account 3. Repurchase agreements	1. Term deposits 2. Foreign currency term deposits 3. Interest-bearing current account	1. Term deposits

Table 2 - Targeted instruments for incremental investments in Europe

Middle market	Mid-corporate	Large corporate
1. Term deposits 2. Interest-bearing current account 3. Money market funds	1. Term deposits 2. Money market funds 3. Interest-bearing current account	1. Term deposits 2. Interest-bearing current account 3. Money market funds

Table 3 - Expected 20% Increase in Balances North America

Middle market	Mid-corporate	Large Corporate
1. Sweep 2. Notes/Bonds 3. Money Market Fund	1. Money Market Fund 2. Sweep 3. Commercial Paper	1. Money Market Fund 2. Commercial Paper 3. Offshore Accounts

deposits, to offer attractive yields through term structures and to address the fragmented nature of global liquidity through foreign currency deposits.

Within Europe, we see two key trends - firms are planning to invest money further out on the yield curve via term deposits and all segments show an interest in directing additional liquidity into money funds. This dynamic underscores the increasing adoption of money funds by European Treasurers.

Across Europe as a whole, the interest in money funds is relatively consistent across turnover segments. However, in France, where money funds are well penetrated, corporate treasurers exhibit distinctive differences in target instrument by firm size. While all segments show an intention to direct additional liquidity into money funds and term deposits, the segments vary in the targeted deposit instrument. In France, middle market firms, possibly due to lack of investment scale, plan to invest incremental liquidity in non-interest bearing current accounts; mid-corporates plan to direct incremental liquidity into interest-bearing current accounts; and large corporate firms plan to invest in repurchase agreements.

In all cases, the constant theme is that corporate treasury is looking for safe, stable investment options.

The key issues

Key issues are remarkably consistent across regions, reflecting the integrated nature of the global economy and the tendencies for best practices in one region to be adopted in other regions.

In 2007, Treasury Strategies called upon treasurers to 'bullet-proof' treasury - to safeguard every dollar of cash flow throughout its lifecycle via appropriate controls, policies and pro-



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cedures that identify, measure, monitor and manage risk. Treasurers that heeded this advice were well served and were able to continue their pursuit of a strategic agenda while minimising the distraction from market turmoil. As can be seen by the survey results, however, many corporate treasurers are now revisiting their risk, liquidity and funding capabilities in light of recent market events.

As expected, liquidity management, risk management and credit/funding dominate the 2008 rankings of issues that are keeping treasurers up at night - no matter what time zone they live in. These three treasury issues dominate all turnover segments in North America and reflect the impact of tight credit conditions following the

US mortgage meltdown, as well as extreme US dollar declines / volatility, a struggling economy and heightened regulatory oversight.

Asia shares North America's focus on liquidity and credit / funding, while in Europe, corporate treasurers are worried about liquidity and risk management. But for bankers in any region, the topic of conversation is clear - "how can we help you manage risk and optimise liquidity?" Now, more than ever, corporations must optimise working capital. Given the cost of credit and the premium on liquidity, corporations must accelerate collections, gain visibility into pools of cash, gain access to those pools and mobilise them to pay down debt, invest or fund working capital needs.

Table 4 - Key issues

North America

Middle market	Mid-corporate	Large corporate
1. Risk management 2. Credit / Funding 3. Liquidity management	1. Liquidity management 2. Risk management 3. Credit / Funding	1. Liquidity management 2. Risk management 3. Credit / Funding

Europe

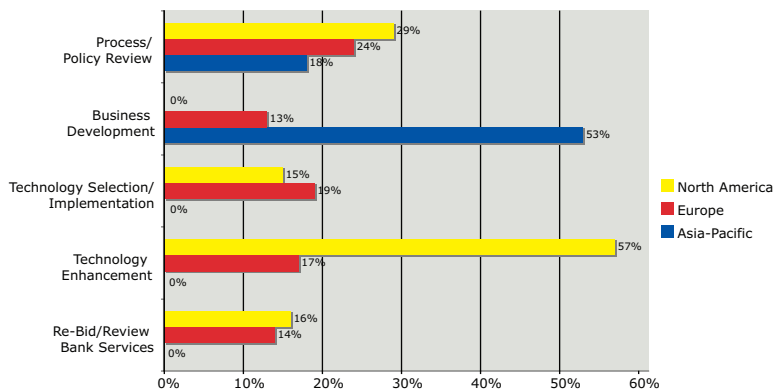
Middle market	Mid-corporate	Large corporate
1. FX risk management 2. Risk management 3. Liquidity management	1. FX risk management 2. Liquidity management 3. Risk management	1. Risk management 2. FX risk management 3. Liquidity management

Asia Pacific

Middle market	Mid-corporate	Large corporate
1. FX risk management 2. Credit / Funding 3. Market conditions	1. FX risk management 2. Credit / Funding 3. Liquidity management	1. FX risk management 2. Credit / Funding 3. Liquidity management



Fig 2. Planned Projects



The response by corporate treasuries

The initiatives treasurers have planned for the next 12 months reflect both current liquidity and risk concerns and the emerging strategic nature of treasury. As can be seen, a significant number of firms are either selecting or implementing treasury technology or are working to enhance their current treasury technology. In many cases, the focus on technology is driven by a desire to address the key issues of improved risk and liquidity management.

By automating functions and improving access to information, treasury can better control and monitor the financial activities of the firm. Technology also provides a platform for centralisation, a critical component in controlling risk and gaining visibility to liquidity. Lastly, through automation and access to information, technology helps treasurers free up resources for strategic activities and gain access to key infor-

mation needed to support strategic decision-making.

The one exception to the focus on technology is Asia, a dynamic that is somewhat surprising in light of the relatively low adoption of treasury technology combined with relatively high staffing levels. Here we find a strong interest in business development, as treasury is involved in cross-functional initiatives to grow revenues and strengthen financial relationships with customers.

Conclusion

In response to market turmoil, treasury is rebalancing its cash portfolios and restructuring banking relationships. Market turmoil has led treasurers to reduce portfolio risk, often by moving money out of active investments and into lower risk, passive investments such as money market funds and bank deposits. In most regions, treasury is planning to rely more heavily on banking providers, expanding service usage with a core group of strategic

partners. Treasury is turning to technology, process reviews and re-engineering of banking relationships to improve liquidity management and increase control and risk management.

For financial services providers, the mandate is clear: deliver enhanced banking solutions that optimise liquidity and manage risk. For larger firms, this may entail integrating payment and data into treasury management systems and structuring global banking relationships that optimise liquidity through superior consolidation of funds and straight through processing of payments and financial information. For smaller firms, this may translate into the delivery of web-based treasury solutions whereby banks assist firms in consolidating cash, monitoring liquidity and evaluating and executing investment activity. In all cases, it is imperative that banks understand their clients' unique liquidity and risk management needs. By understanding their clients' liquidity and risk needs, bankers can deepen their relationships in a time when many corporations are centralising treasury functions and rationalising banking relationships. □



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Chrystal Pozin has been a key member of the consulting team at Treasury Strategies, Inc. since 1997. She works with financial institution clients in the areas of product development and positioning, market research and strategy development. She has particular experience in the areas of liquidity management and revenue optimization.

For corporate clients, her work includes domestic and global treasury operational reviews, best practice analyses, technology selection, and bank and vendor request for proposal (RFP) assistance.

Ms. Pozin holds a B.A. in International Relations from Emory University and is a Certified Treasury Professional.

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