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July/August 2013

Private placement market

The private placement market in 2012 had a record-breaking year in terms of issuance, with global supply soaring 23% year-on-year, hitting $56.1 billion. But what should a treasurer know about private placements before leaping in?

Women in Treasury

Marianna Polykrati

Group Treasurer

Chipita Group

The Bank Interview

Mark Stockley

Head of International Cash Sales

BlackRock Investment Management

Supply chain finance

Terms of endearment

Risk management

Under cyber siege

Special report

Financial transaction tax

Sustainability

Corporate social responsibility

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A Canadian walks into the Bank…

This may sound like a good start to a joke, but Mark Carney's first week has shown that he is serious about shaking things up as Governor of the Bank of England (BoE). In an attempt to shed his 'rock star' celebrity status for a more 'man of the people' image, Carney joined other City commuters in taking the tube to work and agreed to meet a group of protestors to review female representation on bank notes.

More importantly, he stood shoulder-to-shoulder with Mario Draghi, European Central Bank (ECB) President, to squash any expectations for an early rise in interest rates, a move which sent stock markets soaring and devalued the pound. Carney said that investors were "not warranted" in thinking that interest rates would start rising from the end of next year, as markets currently expect. This statement radically broke with existing protocol by setting out a potential timeframe for rate policy – coined 'forward guidance'.

Carney also took the unusual step of issuing a statement after his first Monetary Policy Committee (MPC) meeting. In it, the MPC said: "The significant upward movement in market interest rates would weigh on" growth and that the recent "implied rise in the expected future path of bank rate was not warranted by the recent developments in the domestic economy". Additionally, Carney left the door open for more quantitative easing (QE), in response to the Chancellor's request that the BoE examine alternative strategies in time for next month's meeting.

As the first non-British appointment to the post in the 319 year old institution, Carney is going to have to go the extra mile to prove himself – and the increased level of transparency he is putting in place might go a long way in helping his cause. But he has his work cut out for him: the UK economy is still in a weak state and there are major divisions within the MPC. Sir Mervyn King, Carney's predecessor, faced many months of opposition to suggestions for expanding the BoE's policy of QE.

Carney is no stranger to conflict, as evidenced by his very public spat over the implementation of Basel III with J.P. Morgan CEO Jamie Dimon in 2011, when Carney was Governor of the Bank of Canada. In one of his many shots across Dimon's bow, Carney stated: "If some institutions feel pressure today, it is because they have done too little for too long; not because they are being asked to do too much, too soon."

As one of his fellow Canadians and former government colleague, Scott Reid, said: "He's going to tear through London like a lion." And that may not be a bad thing.

IN THIS ISSUE

INSIGHT & ANALYSIS 15

Terms of endearment

Supply chain finance (SCF) is touted as the perfect solution for buyers wanting to extend their payment terms and sellers wanting to get paid as quickly as possible. The adoption of cross-border SCF programmes will continue to gather pace, but will the complexity involved allow banks to maintain its 'value-add' status?

WOMEN IN TREASURY 6

Marianna Polykrati
Group Treasurer

Chipita

Rising to the challenges thrown at her during the financial crisis in Greece, Marianna Polykrati, Group Treasurer, recently moved from Greek food conglomerate Vivartia to Chipita Group, which is a food company of Greek origin but with a strong international footprint.

CORPORATE FINANCE 27

Private placement

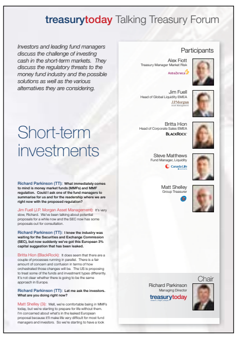
Private placement (PP) is the direct sale of long-term mainly fixed rate securities. For issuers, it is a way for firms to diversify their source of funding away from the banks, spread maturities and potentially lock in the cost of funding for a longer period. But what should a treasurer know about PPs before jumping into the market?

RISK MANAGEMENT 41

Under cyber siege

Whether growing concern about cyber security reflects an actual increase in the frequency and severity of cyber-attacks is difficult to substantiate – cyber-crime, after all, is not something companies like to talk about, at least publically. What practical steps can be taken to prevent and minimise the damage of a data breach?

TALKING TREASURY FORUM 19



treasurytoday Talking Treasury Forum

Short-term investments

Participants

Chair

Short-term investments: state-of-play

While many corporates use money market funds (MMFs), they need to start preparing for life without them as new regulatory proposals filter through on both sides of the Atlantic. What alternatives are out there? Are corporates putting contingency plans in place?

PRODUCT PROFILE 33

Supply chain finance – modern, simple, effective

Lionel Taylor, Head of Trade Products at Lloyds Banking Group's Transaction Banking unit, gives a guided tour of all that SCF means today and in the future.

in association with LLOYDS BANK

These pages contain edited versions of a few of the Treasury Insight pieces written in the last month. The full versions are posted on treasurytoday.com as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at treasurytoday.com

A day to celebrate

On Thursday 20th June, Treasury Today hosted the sixth annual Adam Smith Awards ceremony, sponsored by Bank of America Merrill Lynch (BofA Merrill), in Plaisterers' Hall, London. The event, which has come to be recognised by treasury professionals globally as the definitive industry benchmark, attracted more than 200 people from Asia, the Americas, the Middle East and Europe.

In one of the ceremony's many highlights, Richard Parkinson, Managing Director at Treasury Today, presented the special Lifetime Achievement Award to Patricia Greenfield, Treasury Director at AstraZeneca. Greenfield, who began her treasury career at Unilever in the early 1970s, spoke to Treasury Today of her surprise and delight: "I felt really proud and shocked – I had no idea that it was coming."

Greenfield is opting for early retirement when AstraZeneca relocates its corporate finance operation from London to the North West of England in mid-2014. After a highly successful career, she is now looking forward to having more time on her hands to holiday in South-East Asia and indulge in her recently-acquired passion for golf.

But with so much professional knowledge and expertise to offer, will she still be keeping in close contact with her team after she leaves? "Of course," she said with a chuckle. "I'll definitely be on speed dial."

Too much information

The trouble with information that may ultimately affect share price is that there is just so much of it, coming from multiple sources. But for the investor relations officer (IRO), gathering data from across the world is not enough – it needs to be analysed and distilled into usable facts for every stakeholder, when it is needed.

MagnaChip Semiconductor Corporation is a business at the heart of the high-tech industry. In March 2011 it completed an initial public offering (IPO) of 9,500,000 shares of common stock, listing on the NYSE. It is vital that the firm's management are aware of and react to changes and trends in the consumer electronics industry just as it is vital for the business to be receptive to the mood of its investors.

It's all in the detail

Although headquartered in Seoul, South Korea, MagnaChip's IR function is handled out of California's Silicon Valley. Its IR Director is Robert Purcel. Until recently, he had been using IR software that he had created "to try to watch and manage the different data points" that reflect the ebb and flow of the industry and the investment community.

Since May, Purcel has been using a new IR tool from Bloomberg. This is a 'dashboard' concept that forms part of the vendor's Professional Services product line. By including real-time information, news, research and analytics, Purcel is set up to monitor relevant markets, compare individual company performances, manage analyst and existing investor relationships, evaluate shareholder composition and activity, and better target new investors.

Although he uses the Bloomberg offering alongside his own in-house built solution, Purcel explains the new system offers "a lot more detail". "With the Bloomberg product I can see all that at one time," he says. "It gives me the news, a barometer of what my peer group is doing today and what we're doing today. It maps what MagnaChip is all about."

Any announcements that are made or industry trends that emerge – especially those generated by major electronics-industry players such as Intel or Samsung – are immediately apparent and can be translated into how MagnaChip's own stock is, or should be, behaving.

One for all

For a senior management team tasked with forming strategy, the Bloomberg IR system acts as a barometer for the company, says Purcel. "For me, it's like a GPS, letting me know where I'm at." Because it's on his desktop allowing him to watch what's going on in real-time, minute-by-minute, "if something seems to be askew during the day, I can jump on that and report back to management so they can formulate what the response should be." For MagnaChip and Purcel, the days of too much information may be at an end.

Walk... Don't walk

If 82% of respondents to a treasury-specific survey said they had not adopted a certain technology and only 12% said they would consider using it somewhere down the line, it might seem that the time was not right for that technology. But that is exactly what the Treasury Today European Corporate Treasury Benchmarking Study 2012 revealed about the adoption of mobile treasury devices.

Nick Diamond, Head of Cash and Payment Sales, Commercial Banking, Lloyds Bank, admits that although many system providers have already created mobile versions of what they do, there has been "some reluctance" within treasury to adopt these solutions despite the level of noise – at conferences in particular – that says mobile is the next big thing.

"The viewpoint is that, if you step outside the ring-fence of office security by using a mobile device, you may be compromising that security by offering more opportunity for criminals to hack into the system," says Diamond. "I think it is right for treasurers to take appropriate measures to protect against hacking, but I don't think it should be a reason why they do not embrace mobile."

Paul Taylor, Head of Regional Sales, Global Transaction Services (GTS), EMEA, Bank of America Merrill Lynch (BofA Merrill) agrees, stating that the authentication and validation tools on the bank's mobile channel are just as robust as that of its normal treasury offering. "There is no heightened risk or sensitivity because it is mobile, on either smartphone or tablet," he argues.

The generational shift into treasury of a more sympathetic user-base starts with consumer change and that, says Diamond, is something that today's treasurers need to consider, even if mobile treasury is not on their personal agenda.

The mobile revolution is not yet a revolution for treasurers and how it fits into changing market places and demographics of the different regions is an on-going story. To make an impact it seems that the solution should answer a specific need that treasurers have and should not harbour distractions that detract from the usefulness of the device and it should never be seen as a means of replacing an entire existing traditional platform.

SEPA's BIC Problem

The SEPA regulation states that payments initiators will not be required to provide a BIC for domestic payments after 1st February 2014 and for cross-border after 2016. However, the Payment Services Directive (PSD) allows for previous contractual agreements between PSPs and business users, where unique identifiers are stipulated for the successful execution of a payment. Therefore if, for example, an agreement was previously made to provide both BIC and IBAN, then that agreement will still stand. This means that if the customer fails to provide the BIC, then the PSP will not be liable if a payment is not correctly processed.

"BICs still apply," says Ruth Wandhöfer, Global Head of Regulatory and Market Strategy, Citi Treasury and Trade Solutions. "While in some cases it is possible to extrapolate a BIC from an IBAN, there are many instances where the IBAN does not contain sufficient information to enable the determination of the correct destination bank branch, in particular for cross-border transactions. In addition, the risk of non-execution or wrong execution would belong to the corporate if they do not provide the BIC."

The idea of a pan-European IBAN and BIC database is an attractive solution. This would work by requiring every bank to load up all IBAN and BIC they have each day to central archive, which payments initiators can then access to find the relevant data. But it would not be practical to expect the banks to manage such a database single-handedly and, unfortunately, the potential for an EU institution to get involved was removed from the SEPA regulation during the negotiation stage.

Step up SWIFT

SWIFT, the financial messaging services provider, tells Treasury Today that it already has a solution on the market that might ease some of the pain for corporates. SWIFTRef is a data platform which was launched in the spring of 2012, allowing users to find all the information they need for making SEPA compliant payments in one place.

But Citi's Wandhöfer is unsure whether SWIFT's new offering provides a satisfactory solution to the 'BIC problem'. To begin with, she argues that SWIFTRef is a commercial offering, and the database "if required by regulation, should also be run by an EU institution". She also voices concerns that SWIFTRef, in its present form, is not reliable enough to provide complete reassurance for corporates.

Patrick Neutjens, Head of Reference Data at SWIFT, concedes that there remains some margin of error for SEPA transactions – but the banking co-operative is working hard to eliminate it. "I think one of the strengths of our SWIFTRef offering is the quality, completeness and accuracy of the data we provide," he insists.

"We collect all of this data on behalf of our customers. We test it, cross-reference it and complete it – if there is something missing, we will find the inconsistencies so that the burden falls away from the corporate." ■

Longer versions of these articles are available at treasurytoday.com/treasury-insights

This much I know

Marianna Polykrati

Group Treasurer

Chipita

What is your career-defining moment?

The moment I decided to switch from the banking to the corporate side. I found it challenging at the time, but it proved invaluable in broadening my experience and knowledge.

Which women in business most inspire you and why?

I think that women who are in executive level positions and also have families are admirable. In Greece, those women are a minority – making up less than 10% of corporate executives. However, the fact that they are able to effectively handle a family and work at the same time inspires and motivates me.

What is the biggest challenge you are facing just now?

Managing and safeguarding the group's purse is a challenge because of the difficult economic conditions in Greece. Bank funding in Greece is scarce, so most Greek companies are now tackling working capital management on a daily basis. Since Chipita has the majority of its business outside Greece, financing is not an issue; therefore treasury is focused in optimising the current debt capital structure and investigating different cash pooling methods.

What couldn't you manage without?

Working with people that are both professional and show their human aspect is very important to me. I have been extremely lucky to date in that the people I report into and those that report into me are professional and their work is excellent, while at the same time they haven't lost their human side in a business context.

What would you like to do more of in your job?

I like to work more globally, hence the move to Chipita, because there are so many things that can be engineered in treasury, in terms of banking and financing, trade finance and supplier finance, which are currently limited in the Greek market.

What advice would you give to other women in treasury?

Keep calm and be patient. Taking into consideration that there are few women in treasury positions, we have to keep calm because – due to their female nature – women are best equipped and quite resilient to handle the current difficult and stressful conditions.

If there is one thing you could have done differently in your career path so far, what would that be?

I consider myself lucky because I have worked with excellent people throughout my career. I have learned many lessons in previous jobs and I hope I will learn many more from future ones.

"Bank funding in Greece is scarce, so most Greek companies are now tackling working capital management on a daily basis."

ON THE WEB

To read all the interviews in this series go to **treasurytoday.com/women-in-treasury**

Marianna Polykrati has the difficult – some may say unenviable – job of protecting a Greek company's balance sheet in extreme market conditions, which have not eased since the onset of the financial crisis in 2008. It is a good thing that she thrives on challenges. She has recently made the move from Vivartia, a food production conglomerate brand in Greece, to Chipita Group, which is a food company of Greek origin but with a strong international footprint

She began her career in 1996 in the banking sector, working for a Greek leasing company. After four years, she moved to a venture capitalist (VC) company within the same bank group and through the VC switched to corporate finance. Polykrati says that she has "never regretted nor looked back". In hindsight, it was a good move at the right time because today the banking sector in Greece is quite weak, whereas the corporate sector has proved to be more resilient to the crisis.

The corporate side is also more interesting, with a unique set of challenges. "In treasury, we work as a partner with many business departments including production, distribution, marketing and sales, which allows us insight into the different sections of the company. In addition, we interact with the banking sector. As a treasurer you never really leave the banking sector, but you are a part of something that is much more intriguing and challenging."

Polykrati's day-to-day job as Group Treasurer at Vivartia had undergone a major transformation since the onset of the crisis. Pre-crisis, when there was a lot of available credit, treasury was not overly focused on cash management because food production conglomerate Vivartia had excess cash. In addition, the company's large size meant it could help support its suppliers' and clients' credit terms. The company had no problems accessing credit and financing its working capital. "We were offered facilities by both Greek and international banks – up until 2010 we had a lot of loan syndication with foreign banks," she says.

Although the crisis started in September 2008, Greece was more affected in late 2009. Vivartia was one of the last corporates to feel the impact – this happened in mid-2010. Treasury had to reorient its activities because credit became more difficult to obtain; as a result it began renegotiating terms with both clients and suppliers in order to improve its working capital cycle.

At the same time it focused much more on cash management. "We started really working on our cash flows," says Polykrati. "Previously, we looked more at indirect cash flow methods. Since 2010, and especially 2011 and 2012, we focused on direct cash flow reporting and implemented an in-depth analysis of our actual trend year-to-year. Every month we do a rolling forecast for the remainder of the year."

Vivartia has 95% of its operations in Greece, with very few exports but some of its suppliers sit outside the country. "Within the country, consumption is falling and unemployment is rising, and with bank funding almost non-existent we have to tackle working capital on a daily basis. We are tackling payments almost like cash-on-delivery (COD). All of these areas are very challenging right now in order to cope with daily cash flows in Greece," says Polykrati. Insurance companies still don't insure receivables that are 100% based in Greece, which is another big issue for treasury.

Chipita, on the other hand, is a completely different story. Due to its international presence, with the majority of its operations outside Greece, the Greek crisis has only remotely impacted the group's operations compared to other Greek companies. Hence for treasury, funding is not the major issue; instead it is split between optimising the current debt structure and tapping into alternative capital and debt markets, while at the same time proactively strengthening cash management in each country and assessing cash pooling methods, as well as monitoring foreign exchange (FX) risks.

Although a number of networking groups have cropped up in Greece specifically to promote a more optimistic view of the market environment and develop new business initiatives, there are currently no organisations that are looking specifically at women and the challenges they face. Polykrati believes that it would be a good idea to create networks of women because they have a greater propensity to be able to handle the current difficult and stressful market conditions by developing creative solutions.

On an individual company basis, a corporate mentoring programme could also help promote new ideas and ways of thinking. More importantly, it could put in place a pipeline of female treasury professionals that could help change the gender balance from the bottom up to the executive level – in Greece less than one in ten Executive Board members are women. Polykrati believes this will prove to be a better solution than a quota system. "I don't understand why you should have a quota for something that should be self-explanatory. If you have a quota for the Board but you don't have one in the lower echelons of the organisation, then I don't believe it will make a difference. If you don't have women at executive levels, then the women on the Board will not have the necessary experience."

In terms of career development, Polykrati believes that there is a role for both on-the-job training and professional qualifications. "There are always things you can gain with professional training that you can't find on the job. However, for me it is more preferable that junior staff have on-the-job training because when they come out of school they usually lack experience as to how things work in the real world. Better to have on-the-job experience at the start, and then as you go on have more training outside the job."

Marianna Polykrati joined Chipita S.A., a confectionary company of Greek origin with a strong international footprint, as Group Treasurer in June 2013. Most recently she was Head of Group Treasury at Vivartia, which is one of Greece's largest food and beverage groups, consisting of 125 companies. At Vivartia, she focused on strengthening cash and liquidity management, improving corporate financial management, investigating new capital markets funding, managing risk and controlling treasury operations. Prior to joining the Vivartia Group and working for the corporate side, Polykrati has worked for eight years in financial services. Her career started as an account officer for Emporiki Leasing (member of Credit Agricole Group), where her clients comprised of medium-sized Greek companies, ranging from small retail stores to large manufacturing plants; she then moved to Emporiki Venture Capital (member of Credit Agricole Group) as an investment manager, with responsibility for projects in Cyprus, Russia and distressed Greek companies. Her transition from the financial services to the corporate sector was initiated through the assignment of the role of deputy general manager in one of her distressed projects, Polychromo, a small printing unit in Greece and Romania, which was accomplished at Vivartia.

Share of wallet

Tapping our collective knowledge to get better information

"How do treasurers determine share of wallet with their banks?"

Gavin Jones, Vice President, Deputy Treasurer, Ahold:

At Ahold, our relationship bank group is based on the 14 banks participating in our revolving credit facility. To proactively manage that relationship we deploy two tools: a bank performance scorecard and a share-of-wallet calculation. Both are integrated into our six-monthly bank relationship reviews.

Our share-of-wallet calculation focuses on the revenue each bank has earned, broken down by product category, including payments, card and cash management, investments and derivatives, through to the more highly-prized capital markets transactions or merger and acquisition (M&A) advisory. We either calculate the transaction fees actually paid to a bank or, in the absence of a fee, we have used a conservative assumption on what a piece of business is worth. For example, for a money market fund (MMF) investment, we'll use the asset manager net fees to calculate an actual revenue stream. Whereas for a term deposit, we'll make an assumption on how much a bank saves by taking our deposit, compared with borrowing the equivalent from the market.

Foreign exchange (FX) and interest rate swaps (IRS) derivatives are product areas where we use a revenue assumption. Our wallet model does not consider profitability, largely, as each bank has very different approaches on what costs and risk-adjusted returns they attach to a specific piece of ancillary business.

The main objective of the wallet is for us to proactively manage the relationship, so we classify banks into three categories: underfed; on target; and overfed, using revenue run rate approach. Critical to this is establishing a revenue target for each bank, so an integral part of the wallet process is having a transparent dialogue with our banks on their revenue expectations. We do this once a year with the relationship managers. Whilst our revenue calculation may not exactly match the banks internal assessment, we typically find we are in the same ball park.

Our share of wallet does provide useful insight in the structure and flexibility of our wallet, which strategically has allowed to shape the size, capability and composition of our bank group to ensure that banks revenue expectations can be serviced. Operationally, using both the model and performance scorecard, we can identify whether an increase or decrease in banks' revenue can be attributed to a change in the product teams performance. Our relationship managers have reacted positively to the transparency and directional insight we can give, and this year we will be distributing the performance heat maps, so they can visually see how they are performing.

Didier Vandenhaute, Director, PwC Treasury Consulting Practice, Belgium:

Over the past few years, banks have increasingly squeezed their corporate clients in order to secure a bigger share of their overall wallet. This has been a way for banks to meet the expected levels of return on capital employed imposed by their own boards. Quite often, corporate entities have not been in a position to provide banks with quantifiable arguments against further wallet sharing or have a constructive dialogue.

In recent years, we have seen corporate entities investing time and money in developing solutions to be able to actively manage wallet sharing, to different degrees of complexity. We have simplified below our view of the market into three categories, taking an incrementally more complex approach to the issue:

1. **Country allocation**

At the most simplistic end of the scale, corporate entities will allocate their business on a country/regional basis and compare the percentage of sales allocated to one bank to its share of the overall credit support provided to the group by all banks (participation in syndicated credit, bilateral committed lines, working capital and trade lines, FX lines, etc).

2. **Balanced allocation**

The corporate entity will go a step further and quantify the value of the wallet allocated to each bank per product (transactional fees, commissions, trade finance fees, etc). They will also actively balance the quantitative elements of the relationship against the quality of the relationship through a balanced scorecard (customer service, in-country support, implementation services and liquidity management). Finally, some corporate entities will use or set up their treasury management system (TMS) in a way that will better enable them to actively track the overall business and fees passing through the banks (using FXall or SAP, for example).

3. **Tactical asset allocation**

In this case, the corporate entity will put themselves as much as possible in their bank's shoes and try to analyse the value of the relationship from the bank's point of view. Corporate clients realise that Basel III has an impact on all banks, but in different ways depending on their balance sheet composition. As a result, the same corporate product might be priced differently from one bank to another. Based on these factors, the corporate client will make their own analysis per bank of the overall profitability generated through the relationship, and each product will be allocated to the bank that is best able to manage it, understanding the real value of this asset to each bank ('golden asset' management).

Conclusion

If banks are not ready to open their books and share the revenue generated through the relationship and the return on capital employed, corporate clients will have to find ways to estimate their wallet and analyse how to best share it among their core banking partners. The better the corporate entity is able to value its wallet, the better they will be able to establish a longstanding and reciprocal relationship with their bank.

Sander van Tol, Partner, Zanders:

The first division you can make is between direct fees and expenses and indirect ones. The direct fees are something for which you would normally receive an invoice, for example an agreement with the bank for cash management services that they deliver to you. Indirect fees, on the other hand, are those that are earned by the bank when you are, for example, trading derivatives.

This can make it difficult to see the actual fee. If you are depositing money with a bank, normally the bank may take a certain yield on that deposit, so you will assume a number of basis points on that deal. Therefore, the first thing that corporates are looking at is the split between direct and indirect fees.

A deeper analysis would involve not only looking at the gross fees or gross revenue that you pay to the bank, but to also consider the profitability of the revenue for the bank – and that can be very challenging to establish.

Another determinant could be whether the treasurer has a complete overview of all the business done with the banks. For example, if you look at multinationals it is quite difficult to have complete oversight of all the different banking relations, first of all, but also to see what your operating companies are actually doing. What you often see at the operating company level is that there are bilateral contracts between the operating company and the bank which are not known to the treasurer.

There are also contracts with banks which are not within the remit or scope of the treasurer – insurance is one example, but there are a lot of other services offered by banks that make it difficult for the treasurer to get a complete overview. Treasuries that have a more centralised structure can usually achieve a reasonably good overview; but for those who are organised in a more decentralised way, it is much more difficult to assess the total wallet. ■

The next question:

"When selecting a payroll service provider, what should be included in an RFP?"

Please send your comments and responses to **qa@treasurytoday.com** ecr research

Eurocrisis persists due to timid politics

With the European crisis continuing to rumble on, what will it take to break away from the past and take concrete steps towards a banking, fiscal, economic and political union?

At the March session of the Brussels Forum, British historian Timothy Garton Ash said: "The EU today is an experimental laboratory of the future of the world." Unfortunately, this laboratory is brewing a lethal concoction of isolationism, protectionism, apathy, populism and disillusionment.

Europe appears a prisoner of the past. Often the main argument in defence of further integration and the survival of the euro is that both have brought peace to the EU after two world wars. There are few convincing stories that place the EU in a global context and/or make a case for a starring role for the EU in world politics/economics. The result, as the Dutch professor Paul Scheffer contends, is "piecemeal erosion instead of piecemeal integration". Will Europe be able to turn this narrative around?

Continuing European frictions

Owing to the twin political and economic crises, differences within Europe have widened; yet in some ways, trends are converging. This is not a positive development with regards to the latter: northern euro countries are no longer immune to the crisis. Even growth in Germany has been minimal.

It is imperative that the EU becomes stronger and takes concrete steps towards a banking, fiscal, economic and political union. However, in reality, most member states are moving in the opposite direction. They want to limit the powers of Brussels and gain more autonomy. Significantly, in recent years the decision-making process regarding the crisis has shifted from the European Commission, the supranational body governing the EU, to the European Council, consisting of the national leaders.

Friction also exists between the need for rapid intervention (as the crisis can, potentially, spiral out of control at any moment) and numerous rules, laws and procedures that are in the way of decisive action. The cases sitting before the German Constitutional Court are a prime example. Equally controversial is that the interests of global capitalism/the international financial markets and national politics are diverging. In a crisis, markets demand a different approach than the electorate and national (opposition) parties. Politicians are often caught between a rock and a hard place if they want to placate both markets and voters. For now, they are going down a road that makes many voters profoundly unhappy.

All these tensions lead to four schisms between:

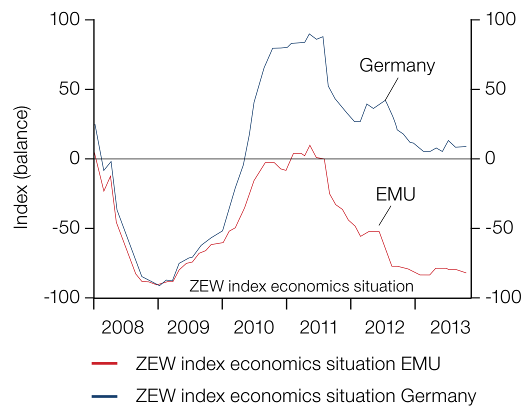
1. Euro countries and the other EU states. Several non-euro countries within the EU have indicated they do not like the fact that small groups of Eurozone members are taking decisions that impact on the rest. One fear is that the sphere of interest of these 'cliques' will gradually extend to other areas.
2. Debtor and creditor countries. Until now, this has largely been a North-South divide.
3. Countries that are happy to take the lead in 'two-speed Europe' and states that fear being left behind and marginalised.
4. Germany and other countries – the abyss between Berlin and the rest of Europe is increasing. Surveys indicate that the Germans are seen as the most arrogant and least compassionate Europeans (albeit extremely reliable).

Presently, Germany is – partly against its will – the undisputed European leader. Yet it is clear that France, in particular, is becoming very nervous about the growing power chasm between Germany and its fellow Europeans.

Will Europe be torn apart?

Indisputably, the Eurozone has calmed down since the summer of 2012. This could well change before the year is

Chart 1: Germany: not immune to the euro crisis



Source: Thomson Reuters Datastream/ECR out. Crumbling confidence in the EU will make it very difficult to justify a transfer of power to Brussels. Meanwhile, Brussels can only inspire confidence if it persists with the European integration project.

Plummeting faith in the national politicians and democracies is eroding Europe from the inside and thwarts a successful tackling of the crisis. Signs of this are political instability in Italy, Greece and other European countries, not to mention the corruption and abuse of power scandals, anti-democratic tendencies and government crises in Romania, Hungary, Bulgaria, Slovenia, etc.

Another development that threatens to tear Europe apart is the anti-European course of the UK. The British were never big fans of the EU but their antipathy seems to be in the process of becoming endemic. On top of this, a misguided strategy in the domestic EU debate has weakened the Prime Minister. Unless he is very careful, David Cameron could go the way of his predecessors, Margaret Thatcher and John Major, who were tripped up by inter-party quarrels about Europe. Of course it won't do Europe any good if Britain becomes rudderless.

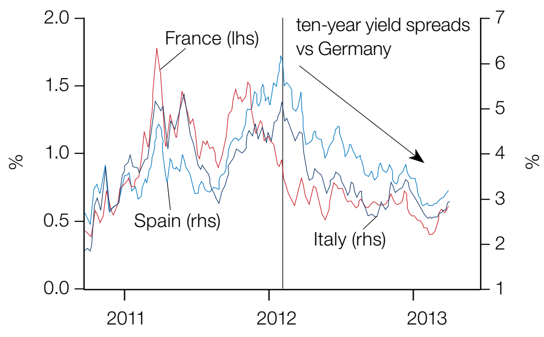
Finally, Germany's increasingly isolated position is ominous. A virtually unbridgeable gap seems to have opened between Paris and Berlin. Not so long ago, little could happen without the approval (and material support) of the solid Paris-Berlin axis. Recently, France has mooted a number of proposals that were meant to tie Germany to a full-fledged union. However, Germany is clearly not sold at all on further integration, which will take a long time and will probably require a lot of political capital.

To be or not to be?

Evidently, the EU and the Eurozone need to make fundamental choices. Either Europe should slow down the process of integration and adjust its procedures accordingly, or it should get squarely behind the EU and the Eurozone. This would imply a full-blown banking union, with a communal deposit guarantee system as well as a shared resolution mechanism, as a stepping stone towards the political and economic union of Jean Monnet's dreams. However, it is not likely that the latter will happen in the immediate future.

Europe has been sucked into a whirlwind of emotions, tendencies, and developments: fear, uncertainty, fury, introversion, doubt, populism and isolationism. As the experts point out, the 'old continent' is still milking its past glory. In addition, the European elite gives the impression that it is (totally) oblivious to how outsiders view the EU. A tentative conclusion is that as long as Europe lacks a critical

Chart 2: Yield spreads could rise again



Source: Thomson Reuters Datastream/ECR

sense of self-reflection and turns a blind eye to its failures, it cannot recover from its malaise.

The move to "great politics"

Will Europe take decisive action in the remainder of 2013? Unlikely. It will probably continue to stumble on, even if events show that this strategy is unsustainable. Shock therapy would be a better solution.

During a symposium about Europe, a professor from China cited a Chinese proverb: "It takes a year to grow rice, ten years to grow a tree and a century to cultivate people." In short, the EU's culture should undergo drastic changes but it will take a long time until the European minds (and hearts) are ready for this.

Eventually, there could be some positive surprises. Unfortunately, the trigger that forces Europe to act may well be an erupting crisis. In any case, Eurozone tensions are expected to increase this year because the EU and the EMU will likely remain stuck in a mire. Subsequently, the euro will depreciate against the dollar, as bond yields rise in the periphery and fall in Germany.

Should the Eurozone fail to put a lid on the tensions, in the longer term the markets will realise that the Germans will have to stand guarantor for the financial problems in the rest of the Eurozone. By then, German government bond yields could rise.

One thing is for sure, the European continent will keep struggling with a political, economic and social crisis as long as countries, and the EU as a whole, have to make do with – in the words of German sociologist Ulrich Beck – "pusillanimous" (faint-hearted) politics instead of "great politics". ■

James Taylor

Director of Finance

ghd

good hair day every day

Good Hair Day, popularly known as ghd, is a UK-based premium hair care brand. Launched in 2001, the company has built up a range of styling products which are sold across 14 countries globally, mainly through salons.

Problem…

Sales of Good Hair Day (ghd) products are seasonal, peaking in Q4 as the group capitalises on the Christmas gifting market. Although generally a cash-rich company, this seasonality has some clear working capital implications. The lead time on manufacturing, for example, means that Q4 production is ordered in May. Manufacturing takes place in China over the summer and the goods are shipped to the UK for distribution to salons in October. While the salons are on normal credit terms, with payment due at the end of the year, the European and US-owned manufacturers require settlement ex-works. This creates a funding gap, requiring ghd to hold more cash on its balance sheet than it might normally do. To maximise shareholder value, ghd wanted to release that cash to the business.

…Solved

"Our Barclays relationship director introduced us to the bank's supplier finance product," says James Taylor, Director of Finance at ghd. As lead bank in the firm's lending syndicate, Barclays was very familiar with ghd's business and had taken the time to understand its working capital cycle, he recalls. "As a cash-generative business our assets were never truly maximised and Barclays was keen to help us achieve that."

Despite some initial reservations, ghd quickly saw the benefits of supplier finance. "One of the key advantages is that it is off-balance sheet and outside the current loan documents so it is not caught under any debt finance rules," Taylor explains. This means that it does not impact lines of credit. Clearly this requires ghd to have a robust balance sheet and credit terms with Barclays, and it also required the other banks in ghd's syndicate to assess the viability of the solution.

The intention was for ghd to use this solution with a limited number of trusted partners, initially approaching just two major suppliers. For an overseas business with limited access to low-cost debt, this solution can be "extremely advantageous", notes Taylor.

Because ghd settles invoices with the bank, the interest rate available to suppliers is based on ghd's credit rating with Barclays. This means that, although an overseas supplier with tight margins will have more risk around its credit terms, they can draw down the cash in the system with "extremely competitive" UK interest rates.

The other clear benefit to suppliers is control of the draw down process and therefore the cost to their business. Invoices are approved immediately by ghd and on the system suppliers can draw down funds right up to the due date. As a result, the supplier using the facility found it a useful means of managing its own cash flow, Taylor reports.

In operation, supplier finance has proven to be "very user-friendly". It has also created an immediate uplift of ghd's cash balance, adding 60 days to its working capital cycle and enabling the firm to be a lot more efficient with its cash. For Taylor, optimisation of assets is the main corporate advantage but there are also practical instances where supplier finance has proven its worth. It is, he notes, "a useful tool in any negotiation with the supplier; if they don't want to move on price we may be able to move on credit terms."

With the solution working "extremely well" from the outset for all parties, Taylor is now looking to extend it to more suppliers. And whilst he will be "cherry-picking" the ones he feels are most likely to benefit, he is clear that ghd will be working collaboratively with its suppliers and Barclays to build on the success of its current supplier finance proposition. ■

Terms of endearment

The problem is one as old as commerce itself: buyers want to extend their payment terms, whilst suppliers want payment sooner. Net result: mutual tension. Is supply chain finance (SCF) the perfect solution for buyer and supplier alike?

The age-old problem of buyers wanting to pay as late as possible and suppliers wanting the cash immediately seems an intractable one at best. Of course, corporate buyers could pay their suppliers in good time, but different markets have different attitudes to this issue. D&B reported a set of figures from its annual review of Asian, European and North American payment practices last year which showed that in 2011 Taiwan led the pack on due-date settlement with 69.3%. Hong Kong had a 34.5% punctuality record and China 33.1%. The European average was 37.8% with Germany way ahead on 74.7%, while Switzerland followed with 55.3% and the UK lagged way behind at 26.3%. Only Portugal was slower to pay, with a punctual payment figure of just 21.8%. The US displayed an average 51% punctuality record, while Canada's average due-date payment was 44.9% and Mexico was 59.9%.

Lelaina Lim, CFO of RSH Limited, told Treasury Today that when she first started in her role as the Shanghai-based Regional Financial Controller of International SOS (a medical evacuation company) she was faced with a receivables turnover of 350 days. She brought this down to 120 days over a two-year period but said even this was not easy. "It was hard and people thought I was very harsh, but after two years people realised that it was a do-or-die situation. A business that doesn't collect cash can't survive."

In Europe, the EC issued Directive 2011/7/EU to try to encourage a fairer play between both parties. The directive came into force on 16th March 2013 as a means of combating late payment in commercial transactions. However, the Directive does not harmonise payment periods across the region, but instead creates a statutory right to interest 30 days after the date of the invoice, unless of course another payment period has been negotiated in the contract.

A place for SCF

This is where supply chain finance (SCF) has a role to play in easing the tension. SCF has been playing an increasingly significant role in the trade finance portfolios of some banks, with major global institutions claiming an average annual growth rate of up to 40%. According to the annual industry survey of global banks and corporates by working capital solutions, advisory and technology provider, Demica, this sustained uptake will continue to the end of the decade.

Growth in SCF programmes indicated by those surveyed is highest in the US and Western Europe, particularly in the UK (with its low payment punctuality record) and Germany (with quite the opposite), with Eastern Europe, India and China (the worst of D&B's payment punctuality Asian countries) noted as leading regions with the greatest SCF market potential. Some 90% of bank respondents see SCF as a "must-have" financial product for corporate buyers and more than 75% of them see it as an "added-value" product. Respondents believe that domestic SCF programmes will lead the expansion and that the level of competition between banks will soon commoditise the offering. The adoption of cross-border SCF programmes will continue to gather pace but the greater complexity involved will enable it to retain its 'value-added' status.

Asian trade

Sanjay Dalmia, EVP Global Cash Management and CEO of Fundtech India, notes "a pick-up" of interest in SCF, particularly in the Asian markets. "But challenges remain," he adds. From the banking perspective there is a degree of separation from the actual beneficiaries of the solution. As banks work with the CFOs, it can be difficult to steer procurement managers and suppliers towards a common platform and to get them to understand the benefits of such a programme. The parties often cite perceived issues and complexities around supplier on-boarding and technical integration of systems and workflows as a reason for not doing it.

Although he agrees there may be workflow issues within certain corporates, Dalmia says this is not solely an IT issue, but also one of poor communication caused by operational silos. These silos underpin a misalignment of purpose internally between accounts payable (AP), procurement and treasury, and where respectively each is intent on holding on to cash, keeping suppliers happy and keeping on top of cash management.

The purpose of supplier finance in its various forms is to bridge the payment gap between a supplier's delivery of goods and the final settlement of its invoice by the buyer. The latter typically initiates a programme via its own bank (and so it does not impact the buyer's own balance sheet), using its own strong credit rating to secure better rates than its suppliers can on their own. The corporate may even self-fund the programme "if it is flush with liquidity", notes Dalmia, adding that this obviously has balance sheet implications and that any charges must be set "at arms length".

In terms of technology, Dalmia comments that "the tools are improving all the time, but the model of operation broadly remains the same." David Gustin, President of Global Business Intelligence, a Canada-based international trade research and advisory firm, has been following the industry closely for many years and notes that there are a lot of misconceptions about what the various forms of supplier finance are and how they work. As part of his research Gustin is currently finalising a 'vendor positioning grid' that looks at a multitude of vendors that market various working capital technology solutions to try to understand the lay of the land.

"Certainly in an effort to leverage the wider adoption of supply chain automation tools, or in believing specific under-served opportunities exist, many vendors have been adding working capital capabilities to their product suite," he notes. These solutions may not fit all purposes and Gustin notes too that large-scale buyers – multinationals – that have developed approved programmes have tackled the matter in a way that complements their own industry peculiarities and as such "they are all very different and have met with varying degrees of success".

The typical view of the supply chain, from the finance perspective, considers the funding of suppliers. This will mostly take the form of post-shipment finance but increasingly in Asia the requirement is for pre-shipment finance, says Ashutosh Kumar, Global Head of Corporate Cash and Trade at Standard Chartered. The beneficiary of post-shipment finance is the direct supplier. Pre-shipment finance will push the finance "much deeper into the supply chain", to the point of funding the upstream suppliers that supply raw materials to direct supplier, he explains.

These upstream suppliers tend to be in the small and medium-sized enterprise (SME) sector and often do not have a sufficiently strong balance sheet to secure lower-cost bank funding, or may even find that funding in their domestic market is not readily available. The arrangement of pre-shipment finance moves away from a predominantly balance sheet-based discussion towards a supply chain risk analysis, executed by the bank (because it is the one taking the financial risk) in tandem with its corporate client. This, explains Kumar, must consider many points of the relationship between buyer and supplier to determine acceptability, pricing and so on. Assessment includes factors such as the unresolved rejection rate of the goods supplied, the nature and marketability of the products being bought and the dynamics of the market itself.

The other half of the story

But SCF is "only half of the story" in the Asian markets, says Kumar. Corporate clients of the bank are now asking for extended programmes to cover funding of their distributors too. "Of late we have seen a much greater demand for distributor finance; currently every company is looking to sell more and this is a way of helping distributors to achieve more sales without having to worry about finance."

Indeed, in China, Benjamin Lam, China Trade Head, Managing Director, J.P. Morgan, noted in a recent Treasury Today Question Answered article that as domestic companies increasingly trade cross-border and international firms continue to invest in China, demand is rising for properly integrated supply chain finance solutions that can link upstream and downstream procurement, buyers, vendors and distributors.

Distributor finance mirrors supplier finance in that the large corporate buyer becomes the supplier, using its credit status to finance the distributor's purchase of goods. It is prevalent in markets such as India, China and Korea and, notes Kumar, it is evolving in quite a few other regional markets, but in all cases cuts across a broad spectrum of industries.

There is a difference between the procurement and sales side in how risk management is handled. As a corporate moves into an Asian emerging market trading on open account terms (because letters of credit (LCs) may prove too administratively restrictive or expensive), a detailed supply chain risk analysis is essential. But this almost takes the reverse view of a pre-shipment finance risk assessment, considering factors such as the marketability of the corporate's own products, its position in the market, the relative strength of that market and the financial dependencies between the corporate as supplier and its distributors.

The role of SWIFT's BPO

Where a corporate exhibits a level of discomfort with the counterparty risk of its buyers, credit insurance would be appropriate but, says Standard Chartered's Kumar, this is not readily available in some Asian markets. This drives companies to use LCs as a risk mitigation tool but, he notes, these can be inefficient from an administrative perspective, often adding up to ten days in processing time.

This is where the International Chamber of Commerce (ICC)-approved SWIFT Bank Payment Obligation (BPO) (which became effective in July of this year) could play a major role by helping firms working in and out of the region to mitigate the counterparty risk arising from open account trading. Standard Chartered has already carried out transactions – with BP Chemicals and its client Octal – using this tool (see

AB Electrolux and Deutsche Bank – on-boarding suppliers

Case study

AB Electrolux is a global household name. It manufactures white goods for distribution in more than 150 markets, generating revenues in 2012 of $16.9 billion. In June 2011 the company asked Deutsche Bank to help set up a SCF programme for its North American business. Amongst the main aims of the project, AB Electrolux wanted to improve supplier liquidity (funded by the bank) to reduce "often costly" supply chain disturbances, said James Krikorian, North American Treasury Manager, AB Electrolux. Speaking at the recent EuroFinance Miami conference, he said the company also had a keen eye on freeing up its own working capital by extending days payable outstanding (DPO) (using the cash instead for core business growth), moving towards a standardised electronic invoicing (e-invoicing) process and harmonising payment terms for its suppliers.

In total, AB Electrolux uses 300 suppliers with which it has an annual spend of around $2.7 billion. The majority (225 businesses with a spend of $1.115 billion) are based in Europe, with seven in Asia (spending $400m), 60 in South America ($750m) and 20 in North America ($400m annual spend). AB Electrolux's more than 50 buyers are located in 25 countries, with US and Australian dollar, euro, Thai baht and Chinese renminbi as the main currencies. This structure is not set in stone and given the changing economics of global manufacturing AB Electrolux has some major plans involving some 450 targeted Asian suppliers located in eight countries in the region. The flexibility and scalability of its SCF programme will be tested, but the preparation work has ensured it has a solid base to work from.

The original project was managed by a cross-functional team within AB Electrolux covering procurement, legal, AP, IT and treasury, and followed discussions with other companies that had already implemented similar programmes. Krikorian advised anyone considering this path to start by gaining top management buy-in and to use key performance indicators (KPIs) throughout to "keep focus on the SCF programme and ultimately to reach those targets".

In practical terms, the first step for Krikorian's team was to build a comprehensive picture of flows with a view of seller and buyer locations and currencies. From here it was possible to build a business case and evaluate the inherent risks, which might include counterparty risk (whether that is the chosen bank partner or platform provider). Therefore, a set of what-if scenarios were prepared so that should the worst happen and the programme had to be wholly or partly terminated the results could be understood. The regulatory environment for each jurisdiction and the accounting treatment of the programme was also considered as part of the foundation project.

In assessing its banking partner – naturally the chosen one had to match the existing supplier and buyer locations of AB Electrolux, have the credit capacity to handle the full programme (using a syndicated structure where necessary) and not present any IT integration issues – both credit capacity and IT integrity were considered "pass or fail" criteria. However, AB Electrolux was seeking not only financial, technical and IT expertise for operations and support (including the ability to provide data extracts of AP) but also the ability of the bank to on-board and follow up on suppliers in additional countries and in local languages, especially as the Asian expansion programme was on the horizon.

Having established the partnership with Deutsche Bank, AB Electrolux was able to form a rigorous on-boarding strategy using the experience of the bank to support its decisions. Krikorian also reported that one key contact was appointed from procurement for the SCF programme and other members of the department were trained to assess and understand the effects of the programme on the suppliers, each considered for their criticality to the manufacturing process, their current payment terms, level of business and spend and current credit rating. In building out the approach for its supplier base, AB Electrolux established a number of on-boarding models, using one-to-one meetings, seminars, webinars and mailing of details regarding the mandatory change of current terms. Suppliers were then divided into one of three tiers (as Krikorian noted, "one size does not fit all") and some "low-hanging fruit" were identified as potential "quick and easy wins".

By defining a timeline for supplier negotiations and establishing the level of internal resources needed it was possible to allocate with precision "who does what and when" and to set expectations. To test its processes, AB Electrolux set up a small number of "well connected" suppliers as pilot cases to try "two or three of the preferred on-boarding strategies" and to test its file and payment transfers before evaluating and adjusting prior to full roll-out.

Treasury Today's May 2013 Corporate View with BP Petrochemicals' David Vermylen).

SWIFT promises that the BPO will give easier access to risk mitigation around pre and post-shipment finance. It allows sellers to electronically send trade documentation to their buyers and exchange the documentation data with both obligor and recipient banks. This enables them to get involved earlier facilitating payment as soon as the buyer raises the purchase order (PO), not delaying until the invoice has been approved as is the case with LCs. The four-party approach also means suppliers can use their own local bank rather than the buyers' banks (as would be the case in the traditional SCF programme), removing Know Your Customer (KYC) from the process and potentially lowering on-boarding costs.

"Asia is the centre of global trade growth and as the supply chain space evolves, more corporates will be looking towards open account and supply chain solutions," says Vinod Madhavan, Standard Chartered's Global Head, Local Corporate Products and Receivables and SCF. "Our expectation is that many corporates will now start using BPO to free up their working capital."

Whilst treasurers know that freeing up working capital is beneficial, an increasing number of large corporates are aware that doing it by extending days sales outstanding (DSO) too far can harm their suppliers – as such SCF is gaining traction. The two case studies illustrate different ways in which it can be approached. ■

Stanley Black & Decker and Citi – a centralised working capital tool

Case study

Stanley Black & Decker (SBD), a global supplier of tools, hardware, appliances and security systems for industrial and consumer use, has an inclusive approach to improving its working capital management including supplier finance. Yannick Croiger, Director of Financial Risk Management and Corporate Finance, explains that since 2007 the company's primary focus has been the implementation of the group-wide Stanley Fulfilment System (SFS), covering the central management of inventory, accounts payable (AP) and receivable (AR). The system is based on a number of common platforms including SAP, Hyperion, Navision, JDA, Red Prairie, Demand Solution, Share Point Server, Business Objects and Citi's Supplier Finance platform.

The problem with working capital, Croiger notes, is that it is cash that is locked up in operating the company from day-to-day and as such it is preferable to have as little as possible in this state; it is money that could be used for more accretive purposes. Decreasing inventory, collecting payables sooner and working out how to pay suppliers later without damaging them is the goal. "The concept is extremely easy to understand. Implementation on the other hand requires effort and discipline."

What SBD is creating (it has been an ongoing project since 2007) is a methodical, process-based approach to supplier finance and working capital that provides a "user friendly, automated and error-proof customer experience, from intent-to-purchase to shipping and billing to payment". From a group perspective it has become a "critical business process that keeps supply and demand in balance".

Kicking off a project of this nature will require senior management buy-in and it is also essential to communicate a policy on minimum terms and to enforce this policy right from the start. The centralisation of the project team at corporate level helped SBD leverage the knowledge and experience of cross-functional teams drawn from treasury, global sales and marketing, IT and accounting departments.

In practice, SBD's suppliers follow existing protocol for submitting and processing invoices but, for those within the scheme, twice a week SBD will upload payment files (which include invoice-level details based on established terms between SBD and the relevant suppliers) to Citi's web-based Supplier Finance platform. Suppliers are then notified of the due payment of their approved invoices via email. They may then log into the system and elect to discount some, all or none of these. Having done so they will typically receive funds (less the discount) on the next working day, with SBD paying Citi in full on the invoice due date, according to the agreed terms.

Entities (and thus their suppliers) within SBD that wish to join the scheme are prioritised around considerations of jurisdiction, currency and internal credit capacity as well as practical matters such as connectivity with the ERP. Croiger says it now takes between three to six months to admit a new company member. This allows the team to assess the most suitable supplier candidates, the preparation of legal documentation, any IT work and of course for the procurement team to introduce the Citi Supplier Finance concept to their suppliers.

For SBD, its efforts and actions have resulted in outperformance of its industry peers in terms of working capital reduction despite continued growth through acquisition. Croiger feels that the process may have initially "caused headwinds" but ultimately it has provided opportunities; SBD has seen a working capital reduction in the last 12 years of over $450m. However, he is adamant that the kind of discounting alternative the company has used "should be used to supplement good operating procedures, not to mask poor or lagging performance". Indeed, Croiger warns anyone considering this model to first establish rigorous operating processes, especially as it requires the business to strive for automation and the leverage of common platforms where possible. As well as ensuring the structure is as scalable as possible, he advises companies to invest time and money automating as much as possible up front, "even if the implementation takes longer".

Investors and leading fund managers discuss the challenge of investing cash in the short-term markets. They discuss the regulatory threats to the money fund industry and the possible solutions, as well as the various alternatives they are considering.

Short-term investments

Participants

Alex Fiott
Treasury Manager Market Risk
AstraZeneca

Jim Fuell
Head of Global Liquidity EMEA
J.P.Morgan Asset Management

Britta Hion
Head of Corporate Sales EMEA
BlackRock

Steve Matthews
Fund Manager, Liquidity
Canada Life Investments

Matt Shelley
Group Treasurer
3i

Chair

Richard Parkinson
Managing Director
treasurytoday
research | insight | analysis

Richard Parkinson (TT): What immediately comes to mind is money market funds (MMFs) and MMF regulation. Could I ask one of the fund managers to summarise for us and for the readership where we are right now with the proposed regulation?

Jim Fuell (J.P. Morgan Asset Management): It's very slow, Richard. We've been talking about potential proposals for a while now and the Securities and Exchange Commission (SEC) now has some proposals out for consultation.

Richard Parkinson (TT): I knew the industry was waiting for the SEC, but now suddenly we've got this European 3% capital suggestion that has been leaked.

Britta Hion (BlackRock): It does seem that there are a couple of processes running in parallel. There is a fair amount of concern and confusion in terms of how orchestrated those changes will be. The US is proposing to treat some of the funds and investment types differently. It's not clear whether there is going to be the same approach in Europe.

Richard Parkinson (TT): Let me ask the investors. What are you doing right now?

Matt Shelley (3i): Well, we're comfortable being in MMFs today, but we're starting to prepare for life without them. I'm concerned about what's in the leaked European proposal because it'll make life very difficult for most fund managers and investors. So we're starting to have a look around at other propositions and products, because MMFs may or may not fit the bill in 2014 and 2015.

Alex Fiott (AstraZeneca): I'd say we're largely in the same position. We concentrate a significant portion of our surplus cash in MMFs and had to ask ourselves whether we should be diversifying, which we are now doing. This may be slightly unfair but I get a feeling that there's a general inertia amongst corporates on this. I don't think they really want to admit that the scale of the issue could be coming their way in terms of the potential changes to the landscape. As a result, there could be a bit of a panic, or knee-jerk reaction, when it does come through because I just don't think we're necessarily prepared for it.

Matt Shelley (3i): I'm starting to form a view that actually a lot of corporate treasuries are slightly behind the curve in terms of all the regulation that's coming. It's not just MMFs, you've got European Market Infrastructure Regulation (EMIR), Dodd-Frank, Alternative Investment Fund Managers Directive (AIFMD), Financial Transaction Tax (FTT) – a whole suite of regulation that's going to be pretty onerous on providers and corporate treasurers.

Steve Matthews (Canada Life Investments): I agree wholly with what Alex and Matt have said but we'll be watching the developments closely and at the first sign of MMFs having trouble, we will re-focus on the alternatives that are available to us. Until then we will support them as much as we possibly can, and we'll put our voice behind those in favour of regulation that will support MMFs into the future.

Alex Fiott (AstraZeneca): I'm not convinced most corporates actually have got alternatives available. They'll go back to their boards, back to the investment policy, and say 'well, this is the new world we're living in. Can we accept a variable net asset value (VNAV)?' I don't have an answer to that, but that's how I see it playing out. At AstraZeneca, we already have the ability to move out of MMFs quickly.

> Variable net asset value (VNAV) is seen by many as the only practical and commercial structure by which the money fund industry will be able to exist under the proposed rules. Put simply, the principal value may vary although managers would do their best to avoid this.

Richard Parkinson (TT): You have a contingency plan in place?

Alex Fiott (AstraZeneca): Well, we could move to treasury-only funds and actually invest straight into US Treasuries, and we're preparing the legal documentation for tri-party repo transactions. Not on a full scale, but just dipping our toe in the water to see what this product offers; then gradually we could have an exit strategy from MMFs, if that was deemed appropriate.

Unfortunately, it's a 'perfect storm' building against MMFs. Regulation is obviously one aspect but there is also low yield, income fees and even negative yield environment. If you put everything together, the question is should we be concentrating so much cash into this one instrument?

Jim Fuell (J.P. Morgan Asset Management): I don't think it's just MMFs that are being impacted by potential regulatory reform. Regulation is affecting the broader short-term fixed income markets, so you can't make a decision to move away from MMFs without encountering regulation somewhere else. Proposed regulation such as the FTT and Basel III are just two examples. There are a number of moving parts, and to just focus on MMF regulation in isolation may not be the best approach.

Another point to keep in mind with respect to MMF reform is that we are anticipating in the first instance a 'proposal', and not an immediate change in regulation. Any proposal will have to progress through a political process, which will likely take a fair amount of time. Changes are not going to happen overnight.

Steve Matthews (Canada Life Investments): There could be a more joined-up approach to our protestations. What we've currently got, in terms

Steve Matthews
Canada Life Investments

> The Financial Transactions Tax (FFT) being proposed in Europe would levy a very small percentage charge on all financial transactions. The effect would be to tax away the return on transactions with very thin margins/small returns.

of MMFs, is working. The industry is well-regulated. If it gets broken up, because of the way regulation moves, then all of the corporate treasurers are going to have a nightmare trying to find homes for their money. So I don't think it's actually going to solve anything in the long term. Maybe it is time that we got together to provide a unified voice on the changes we object to on both the investor side and the fund side.

Britta Hion (BlackRock): The question is, if you apply a doomsday scenario that all investors will exit MMFs, whether the new regulated world is a better place from a risk management, market liquidity and financing perspective? Arguably it's not. The proposed regulations are going to take an important element of the functioning markets away.

Matt Shelley (3i): Some of the proposals are pretty sensible and actually nobody would argue with them, such as those around transparency, disclosure, prescribed liquidity, etc. No one is going to have a problem with that. Where there is a problem with the proposals is the capital buffer of 3%, which will hurt the economics of the MMFs and which will be passed onto the investor.

There is also the constant NAV (CNAV) versus VNAV debate, although I think that might not be quite as fundamental as people think. I think investors, with the right outcomes around the accounting and tax questions, will be able to get their head around it, although no one I speak to wants to see the change.

Richard Parkinson (TT): What's the industry going to look like in 18 months?

Matt Shelley (3i): I think it depends on two fundamental questions around the VNAV/CNAV and capital requirement. If those two issues don't get resolved favourably, then I see the MMF industry potentially being smaller than it is today. I am interested in the BlackRock and J.P. Morgan Asset Management viewpoints on this.

Jim Fuell (J.P. Morgan Asset Management): It's a difficult one to predict, obviously. Asking the hypothetical question right now – if MMFs are regulated in such a way that the CNAV structure disappears, will you continue to invest? – isn't necessarily indicative of what investors will do if they are truly faced with this decision. I think prudent investors will look at any regulatory proposal in its entirety and make a decision based on complete information.

I agree with your thoughts around potential changes to the underlying CNAV/VNAV structure. The typical treatment of the CNAV MMF product as a cash and cash-equivalent instrument is critically important for most corporate investors, and they will also want to understand if this is possible in a VNAV MMF. The tax treatment of the gains/losses on redemptions in a VNAV product is also an issue which corporate investors will no doubt want to understand. I don't totally disagree with your point that you may see a more concentrated market place from a managers' perspective.

Britta Hion (BlackRock): It's entirely possible that the market will shrink for a period of time. But then we'll have to be looking at what options are available in a low interest rate environment, what solutions are managers coming up with, and what is palatable for investors? It's quite possible that the industry won't look as uniform as it does at the moment, which in itself wouldn't necessarily be a good thing because you potentially lose the slightly commoditised element in this space and being able to compare like products with like.

Matt Shelley (3i): Alex, what are you going to do with your US dollars in a negative rate environment?

Alex Fiott (AstraZeneca): I have invested in US T-bills, paying 0% in the last two years, in the short term. It was unpalatable to go for a negative interest rate, so I just looked at the curve where there was a pocket to actually get nothing, rather than negative. It partly depends on the environment we would be in, but probably we'd be prepared to pay negative interest for security.

Britta Hion (BlackRock): Just with government risk or bank risk as well?

Alex Fiott (AstraZeneca): I think just with government risk, straight into US Treasuries. But going back to the question, I think that in the next 18 months we will actually be bringing in-house the management of some of our cash, rather than nearly 100% going to the fund manager.

Britta Hion (BlackRock): I think that is something that we're definitely seeing across the investor base – they are looking at cash balances much more holistically and terming it out. They are separating out what is doable, where they can take the risk and what needs to be instantly accessible – investors are much more focused on that than historically.

Steve Matthews (Canada Life Investments): I think the environment changes the context in terms of how you hold cash. If you have a general pool of cash, then you have one set of rules for it. But if you're holding cash for a specific purpose because you've switched into cash waiting for a better opportunity, well, the cost of holding that cash then becomes part of your trade, doesn't it? And then you make your decision as to whether or not you can lose one, two or ten basis points (bps) on a holding for one, two, three months, while you're waiting for your next investment opportunity.

Britta Hion (BlackRock): And the real yields are negative anyway. Therefore, depending on how long you're sitting on it, you might be losing value.

Jim Fuell (J.P. Morgan Asset Management): I'm just going to go back and pick up on one thing. There is a level of knowledge which has to be achieved around the concept of VNAV funds. The general assumption is that it implies more risk, but this isn't necessarily the case. You could, for example, see managers introduce VNAV products where the risk profile is more conservative than that of existing prime MMFs, in order to dampen or even eliminate any underlying market NAV volatility. However, this type of approach will make it harder to deliver the yield element of the triad — capital preservation, liquidity and yield – for which MMFs have been so well known and regarded.

Steve Matthews (Canada Life Investments): It'll be whether the settlement is T+0 or T+1. That's what it'll come down to in the long term. T+1 is not same-day liquidity.

Richard Parkinson (TT): **Let me just understand this settlement point. Are you saying that it would always be T+1 for VNAV funds?**

Britta Hion (BlackRock): It's just very challenging to do true mark-to-market with same-day liquidity. You'd have to have such an early cut-off in order to properly price the funds to then provide the same-day liquidity, which might not be feasible from a trading perspective. MMFs might lose some of their usability if you have a very early cut-off, and there could be potential pricing issues during the day. So that's the real challenge.

Jim Fuell (J.P. Morgan Asset Management): There's a lot of cash that we manage from investors who don't always need same-day liquidity. I understand that some need same-day liquidity, but we see a level of cash invested in MMFs by investors that can accept, for example, next-day liquidity. So banks, if I take an evolving short-term angle, have greater appetite for operational balances, and maybe that's where some investment is placed for that portion of corporate cash for which there is a clear need for T+0 availability. The dynamics continue to underscore the importance of transparency and the ability to tier or segment cash balances.

Jim Fuell
J.P. Morgan Asset Management

Alex Fiott (AstraZeneca): I would guess most corporate policies treat MMFs as overnight, which is technically not correct given that, if you needed to redeem your whole cash balance, it would probably take a few days.

Richard Parkinson (TT): **Are you saying the industry will offer both same-day and T+1?**

Jim Fuell (J.P. Morgan Asset Management): I think the industry recognises that if we want to manage working capital, the ability to deliver on a T+0 basis is critical. Whether or not we operationally are able to get to that is the unanswered question right now. There are some challenges around it, not the least of which is getting accurate market pricing and being able to conclude the determination of the NAV within a reasonable time frame in order to deliver T+0.

Matt Shelley (3i): Are J.P. Morgan Asset Management and BlackRock having more conversations with investors about segregated mandates?

Britta Hion (BlackRock): Yes, we are. And we were having those conversations a few years ago, but it always felt a little bit academic. When it came down to it, after looking at the logistics of setting up the segregated mandates and model portfolios, then typically what we've found is that investors actually shy away from it.

Now it feels more real – that it might be something that is actually going to happen. We are sensing that there is a real change in investor appetite. This is also partly in preparation for the potential regulation changes, so it's not just yield driven.

Richard Parkinson (TT): **What are the investors around this table thinking about doing?**

Matt Shelley (3i): Well, as I said, we've got a similar position to Alex in terms of having high concentrations in MMFs. We have seen banks offer better yields on bank accounts than MMFs, and those are banks whose credit I'm comfortable with. So with yields better than the MMFs, we've started to leave our operational cash floats with one bank.

In addition, we've looked at evergreen deposits and collateralised deposits, and we're learning about tri-party repos.

Richard Parkinson (TT): **How does an evergreen deposit work?**

Matt Shelley (3i): Under the new liquidity requirements, there's a lot more priority given to liquidity that is 'sticky', and particularly for deposits over three months. So an evergreen deposit – where you give notice to the bank to mature the deposit but you receive the cash back in three months' time, or otherwise the deposit will continue in perpetuity, that helps the bank from liquidity ladder perspective and can support a higher yield. You've got to be comfortable with the credit of that particular bank; but if you are, that can help.

Steve Matthews (Canada Life Investments): We currently use evergreen notice accounts (ENAs). We have some that mature over 35 days, over 60 days and some over 95 days, depending on our view of the risk of the counterparties. We hold those on an evergreen basis and we don't intend to call upon them until they are no longer economically viable from a liquidity, credit or rate perspective.

They're structured in a way that we want to keep them within our portfolio because they enhance returns. A small amount of extra risk for an appropriate amount of the yield. The only problem with them is that they never mature unless you call upon them. They never march into that sub-30-day bucket.

But if you're using it as 'sticky' money and plan to keep it there for two years, while getting three month LIBOR+10, then you're getting 60bps for a two-year deposit when you could get 48bps from rolling it every three months into your maturity bucket. So it's quite a call to make, and you should take all of that into consideration.

Matt Shelley (3i): If you compare the yields that you get on those 35, 60 and 90-day ENAs, does it compare favourably to a three and six-month deposit?

Steve Matthews (Canada Life Investments): We've done some and rejected others because the numbers just didn't work. Essentially what we wanted to do was achieve something around one-year money for something that was staying out there at just three months. Otherwise there was just no point going past three months, which tends to be the 'sweet spot'. So we look at offers on a case-by-case basis and negotiate from there.

Matt Shelley (3i): The yield curve is so flat and no one's paying for any kind of duration up to that tenor, so it's the evergreen – or that kind of deposit category – that creates a small pick-up in yield because it does help the banks in terms of their liquidity ladder.

Britta Hion (BlackRock): Can I ask Alex a question? In terms of everything that you're doing – taking things back in-house, fairly intensive layering and all the rest of it – presumably that's more resource heavy from your perspective?

Alex Fiott (AstraZeneca): Yes, most definitely. We just felt that we've got to start de-risking ourselves and put some process in place. Whether that will be the case in the long term, I'm not sure; but certainly, given the size of our balances, it makes sense to be able to do a direct repo transaction ourselves. But you're right – the more you bring it in-house, the more internal credit discussions you will have over what you're invested in.

Jim Fuell (J.P. Morgan Asset Management): Investors do four things with their cash: deposit it in financial institutions; invest it in pooled funds, such as MMFs; buy direct instruments, such as commercial paper (CP), certificates of deposit (CDs), etc; or establish a separately managed or bespoke investment vehicle, where they engage the support of an active asset manager.

One of the key benefits MMF investors get is the credit and risk management oversight provided by the underlying asset manager.

Steve Matthews (Canada Life Investments): That is the reason why we use you.

Matt Shelley (3i): But it's not 'fire-and-forget' – we still want visibility of strategy and holdings.

Jim Fuell (J.P. Morgan Asset Management): I agree. I look at the investment alternatives we've talked about today: bank deposits, CP, CDs and tri-party repo. We buy every single one of those instruments within a MMF. If you're achieving a


Alex Fiott
AstraZeneca

greater yield on a direct basis, it may be partially down to the fee a manager charges for the work they do; but it may also be because you're taking a level of direct risk that your asset manager simply isn't comfortable taking.

Alex Fiott (AstraZeneca): I think it's a Catch-22 situation, in the sense that we've got too much exposure to bank debt. If I ask a particular MMF why they haven't got more corporate paper, they say that there's not a lot out there.

Matt Shelley (3i): Whereas the corporate issuers that are in MMFs are consistently the same names.

Jim Fuell (J.P. Morgan Asset Management): It's also a function of the MMF design, where we're managing to a short-dated weighted average maturity (WAM), prescribed liquidity buckets, etc.

Britta Hion (BlackRock): A lot of it is to do with issuances as well. We'd all love to buy it, but it doesn't sit within the risk framework, it isn't sufficiently rated.

Alex Fiott (AstraZeneca): But I'm sure if you asked any corporate investor whether they would like to see more corporate names in a particular MMF, I think the answer would be an unequivocal yes.

Jim Fuell (J.P. Morgan Asset Management): Of course.

Britta Hion (BlackRock): It's the same for providers. We'd love to do more of it.

Richard Parkinson (TT): Are investors also taking or accepting more risk?

Britta Hion (BlackRock): Sadly, I think yes. I'd love to sit here and say 'no', but we are seeing that in some cases. Obviously some of the debate around this table is addressing that issue. It depends how you define risk, but we're seeing that the yield concerns are pushing investors to do things that they wouldn't previously have done. So yes, I think some investors are heading in that direction.

Jim Fuell (J.P. Morgan Asset Management): I'm not sure I'm sad about it. I think people who want the features that MMFs deliver should be focused on a product that has those characteristics. I think what we're seeing is connected to the tiering of cash, combined with greater transparency over cash positions. There are strategies that we're delivering that are offering greater yield and corporate money is starting to be attracted to those strategies. It's not a replacement for cash investments – it's a complement to cash investments; and there's appetite for it, whether in a pooled product or separately managed account form.

Steve Matthews (Canada Life Investments): We don't believe there is much risk-return out there. As Matt was saying, the curve is flat so there's not a lot of point going beyond three months – and with many banks there's no point in going beyond one month because you're only getting a couple of basis points for trebling your term.

For us, the change to risk happens when you come out of the cash market and look to invest out of a zero-yield area into something where you can get some kind of pick up. But that's a bond investment decision, which is something completely different to the cash market.

Matt Shelley (3i): What different things are investors doing and what risks are they taking? Is it duration or credit criteria?

Britta Hion (BlackRock): A bit of duration, a bit of a drop in credit quality and liquidity – all of the above. There is a divergence in terms of client type. One of the things that slightly concerns me when I'm talking to clients is that it's almost a reversion to pre-crisis behaviour, where you see some of the smaller, less sophisticated clients who are much more sensitive to yield, beginning to think about yield again and maybe start venturing into areas that perhaps they shouldn't be, or where they should conduct some additional investigation before they go down that route.

With regards to Jim's earlier point, there is obviously a huge discrepancy between client approaches. There are those who are very informed and well-resourced and will take very prudent decisions. But I'm more concerned about the people who don't have the resources or the experience perhaps, and may be inclined to forget some of the lessons learned over the course of the past few years.

Matt Shelley (3i): It's interesting looking around this table. I mean Alex is clearly US Treasuries, risk-averse and capital preservation-focused. I'm in the same camp, although focused around MMFs and banks rather than US Treasuries. Steve, are you taking any additional risk?

Steve Matthews (Canada Life Investments): Not particularly. It is not right for our cash funds and our 'on balance-sheet' monies don't need to chase yield.

Matt Shelley (3i): So I think capital preservation is still key for all of us.

Jim Fuell (J.P. Morgan Asset Management): I'm not fully aware of each of your respective investment policies, but I would just say that the approach in the UK does differ slightly when compared to the rest of Europe. As I sit in the UK as well, I do have to sometimes think beyond that. Certainly, from my observations, there is a more conservative investment approach in the UK.

Steve Matthews (Canada Life Investments): There's also the question around the definition of taking more risk. Is putting money with an A-2 corporate in CP more risky than putting it with an A-1 bank in CP? And you can argue there's a point where the diversification and the movement away from the banking sector actually decreases your risk, even though it's got a lower rating.

Britta Hion (BlackRock): Yes, exactly. It depends how you define it.

Jim Fuell (J.P. Morgan Asset Management): There's a trusted advisory relationship that we have with our clients, which means they're willing to hear us out on options and alternatives to add incremental yield. Adding incremental yield sometimes puts you into a total return-type structure, which isn't the way cash investors think. However, there's an opportunity to pick up yield when you access corporate issuance, with a level of incremental credit risk with which we are comfortable. Additionally, from an interest rate perspective, it can be a key component to push out and/or manage duration to a greater extent.

Matt Shelley (3i): And that's where your trusted advisor relationship and credibility really comes into play, because a significant number of investors will not actually have the resources or skills to do a really good job on credit risk management.

Alex Fiott (AstraZeneca): We're considering changing our investing instruments and buying a product that, hopefully, can sensibly increase yield. But it's very hard to pick up 15 or 20 bps in this low interest environment. The problem for a company is on the liability side, where they may be paying 4.5-5% on long-term debt, then getting 20bps for what could possibly be viewed as quite a lot more risk. It's just not worth it. Therefore, the liability management side of your business is the one that could be making you twist and do something silly.

Jim Fuell (J.P. Morgan Asset Management): I understand what you are saying – inside the corporate structure and the need to sell it upstream to management – but we are talking 20 to 40bps in incremental return off the back of a commensurate level of risk.

Alex Fiott (AstraZeneca): Oh, it's meaningful but it doesn't really cut your negative carry that much when you've issued debt five or ten years ago.

Matt Shelley (3i): Well, you can't do much about that, so I think nominal capital preservation remains key. And looking around the room, I'm sure everyone would agree that the financial markets are by no means 'fixed'.

Jim Fuell (J.P. Morgan Asset Management): There's a reason rates are low.

Matt Shelley (3i): Absolutely. Lots of markets are now looking very 'frothy' following the monetary easing by a number of central banks.

Matt Shelley
3i

Richard Parkinson (TT): As investors, you've talked about staying short and risk-free. Is negative yield acceptable?

Steve Matthews (Canada Life Investments): Depends on which bucket we're looking at – with some of my portfolios, I've bought assets with negative yields in order to maintain the investment policy but only in certain groups. Towards the end of last year, we bought some negative Dutch T-bills and Bubills (German T-bills). Therefore, sometimes it is a case of 'well, if that's where the markets are, then that's where they are', but I've kept that to an absolute minimum and haven't needed to do it this year.

There is currently an 8bps difference between reasonable quality three-month bank deposits and Bubills. If that relationship remains if Bubills go further negative, then I can assure you that Canada Life Investments will not be investing directly with a bank at negative rates. We would either maintain our positions with MMFs, or we would go direct into Bubills.

Matt Shelley (3i): We will have to accept negative rates, given our desire for short-term liquidity, either through direct interest rates or forward points on foreign exchange (FX) swaps.

Alex Fiott (AstraZeneca): Are you doing cross-currency swaps for a yield pick-up? No. We have looked at that on the basis that with a dollar base you can invest in Japan with a dollar/yen swap and achieve quite an attractive yield pick-up. But then you look at it more and you realise that you are taking on more bank risk because of a big FX exposure. We considered it because you can transact cross-currency swaps – or you certainly could six to nine months ago with the way the dollar/yen swap worked – to get a yield pick-up through the arbitrage opportunity.

Richard Parkinson (TT): Maybe some final words of advice to the reader as to what investors should be doing right now.

Alex Fiott (AstraZeneca): I think there's a lot to learn about repos, if you're going down that direct route. Corporates may have naively thought that they could lend cash to one of their strong counterparty banks and receive US Treasuries as collateral in order to get a yield, but the reality is that it's not quite that simple. You should have frank discussions with your banks as to how you're going to play out repo transactions and what securities you will accept.

Jim Fuell (J.P. Morgan Asset Management): I agree with you that there is a little naivety around the use of repo. This is meant with respect, but I suspect that most investors don't have the ability to analyse the underlying collateral sets, which may limit the capacity that a product like repo can offer particularly for non-government collateral.

Alex Fiott (AstraZeneca): Moving into a space that you haven't been involved in before means that you should look at a clearing house like Euroclear or Clearstream. Then if you decide to go into direct investments, do you open up a custodian account with one of the big custodian banks? That comes with a lot of associated costs. So then it comes down to why don't you let the experts – the BlackRocks and the J.P. Morgan's of this world – manage your cash? Doing it by yourself can be very expensive.

That's where we are at the moment. We haven't fallen into either camp but we want to de-risk ourselves, so we are exploring both camps in order to make a decision from there.

Matt Shelley (3i): My advice is to get ahead of all the regulatory changes that are coming. They will have direct impact on your company, but will probably also have an indirect impact because they will change the markets. You may not get to a position immediately where you're 100% happy with the impact of the regulations, but at least you can get to the point where you understand where it's not clear, why it's unclear and what the likely impacts might be. Many treasurers will have to spend quite a large percentage of their working week dealing with regulation now, which wasn't true historically.

Jim Fuell (J.P. Morgan Asset Management): I'll just say that the benefits of a trusted advisor relationship are becoming increasingly important and investors should take advantage of it now. It's not that we have all the answers but I think the relationship brings with it a dialogue. Therefore, if you're thinking about changing your investment policies, you shouldn't do it in isolation. There's a lot of interconnectivity in short-term markets and our expertise can often assist corporate investors as they think through and evaluate the evolving landscape. And we welcome the opportunity to talk with clients about these issues.

Steve Matthews (Canada Life Investments): I think the risk-return calculation has come back more into play recently, especially with the yield curve compressing so much – and it's going to become more difficult before it becomes easier. My advice at the moment is to remain short and wait for the opportunities to invest to come around. If you go chasing after yield and suddenly the regulations come in and the marketplace changes, you could find yourself holding the wrong assets.

I don't think we've seen the last of the trials and tribulations in Europe and there are more echoes to come around and hit the UK market.

There are no answers out there at this moment, therefore in the meantime I'm just keeping short. The problem with that is the additional pressure on banks to take longer cash. So, continue talking to all of the people that you can talk to and explore other options with the banks that you've got on your counterparty list. You can almost guarantee that there's someone within that organisation that will have an idea as to what else you can do with them that meets their requirements and gives you a better pick-up in yields, without necessarily taking more risk.

Britta Hion (BlackRock): We do see there are opportunities out there and we've discussed some of them. Perhaps if you go a little bit further out on the curve and think flexibly about what you can do in this environment, then that needs to be worked through in terms of policy and risk appetite with your partners – banks, fund providers, etc. You just have to be fairly creative and come into it with an open mind-set. The feedback loop is very important and then we can come up with solutions that will work over the longer term and are hopefully fairly 'future-proof'.

Richard Parkinson (TT): Thank you everyone.

Private placement market

The private placement (PP) market in 2012 had a record-breaking year in terms of issuance, with global supply soaring 23% year-on-year, hitting $56.1 billion. Whilst 2013 started off slower, as the half-way point beckons volumes are picking up rapidly. With oversubscription common and the sub-3% coupons being seen, the environment is ripe for issuers. But what should a treasurer know about PPs before leaping in?

If the concept of private placement (PP) is an alien one to you, it is certainly not to 33 of the FTSE 100 or 46 of the FTSE 250 firms, all having executed programmes in recent years. For those that do know of PP, it may have a reputation for being an alternative funding source for the smaller company, but clearly it is working for some of the major UK-listed businesses. In the wake of the UK government's Breedon report (issued in March 2012) which predicted that within five years the country could see a business funding gap of up to £191 billion, here is an alternative solution that has been quietly providing firms with capital for many a year.

So what is PP? In essence it is the direct sale of long-term mainly fixed rate securities – typically senior unsecured notes, ranking *pari passu* with other creditors – to qualified institutional buyers (QIBs), mostly US-based insurance companies and pension funds. As such, investors that are attracted to this form adopt an 'invest and hold' mentality because they are usually looking to match their long-term liabilities with assets of a similar size and maturity. The PP concept restricts the desire or need for a secondary market. Notes are subsequently sold, but rarely – the most likely reason being an insurance company merger which has led to over-exposure to a certain issuer.

On the issuer side, it is a way for firms to diversify their source of funding away from the banks, spread maturities and potentially lock in the cost of funding for a longer period. (A good source of who is doing what can be found at www.privateplacementmonitor.com.) Maturities range from three to about 30 years, but predominantly sit between seven and 12 years. In terms of size, it starts at around $30m for a bi-lateral deal; any lower than this, says David Cleary, Co-Head US Private Placements, Corporate Debt Capital Markets, Lloyds Bank Commercial Banking, and the legal and process costs tend to outstrip the value. Indeed, he adds, "the bank market is currently liquid and keen to lend money so it can pick up anything below that." The typical deal is for between $150m and $500m, but the occasional jumbo-deal will go beyond the $1 billion mark. Weir Group, Thames Water and HS1 all issued in the UK deals of around in excess of $750m each in 2012. Because most of the funding comes from the US, US dollar is the primary currency, with the issuer's bank doing the swap to sterling or euro. Over the past 18 months or so the pool of investors offering direct sterling or euro funding has expanded, he notes.

Issuers can split funding into two or more tranches, with different currency (mostly sterling or euro) and tenor if required, which means there is no one-off 'bullet' payment at maturity, series repayments enabling a business to correct its amortisation profile.

Pre-paying a PP can be done at any time by the issuer but as a fixed rate instrument, if rates have moved against them there will be a pre-payment penalty based on a 'make whole' provision. This seeks to compensate the investor for loss of future interest payments – and it can be punitive. If rates have risen there may be no penalty, but then the issuer will surely want to keep that debt. According to Tony Fordham, Managing Director, Private Placements, RBS, "issuers should only take advantage of any fixed rate term debt – whether it's a bond or private placement – if they are comfortable they will be able to use that debt in the business for the life of the facility."

Deals on average will be funded by eight to ten investors. A small number of these have the appetite to hold in excess of $100m (and may try to bid for the whole book on some issues). Smaller investors may take between $3m to $5m but the average holding per issue is around $30m. In terms of total exposure limits for individual issuers, Fordham notes an increase in appetite: "Two or three years ago, investors may have set a limit of $100m to a name; this year it may have stretched it to $150m."

A PP has no requirement to file with the US Securities and Exchange Commission (SEC) or for any other ongoing reporting. As such, notes Fordham, "from a regulatory touch, it is a light market". This does not make it a higher risk instrument. PP investors are typically conservative, he notes. Whilst there is no requirement for issuers to have a public debt rating, the majority have implied investment-grade status. Quality is typically indicated by having a net debt to EBITDA ratio that is within the scope of an investment-grade covenant (so leverage of less than three times). In the US market, as a means of ranking issuers, after each placement the industry regulator (the Securities Valuation Office of the National Association of Insurance Commissioners, or NAIC), will give a designation to the notes. These range from NAIC-1 at the top, down to NAIC-6.

The rating determines the amount of capital that investors have to hold against their investment and will also influence the coupon rate payable by the issuer. NAIC-2 covers the equivalent S&P BBB+ down to BBB- rated firms, and typically attracting a US dollar coupon of about 4%. This bracket accounted for 63% of transactions in 2012. Thirty-six per cent were NAIC-1 (AAA down to A-) which generated a typical 3% coupon, although the first sub 3% ten-year coupon was issued recently by Johnson Matthey. The remaining 1% of last year's market came from the sub-investment grade NAIC-3, covering firms rated down to BB-. "The focus since 2008 has been NAIC-1 and 2," says Cleary.

However, some of the firms designated NAIC-3, he adds, have performed well and have been upgraded accordingly. However, he notes that the trend for investors to seek more opportunities has seen them either going down the credit curve slightly or going for a longer tenor. "In the past 12 months there has been some availability for new investment in NAIC-3 firms which would not have been available before."

There are clear limits as to what investors will touch; they will not lend to start-ups or companies in industries susceptible to rapid change such as the hi-tech field, says Fordham. Financial institutions, although not avoided, may warrant deeper scrutiny; there is an element of not wishing to lend to the competition but also a wariness of the increased risk amongst financial institutions that emerged post-Lehman's (firms that have accessed the PP market include specialist lenders such as Intermediate Capital Group and Provident Financial). "Investors much prefer asset-owning companies, those that have steady non-cyclical income or businesses with strong contractual cash flows," says Fordham.

As the name suggests, PP is conducted in private in bi-lateral discussions with the investor base. It is rare that direct deals are done between issuers and investors and then only with follow-on issues. This is not just because the initial issue may be daunting, but also because many treasurers value their relationships with their primary banks and if one or more of these that will take the role of agent for the deal (around two-thirds of all issues over the last 12 months have been joint-agent transactions). The agent facilitates the sale between parties, having all the dialogue with investors on its client's behalf and typically, at the closing stage, will run the auction (on a Dutch auction 'bid down' basis) to secure the best investor bids.

From the start, the agent steers the company through the process. This covers three key stages:

1. Preparation (which may take up to five weeks).
2. Marketing (approximately ten days)
3. Closing the deal (a two to four-week process).

The initial phase requires the creation of three documents. The first is an information or PP memorandum, which describes the business in detail. This may be up to 80 pages in length and will go back to first principles and include the past five years' financials. This document will aid investors in their decision as to whether to proceed or not, such is its importance.

The package of information is then formed into the second key document, which is the presentation material used for marketing the PP to a panel of agent-selected individual investors. For a debut deal at least, this will form part of an investor 'road-show' which the agent will have arranged in advance. For a UK business it typically requires a group meeting in London followed by a few days of meetings in the US (mainly the investor centres of New York, Hartford, Philadelphia, Chicago, Des Moines and Milwaukee). Interested investors will then submit their bids to the auction process.

The final document, known as a note purchase agreement (NPA), where the issuer is actually selling a promissory note, sets out the terms and conditions of the placement. Often drafted from a model form subsequently amended to reflect the needs of the individual issuer, the legally binding NPA will include a statement warranting that the information contained in the PP memorandum is complete and not materially misleading thus serving to regulate any tendency towards marketing hyperbole.

But it also contains fairly tight financial covenants that are in line with those of the issuer's primary bank. As Cleary observes: "All the investors and banks in the senior debt piece are aligned."

The caution of the investor space is evident at this stage. "Whereas investors are happy to push the boundaries on price, they still care about what is in the NPA," says Fordham. Covenant relaxations seen in 2006 and 2007 are no longer; this is senior debt and investors rank *pari passu* with the banks. "What they learnt during 2008 and 2009 is that if there is a problem they want to be around the negotiating table at the same time as the banks, not several months behind."

That said, the default rate on PP is currently well under 1% and holding up extremely well during the recession. "Investors have found that recovery rates are much better in PP lending than in public bond lending," says Fordham. Bonds may go from trading around par to being distressed quite quickly, leaving the bond-holder largely helpless or trying to offload in what rapidly becomes a very illiquid market. In PP, financial covenants ensure that issuers engage much earlier with their lenders with "a greater effort to find a common ground going forwards". Issuers may ask for a covenant change when trouble hits (a number of house-builders in 2008/2009 saw their EBITDA fall off the cliff), and whilst this may cost them a fee or an increase in coupon, the contract remains intact.

Major US players on the investment side include MetLife (which put $8 billion to work last year), US Prudential, New York Life, Canada Life and Aviva US. Of course, some investors operate on both sides of the Atlantic but the European PP investor market is comparatively small. In the UK, in addition to the London offices of US firms, there are just three active investors – Legal & General, M&G and Aviva – the latter two having been active in the PP space for around ten years. Others have engaged with the occasional high credit-quality placement but have yet to dip their toes in the lower credit orders.

The US players have been exposed to a PP market that started back in the 1930s and Cleary notes that the main players have long since established credit teams that are "comfortable buying unrated senior debt and making unrated credit analysis". The reticence to go further into the PP market in the UK is largely because investors here are set up to buy rated public bonds so would have to form the right credit team and initially would only be able to invest in the best credits. This creates a pricing issue, according to Cleary. "When the pricing for a new issue comes in, the US firms are seeking relative value off US public bonds and the UK firms are seeking relative value off UK public bonds; the UK market publically is more expensive than the US, so they often struggle to get there on price."

Overall, the PP market is in rude health, the only 'problem' being the shift back to more historical levels from 2012's boom. "In order to provide growth in the market we need companies to undertake M&A and to put some more leverage onto their balance sheets, but overall, corporate Europe is de-leveraging," says Cleary. In an environment where heavy investor-demand has already caused oversubscription on a number of deals – Mars in the US recently ran with the biggest ever PP at $2 billion, this being massively oversubscribed at $3.5 billion – and where the first sub-3% ten-year coupon has already been issued, PP looks like a very attractive alternative proposition. The Breedon report would surely concur. ■

The voice of experience

Specialist international distribution and outsourcing group, Bunzl plc, has been to the US private placement market six times. Its Group Treasurer, Tim Hayter, describes the experience and offers advice to newcomers.

If you want to know how the private placement (PP) market works from the issuer's perspective, then asking Tim Hayter, Group Treasurer of Bunzl plc, is a pretty good place to start. Bunzl has now completed its sixth US PP, having gone to market in October of last year to refinance some of its debt facilities by raising $350m.

The company had previously gone to the PP market in 2001, 2006, 2008, 2009 and 2010. Bunzl has always used one of its key lending banks as an agent. Having gone through the process a number of times, might it not be cheaper to go direct to the investors? "We have thought about it," Hayter says, "and you may save the agent's fee, but you lose an unquantifiable amount by destabilising the relationship you have with your banks."

By not giving a certain bank a portion of its wallet through ancillary business – one aspect of which is PPs – when a corporate renews credit lines, for example, the price might be higher, the amount of liquidity available might be reduced or the relationship could even be terminated. Hayter stresses that the most important element at stake here is the banking relationship, which he describes as being "absolutely key to having a strong bank group".

The main driver for reaching out to the US PP market is to diversify away from the banks. But it also provides longer-term funding than the banks, helping to push Bunzl's maturity profile out and these maturities can also be multi-tranche. The 2012 placement, for example, was for seven, nine and 11 years. "When we did that issue we had $240m maturing in April 2013, so we went out for $350m, re-financing the $240m with $110m of extra funds. We took the $110m at the time and had a six-month delay on the $240m, drawing that down when we needed it in April 2013." The delayed drawdown is, he adds, a useful feature of market.

Hayter says the PP model enables companies to divide maturities into bite-size chunks rather than having a large bullet repayment as in the public markets. Bunzl has a series of manageable tranches maturing every year until 2024; the largest amount in any one year being $170m.

Please go to www.treasurytoday to read the full case study.

Kirit Patel

CEO

day lewis

Day Lewis Group is the UK's largest independent pharmacy chain owning and managing over 200 pharmacies across the country. These outlets are predominantly based in local community and secondary high street locations. Throughout its 38-year history, Day Lewis has been developing from a traditional retail pharmacy business into a patient-orientated service provider, dispensing pharmaceutical and other retail products, providing a diverse range of clinical services to its customers.

Problem…

Day Lewis needed capital in order to expand its store base. As a supplier of pharmaceutical products to the NHS, the company joined a supply chain finance (SCF) scheme provided by Citi which allowed it to unlock credit and boost its working capital at a much lower cost.

Day Lewis has over 205 pharmaceutical outlets in the UK, each providing prescription medicines to NHS patients. The company then invoices the Department of Health (DoH) which reimburses the company on average 36 days later.

In the aftermath of the credit crisis, Day Lewis' banking partners imposed a working capital covenant on the business, presenting it with a significant challenge. Making internal improvements to its working capital management was not easy: one problem was that the NHS does not reimburse pharmacy the VAT paid by the contractors for customer prescriptions on time, obliging it to claim it back through a separate and lengthy accounting process with HM Customs and Excise.

Affordable bank finance might have provided the business with some respite, but with a lack of liquidity in the market place, the company found the cost of borrowing prohibitively expensive. The credit rating of its NHS debtor, because of the absence of documentary evidence, was not taken into account by the bank, making the interest rate payable much higher. Under these conditions, finding the required capital to follow through on its plans to open new stores and grow the business became increasingly challenging.

…Solved

Day Lewis considered selling its NHS debt to a third party, but found the rates on offer too steep to provide a sustainable solution to the problem. Then the company heard about the SCF solution provided by Citi on behalf of HM Government. Through this solution, Day Lewis secured cheap invoice finance based on the NHS's credit rating. This meant Day Lewis not only received payment for its prescription invoices a month earlier, but the cost of borrowing was significantly cheaper than options explored previously.

Kirit Patel, the company's CEO, admits he was surprised at how straightforward the process proved. Besides a few minor formalities concerning its syndicated borrowing facility, the company faced few legal obstacles to its participation in the scheme. As soon as Citi had spoken to the syndicated banks on Day Lewis' behalf to explain the terms of the arrangement, the company was given the go-ahead.

"The only reservation I could think of at the time was that it seemed to be too good to be true," Patel recalls. "But we investigated it and we had high-level meetings – and there was really no catch." Following uptake of the Citi solution, the company's balance sheet was transformed, almost overnight. In addition to a substantial saving of £200,000 in interest costs, Day Lewis was able to reduce its overdraft. In turn, it also received a sum of £6.5m back for capital expenditure.

That money will now be used to expand the Day Lewis store base. "We have freed up working capital and acquired capital expenditure to increase the number of shops," says Patel. "It was a Downing Street scheme to free up working capital for capital expenditure. Now, that is exactly what we are going to be doing – spending more money on new stores and freeing up cash in the economy." ■

Joseph Schumpeter

"Can capitalism survive? No, I do not think it can," said Joseph Schumpeter in his seminal work 'Capitalism, Socialism and Democracy'. Unlike Karl Marx, however, he didn't believe that the system would be destroyed by the proletariat but instead by its successes.

Joseph Schumpeter, an Austrian-American economist and political scientist, is much honoured as an economic prophet: in 1983 Forbes pronounced him a better guide to the tumultuous world economy than John Maynard Keynes; and in 1986 John Kenneth Galbraith described him as "the most sophisticated conservative of this century". One of the most influential economists of the 20th century, Schumpeter popularised the term "creative destruction" in economics.

On 17th September 2009, The Economist inaugurated a blog on business and management named "Schumpeter". The initial Schumpeter blog praised him as a "champion of innovation and entrepreneurship", whose writing showed an understanding of the benefits and dangers of business that proved to be far ahead of its time. Subsequently the blog has covered cutting-edge innovations, including most recently 3D printing, sustainable start-ups and wi-fi offloading. There are Schumpeter lectures, Schumpeter societies and Schumpeter prizes. In addition, his theories live on in the hearts and minds of policy makers. For example, the EU's innovation programme, and its main development plan, the Lisbon Strategy, are influenced by Schumpeter.

Beyond his economic prowess, he was infamous for his public persona. Schumpeter claimed that he had set himself three goals in life: to be the greatest economist in the world, to be the best horseman in all of Austria and the greatest lover in all of Vienna. He duelled with a university librarian over restrictions on lending privileges and often taught classes while wearing jodhpurs.

Early life

Schumpeter was born in 1883 in Třešt, in what is today part of the Czech Republic, and his father and grandfather were local textile entrepreneurs. The family moved to Vienna, the capital of the Austro-Hungarian Empire, after the death of his father in 1887. Living in one of the world's leading centres for economics piqued Schumpeter's interest in economics. He received his doctorate in 1906 and, after some years abroad – mainly in England and Egypt – he settled down to a conventional career as an economist. During the years 1908-1914, while still in his twenties, Schumpeter published three brilliant books in economics and advanced to full professor at the University of Graz. One of these, 'The Theory of Economic Development' (1911; English translation 1934), was the first major work by an economist that was devoted entirely to entrepreneurship. It became a classic and by far Schumpeter's most influential economic work.

As Schumpeter's professional success grew, so did his personal ambitions and he yearned for a high political position in the Austro-Hungarian Empire. After World War I the Austro-Hungarian Empire disintegrated, which may have dashed his dreams, except that in 1919 the Social Democrats asked him to be Secretary of State for Finance in the new Austrian Republic. However, he was sacked in November of that year amid hyperinflation and broader economic collapse. He received a banking licence in lieu of a pension.

After a decade of lecturing at different universities, as a Professor at Graz and Bonn and as a visiting Professor at Harvard University in 1927 and 1928, lecturing at Hitosubashi University Japan in 1929 but failing to gain a chair at Berlin in 1931, Schumpeter was appointed a professor at Harvard in 1932, in succession to Frank Taussig. There he taught Wassily Leontief, Paul Samuelson and John Kenneth Galbraith among others. In 1939 he published the two-volume 'Business Cycles: A Theoretical, Historical and Statistical Analysis of the Capitalist Process', which was overshadowed by Keynes' 'General Theory'.

In 1942 Schumpeter released the more popular 'Capitalism, Socialism and Democracy', at once praising large corporations as the engines of economic growth and warning that a Gramscian new class of government bureaucrats (wearing New Deal clothes or otherwise) might lead to the triumph of socialism. It featured praise of capitalism as 'creative destruction' – "creative destruction is the essential fact about capitalism. Stabilised capitalism is a contradiction in terms."

Galbraith's assessment of this book was that it must be read "not for the agreement or disagreement it provokes but for the thought it invokes".

Creative destruction

The bulk of his immense theoretical contribution was directed toward an investigation into entrepreneurial capitalism as a transitory, historical phenomenon. This analysis of the growth of capitalism was tied to both a general theory of social classes and a detailed inquiry into the nature and function of the capitalist class.

Schumpeter's two greatest insights were that innovation is the driving force not only of capitalism but also of economic progress in general, and that entrepreneurs are the agents of innovation. Entrepreneurs are possessed by "the dream and the will to found a private kingdom", but they are confronted with obstacles. Innovation is hard to produce and harder to sustain: all successful businessmen stand on ground that is "crumbling beneath their feet".

Schumpeter was among the first to lay out a clear concept of entrepreneurship. He distinguished inventions from the entrepreneur's innovations. Schumpeter pointed out that entrepreneurs innovate not just by figuring out how to use inventions, but also by introducing new means of production, new products, and new forms of organisation.

Innovation by the entrepreneur, argued Schumpeter, leads to gales of "creative destruction" as innovations cause old inventories, ideas, technologies, skills, and equipment to become obsolete. The question is not "how capitalism administers existing structures, but how it creates and destroys them." This creative destruction, he believed, causes continuous progress and improves the standards of living for everyone.

Schumpeter argued that some degree of monopoly is preferable to perfect competition, which was the prevailing view as a way to maximise economic well-being. Competition from innovations, he argued, is an "ever-present threat" that "disciplines before it attacks." He cited the Aluminum Company of America as an example of a monopoly that continuously innovated in order to retain its monopoly.

Schumpeter and Keynes

Born just months apart and dying within a few years of each other, Schumpeter and Keynes were contemporaries in the best sense, as illustrated by the former's respectful obituary of the latter. Austrian-born American management consultant, Peter Drucker, backs up the assumption that the two men were not antagonists. "Both challenged longstanding assumptions. The opponents of Keynes were the very 'Austrians' Schumpeter himself had broken away from as a student, the neoclassical economists of the Austrian School. And although Schumpeter considered all of Keynes's answers wrong, or at least misleading, he was a sympathetic critic," wrote Drucker in his essay, 'Modern Prophets: Schumpeter and Keynes?' (1983).

When Keynes's masterpiece, 'The General Theory of Employment, Interest and Money', came out in 1936, Schumpeter, by then the senior member of Harvard economics faculty, told his students to read the book and also that Keynes's work had totally superseded his own earlier writings on money. Keynes, in turn, considered Schumpeter one of the few contemporary economists worthy of his respect.

According to Drucker, the differences between Schumpeter and Keynes went much deeper than economic theorems or political views. The two saw a different economic reality, were concerned with different problems, and defined economics quite differently. For example, Keynes operated entirely within the classical economics framework. Economics was the equilibrium economics of Ricardo's 1810 theories, which dominated the 19th century. Keynes's key question was the same question asked at that time: "How can one maintain an economy in balance and stasis?"

Schumpeter, on the other hand, held that a modern economy is always in dynamic disequilibrium. Schumpeter's economy is not a closed system like Newton's universe – or Keynes's macroeconomy; it is forever growing and changing – more biological rather than mechanistic in nature. The 'Theory of Economic Development' begins with the assertion that the central problem of economics is not equilibrium but structural change.

Classical economics considered innovation to be outside the system, putting it in the category of "outside catastrophes" with earthquakes, climate or war, which have profound influence on the economy but are not part of economics. Schumpeter insisted that, on the contrary, innovation – or entrepreneurship that moves resources from old and obsolescent to new and more productive employments – is the very essence of economics and most certainly of a modern economy. ■

Seminal works

The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle (German 1911/English 1934)

In this classical analysis of capitalist society Schumpeter proclaims that economics is a natural self-regulating mechanism when undisturbed by "social and other meddlers." Despite weaknesses, he argues, theories are based on logic and provide structure for understanding fact. He proceeds to demonstrate that there are underlying principles in the phenomena of money, credit and entrepreneurial profit that complement his earlier theories of interest and the business cycle.

Business Cycles: A Theoretical, Historical and Statistical Analysis of the Capitalist Process (1939)

Schumpeter focuses powerfully on the historical role of technological innovation in accounting for the high degree of instability in capitalist societies. He aims to analyse empirically the actual process of economic development using historical and statistical material based on the theoretical framework he developed in earlier writings.

Capitalism, Socialism and Democracy (1942)

Schumpeter's contention that the seeds of capitalism's decline were internal, and his equal and opposite hostility to centralist socialism, have perplexed, engaged and infuriated readers since the book's publication. By refusing to become an advocate for either position, Schumpeter was able both to make an original contribution and to clear the way for a balanced consideration of the most important social movements of his and our time.

History of Economic Analysis (1954)

Published posthumously, this classic text provides a complete history of economic theory from Ancient Greece to the end of World War II. Topics addressed include the techniques of economic analysis, contemporaneous developments in other sciences and the sociology of economics.

Other works include:

- The Nature and Essence of Theoretical Economics (1908).
- Economic Doctrine and Method: An Historical Sketch (1914).
- The Crisis of the Tax State (1918).
- Depressions: Can We Learn From Past Experience? (1934).

Supply chain finance – modern, simple, effective

Supply chain finance (SCF) may have been available for many years, but there is no shying away from the fact that it has never quite taken the starring role in the pantheon of banking products. It may lack glamour but, for those that know, it is a simple and effective working capital solution that functions in the background helping both corporate buyers and their supply chain. Lionel Taylor, Head of Trade Products at Lloyds Bank Commercial Banking, gives Treasury Today a guided tour of all that SCF means today – and what it may mean in the future.

The often unrecognised beauty of working capital solutions, also known as supply chain finance (SCF), is that it is simple and it works. There is no mystery or magic about its success – it just provides an answer for trading partners that otherwise have polarised needs, which often lead to the buyer wanting to pay their supplier as late as possible by extending their payment terms (days payable outstanding (DPO)), and the supplier wanting to reduce those terms and be paid as quickly as possible (days sales outstanding (DSO)).

"One political critic recently suggested that SCF may well be redundant if large companies paid their bills on time". This opinion entirely misses the point as the payment terms and approval process dictated by the buyer may themselves be prohibitive. Also, if corporate buyers use up their excess cash by paying their suppliers earlier, they will deplete their own working capital which is essential for investment and expansion as the economy grows. In essence, a SCF programme is (mostly) a bank-led bridge spanning the needs of a buyer and its corresponding supplier chain. Despite this, a supplier only has to calculate its cost of borrowing for carrying the receivable under its own credit line on its existing terms and compare it to the cost of supplier finance initiated by its buyer to see that it will probably (but not always) be better off signing up for the latter.

What's more, because most major buying organisations prefer to be seen in a positive light, in terms of business conduct, and most suppliers are keen not to upset the balance of the relationship with their buyers, both buyer and supplier need to exist in a state where all forces are equal and opposite and anything that can facilitate this state of harmony is surely welcome. Buyers are looking to introduce the SCF scheme as part of a wider corporate social responsibility (CSR) policy.

Taking SCF further

The common perception of SCF today begins with the payables finance model operating between a large corporate buyer and its many suppliers. This model enables an accelerated payment to a supplier based on the buyer's approval of its invoices.

> In order to understand the whole spectrum of buying and selling for a specific company, it is essential to get straight to the heart of a client's trade relationships and the context in which that business is carried out. This demands a detailed discussion covering the precise nature of the business, where it is buying from and under what terms, what it is doing with its purchases, who it is selling to – and so the list of questions continues. It is an exhaustive, but nonetheless essential stage that enables Lloyds Bank to offer the right solution first time.

For Lloyds Bank, the aim is to take such an offering beyond mere talk of a specific product and steer it towards an intelligent discussion, based on genuine customer need. "We spend a lot of time across the whole of the transaction banking space talking about working capital solutions," says Lionel Taylor, Head of Trade Products at Lloyds Bank Commercial Banking. "We have a variety of products ranging from an overdraft to more specialised offerings such as trade finance, but the bank is focused on being able to find out exactly how our product set best suits the needs of our customers."

This inclusive approach within Lloyds Bank transaction banking requires an intimate knowledge and understanding of the supply chain of each client. From order-to-pay, this must include the various touch points along the way, from agents to shippers to financiers, depending on the nature of the business. "It starts with trade cycle analysis," explains Taylor. In order to understand the whole spectrum of buying and selling for a specific company it is, he notes, essential to get straight to the heart of its client's trade relationships and the context in which that business is carried out. This demands a detailed discussion covering the precise nature of the business, where it is buying from and under what terms, what it is doing with its purchases, who it is selling to – and so the list of questions continues. It is an exhaustive, but nonetheless essential stage that enables Lloyds Bank to offer the right solution first time.

Indeed, whilst any discussion around SCF with a client implies an immediate or impending need, Taylor says engaging in this way generally opens up a wider discussion based around anticipated growth and expansion of that client's business. This is exactly the reason why Lloyds Bank has adopted the inclusive approach he says, but stresses the need to be mindful that future-proofing cannot be executed at the expense of today's need. "We find out where the pressure points are and then start to think more closely with the customer as to how we might provide the right solution. This is for the long term and we want to make sure that what we put in place does what the customer needs now and in the future."

Aligning the functions

There is a natural tension within the buyer organisation between the treasury's need to extend terms and the procurement department's desire to pay early to protect its supply chain. "But in recent years I have seen a trend evolving towards a greater degree of alignment between the divisions," notes Taylor. The progressive move to open account trading by some trading partners may have seen some buyers wanting to push terms out ever further. But as the economic environment turned downwards, a number of companies started to think more in terms of how to protect key suppliers with programmes such as SCF spearheading the way.

By ensuring suppliers can take advantage of more competitive funding, secured through the buyer's superior credit strength, it secures the supply line and potentially puts improved pricing on the buyer's table, and also enables treasury to extend terms. "It's good for everyone," comments Taylor.

> The progressive move to open account trading by some trading partners may have seen some buyers wanting to push terms out ever further. But as the economic environment turned downwards, a number of companies started to think more in terms of how to protect key suppliers with programmes such as SCF spearheading the way.

Putting a programme in place

Once Lloyds Bank receives a mandate from its client to put a SCF programme in place, it will begin working with that client to introduce the concept to its suppliers. "We take as much care on the supplier side as we do in bringing in a major buyer," states Taylor. The care and attention required, particularly on the part of the supplier, can sometimes reveal SCF as a product that takes a while to be put together, erroneously making it a target for criticism.

"The truth is that if a programme is put in place, the buyer will be extremely sensitive as to how it works before they will consider rolling it out fully," Taylor explains. The buyer will typically want to see a pilot project to make sure it works, and that, he concedes, does take time. Lloyds Bank consciously adopts a 'softly, softly' approach with suppliers because most will have established payment patterns in place. SCF will move them away from those patterns. "The supplier, rightly so, has to make its own decision about SCF in its own time and that decision must be right. It is a fallacy that they do what their buyers tell them to do – even the smaller suppliers will speak up if it is not right for them."

Transparency and simplicity

A phrase that Taylor hears from time to time in discussion with suppliers is that SCF "sounds too good to be true". Getting funding at a competitive price and without having to give any security does seem like a fanciful proposition for any supplier but, he assures, SCF is what it claims to be. It may not suit some suppliers, particularly those that are part of a larger group who can benefit from advantageous inter-company lending rates, but generally SCF really is beneficial to all parties.

"Transparency is the key," notes Taylor. Because it provides suppliers with greater visibility over buyer approvals, although many suppliers will "watch and wait for a while" before immersing themselves in SCF, it often becomes the preferred method of payment. "Suppliers also tell us that it removes some of the concentration risk they have with certain buyers."

Programme success

Having typically been through a request for proposal (RFP) process to secure the client mandate, all stakeholders will be keen to ensure the success of an SCF programme. From a banking perspective, Taylor says it is essential to know that every function that SCF will touch in the buyer organisation is entirely comfortable with the concept, not least because suppliers invariably call upon their contacts on the buyer side to learn about the programme independent of discussions with the bank.

> The main concern around international expansion is not necessarily one of technology or risk mitigation, but instead more around the management and care of suppliers. On-boarding a supplier in a country far-removed from its buyer may not be easy if that supplier is located in a country not served directly by the bank running the programme: a global bank may have a presence in that country, but it is unlikely it will have a team dedicated to SCF. Thus it becomes a matter of ensuring the level of service is of an equally high standard across the board.

Once the facility is in place and Lloyds Bank has created the necessary web pages and portal for suppliers to enrol, the bank will undertake an educational programme, putting together comprehensive and bespoke information and training material for both buyer and supplier. This programme may also involve joint roadshows with the buyer, where more intensive and personalised discussions are held with suppliers. Whilst most of the work in creating a successful SCF programme must be done upfront, the good news, Taylor says, "is that once suppliers are on-board, because it is largely automated, from then on it is easy to run".

Technology

The technology required for most providers' SCF programmes, at least at the user interface, remains purposefully simple. Each has to make information available and visible, so a supplier can see what has been approved and choose if and when it will discount those invoices, with payment being made automatically if required. But it must do so in the most intuitive way. Like most things in life, states Taylor, the simpler it is, the better. "The key with SCF is to resist the temptation to over-engineer it, making it more complicated than it needs to be."

This is a challenge for a bank such as Lloyds Bank where there is a clear need to drive the service deeper into its banking infrastructure – to open up products and solutions from other banking sectors – or expand functionality beyond payables finance and, for example, enable funding against purchase orders. Because the immediate function of an SCF programme is largely about the interpretation of data, technology has a major role to play. But, insists Taylor, "whatever challenges arise at the back end, it still has to be as clean and simple for the user as possible."

Making the difference

If the SCF products offered by the banking community are all purposefully uncomplicated and somewhat similar in approach, at least at the front end, how does Lloyds Bank mark itself out from the crowd?

"The truth is that differentiation is all about the execution and whether the client is confident that its bank can provide the right level of service and due care and attention for both buyer and supplier," notes Taylor. With a strong reputation in terms of its relationship with customers of all segments, he adds, "this is where Lloyds Bank achieves and succeeds very highly" and where the focus is on "people meeting people" and "real conversations".

> Once the facility is in place and Lloyds Bank has created the necessary web pages and portal for suppliers to enrol, the bank will undertake an educational programme, putting together comprehensive and bespoke information and training material for both buyer and supplier.

This means following-up on every promise, ensuring progress is being made and that if an issue is raised, it is tackled quickly and effectively. This applies equally to buyer and supplier but, for suppliers, there will perhaps be special provision: "As simple as the concept may sound to some, there may be a supplier who has no knowledge of it whatsoever. We have to respect that and take them through each step."

What lies ahead

The challenge for banks in advancing their SCF programmes lies in how they will expand their international capabilities, Taylor notes. One up and coming enabler for an SCF programme in this context is SWIFT's Bank Payment Obligation (BPO) tool. Where a Lloyds client (as a buyer organisation) is working with a trading partner in another country, trade will require a level of guarantee between the two banks; if the overseas bank is making a payment to a supplier under the SCF scheme, it will of course seek a recovery from Lloyds Bank if there is an issue. In this respect, he feels that the BPO mechanism would mitigate that risk, acknowledging the International Chamber of Commerce (ICC)-approved solution as "an aid going forward".

However, Taylor feels the main concern around international expansion is not necessarily one of technology or risk mitigation, but instead more around the management and care of suppliers. On-boarding a supplier in a country far-removed from its buyer may not be easy if that supplier is located in a country not served directly by the bank running the programme: a global bank may have a presence in that country, but it is unlikely it will have a team dedicated to SCF. Thus it becomes a matter of ensuring the level of service is of an equally high standard across the board, says Taylor.

"At Lloyds Bank, because our service in the UK is run so well, it is natural for buyers to ask if we can look at expanding it to other areas. We can do this – on a very careful, step-by-step basis – by collaborating with other best-in-class banks in the relevant region," he explains. "But whatever we put in place, it has to be at least as strong as it is in our client's home market."

Lionel Taylor

Lionel Taylor is Head of Trade Product at Lloyds Bank Commercial Banking. He leads a team responsible for the development and delivery of the bank's international trade products and supply chain finance proposition. Taylor has over 25 years of international trade and receivables finance experience – at senior management and director level – with major European and US financial institutions including RBS, Citi and Rabobank. He has extensive knowledge of working with companies operating in Asia and is also at the forefront of innovation in the field of supply chain finance.

A modern model treasury

Neil Schloss
Vice President and Treasurer

Ford Motor Company

Neil Schloss is Vice President and Treasurer for Ford Motor Company. He was promoted to this role in 2007, having been Assistant Treasurer for the Detroit-based global automotive manufacturer since 2003. Schloss joined the company back in 1982 as a Senior Financial Analyst in the controller's office of what was Ford Aerospace in California. He has worked in a number of treasury office positions for Ford and Ford Motor Credit since 1991, including Director of Risk Management, Director of Financial Strategy, Manager of North American and European Financing, Manager of European Financing and Manager of Corporate and Domestic Financing.

There are over one billion vehicles on the road today and it's probably true that almost everyone who can drive has owned or at least driven a Ford at some time in their life. As one of the world's largest automotive manufacturers, looking to a future that could see vehicle numbers double by 2020 and double again by 2050, it needs to position itself with precision to meet that need with the kind of vehicles – and a business model – appropriate for a crowded planet concerned with environmental issues. The technical, scientific and artistic input required to achieve this are a given, but it is essential too for the company to have strong financial leadership.

As other players in this sector have struggled, Ford brought in a pre-tax income of $8 billion in 2012, having maintained 14 straight quarters of operating profit. The company's automotive division ended the year with gross cash of $24.3 billion, exceeding its debt by $10 billion, and a healthy liquidity position of $34.5 billion, an increase of some $2.1 billion over 2011. This balance sheet rigour is in no small way due to Ford's Vice President and Treasurer, Neil Schloss, and his team.

The progress Schloss has made in the 31 years he has been with the company has seen him move from California to Detroit, from aerospace to automotive, and from general finance to treasury. The shift between roles is a key part of Ford's approach to staff development, exposing people to different aspects of the business and offering greater responsibilities as they progress. Upon arriving in treasury, he says he had found something he "very much enjoyed".

Initially it was the "adrenalin of the capital markets" that got him up every morning, but for the past 20 or so years he has had a number of different roles within treasury, moving between Ford and Ford Credit, which prior to 2000 had operated as separate treasury organisations reporting into the group treasurer. Having moved into his current position as Vice President and Treasurer in March 2007, Schloss muses that "timing is everything" arriving just as the industry and the markets were on the verge of "some very difficult times". But armed with a wealth of experience at the sharp end of treasury, he has actively engaged with many of Ford's strategic initiatives that have served to strengthen the business in the face of adversity.

Major initiative

Indeed, one of the most important initiatives was the restructuring of Ford's liquidity position, enhanced materially at the end of 2006 with a reworking of its bank facility to raise some $23 billion. Described at the time by the company's CEO, Alan Mulally, as "the largest home-improvement loan ever", this mix of secured and unsecured borrowing has without doubt helped Ford through the worst of economic times. When the economic environment did start to improve Ford had "the best product line-up that we've ever had" because so much of its "home-improvement loan" was devoted to product development and engineering better future vehicles for customers.

Integration is key

In the early years of his treasury work, Schloss was a major participant in the shaping of Ford's treasury, giving him a solid technical grounding and awareness. Having taken ownership of the function in 2007, he has presided over some major structural changes. Growth of the company globally has seen the main treasury centre in Detroit and its European satellite complemented by regional treasury operations covering South America and Asia (the latter with headquarters in Shanghai). In addition, and consistent with the company's overall low-cost sourcing plan, Ford now has a 25-strong treasury back office function located in the Indian city of Chennai. In total, Ford Treasury now employs about 280 globally, some of the treasury functions in the smaller markets sharing personnel with accounting and finance.

The sharing of some roles at a local level is a reflection of Ford's bigger picture view (known internally as the 'One Ford Plan') that integration is vital for success. Schloss' own responsibility is to the CFO. "On many things we are independent from finance, but there also are many aspects of Ford's treasury organisation that are integrated and dependent on Ford Finance."

The nature of integration extends beyond day-to-day finance work within the framework of the business to include also the career path and development of general finance personnel. Around 60% of the professional treasury team have treasury roots, while the remaining 40% coming from a broader finance background. The path that can be taken by individuals is a perfect route for those seeking broad finance experience: there are people such as Schloss who arrive in treasury from a general finance field, or who arrive directly into treasury, "who love it and never want to leave" just as there are people who pass through treasury en route to other finance-based destinations. By fitting everyone into the personal development process of the company, the depth and breadth of experience generated can be shared across the entire function, bringing to bear a level of knowledge and understanding that many businesses would do well to replicate; clearly it works for Ford.

The march of regulation

Of course, garnering broad levels of experience does not exempt a business from uncertainty. In the current environment, where regulatory change is rampant, any change must be understood and, importantly, acted upon, both in terms of its direct impact on the business and its far reaching impact, whether Dodd-Frank in the US, its transatlantic equivalent, the European Market Infrastructure Regulation (EMIR), or any other proposal mooted by the authorities.

From Schloss' perspective, this means that even if a company believes that it can secure the exemptions it needs, it still has to spend a lot of time and money putting the infrastructure in place in order to comply, simply because "no action required" letters tend not to arrive until the eleventh hour if at all. "There is uncertainty that we just have to be prepared for."

There are direct market challenges – foreign exchange (FX) or commodity price volatility, for example – which obviously impact on the cost structure of a company such as Ford. The treasury team naturally watches the markets closely and, like most professional treasuries, has views on what happens. But in Ford's case it does not trade on those views, says Schloss. It will not, he explains, put its balance sheet or business operations at risk by, for example, speculating on whether the dollar is going to strengthen or weaken, or the euro is going to go in a certain direction. "We have a routine process in terms of guidelines on hedging exposures on currency and commodities for the auto business and interest rates on the credit side. We're not in the business of taking those bets; we're in the business of making cars and trucks."

On the debt side of the equation, Ford is a big user of capital market capacity, both public and private, and the impact of regulation on the availability and cost of capital is a concern. Whilst he does not feel that regulation will disrupt the markets per se, he does accept that the cost of capital will go up over time as a result of bank having to put in place bigger liquidity buffers. "We haven't seen a lot of that yet – Basel III has not been implemented broadly – but we are anticipating that it will have an impact."

Banking

Ford's banking structure is global in reach and it has almost 50 different providers of credit, spread across all regions. Together they provide a corporate facility of $10.7 billion. "We spend a lot of time and energy managing those relationships," states Schloss, acknowledging the important part that the banking community plays in Ford's life. He recognises that banks are businesses too and that inherently there is some tension in the relationship between keeping the client happy and running a commercial operation.

"Balancing that is important. Is everybody satisfied? Yes. Is everybody thrilled? Probably not, but I think we do a really good job at Ford. If you were to ask the banks who is good at managing their relationships, I think we would be high on their list." Indeed, he adds, one of the advantages of being Ford and of adopting the hands-on relationship approach is that "we get the best people and ideas that Wall Street has to offer".

Adopting IT

Getting the best out of people in a complex finance environment sometimes calls for the adoption of technology to bring it all together in the most efficient way. In fact, Schloss sees IT as a "critical" part of treasury. "As treasury becomes more efficient, technology becomes the enabler. But what it means is that we can almost do our jobs from anywhere – it facilitates low-cost sourcing and consolidation of functions right across the regions, for example."

As a key part of Ford's operations, over the years treasury has taken to running a multitude of supporting systems. But its IT infrastructure is currently being revamped as part of a three-year project that will see the company fully automate processes around areas such as cash management, debt derivatives, FX and commodities pricing – and this is taking place on a global level. So, where some of its affiliates might not have been as streamlined as the Dearborn (Mick) headquarters would have liked, all now will be brought into the fold, allowing better controls to be put in place right across the board. "We're about half-way through that project."

> Clearly Schloss and his team are ready, willing and able to tackle the issues that confront Ford.

With so much of what treasury does being integrated into the overall set of business processes that Ford has adopted there is a uniquely co-operative flavour to treasury's domain. This translates into a special position for Schloss. "We are as broad an organisation from a treasury responsibility as I've seen in industry," he states. This goes a long way to keeping the role interesting.

While a lot of the treasury work within Ford is generic, the function itself has "that much more responsibility", taking on tasks that many of its peers do not handle. The pension fund on the asset side, for example, is often an HR function, but Ford handles that within treasury. "And a lot of corporate treasurers don't have as much international influence as we do, from a standpoint of what our affiliates are doing," comments Schloss.

Having a treasury that includes both an automotive business and a finance company is rare too. "There are very few like us in the world that have the scale and scope that we have," he notes, adding that the sheer size of Ford means most treasurers "can just add a few zeros to everything they do". This is not idle boasting but a statement of fact. "The reality here is that treasury has a seat at the table with senior management and an influence on how the business is run."

On debt and cash

"At the auto company, we're not a frequent borrower," says Schloss, noting that on the automotive side, a 30-year bond was placed in January of this year, the first it had offered in almost ten years. "At Ford Credit, we are active participants in the global capital markets, issuing $8 billion to $10 billion annually in the public unsecured markets. In addition, Ford Credit also issues over $10 billion in the public asset-backed security (ABS) markets, using multiple asset types and global markets."

Ford's investor relations (IR) group reports to treasury (another rarity) and, because of the scale and influence of Ford Credit, he explains that the company has a separate fixed income IR group which even runs an earnings call for bond investors.

On the investment side, most cash is managed internally within Ford's own investment group. At the end of the last quarter it had around $25 billion in cash within the auto company and another $11 billion on the credit side. Short duration is the order of the day, with the focus predominantly on treasuries and agencies (securities), globally. Ford also has up to $60 billion in assets in its pension fund, the company hiring external managers (but managed internally). The fund takes a range of long-duration fixed income, equities and alternatives.

Preparing for the future

Clearly Schloss and his team are ready, willing and able to tackle the issues that confront Ford, but like most treasurers, he keeps a watching brief over the economic uncertainty that surrounds us all. "The global capital markets have improved measurably in the past six months, especially fixed income," he says. "But I'm hard-pressed to think that the underlying economic environment has improved that much. Lots of uncertainty remains and as a global treasury organisation, we must stay abreast and be prepared to react. Funding early is never a bad strategy."

Of course, he continues, there are many more global financial issues out there that do or could affect not only what Ford does as a company but what treasury does. "I spend a lot of time on people development, making sure the team has the right balance of skills. Making sure we keep the level of talent and the consistent recruiting process throughout the organisation is of key importance."

Ford's treasury operation has its work cut out over the next few years to stay ahead of the game in an ultra-competitive industry. But for a company that is still going strong 100 years after the first Model-T rolled off the line, it has clearly adhered to the words of its founder: "Coming together is a beginning; keeping together is progress; working together is success." It is, in essence, a modern model treasury. ■

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Under cyber siege

Cyber risk is a growing concern for businesses. But how can a treasurer help to manage this risk? In this article, we examine the nature of threat faced by companies today and the practical steps that can be taken to prevent and minimise the damage of a data breach.

Cyber security is a growing source of anxiety for businesses. Several studies published this year indicate the growing attention cyber related risks are now being afforded by organisations. For example, a PwC study, published in conjunction with the Department for Business Innovation and Skills (BIS), reported that budgets dedicated to cyber security at UK businesses have increased by 2% over the past year, with an average of 10% now being reserved for cyber-crime prevention and mitigation. And it appears to be a similar story in the financial sector. In the Bank of England's (BoE) twice-yearly systemic risk poll, more respondents cited cyber-crime as the main threat to the stability of their bank.

Whether this growing concern about cyber security reflects an actual increase in the frequency and severity of cyber-attacks is difficult to substantiate – cyber-crime, after all, is not something companies like to talk about, at least publically. But John Salter, Head of Cash and Payments at Lloyds TSB, argues that it would still be reasonable to assume that the threat is a growing one. An ever-growing quantity of data and assets stored in the virtual world mean that the incentives for criminals to steal money or information through corporate networks have never been greater.

"You wouldn't risk breaking into a vault when there is only £50 inside, but you might do if there is £50m," says Salter. "The virtual world has become a much more interesting place to exploit now through criminal activity because it is easier to do on a large scale – and the payback can be much bigger."

Consequently, organisations have found themselves under almost constant siege from criminals in the cyber world. "They knock on the door almost on a permanent basis," he adds. "I would use German blitzkrieg tactics as an analogy – criminals will probe for weak spots and when they find one they steam their whole division through it."

Fighting back

In order to keep up with this evolving threat, companies are being forced to rethink how they approach cyber security. Salter, who recently spoke on the subject of cyber-related crime at the Association of Corporate Treasurers (ACT) conference in Liverpool, believes many companies still have a way to go.

Most banks will have a dedicated group function to manage this specialist type of criminal activity, he says. When he asked treasurers at the ACT conference how their businesses were managing the threat, it quickly became clear to him that non-financial companies have not been addressing it in the same way as banks have been. "In a room of maybe 100 people, only 20% responded positively to that question," he says. "So I'm not sure that companies fully understand the nature of the threat they face today and are responding as well as they could or should be."

However, some businesses are beginning to recognise that defending their networks is no longer just about having the right firewalls and anti-virus programmes in place. To protect against some of the more sophisticated types of attacks being perpetrated today, experts unanimously agree that a more holistic approach is required.

The growing use of analytics technology provided by companies such as SAS could be one example of a new level of realisation. "I think if you look at cyber security as an IT problem alone, you are always going to be ten steps behind," says Joanne Taylor, Director of Public Security at SAS. "What we offer is the next stage in the evolution." A large company will, she says, accumulate masses of information that serves to inform them of different types of attacks originating from different areas of the business. SAS' solution gathers this data together and uses an analytics platform to scan for suspicious activity.

This is perfect for identifying the "low and slow attacks" referred to by Salter, and evidence shows such technology can help to reduce the cost of a security incident (see Chart 1). By linking cyber-activities to business events – the opening of an account, for example – analytics software is able to pick up on potentially suspicious events that a firewall or anti-virus would almost certainly have considered innocuous. "They are constantly hitting an organisation over a long period of time," Taylor explains. "But because the organisation is not connecting the dots, they are often unaware they are being probed for weak points."

Chris Pickles, BT's Head of Industry Initiatives for the Financial Sector, agrees. "Pattern recognition is an important development." Yet a basic anti-virus package is simply inadequate for the needs of some companies today, he says. The types of attacks that companies are experiencing have become so advanced, and the consequences for those that fall victim so severe, that companies need to change their tactics. "It is the difference between putting a bolt on your door and installing a managed alarm – the alarm not only monitors your surveillance systems throughout the day, but also looks for patterns."

Despite these advancements companies realise that the risk of a breach cannot be eliminated fully. For those businesses whose operations make their potential losses from a cyber-breach very substantial – for example, companies that aggregate a considerable amount of personally identifiable data – they should begin looking into hedging that risk by taking out cover with a cyber-insurance provider.

Although Europe's cyber insurance industry is still in its infancy, Kevin Kalinich, Global Practice Leader for Cyber Insurance at Aon One, believes that might be about to change. An increasing number of EU companies are taking out first party cyber liability policies to cover business interruption and the costs associated with sending out notices to aggrieved customers if personal data is compromised.

It is no surprise, he says, that this increased interest in cyber insurance has coincided with recent proposed amendments to the EU Privacy Data Directive that will require mandatory disclosure of all data breaches. "In the US and Asia, there wasn't a big growth in cyber insurance until there was a data breach disclosure law. After that, there was an almost linear increase in litigation, which was followed by a linear increase in cyber insurance."

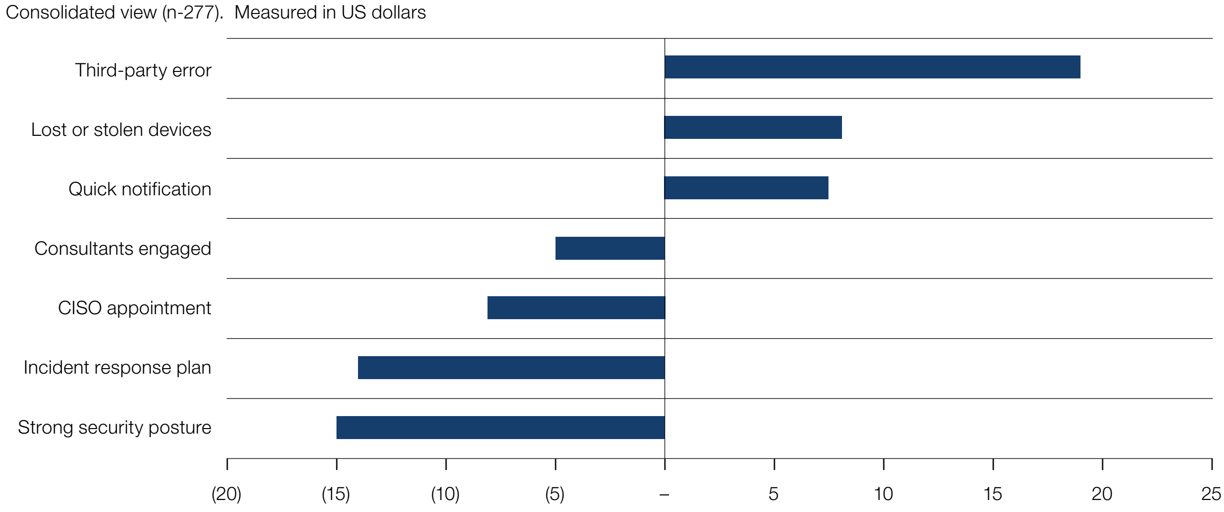
Building a cyber-savvy treasury

Treasurers are not known to be the most tech savvy individuals, and in today's challenging economic environment

Chart 1: Activity cost comparison and the use of security intelligence technologies

Source: Ponemon Institute

Chart 2: Impact of seven factors on the per capita cost of data breach



Source: Ponemon Institute

one might argue that they have enough on their plate managing financial risks without having to contemplate escalating cyber threats.

However, there are areas where the treasurer can make a noticeable difference. Earlier this year, the Ponemon Institute published a study that examined the impact of a data breach on company balance sheets. The research found the companies that were most successful in minimising the cost of a data breach tended to be the ones who had adopted a strong security posture. An example of this are organisations which had centralised the management of data protection with the appointment of a C-level information security professional, a chief information and security officer (CISO), who works with treasury and other company departments in order to lead a more co-ordinated response.

"It is usually the job of the CISO to make sure that there is effective security in place," says SAS' Taylor. Instead, a treasurer's role when it comes to cyber security, as with every other employee, should be on understanding that the information they handle has a value, she says. "Taking responsibility has got to be the starting point for individuals in a company."

This is particularly important when applied to the security of information stored on mobiles, laptops or USB memory sticks – among the leading factors cited by the Ponemon Institute as driving up the cost of a data breach when it resulted in the loss or theft of a device. This, Taylor thinks, should make treasurers, and indeed all individuals within a company, consider carefully how they handle information. "The trend towards bring-your-own-device does open up massive security problems for organisations. At the individual level we all need to change our behaviours. Whatever job we are in, our information is an asset which means we don't share it and we must think about how we are protecting it."

Kalinich agrees. "A treasurer should be looking at the information assets within his department," he says. If these are increasing then the issue clearly demands more scrutiny. Although he says it would be wrong to expect the treasurer to be an expert on the finer details of cyber security, Kalinich believes a basic awareness of the issues is required in every senior area of corporate management if losses are to be minimised.

"Treasurers should have some involvement in the procurement process when it comes to hiring the services of third-party vendors – be it for mobile, big data or cloud computing – and ensuring that those providers will be maintaining the highest level of security." The CISO can then dig down into the technical detail to answer this question, Kalinich adds, but it is important for treasurers to know where within an organisation they can go to get help on cyber security-related questions affecting their department.

In this space, there is clearly an area of internal policy compliance for treasurers to think about, says BT's Pickles. "Corporate treasurers will see a lot of cash management processes can be carried out with the help of smart phones now. But obviously there are security challenges relating to this type of technology, and maybe that is why it has not yet progressed, in terms of adoption, as quickly as some might have hoped." That doesn't mean the technology should be regarded as off limits, he is at pains to emphasise, just that "implementation needs to be done in a proper, controlled manner".

Treasurers should also be considering what contingency plans the department has in place in the event that one of their banking counterparties is hit by an attack, Pickles adds. In the autumn of last year, a number of large financial institutions, including Bank of America Merrill Lynch (BofA Merrill) and J.P. Morgan (JPM), were victims of this type of attack. Although the disruption was short lasting and mostly limited to retail, rather than corporate clients, the fact that they happened should emphasise to treasurers the need to look again at their contingency plans for this type of scenario. "There is a perception that banks know about security," says Pickles. "But when you look at the security breaches they've had over the past few years – whether that is banks, credit card companies or other financial institutions – it is clear that companies shouldn't be blindly relying on them." ■

THE INDUSTRY VIEW

Mark Stockley
Head of International Cash Sales

BLACKROCK®

The Securities and Exchange Commission (SEC) recently published a revised set of proposals in an attempt to bring further resiliency and transparency to the money market fund (MMF) industry. What does this mean for investors and fund managers and how will the European legislators react? Mark Stockley, Head of International Cash Sales at BlackRock Investment Management, considers the implications for all stakeholders.

What is the state-of-play with money market fund (MMF) regulation, especially with regards to proposals made by the Securities and Exchange Commission (SEC)?

In the world of MMFs, the cardinal sin is 'breaking the buck'. If the fund's market-based value drops below the consensus $/£/€1 stable share price (known as constant net asset value (CNAV)) investors can lose value – and faith – in their investment.

The last time this happened, in September 2008, the potential contagion was halted when the US Treasury stepped in to provide support for the ailing fund in question, the Reserve Primary Fund. The SEC's response was to seek reforms to limit the likelihood of a repeat event.

By March 2010, a number of amendments had been published concerning the SEC's existing MMF Rule 2a-7 (the exemption dating back to the 1980s that allowed MMFs to maintain the stable $1 share price instead of being subject to market fluctuations in the value of the securities held by the fund). The amendments sought to impose stability by reducing credit and liquidity risks within MMF portfolios without, it hoped, stifling the market.

Roll forward to June 2013 and the SEC, having had time to review the effectiveness of its amended rule set, responded by publishing an additional batch of MMF-reforming proposals designed to further protect investors in this $2.9 trillion market. In the words of Mary Jo White, Chair of the SEC, speaking in June 2013: "These proposed reforms should further enhance the resiliency and transparency of this important product, and are significant complements to the other proposals."

> "The MMF space remains a challenging environment both from an investment and a regulatory perspective. Indeed, looking at the challenges by currency, the euro continues to be the most demanding, with shortage of supply, generally low rates and with an increase in provider consolidation."

Alongside a set of enhanced disclosure requirements, proposals for stronger diversification of portfolios and enhanced stress testing, the latest suggested proposals include two principal alternative reforms that could either be adopted alone or in combination. The first requires a variable net asset value (VNAV) for prime institutional MMFs. Removing the $1 stable share price model, and instead allowing daily share prices of MMFs to fluctuate alongside the market price of securities in the portfolio, is seen as a way of not only increasing investor awareness of MMF risks but also as a method of reducing the likelihood of a run on a fund in times of financial stress.

Where prime institutional funds may currently "penny round" their share price to the nearest whole unit, if the proposals are accepted in their current form they will be expected instead to "basis point round" their share price. This will create a more precise valuation and pricing model for investors, although government, treasury and certain retail MMFs will be exempted from this requirement.

The second alternative allows MMFs to carry on transacting at a stable share price but deploy liquidity fees and redemption gates in times of stress to limit runs. The former proposes that if a fund's level of weekly liquid assets (typically cash, US Treasury securities, certain other government securities with remaining maturities of 60 days or less, and securities that convert into cash within one week) drops lower than 15% of its total assets, then a 2% liquidity fee may be imposed on all redemptions (unless the fund's board believes it would be imprudent to do so). A redemption gate is intended as a temporary suspension of redemptions (for no more than 30 days in any 90-day period) to be imposed when a fund reaches a certain level of redemption activity. All MMFs will be required to deliver prompt public disclosure of either action.

Are these new regulations in effect?

At this stage, these are nothing more than proposals – but the required 90-day public comment period is underway and the industry is ramping up for action. The MMF space remains a challenging environment both from an investment and a regulatory perspective. Indeed, looking at the challenges by currency, the euro continues to be the most demanding, with shortage of supply, generally low rates and with an increase in provider consolidation where assets under management (AUM) are moving out of some of the smaller managers whose scale, in terms of distribution, has forced them to withdraw from the euro cash market altogether.

As the MMF industry moves into the period of consultation around the SEC's proposals, quite a lot can happen. It is now down to sponsors, providers and – importantly – investors to make their opinions known. All things considered, aspects of the new SEC proposals demonstrate a pragmatic approach to market change, and allowing CNAV vehicles to continue, with the ability to apply gates and liquidity fees in certain circumstances, is a thoughtful, well-considered angle to take.

What is BlackRock's opinion of the proposals?

BlackRock is not supportive of mandatory conversion to variable net asset value (VNAV) because it does not address the key criteria driving the regulation, particularly the run-risk in the market. With the devil very much in the detail of this circa 700-page report there will be nuances therein that interested parties must carefully work through and fully understand before responding. As much as it is now about feedback on what the SEC has proposed, there will be a degree of clarification required.

In general, we support and applaud the steps being taken and will provide clear written feedback on what our thoughts are on the proposal.

Certain clarifications aside, the readiness of the industry to meet the SEC's proposals is not in question. Once the period of consultation is completed, there will be another period before the final draft is issued, most likely followed by a period of grace for providers to comply with the changes. At this point BlackRock is well positioned to navigate that process.

> "With the devil very much in the detail of this circa 700-page report there will be nuances therein that interested parties must carefully work through and fully understand before responding. As much as it is now about feedback on what the SEC has proposed, there will be a degree of clarification required."

Indeed, with the rule changes of 2010 having required greater levels of liquidity and more disclosure, and the industry voluntarily publishing 'shadow NAVs', or mark-to-market valuations, on a daily basis (the SEC publishes MMF-reported portfolio holdings and prices on a 60-day delay), some of what is being proposed is already being complied with. And, in the interest of executing "good market practice and business conduct", institutions such as BlackRock have been doing so for some while.

How will the new proposed regulations impact the investor?

For the investor, as future changes are introduced, they will need to be fully understood and where necessary translated into individual investment guidelines and reporting requirements. Part of the proposal requires funds to be run shorter and more liquid which means, over time, yields may fall. Given the low-rate environment, many investors are in this mode of thinking anyway, but they will need to be more mindful of how they segment their cash. They should be reviewing the kind of ladders put in place and differentiate between working capital that needs to be truly liquid versus that which can be considered more strategic and moved further out the curve, towards slightly longer-duration vehicles where they can get a better yield pick-up.

Being pushed into a VNAV situation will demand a more dramatic reaction with considerations around accounting and tax treatment potentially being more impactful and damaging to the industry and client interests.

With this threat hanging over the industry, through the consultation period investors will become more vocal. Their thoughts will find voice through varying associations, such as the Association of Corporate Treasurers (ACT), European Association of Corporate Treasurers (EACT) and, in the US, the Association for Financial Professionals (AFP), which will be lobbying, as with previous proposals, to have MMFs remain as intact as possible.

> "From the industry's perspective, the best way to reduce risk in these products is to increase diversification, shorten tenors and increase the level of disclosure and transparency on investments. Changing CNAV to VNAV does not reduce run risk caused by systemic issues."

BlackRock together with industry peers, particularly in the US, will now be considering their individual responses. A co-ordinated industry-level response, with questionnaires being distributed amongst clients to ensure these proposals resonate with the investor-base, will then add to the feedback. The response from clients so far is broadly positive, but this is tempered with the knowledge that the end-point may look markedly different from what is currently being proposed.

What should investors be concerned about?

Investors currently face two main perils. The first is the ongoing tough market conditions. Supply is limited, yield-levels are low and ratings-agency actions can impose restrictions and enforced diversification that may not be in the best interest of the investor. It is a very difficult job at the moment for a manager to put together a high credit-quality portfolio that is suitably liquid and paying a level of return that is attractive. The harsh reality is that if a business is holding truly instant access cash then it is difficult to get paid on that, and therefore it has to look at being smarter at how it segments that working capital.

The second concern is how the European Central Bank (ECB) and the European Commission (EC) propose to handle MMFs through forthcoming legislation - an announcement is expected to be made in July and a consultation paper published.

In April, the EC's Systemic Risk Board – worried about massive and sudden redemption requests – issued a paper stating its desire for mandatory conversion of all CNAV funds to VNAV, with a demand for a 3% cash buffer for funds to absorb any losses, amounting to around €14.7 billion across the European industry. The paper also proposed that all MMFs should be barred from accepting collateral with a maturity of longer than 397 days to back repo trades. This may just be a means of forcing participants to come up with a better proposal.

From the industry's perspective, the best way to reduce risk in these products is to increase diversification, shorten tenors and increase the level of disclosure and transparency on investments. Changing CNAV to VNAV does not reduce run risk caused by systemic issues.

Whatever transpires, the conversation between providers and policy-makers must be mindful that a potential situation of "domiciliary arbitrage" – where it is better to launch funds outside of Europe because of the unfavourable regulatory environment – is not the way forward.

Indeed, the most unattractive outcome of the proposals would be for the SEC to deliver a thoughtful solution that is supported by the industry, but with its European counterparts moving in the opposite direction. If the creation of an uneven playing field makes it untenable to offer MMFs within the regulated framework of Europe, providers and investors would be forced to look to other domiciles.

BlackRock strongly hope that there is co-ordination, acknowledgement and recognition of the amount of time and effort that the SEC has taken on this, in terms of cost-benefit analysis and focusing on the specific problems trying to be addressed. It would be disappointing if we come out with anything other than a level regulatory playing field.

How is BlackRock alleviating its customers' concerns?

BlackRock's client-base is being kept up to date on developments in the US and in Europe as developments unfold. We are working with existing clients, plus bringing new investors to the product, ensuring that we keep them fully appraised of what is happening from a regulatory perspective. Our clients continue to be comfortable with the BlackRock investment process, its credit, risk management, research and execution.

Furthermore, it is important to keep in mind that if there are proposals in Europe that differ from the US, there is likely to be a fairly lengthy implementation period during which we will amend our product offering as needed and clients can alter their investment activity. Currently, there is no cause for alarm, as our approach has been – and continues to be – one of staying close to our clients, educating them, giving them the confidence in a product continuum and ultimately providing them with more choice. ■

Taking sustainability seriously

Echoing the economist Milton Friedman, cynics argue that corporate social responsibility (CSR) is a flawed idea; that the pursuit of profit, not social goals, remains the primary objective of business. Yet some corporates and financial institutions are making a huge difference to communities, using their considerable financial firepower to launch environmental sustainability programmes and to fund social responsibility initiatives.

In today's business world, corporate social responsibility (CSR) is no longer an option for companies – it is fast becoming a fundamental imperative for ethical credentials.

One reason is that consumers now expect higher ethical standards when it comes to global brands. According to a 2013 study by Cone Communications/Echo Global, just 6% of consumers believe that generating profit for shareholders is the singular purpose of business. A clear majority (31%), meanwhile, want to see companies doing much more than just donating time and money in communities – they want a long-term commitment to the well-being of the community as a whole.

A stronger focus on CSR is also necessitated by today's changing regulatory landscape. In April, the European Commission (EC), following other jurisdictions, such as India, China, Brazil and South Africa, released a draft directive on sustainability disclosure, a process for publicly disclosing an organisation's economic, environmental and social performance. The policy proposed by the EC requires large companies to annually disclose data on the social and environmental impacts of their activities across their supply chain. Although companies can reserve the right not to report on a particular topic, they will be legally required to explain why they are not doing so.

In the UK, regulation is also expected before long. The Department for Business Innovation and Skills (BIS) is currently consulting with key stakeholders to build a CSR framework. The framework, which is expected to be implemented towards the end of 2013, will encourage companies to manage their supply chains more responsibly and transparently.

It pays to be good

Beyond consumer expectations and regulatory necessity, most organisations also see a growing business case. The notion that environmental, social and governance (ESG) issues have a material impact is now beginning to gain more traction, says Andy White, an Associate Director at Sustainalytics, a research company which analyses the ESG performance of companies on behalf of the investors.

For over two decades, Sustainalytics and others in the responsible investment world have been arguing against the widely-held view that ESG issues have little or no bearing on financial performance. "That has been quite a challenge over the years because the industry mainstream regarded these issues as being largely peripheral," White says. "This perception is changing; around 1,200 investor signatories, globally representing $35 trillion in assets under management (AUM), have signed up to the UN Principles for Responsible Investment (PRI). Such a high level of support indicates that investors want to integrate ESG into the investment process and recognise that ESG is a good proxy for understanding management quality.

"There has been a large amount of research indicating that companies with a good ESG record can perform better, together with a steady flow of assets into responsible investment funds, many of which have performed strongly. And there is plenty of case study evidence at the corporate level to demonstrate that, conversely, poor performance in this area can be very costly. If companies choose to flout health and safety regulations or are involved in big environmental accidents like BP was, for example, the costs of associated clean-ups and litigation can be value destroying for the business."

However, CSR is about much more than just prudent risk management, he adds. Good ESG practices can also influence how a company approaches new opportunities, with emerging markets being a case in point. With consistently strong levels of economic growth, emerging economies clearly look like opportune places at the moment. "But those regions often have very complex environmental and social issues to contend with which require a level of market intelligence that goes beyond traditional financial analysis," he explains.

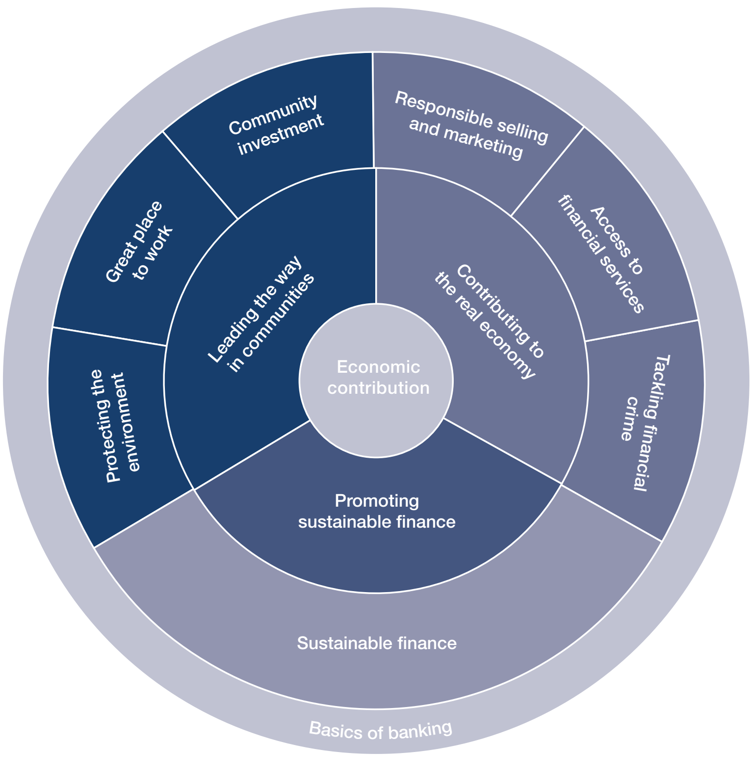
"For example, we've seen incidents like the factory collapse in Bangladesh, severe pollution in parts of Asia and miners shot by police in South Africa. Therefore, as companies expand into emerging markets there are great opportunities, but there must be some awareness of how to manage the ESG risks in those countries as well. Long-term reputation damage can ensue if companies are linked to environmental and social problems, and with the rise of instant media and messaging, companies are more in the spotlight than ever before, no matter where they operate."

If White is correct and integrating ESG with business objectives can have a tangible effect on the bottom line, then companies will surely want to know what measures they can take to improve their performance in this area. Drawing on lessons learned from recent ESG initiatives by Standard Chartered and Bank of America Merrill Lynch (BofA Merrill), Treasury Today has compiled helpful pointers that companies may wish to consider when thinking about how to enhance their social, ethical and environmental performance.

Evaluate your performance

In 2010, Standard Chartered published a series of independent studies assessing its impact upon markets in Ghana, Bangladesh and Indonesia – the first of their kind to be conducted by a major financial institution. These reports were produced to help the bank better understand how well it has been performing in relation to its three over-arching CSR principles:

Chart 1: Standard Chartered's sustainable business model



Source: The social and economic impact of Standard Chartered Ghana

1. Enabling the real economy to achieve sustainable growth.
2. Delivering sustainable finance to respond to risks and opportunities.
3. Leading by example in the workplace and community.

Using a combination of quantitative and qualitative assessments, the Ghana report found that through its core business activity Standard Chartered was making a significant contribution to the country's socio-economic development. The launch of new products was said to have helped widen access to finance, with basic current accounts benefiting thousands of previously unbanked Ghanaians. The report praised the bank for its commitment to environmental targets, the introduction of sustainable finance criteria and investment in community projects.

But, importantly, these reports were not produced exclusively for the purpose of drawing attention to all the good work Standard Chartered has been doing in developing countries such as Ghana. It was also written in order to highlight areas where the bank can potentially improve and deepen its impact upon the Ghanaian economy.

In Ghana, these included:

- Working with the government to ensure more favourable conditions for small and medium-sized enterprises (SMEs).
- Support diversification of the economy.
- Align community investment programmes with its core skills and services.
- Continue to provide employees with world class training and opportunities.
- Collaborate with government to improve business infrastructure.

By looking critically at its impact on countries such as Ghana, Standard Chartered is demonstrating that it understands the business case for CSR. "We recognise that the long-term sustainable nature of our business is closely linked to the health and prosperity of the communities where we operate," says Mark Devadason, Group Head of Sustainability at Standard Chartered. "We seek to contribute to sustainable economic growth in our core markets, by promoting robust, responsible business practices and widening access to finance.

"The independent impact studies we have recently commissioned allowed us to assess how we are meeting this objective and better understanding the contribution our business makes to a local economy," he adds.

Focus on your strengths

When it comes to social projects it helps to have a good understanding of the focus of your business, says Andrea Sullivan, Head of Corporate Responsibility for Europe and Emerging Markets (ex-Asia) at BofA Merrill. For many years now, the bank has been using its expertise to promote and teach financial literacy in communities across the globe through its 'Your Financial Future' curriculum. In the UK, Sullivan is thrilled to see an issue that the bank has spent time and money on, to raise awareness about gaining government recognition. "Use your strengths to match the needs of the community," says Sullivan. "Financial education is now part of the UK curriculum, and that is encouraging; we can marry up what we do well with what is needed – and that alignment is always where companies are going to make the most impact."

The bank already does a lot of work in communities where its focus is on financial education and employability. The bank's Financial Education and Employability programme is one of the largest of its kind in the UK, says Sullivan. Over the past six years, more than 6000 young people have passed through the teaching which has been delivered to schools by 2000 BofA Merrill employees. The programme not only teaches young people about financial awareness, but more importantly it teaches employability skills.

Some of these students are now beginning to leverage these newly acquired skills to access higher education and enter into employment, Sullivan says. "I cannot claim that this is all down to one scheme. However, in today's competitive world, being articulate, engaging in conversation and understanding how to get your point across are so important for getting a job."

Another initiative the bank is sponsoring is the 'Tech for Good Challenge', a competition led by Big Issue Invest and Nominet Trust that offers digital technology entrepreneurs the opportunity to work with leading corporates to develop business plans to help solve social issues for or with young people. BofA Merrill has committed financial resources and eight mentors from within the bank to help the participants put together their business models. As well as ongoing support from business experts, the challenge also offers each successful applicant an investment in their business of up to £50,000. This initiative, Sullivan points out, is another example of the bank focusing on its strengths. "One of the things we have is an understanding of business and a strong technology group," she says. "We have the knowledge, resources and people, and by connecting start-up capital with need we are able to support innovative ideas to help drive healthy economies."

Get everyone on board

It is important to ensure that principle of responsibility is firmly embedded throughout the business. "To do that you have to create processes, procedures and an atmosphere of people working together and wanting to do the right thing," says Sullivan.

The culture within BofA Merrill is now one where employees understand that acting responsibly is to their benefit and that they, as staff members, have a duty to raise issues when they are not right. This, she says, is of central importance to the bank's CSR agenda. "Addressing the wider community's social and environmental needs is crucial to the strength of the economy and to the sustainability of our business. It is important that we all understand this proposition," she explains.

If this can be achieved, then improving CSR doesn't necessarily mean spending more money. According to BofA Merrill, over the past few years its spend on CSR initiatives has remained reasonably steady. Instead, the difference is that the bank is thinking more strategically about its CSR commitments. In 2011, the bank created an EMEA CSR council to bring together senior management from different areas of the business to discuss the strategic direction the bank should be moving in terms of CSR in the region, and the measures needed to be introduced to achieve its goals.

"This is a journey," she explains. "We are working together to improve, to be better connected and to be more focused – and that is great for the bank and for its employees.

"These initiatives are not just a 'nice-to-do', by any means," she adds. "If we look ten years out to what we where to be as a company, social responsibility is going to help get us there." ■

FTT: a ticking time bomb for bonds

With bank finance contracting, smaller businesses in Europe are finding it increasingly difficult to access credit. In response, governments in Europe have been busy promoting capital markets as an alternative source of funding. But experts warn that the proposed Financial Transaction Tax (FTT) runs in contradiction with this ambition.

FTT

European leaders want to foster the development of deeper, more liquid bond markets for small and medium-sized enterprises (SMEs) to fill the funding gap left by weakened banks.

But the plans of 11 eurozone governments, including France and Germany, to bring corporate debt markets under the umbrella of a Financial Transaction Tax (FTT) will have the opposite effect, experts warn. If the FTT is passed in its current form, it could cut off many companies – small and mid-caps particularly – from a vital source funding. In a worst-case scenario, nascent platforms in Europe that help such businesses issue could even disappear completely.

The FTT will apply a 0.1% levy on the value of bond transactions in the EUR-11 area for each participant in the trade. It is difficult to quantify precisely the upward effect that the FTT would have on corporate bond yields, which would already be higher due to the impact of the FTT in the underlying sovereign debt markets. However, it would be reasonable to assume that issuers of corporate debt will have to offer investors higher returns to compensate for the erosion the tax will have on their earnings.

In addition liquidity in the secondary market will inevitably diminish, warns Dr. Gerrit Fey, Head of Capital Market Affairs at Deutsches Aktieninstitut, a federation of companies and institutions in Germany's capital markets. Small and medium-sized issuers, but also large non-financial issuers, in the bond market rely on market makers to access the capital market as a source of funding. They support the trading of corporate securities by continuously placing bids and ask orders to ensure market liquidity. Because the profit margins of these market makers are relatively small, Dr. Fey fears that the business of market making is in danger of receding, if not disappearing altogether.

"It would be very difficult for small and medium-sized issuers to obtain finance through the capital markets under these circumstances," Fey says. "And that, of course, completely contradicts what politicians in the European Council said in a recent Green Paper about wanting to improve access to the capital markets for SMEs."

The German example

This must surely be very troubling for the companies who have issued through the recently developed platforms on European stock exchanges, where the bonds of small and mid-caps can be traded. In Germany, especially, the SME bond market has blossomed over the past few years. Via the platforms that have sprung up at regional stock exchanges in Düsseldorf, Hamburg, Munich and Stuttgart, German companies have successfully issued over €3 billion worth of debt to investors, according to Standard & Poor's (S&P).

Since its launch in 2010, the Bondm platform on the Stuttgart Börse has facilitated 50 issuances, at a time when 'Mittelstand' firms were finding it very difficult to gain access to credit through traditional bank channels. The Bondm platform is very much geared towards the needs of the smaller issuer – companies can promote their bonds directly to retail and institutional investors without the help of an underwriter, allowing them to considerably reduce the costs of an issue.

Executives at the exchange fear that all this progress could be lost if the FTT proposal is introduced by the EC in its current form. Echoing Fey, Christoph Boschan, Managing Director of the Stuttgart Börse, says he is concerned that liquidity in the secondary market will be seriously diminished if market makers are not exempted from the EC's final proposal.

Speaking as a former market maker himself, Boschan says that a tax burden of 10 bps is completely unacceptable considering that the average gains made in market making transactions are between 2-5 bps. Therefore it came as no surprise to him, when the Stuttgart Börse teamed up with the Karlsruhe Institute of Technology to study the impact of France's own – albeit weaker – FTT introduced in August 2012, that the study showed liquidity in the market declined by approximately 25%. In fact, one might expect that this loss in volume would have been even greater had the French government not included an exemption for market makers. "This is the real problem of the tax," he says. "Market liquidity will decrease, spreads will widen and execution times will be longer."

The issue is particularly acute with respect to SME bonds. In this area where Bondm operates, market making is of the very essence, as these are relatively illiquid instruments. A properly functioning secondary market is vital – even when it comes to primary market trading. This is because investor participation in a primary market is interconnected with the potential to reinvest on the secondary market. If that opportunity is not there anymore then Boschan expects the willingness of private investors to participate in initial bond offers (IBOs) will decrease.

The Stuttgart Börse, together with the other German exchanges, recently raised these concerns in a letter to the EC. But Boschan is keen to emphasise that he does not oppose the introduction of the FTT outright. Instead what he and the other exchanges are calling for is, in his words, "a responsible introduction of such a tax". This would involve looking again at the impact of the tax upon the real economy and providing an exemption for market makers and private investors.

"From a political perspective, the solution should be clear," he says. "The objective of the FTT is to compel those who caused the crisis to pay towards the costs of the crisis. But the market maker, the private investor and the bond issuer did not cause this crisis, and they already incurred heavy losses as a result of the mistakes made by the banks."

Looking ahead

According to the EC in its recent Green Paper 'Long-Term Financing of the European Economy', it is the mid-caps and SMEs that will drive the economic recovery in Europe. The problem, as the EC acknowledges, is that in the wake of the banking crisis and the subsequent regulatory tightening, banks are not lending as much as they used to.

Citing the recent surge in German SME high yield bond issuance as an example for the rest of Europe to follow, the EC proposes that more should be done to help smaller companies access capital markets in order to fill the funding void left by banks. This could be accomplished, the EC argues, by improving the information provided by credit scoring companies, and making existing research and ratings information on such companies available to a wider set of potential investors.

But what the EC gives with one hand may well be taken away with the other. By undermining the market maker model that has sustained platforms such as the Bondm on the Stuttgart Börse, the introduction of the FTT would clearly damage the funding opportunities for SMEs in Germany's capital markets, not to mention stifling the development of similar platforms in other European countries.

European policy-makers are presently engaged in reworking the FTT. Recent press reports indicate that the European Central Bank (ECB), responding to opposition from the financial sector, has offered to help the EC redesign its proposal and assuage industry concerns over its "negative impact" on market stability. However, the financial sector will now have a long, nervous wait to see the EC's final proposal. No definitive political decision on the tax is expected to be made until after federal elections in Germany have concluded in September. ■

Chart 1: Corporate bond's price development over the last year

Source: Bondm Index

INSIGHT AND ANALYSIS

FX in the spotlight

Asian currencies have weakened following the Federal Open Market Committee (FOMC) meeting, and there are expectations of greater headwinds for regional currencies stemming from slower growth in China. Whereas on the other side of the globe, it took a state currency intervention to raise the Brazil real from a four-year low. Volatility is still the 'mot du jour' in the FX markets.

CASH MANAGEMENT

Mobile cash management

The hype around treasury on-the-go looks to be little more than just that – hype. For the naysayers, the issue of security is often raised and usually stems from fear of it being compromised whilst in use. Should treasurers change their working habits to take advantage of mobile devices or avoid them like the plague?

TREASURY PRACTICE

Translating treasury

According to a recent survey by the Economist Intelligence Unit, 64% of businesses believe that language differences constrain their international expansion plans. Does this recognition mean that corporates are giving their time and resources to up-skilling their workforce in this respect? Or are they turning to technology to fill the gap?

We always speak to a number of industry figures for background research on our articles. Among them this month:

Christoph Boschan, Managing Director, Stuttgart Börse; **David Cleary**, Co-Head US Private Placements, Corporate Debt Capital Markets, Lloyds Bank Commercial Banking; **Yannick Croiger**, Director of Financial Risk Management and Corporate Finance, Stanley Black & Decker (SBD); **Sanjay Dalmia**, EVP Global Cash Management and CEO, Fundtech India; **Dr. Gerrit Fey**, Head of Capital Market Affairs, Deutsches Aktieninstitut; **Tony Fordham**, Managing Director, Private Placements, RBS; **David Gustin**, President, Global Business Intelligence; **Tim Hayter**, Group Treasurer, Bunzl plc; **Gavin Jones**, Vice President, Deputy Treasurer, Ahold; **Kevin Kalinich**, Global Practice Leader for Cyber Insurance, Aon One; **James Krikorian**, North American Treasury Manager, AB Electrolux; **Ashutosh Kumar**, Global Head of Corporate Cash and Trade, Standard Chartered; **Benjamin Lam**, China Trade Head, Managing Director, J.P. Morgan; **Peter Lay**, Director of Transaction Banking, Standard Chartered; **Lelaina Lim**, Chief Financing Officer, Royal Sporting House; **Vinod Madhavan**, Global Head, Local Corporate Products and Receivables and Supply Chain Finance (SCF), Standard Chartered; **Chris Pickles**, Head of Marketing for Financial Sector, BT; **Marianna Polykrati**, Group Treasurer, Chipita Group; **John Salter**, Head of Cash and Payments, Lloyds TSB; **Neil Schloss**, Vice President and Treasurer, Ford Motor Company; **Andrea Sullivan**, Head of Corporate Responsibility, Bank of America Merrill Lynch; **Joanne Taylor**, Director of Public Security, SAS; **Sander van Tol**, Partner, Zanders; **Didier Vandenhaute**, Director, PwC Treasury Consulting Practice, Belgium; **Andy White**, an Associate Director, Sustainalytics.