



## The threat of unwinding QE

Ben Bernanke only had to mention the word 'tapering' with regard to the US quantitative easing (QE) programme for many emerging market currencies to nosedive. However, most agree that QE unwinding has to happen at some stage, so what is the best possible outcome scenario?



### Women in Treasury

Lisa Tierney

European Treasury Manager  
Luxottica Group

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Streamlining receivables

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Hugo Parry-Wingfield

Investment Director and EMEA  
Head of Liquidity Product  
HSBC Global Asset Management (UK) Ltd

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SEPA phase II

A photograph of several smooth, dark, rounded stones resting on a light-colored, rippled sand surface. The stones are arranged in a diagonal line from the bottom left towards the top right. The lighting is soft, creating gentle shadows and highlights on the stones and sand.

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# SEPA: ready or not?

For those operating in the treasury space in Europe SEPA (or the Single Euro Payments Area to give it its unabbreviated name) seems to have been around for years. As we start 2014, one of the finishing lines for this project is now firmly in sight. The SEPA Regulation (EU) No 260/2012 set the final end-date for 'legacy' national euro credit transfer and direct debit schemes as 1<sup>st</sup> February 2014 in all Eurozone states. This can be deferred until 31<sup>st</sup> October 2016 for non-Eurozone states like the UK. From these dates the existing national euro credit transfer and direct debit schemes will have to be replaced by the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) Schemes and the politicians' goal of having 'no frontier effect for cross-border payments' will have been largely achieved.

It has been a very slow and painful process getting to where we are. The banking industry in Europe was slow to respond despite the EU politicians' vision that was expressed throughout the 1990s. This was reiterated by Commissioner Bolkestein in November 2000. "The full benefits of the single market will only be achieved if it is possible for business and individuals to transfer money as rapidly, reliably and cheaply from one part of the community to another as is now the case within most member states," he said. So, the banking industry was told to build such a system that would also mean that the banks make much less money from transaction fees and effectively eliminate the 'float' that often occurs when making cross border payments. Is it any wonder the banking industry was slow to move?

Differing legislation in the various EU countries also made harmonisation difficult but this presented a revenue opportunity for the lawyers and there have been a series of legislative directives that have driven forward the integration of the euro payment market; notably the Payment Services Directive and sections on the SDD Core Rulebook to assist in the transition from legacy mandates.

The result is that fundamental change has now been achieved and cash management in Europe is never going to be the same.

We can reflect on these developments in two ways – tactical and strategic. Tactically companies are having to react and this issue of Treasury Today includes a Problem Solved case study which shows how one company has addressed SEPA and managed to migrate all its direct debit mandates to SEPA ahead of the 1<sup>st</sup> February deadline. Meanwhile, our Question Answered this month poses the question "What will SEPA Phase II look like for your company?" We provide an answer from three corporates. We will report on more in the months to come as corporate treasurers find ways strategically to take advantage of the new payments landscape in Europe.

But there are also more fundamental issues to be considered. How will business change as these major barriers to cross border trade are finally removed? Even quite small businesses may find ways to reach across borders and try to find new customers. But they will also encounter new competition domestically as companies elsewhere in the EU do the same? Will governments open their procurement to EU wide competition or remain country focussed? How else will trade change?

A different issue is that the introduction of SEPA payment schemes makes any break-up of the Euro payment area that much more difficult. Domestic payment systems will have been replaced in the same way that domestic currencies, including notes and coin, have been. But this does not resolve the fundamental economic pressures resulting from individual government and country surpluses and deficits. This issue is not resolved.

The changes we are seeing in Europe are fundamental and game-changing. We are living in interesting and challenging times.



## Don't fear the taper

An end to quantitative easing (QE) could have big implications for corporates in terms of both funding and foreign exchange risk management. In this article, we examine the scale of these challenges and consider what corporates can do to overcome them.



**Lisa Tierney**  
European Treasury Manager



Lisa Tierney has worked in corporate treasury at Diageo and now with Luxottica, but she also has a banking background, having worked at Merrill Lynch on the treasury funding side. She is currently learning Italian and believes language skills are extremely important in business – now more than ever before.



## Best practices in refinancing

If your company's debt is due to mature in the next few years then you may already be thinking about refinancing in order to lock in low interest rates while they are still around. But what is the key to successful refinancing?



## Managing FX: identifying exposures earlier in the business process to more effectively manage risk

When it comes to foreign exchange (FX) risk management, visibility into business units and understanding how exposures materialise are as important as hedging itself. This article looks at ways in which exposure can be identified, quantified and managed, from inception of the risk through to hedging execution and beyond.

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## Holmes Place Lifestyle Clubs

Read how this company addressed the challenges posed by SEPA and how it has migrated its direct debits programme well in advance of the February deadline.

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**TREASURY PRACTICE 26**

**Are you receiving me?**

Lengthy days sales outstanding (DSO) measures can prove extremely costly to your business in the form of misplaced resources, poor cash flow and inaccurate forecasts. The accounts payable (AP) has always been easier to manage whereas accounts receivable (AR) have proved challenging. How can you streamline the process to improve your DSO measure?



**COUNTRY FOCUS 32**

**From revolution to reform**

On the eve of the third anniversary of the Egyptian revolution, the country remains unsure of its future direction. The interim government is aiming for stability, but the people want much more. What impact has it had on businesses operating in the country?



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**29 The Corporate View**

**Corina Keller**  
Head of Cash Management



Corina Keller assumed her current position as ALTANA AG's Head of Cash Management in March 2011. The role has a strong focus on global bank account management; understanding precisely which accounts are held with which banks and where. Monitoring cost, performance and risk are now daily concerns for Keller.

**THE BANK INTERVIEW 38**

**Hugo Parry-Wingfield**  
Investment Director and EMEA Head of Liquidity Product



Liquidity management continues to challenge most corporates, particularly with the low interest rate environment, imminent regulatory changes and new risks that are emerging. Hugo Parry-Wingfield, Investment Director and EMEA Head of Liquidity Product at HSBC offers his thoughts on how corporates should respond.



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](http://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](http://treasurytoday.com)

## Is the FTT fit for purpose?

Rumours of the death of the financial transaction tax earlier this autumn appear to have been vastly exaggerated.

In September, Europe's plan for a new tax to be levied on financial transactions appeared to hit a wall after the European Council's (EC) legal service concluded that it would "infringe" upon EU treaties. But earlier this month the path was paved for a return to the EU agenda when the tax was included in drafts of the coalition government agreement between German Social Democrats and Christian Democrat parties.

The resurrection of the proposal comes despite the huge volume of evidence mounting against its introduction, neatly summarised in a recent report by PwC.

One of the stated goals of the Financial Transactions Tax (FTT) is to ensure that "financial institutions make a fair and substantial contribution to covering the costs of the recent crisis". However, the report by PwC, which examined a number of published studies on the tax, found that gross domestic product (GDP) across the EU could be reduced by as much as 2.42%.

Additionally, empirical support for the argument that the FTT will foster stability in financial markets was described by PwC as 'debatable'. Some of the studies analysed offered evidence of a reduction in volatility in equity markets as a result of the tax, while some found it would increase volatility and others found there to be no relationship at all.

## Collateral damage

Clearly, there is some ambiguity about whether the FTT will achieve its objectives. But there is little doubt that its imposition will weigh upon more than just the financial sector it is aimed at. Although the EC has attempted to limit the wider impact of the tax by ring-fencing lending and borrowing, the report argues that a "cascade effect" in which the additional costs filter down into the real economy remains a distinct possibility.

This is essentially the case that the Association of Corporate Treasurers (ACT) have been making ever since the idea of a tax on transactions was first mooted by the EC.

"The objective seemed to be to place a tax on the banks, but unfortunately much of the costs will be passed on to end-users, some of whom are non-financial corporates," says Michelle Price, Associate Policy and Technical Director at the Association of Corporate Treasurers (ACT).

Nearly every area of treasury activity – funding, short-term investments, and risk management – will be impacted to some extent by the tax, PwC concludes. But the biggest concern, arguably, is the impact of the tax on corporates who use derivatives to hedge their financial risks.

"The FTT will be punishing those who are trying to hedge by increasing the cost," says Price. "That could also lead to reduced liquidity in the market for certain derivatives products as companies and banks may not be transacting as much."

## SCF benefits to the tune of billions

According to new research from Demica, supply chain finance (SCF) can help unlock a significant amount of liquidity for supplier companies from Central and Eastern European (CEE) countries in the manufacturing, wholesale, and logistics sectors – over €16 billion for supplier firms based in Poland, the Czech Republic and Hungary. Since many of the domestic suppliers are anchored in the supply chains of German companies, German buyers are particularly interested in their financial stability.

In more developed economies like Germany, local German supplier firms could benefit from potential liquidity release of €44 billion with SCF arrangements, according to the research. As regulatory capital requirements for banks are increased, and if future consolidation gradually takes hold in the German banking system, a proportion of companies, especially small and medium-sized enterprises (SMEs) in the supply chain, may find it more difficult to raise affordable relationship credit.

The report, entitled 'Linked In?', illustrates the great potential of SCF in alleviating the credit squeeze confronting firms in the studied countries.

Despite the fact that the size of Poland's economy is around 2.5 times larger than the Czech Republic's, the volume of working capital that can be unleashed by SCF in the latter is almost 85% of that in Poland. This is mainly due to two factors: first, the number of days sales outstanding (DSO) that can be recovered through SCF is higher in the Czech Republic. Secondly, factoring penetration as a percentage of GDP in the Czech Republic is just about half of that in Poland.

Given the difference in the size of their economies, the actual factoring volume in the Czech Republic is therefore much smaller. In other words, significant potential in freeing up working capital is yet to be exploited in the Czech Republic. In the smallest economy among the three, Hungary, firms can still benefit from more than €3.5 billion of working capital through SCF.

The report references a survey Demica completed with a number of major international banks, who reported 30-40% annual growth rates in SCF programmes over the past two years, with growth rates expecting to settle down to 20-30% by 2015, and 10% per annum to the end of the decade. Eastern Europe, along with China and India, are considered to be the top three regions providing the greatest SCF market potential in the future.

## Invoice for sale

With annual revenues of about \$25 billion, US-based Tech Data, one of the world's largest distributors of technology products, is an important part of the global IT ecosystem. Supplied by approximately 500 original equipment manufacturer (OEM) vendors including Sony, Microsoft, Cisco, HP, Apple and IBM, it sells to a customer base of more than 120,000 value added resellers worldwide, most of which are small and medium sized businesses reselling to end users. With daily product sales of around \$100m, and an average order size of under \$2,000, Tech Data is clearly a high volume, high velocity business.

Because the business historically has strong operating cash flow and excellent liquidity, any chance to pull cash out of its working capital cycle allows it to reinvest in other opportunities and provide more credit to its reseller, customers who otherwise may not have the cash flow or resources to maintain high levels of inventory, explained Scott Walker, VP and Assistant Treasurer of Tech Data at the EuroFinance International Cash and Treasury Management event in Barcelona.

One of the ways Tech Data achieves cash efficiency is to focus on streamlining its accounts receivable with the introduction of a Receivables Purchase Financing (RPF) programme. Walker is first to admit "it is nothing fancy", but whilst it was a "relatively easy" programme to put in place, he knows that it delivers some distinct advantages.

## The programme

RPF in this instance takes the form of a \$50m uncommitted revolving facility in which the programme provider (one of Tech Data's banks) purchases the company's receivables from its customers, the bank having assessed each obligor's credit risk and priced accordingly. Tech Data has opted to maintain the servicing obligation on the programme, collecting maturing receivables from its customer, which it does on a weekly basis. This enables it to "keep the customer relationship intact" but it does require Tech Data to set up a collection account (over which the provider bank has a control agreement).

By selling its receivable to the bank, Tech Data is paid an advance on what is due, less a discount based on the credit risk-based pricing. The receivables may be submitted any time prior to maturity (Tech Data's terms typically range from 45 to 60 days) but Walker prefers to submit at the point of sale. As a single obligor programme the advance ratio is 100%. This has an advantage over portfolio-based receivables securitisation programmes which tend to feature reserves or other hold-backs to mitigate the bank's risk.

A master receivables purchase agreement (RPA) forms the overarching structure of the programme and this allows for new customers to be added; the bank assesses the credit risk and sets a limit for each obligor. "The RPA is the key document and needs to be made as flexible as possible," advised Walker. "We've set this up with one seller per jurisdiction and although there will be minor country-specific modifications we fully intend to use the RPA as the foundation for additional obligors and jurisdictions."

The programme does require some additional (spreadsheet-based) reporting to the bank for each submission and collection by Tech Data but it retains discretion on which accounts and which invoices it wants to sell. Regardless of credit risk, the company will always have a limited credit capacity for each customer. For key buyers, because Tech Data has opted for a non-recourse facility, with financial risk being transferred to the bank, the programme effectively allows it to provide more credit capacity – and thus buying power – to its buyers.

## It works

Tech Data is using RPF to supplement its portfolio-based receivables securitisation programme. With large obligors and where advance rates have some limit or hold-back in place (perhaps driven by ratings-based concentration limits), the 100% advance facilitated by RPF is a way of increasing the firm's credit capacity for its customers. "Working with both and optimising which customers are in securitisation and which are in the single obligor purchase programme can really increase your available liquidity," stated Walker. Driven and led by treasury, he added that given the advantages it brings, taking responsibility for the set-up of the programme was "very easy."

Walker believes that Tech Data has found in the RPF programme an efficient alternative form of reducing DSO, improving liquidity and lowering working capital financing. "RPF is very efficient financing and I think any company from a start-up to a major corporation can make this work." ■

Longer versions of these articles are available at [treasurytoday.com/treasury-insights](http://treasurytoday.com/treasury-insights)

# This much I know

**Lisa Tierney**

European Treasury Manager

**LUXOTTICA**

## What is your career-defining moment?

It's hard to define your career in one moment but two that stand out are first of all getting the opportunity to kick-start my career with Diageo Plc, a large multinational company (MNC), and more recently taking responsibility at regional level in Luxottica, where I am European Treasury Manager.

## Which women in business most inspire you and why?

In the early stages of my career in treasury, I worked with some inspiring women who instilled their passion in me. Luxottica actively promotes women in the workplace and our workforce actually comprises a 60/40 female to male split.

## What is the biggest challenge you are facing just now?

Luxottica is a fast growing company and the biggest challenge is integrating new acquisitions and new retail and wholesale subsidiaries into our business model. From a treasury perspective, this entails significant travel as we meet the local finance teams and our relationship banks in order to understand the business operations and relevant banking requirements.

## What couldn't you manage without?

The network of contacts that I have built up throughout my career is invaluable. On occasion, I can tap into their vast experience and knowledge base which enables me to tackle certain challenges that my current role presents. Building and maintaining relationships with people across all functions and departments in Luxottica has allowed me to gain a better understanding of the business and ensures that the treasury department plays a key role in servicing it.

## What advice would you give to other women in treasury?

Gaining as much experience as possible in all facets of the treasury function and building a strong network of contacts are key to progression. Also, in my experience, some women shy away from certain opportunities presented to them such as attending relevant conferences and forums. I find that by attending such events you become more aware of what is happening in the wider treasury world and the financial markets and how other people approach the different challenges.

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

I believe languages are extremely important in business now more than ever before. Working for an Italian company with significant global reach you come into contact with people from different cultures and languages all the time. The company provides language classes for staff and I am learning Italian at present.

“Gaining as much experience as possible in all facets of the treasury function and building a strong network of contacts are key to progression.”

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### ON THE WEB

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To read all the interviews in this series go to [treasurytoday.com/women-in-treasury](http://treasurytoday.com/women-in-treasury)



Lisa Tierney's first taste of the treasury world was with the global beverage company, Diageo, where she worked with a number of inspiring women who held senior positions in the firm. These senior executives acted as mentors in the early stages of her career. They set the standard that Tierney endeavoured to emulate as she progressed in her career. This illustrates the importance of women putting themselves forward for managerial and director-level positions, and acting as a role model for younger women in the business. This will have a greater impact on changing the gender composition of boards and treasury teams than a formal quota, according to Tierney.

She began her career in treasury after completing a degree in economics at Trinity College, joining the treasury team in Diageo at its headquarters in Dublin. "I decided that this was where I wanted to work – in a fast-moving environment with a broad range of activities, such as cash management, inter-company financing and foreign exchange (FX) management."

From Diageo, Tierney moved to the banking side to Merrill Lynch, and was involved in cash and liquidity management – funding various business units on a day to day basis across the various currencies. She embarked on an MSc in Investment and Treasury, studying part-time whilst continuing to work. She then moved to FTI, a specialist international treasury company providing treasury management solutions and consulting services to a diverse range of companies, which gave her excellent experience in dealing with all aspects of corporate treasury both operational and strategic.

"I continued to study at night and the MSc proved very practical, tying in with aspects of what I was dealing with on a daily basis," explains Tierney. "I moved out of the treasury environment for a short time and then found myself returning to a position with Luxottica Trading and Finance in 2009." She has been with Luxottica for four years, starting out as a Senior Treasury Analyst before being promoted to European Treasury Manager in 2011.

What she enjoys about treasury is the integral role it plays within the business. "Treasury deals with many different departments, groups and banks on a daily basis in order to get its job done. I am always talking to different people, for example the local finance teams in our subsidiaries in order to understand their needs and then working with our banks to get the right services in place for those subsidiaries."

Treasury is also a challenging environment, especially in the case of Luxottica, a fast-growing company which is expanding into the emerging markets both on the wholesale and retail sides. Since December, the company has acquired two companies in Europe that it is now integrating into the Luxottica model: Alain Mikli, a bespoke boutique eyewear business in France that has operations across Europe, US and Asia; and Sunglass Time, a retail chain with stores across UK and Europe. Furthermore, Luxottica has incorporated a new wholesale subsidiary in Russia and retail operations in Germany and Italy.

"When we are acquiring a company, or a new company is incorporated, treasury is involved right from the outset with the M&A and legal teams. For a new company all the risk factors are assessed and this can entail evaluating new banking partners, currency of bank account, invoice currency, etc. Where feasible, new group companies are quickly linked to the cash pool structure so they can access funds for their day-to-day operations. For acquisitions in particular, bank account consolidation is key in order to simplify the flows and allow for automation of accounts payable (AP) and accounts receivable (AR) processes. For this, we liaise with our shared service centre (SSC) in Italy, IT and accounting departments as they on-board companies into SAP," says Tierney.

The treasury team in Dublin has responsibility for cash, liquidity and FX risk management activities across Europe. Due to the fact that Luxottica's primary manufacturing site and HQ is located in Italy, the region sees quite significant flows, while at the same time the region accounts for about 80% of the group's total FX exposure. There are approximately 50 legal entities across Europe with the majority linked to the regional cash pool structures. In addition, there are approximately 50 banking relationships to be managed. The challenges include forecasting and ensuring all cash generated is centralised into our cash pools as quickly as possible for use at group level.

The treasury team is involved right down to local level with each of the subsidiaries and Tierney negotiates credit lines, fees, etc, both with Luxottica's local banks and also the main cash pool bank. "It is very important to have a constant communication with our banks in order that they continue to provide good service to us as the business expands. With such a fast-moving environment, we want the process to be as smooth as possible. Having the communication channels open with the various relationship teams makes it a lot easier when a new company comes on board and you want something done very quickly." ■



Lisa Tierney joined Luxottica Group in May 2009 and was appointed European Treasury Manager in January 2011. She has held several positions within treasury, including at Diageo, the world's leading premium drinks corporation. In addition, she has a background in banking, having worked in Merrill Lynch on the treasury funding side. She holds a degree in Economics from Trinity College Dublin, a MSc degree in Investment and Treasury and is an Associate of the Irish Taxation Institute (AITI) having completed the professional tax exams.

Luxottica Group is a leader in premium, luxury and sports eyewear with approximately 7,000 optical and sun retail stores in North America, Asia Pacific, China, South Africa, Latin America and Europe, and a strong, well-balanced brand portfolio. In 2012, Luxottica Group posted net sales of more than €7 billion.

# Women in Treasury Forum

*Treasury Today's Women in Treasury initiative was launched in January 2013. Aiming to provide a platform to support, inspire and increase the visibility of women working in our industry, the project began with a series of profiles in Treasury Today and Treasury Today Asia. These profiles of female high flyers working across the treasury profession presented a personalised view of womens' backgrounds, struggles and career highlights. Following this, in June 2013 we launched the Women in Treasury Annual Study. The first of its kind, our Study was developed to better understand the female treasurer's experience at work, including issues such as salary parity and career development.*



## Women in Treasury Annual Study

To present the results of our Study, bring women in the industry together and provide a networking platform, we hosted a Women in Treasury Forum. On Thursday 31<sup>st</sup> October the first Women in Treasury Forum was held at London's Four Seasons Hotel, Canary Wharf. 150 women from a wide range of industries attended to be part of this pioneering initiative. The Forum provided a rare chance for women in our industry to network, share their experiences and hear our four panellists discuss the key issues highlighted by the Study.

The event started at noon with a pre-lunch networking reception during which Angela Berry, Publisher of Treasury Today, presented an ice-breaking welcome message and an exclusive summary of the Study findings. This was followed by the lunch during which an 'all-star' panel discussion took place.

The panel line-up of four extremely well respected women within the treasury industry was composed of:

- Maeve Robinson, Assistant Treasurer, Omnicom Group and the winner of Treasury Today's Adam Smith Awards Woman of the Year 2013.
- Marie-Astrid Dubois, Assistant Treasurer of Honeywell and Highly Commended Adam Smith Awards Woman of the Year 2013.
- Jenny Knott, CEO, Standard Bank.
- Pam Walkden, Group Treasurer, Standard Chartered Bank.

Our panel focused on four discussion areas:

1. Job satisfaction.
2. Equality.
3. Mentoring.
4. 'Vive la différence'.

The discussion was facilitated by Maia Rushby, CEO of Diversity in Leadership, in leading a lively and inspiring debate around the role of women within our industry, obstacles to their ongoing success and what women can do to improve their career prospects. Going beyond mere theory and conjecture, these four women articulately shared many personal experiences and accounts of the highlights and trials of their impressive careers to show all women in the industry that they can and should be aiming as high as their ambitions permit.

“I thought it was very inspirational because usually you are just working in a team and you don't really think about what the differences are between you and your colleagues. It was good to hear from very experienced women of ways in which you can think about how you operate in the future and how you can change things for people who may be younger than you.”

Sarah Saxby, Treasury Director, Cash Management – Rio Tinto.

A question and answer session followed the discussion, with many interesting and challenging views and questions raised. We recognise the importance of networking, mentoring and support. Our panellists have had many role models that have inspired and encouraged them throughout their careers. Whether an appointed or unknowingly chosen mentor, such figures (either male or female) are vital in raising the ambitions and confidence of any aspiring woman.

The panel discussion and question and answer session echoed many of the views expressed throughout this year by the women featured in our Women in Treasury profile series, where many female treasurers have expressed their fierce commitment and passion for their profession. What resonates from the responses we have gathered is that the majority of women in treasury feel they are experiencing inequality, both in pay and in career prospects, and this appears to be exacerbated for those who have children.



Nearly 60% of Study respondents said that they did not believe they were paid the same as their male counterparts – nor did they feel their career prospects were the same.

Two areas of inequality specific to treasury are identified as the highly male environment that the industry remains and the fact that the nature of the work of a treasurer does not lend itself well to flexible working arrangements, making life particularly difficult for treasurers who are also parents. In addition, one topic that came up during the panel discussion was that women must become more forthright at demanding the (sometimes flexible) working conditions that they need in order to manage the very top jobs and balance that with external responsibilities.

When it comes to professional networking, key to career development, there are very few existing platforms available for women treasurers. Our Study and subsequent Forum have served to highlight the necessity for women to better promote themselves, to find great mentors and to support one another. Although nearly all of the women surveyed stated that they think mentorship is key to career development, over 50% are working for a company that does



not offer such a programme. The Women in Treasury Forum was a perfect opportunity for female treasurers to raise their visibility, learn from each other's experience, and to network amongst their peers.

“I have been to several women's networking events in the past, but this was special because it brought together treasury professionals and addressed the particular issues that women face in that industry.”

Susan Webb, Managing Director, Pfizer



And we aren't stopping there. The Women in Treasury initiative has only served to highlight just how essential it is that we create a platform for the women in our industry. In 2014 we will be holding a Women in Treasury Asia Forum in Singapore in May to create a networking and discussion platform for women in the industry working across the Asia Pacific region. We will then host a networking Forum in London in November. We will, in addition, be developing further print, online and event based networking for 2014 to run alongside our ongoing series of female corporate profiles. ■

“An event like this is long overdue, there isn't a forum that brings women together on this level and the approach is the right one. The candour of the speakers was really something, they were so open and honest and the women here should reflect on the comments made today.”

Marilyn Spearing





“Bank of America Merrill Lynch is proud to sponsor the 2014 Adam Smith Awards for the second successive year. These awards are recognised globally as the industry benchmark for best practice and innovation, regardless of company location, budget or size,” says Jennifer Boussuge, Head of Global Transaction Services for EMEA at Bank of America Merrill Lynch. “Now in their seventh year, the 2014 Adam Smith Awards will again showcase the pinnacle of corporate treasury talent and we are delighted to continue our support.”



# All set for the Adam Smith Awards 2014

Treasury Today is delighted to announce that for the second successive year, Bank of America Merrill Lynch is sponsor of the Adam Smith Awards. Now entering their seventh year, the Adam Smith Awards have gained increasing momentum and are universally recognised as the ultimate industry benchmark in treasury excellence. The Adam Smith Awards recognise, reward and celebrate the success of corporates, regardless of company size, budget and industry sector.

## ENTER FROM 31<sup>st</sup> JANUARY

The Adam Smith Awards are open to all corporates. For the last six years, the competition to win the accolade of an Adam Smith Award has gone from strength to strength and 2014 promises to be the most challenging and exciting yet. Nominations will open on 31<sup>st</sup> January and close on 30<sup>th</sup> April 2014. The short nomination form will be on the Adam Smith Awards pages of the Treasury Today website and should take no more than 15 minutes to complete. There is no limit to the number of solutions that can be submitted and a single project can be entered under more than one category. Nominations can be made by any corporate. Banks and service providers can assist their clients in completing the nomination form. Alternatively, banks and service providers may submit nominations on behalf of their corporate clients, with their approval.

Winners will be announced in May and will be invited to attend a celebratory Awards Lunch which takes place in June at Plaisterers' Hall, a highly prestigious venue in the City of London. As well as being presented with a stunning crystal Award, the Awards Lunch provides a superb opportunity for networking, and enables winners to significantly raise their profile and that of their team, whilst showcasing their achievements to colleagues, clients, investors and peers.

The Adam Smith Awards are *the* recognised standard for excellence in treasury. We look forward to receiving your nominations.

## Award categories for 2014

- Treasury Today's Top Treasury Team 2014
- Best Cash Management Solution
- Best Liquidity Management/Short-Term Investing Solution
- Best Working Capital Management/Financial Supply Chain/AP/AR Solution
- First Class Bank Relationship Management
- Best Card Solution
- Best Financing Solution
- Best Foreign Exchange Solution
- Best Risk Management Solution
- Best in Class Benchmarking
- Best Process Re-engineering Solution
- Best MME/SME Treasury Solution
- One to Watch
- Treasury Today Woman of the Year



**Cees-Jan Dijkstra**  
CFO



Holmes Place Lifestyle Clubs found that getting in shape for the Single Euro Payments Area (SEPA) posed a number of challenges. But with the expert advice provided by its banking partner, Commerzbank, the company was able to overcome these hurdles and successfully migrate its direct debits well in advance of the 1<sup>st</sup> February 2014 deadline. Now the business is no longer worried about compliance and is ready to leverage the benefits of a harmonised euro payments area.

# Problem...

When the 1<sup>st</sup> February 2014 deadline for migration to the Single Euro Payments Area (SEPA) was announced in early 2012, Berlin-based health and fitness chain Holmes Place Lifestyle Clubs knew that it would need to act quickly. The company's treasury teams were aware of the numerous benefits switching to SEPA would bring, such as centralising collections and, possibly, reducing bank fees in the future. However, with direct debits collected from 300,000 members in over 75 locations, much of the company's post-deadline business hinged on how successfully the team managed the transition.

In September 2012, the company began its migration to SEPA. Immediately it was confronted with a number of challenges. Firstly, the company had decided to synchronise its switch to SEPA with the implementation of a new customer relationship management (CRM) system. But in order to migrate to SEPA, every existing database file had to be converted and validated, a task which involved obtaining International Bank Account Numbers (IBANs) and Bank Identifier Codes (BICs) from every customer.

A further problem arose when the company looked at the implications of the SEPA regulation's pre-notification requirements. Under the new regulation, it is mandatory for pre-notifications for direct debits to be sent five additional days in advance. Switching to the new schedule, however, could potentially cause serious disruption concerning the company's cash flow management, which depends on the direct debits received from their members in the first two days of the month.

"We needed a practical solution to this," says Cees-Jan Dijkstra, CFO of Holmes Place Lifestyle Clubs, further explaining that sending out reminder letters each month would not likely be appreciated by their customers, not to mention the considerable costs that the company would incur through such an exercise.

# ...Solved

Fortunately for Holmes Place Lifestyle Clubs, specialist help was on hand. From the beginning, the firm was able to rely on the help and advice of two SEPA experts provided by its banking partner Commerzbank.

"At the outset we held several meetings with the specialists to discuss how the SEPA guidelines were to be interpreted and how we could find a feasible solution for both sides," says Dijkstra. As the project proceeded, the company found Commerzbank's SEPA experts were there to assist at every juncture. "Later on we set up a hotline to the professionals so that any problems that arose could be solved in a timely manner."

In particular, Commerzbank helped convert customer master data into IBAN and BIC for a total of nine countries. This data was then validated, with Commerzbank helping the company by checking business partner master data against the bank's account. Additionally, the bank also provided some assistance with its conversion service for SEPA Direct Debits (SDDs) and by informing direct debit initiators.

Like many corporates, Holmes Place Lifestyle Clubs found one of the biggest challenges relating to migration was interpreting the vast amounts of pages comprising the regulation. For this reason, the advice provided by Commerzbank proved critical, particularly in the case of pre-notifications for SDDs. When the company realised that migrating to SEPA would mean a longer pre-notification period, Commerzbank recommended that they set up a system of three workflows that trigger pre-notifications and SDD files. Through this solution SDDs now arrive in the bank account at the beginning of each month – exactly when they are needed.

Now the Holmes Place Lifestyle Clubs is SEPA-ready and, while many of its peers are scrambling to meet the deadline, the company can now look to how it will leverage the benefits of SEPA in the future. Top of the company's agenda will be to reduce the number of collection banks by utilising SDD for cross-border transactions. "This will create added transparency and more streamlined payment methods for our members," says Dijkstra. "It will also hopefully reduce our bank fees too, even if not by a large amount." ■

# SEPA phase II

“ What will ‘SEPA phase II’ look like for your company? ”

## Gerwin Braam, Senior Bank Manager and SEPA Project Manager, AkzoNobel:



For the most part, the Single Euro Payments Area (SEPA) phase II at our company will be a continuation of the progress already made in the build-up to the 1<sup>st</sup> February 2014 deadline. At AkzoNobel we have applied a lot of effort to ensure we are ahead of the game and SEPA-compliant before the deadline.

One of our key goals in SEPA phase I was to connect all AkzoNobel entities to our centralised payment factory, allowing AkzoNobel to make SEPA payments on behalf of our legal entities. This was built to be SEPA-compliant and is technically ready to process XML payment files. A large majority of our legal entities are already connected to the payment factory, allowing them to process the SEPA Credit Transfer (SCT). SEPA phase II will therefore see us continue to connect the remaining entities to the payment factory – this will be completed in 2014 and will enable our payment process to be streamlined, with one credit transfer type leaving the company and only one bank file to process.

During phase I, we put a lot of energy into the SEPA Direct Debit (SDD) mandate. Today, we have centralised the process creating a collection factory which allows treasury to collect SDD transactions from customers’ accounts on behalf of our legal entities – a system unique to AkzoNobel. The system is technically live and the large majority of our entities, who have had to configure their own local ERP accounts payable (AP) systems, have already migrated. A key part of phase II will therefore be to continue connecting our entities to the collection factory, allowing us to harmonise and streamline the collection process. This involves replacing the legacy structure, where all entities have their own local electronic banking (e-banking) system, to a single system where collection files are sent to a central treasury system and then collected on behalf of our entities. In the long run this will allow us to gain increased visibility over the process and reduce our banking costs, as we will only have one bank contract. In addition, this should also see an increase in the number of direct debits that we have with our customers.

Across all our EU entities, the HR departments have already implemented SEPA-compliant salary payments. This is not something which will be extended to non-euro HR departments during phase II because these countries have their own currency that is not regarded as a SEPA currency payment and therefore do not have to comply with the SEPA standards.

## Almudena Lombardia Escudero, Treasury Administrator, Shared Service Centre (SSC), Gas Natural Fenosa:



The introduction of the Single European Payment Area (SEPA) has simplified the management of Gas Natural Fenosa’s associates across Europe from its Shared Service Centre (SSC). The standardisation of files for the SEPA Credit Transfer (SCT) and SEPA Direct Debit (SDD) mean that we are truly able to talk about synergy in operations.

We have been able to accomplish SCT before February 2014 with the implementation of SEPA formats for most of the countries we operate in, other than Spain. Thanks to the opportunities afforded to us by our global banks we are now using XML SEPA formats sent to our entities via the internet. In this case, mass payments to suppliers are included by most of our associates, with Italy adapting to XML files in February 2014.

We are also waiting until February 2014 to migrate the file structure in Spain, where they will be migrated to the 34-14 format because of the Editran version installed. We will then update the Editran version in phase II before changing to XML format.

The migration to SDD is more complex because of the diversity of commercial interfaces and systems that support gas and electricity invoicing. Gas Natural Fenosa has recently implemented a merger process which has not yet been completed at systems level in the commercial department, and the new invoicing systems are currently in the implementation stage, meaning that both processes will overlap in time.

Only the SDD for Portugal and Spain are currently managed from the European SSC via non-SEPA formats. Migration to SEPA will take place in February 2014 and will be carried out covering the minimum necessities to guarantee operation viability. We are already working to unify physical custody of the mandates and XML files, for all of our associates, along the transition period until February 2016.

We are therefore expecting to finalise and complete the centralisation process in Spain, for operations by our European SEPA associates, once the magical date of February 2014 arrives, for both SCT and SDD.

The single European payment factory will be consolidated, leaving specific residual operations for the local structure in each country, such as small cash payments, payment of charges and particular local taxes.

We will achieve major synergy in our European banking map thanks to the designation of global banks. This will permit simplifying the number of entities we work with in each country, so that there will be a global bank, and in some cases a local bank for specific operations, mainly SDD.

The processes which are currently different in each country, because of the varied equipment used, will be made uniform and unified in the SSC via centralisation. This will confer greater control and knowledge about our operations and the position of our associates beyond our frontiers.

### Gary Williams, General Treasury Manager, Mitsubishi Corporation International (Europe) Plc:



At Mitsubishi Corporation International (Europe) Plc we have applied much effort to meet the 1<sup>st</sup> February 2014 SEPA deadline, as the project overall will give us greater efficiency. This process began around four years ago, when we became aware of the SEPA Credit Transfer (SCT), which we have since adopted and is used for around 53% of our euro payments. In addition, SEPA reduces the amount we pay in bank charges, which is quite significant as we make more than 4,000 payments per year that are eligible for SEPA.

With regards to SEPA phase II following the deadline, it would be ideal if we could conduct all our euro collection activity from one account, as currently we hold several accounts across Europe to collect remittances from our customers. However, we are aware that dependent upon the customer's bank, cross border payments as opposed to in-country payments may attract a higher bank charge. Despite this, we are planning to conduct some analysis on our bank account usage and ongoing requirements. We need to build up a clear picture and fully understand our customer's position before we make any changes.

Another element of SEPA phase II we will be looking at is in regards to the cut-off times for making payments. The SEPA cut-off time for which payments have to be released prevents us from making certain same-day type payments and therefore we opt for the safer high value type payment option. Consequently any extension of this cut-off time in phase two would help us migrate more of our business to SEPA.

Although we have already adopted the SCT, we do not see SEPA Direct Debt (SDD) as constituting a large part of our phase two plans. A few of our vendors want to use SDDs and while we can accommodate, it is not something that we can apply to the collections side of our business. The primary reason for this is that our commodity trading business is based on the issuance of an invoice to collect payments.

SEPA certainly has been a much hyped and discussed subject for some time. The sheer volume of information surrounding the topic has often made it challenging to navigate through and ascertain clear facts. However, in terms of improving business efficiency I believe that it has certainly been worth all the effort. ■

#### The next question:

"How will treasurers be affected if all money funds are required to switch to VNAV?"

Please send your comments and responses to [qa@treasurytoday.com](mailto:qa@treasurytoday.com)

# Europe – happy but perhaps not such a prosperous new year

*European markets are still in high spirits. Yet, regardless of momentary windfalls, the overall trend for Europe remains dour. Before long we can expect rising Eurozone tensions rather than surging markets.*

To start off with the leader in Europe, Angela Merkel will head a Grand Coalition in the coming years which consists of her conservative CDU/CSU (a 'double act') and the social-democratic SPD.

A broadly supported agreement is a good thing but it comes at a price. The parties have not so much picked over the bones of the accord as thrown a bone to the putative coalition partners. To placate the CDU, there will be no tax hikes while older mothers gain higher pension benefits for every child. The Bavarian CSU has pushed through a motorway toll for foreign cars and lorries. And the spoils for the SPD are a national minimum wage of €8.50 per hour.

The Frankfurter Allgemeine Zeitung, like many other media, was very critical of the agreement, which it described as "overcooked mush" that will be "easy for everyone to digest".

There is a risk that, to please the electorate, the new government will backtrack on many of the reforms that the previous (SPD) Chancellor Schroeder implemented. For instance, the retirement age will be lowered to 63 (if people have paid pension contributions for 45 years). In addition, the job market threatens to become less flexible because temporary work will be subject to stricter regulations. This could damage Germany's competitiveness and slow down economic growth.

In regard to the Eurozone, not much has changed: tough reforms and a prudent budget policy continue to be on the cards. Left-wing media were hoping that the SPD could force Ms Merkel to loosen the reins to some degree. At first glance, this does not appear to have happened.

It was slightly surprising that investors welcomed the 'GroKo agreement' with open arms. There is little new under the sun and the few changes that have been made do not bode well for the financial markets, it would seem. Among others, the service sector has not opened up and the pro-European stance is not convincing. Perhaps the markets were enthusiastic because they envisage that a broadly supported (and stable) coalition can be expected to rule Germany for four years. (Because the minimum wage will only become unconditional in 2017, there is a low chance that the SPD will leave the coalition early).

Of course it is positive that the most powerful Eurozone member state has announced four years of political stability and remains committed to Europe. But there is a danger that Germany will be too passive when it comes to streamlining its own economy or creatively addressing the still rampant euro crisis.

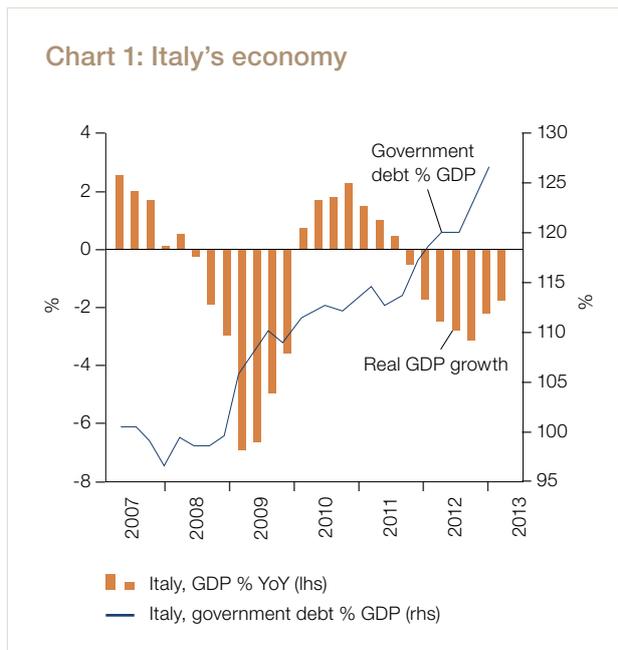
In Italy, Berlusconi has been thrown out of the Senate because of his fraud conviction. Various other cases are still before the court and the media mogul could end up in prison.

Nevertheless, Italians, the papers, and experts are careful not to write off the 77 year old once and for all. Berlusconi's party has split in half. One part continues to support the Letta government and supports the ministers that are in the cabinet. The other half consists of faithful Berlusconi followers and has relaunched under Berlusconi's old party name Forza Italia. It can currently expect to gain 20% of the votes, almost the percentage that voted Berlusconi into office in 1994 when he became Prime Minister.

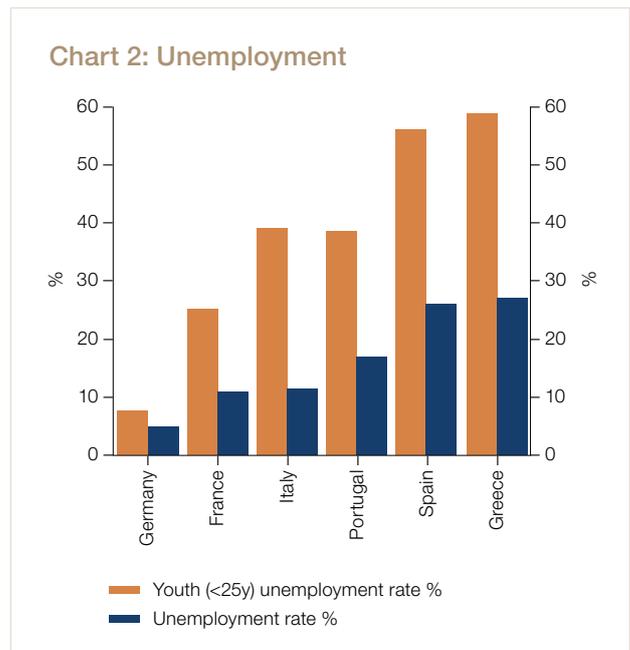
Berlusconi may be barred from public office but that does not mean he will step down as political leader. Beppe Grillo of the Movimento 5 Stelle (M5S), the party that came second in the most recent elections does not have a seat in parliament either. In any case, the former three-time Prime Minister will not hesitate to trip up the government to serve his personal interests.

On the other hand, Prime Minister Letta will sleep a little easier than before. That Berlusconi's PDL is in disarray means his cabinet has become less vulnerable. Yet, even without a government crisis Italy is struggling economically. Berlusconi is symptomatic of a rotten political climate. As Barbara Spinelli wrote: "Berlusconism is still here. And it will be not easy to wean ourselves off this drug that has fascinated not only politicians and parties, but the entire society...More fundamentally, though, it is his (Berlusconi's) cultural and political heritage – his ways of thinking, acting, the 'disease of the century' – that will persist. Without a profound look deep into our conscience, this legacy will continue to intoxicate Italy."

Spinelli's analysis is tough, razor-sharp and scathing. At the time of the Costa Concordia disaster in January 2012, Italy experienced a bout of self-castigation. The coastguard who



Source: Thomson Reuters Datastream/ECR



Source: Thomson Reuters Datastream/ECR

tried to order Commander Schettino back on board was seen as a hero whereas the Costa captain stood for everything that was wrong with Italy. In politics, not enough has changed in the two years since then; even if expelling Berlusconi is a big step. Perhaps it would not be realistic to expect Italy to make a clean sweep in the space of a couple of years. The recent economic data is a case in point. The jobless rate is 12.5%. Youth unemployment is at the record level of 42% and rising. The misery will continue as Italian politicians dominate the news for all the wrong reasons.

The pedestrian German coalition agreement and the struggling Italian republic are but two factors that could whip up tensions in the Eurozone. Other (larger) trends are cause for grave concern. Across Europe many politicians are making populist, isolationist, and protectionist statements or presenting proposals to pander to these sentiments. Some seem to display racist tendencies; for example in France, Italy, and the Netherlands.

The economic foundations under the European integration project – freedom of movement for goods and services, capital and individuals – seem to be crumbling. Some areas were never that "free" in the first place (Germany, which is supposedly exemplary, jealously guards some segments of its services sector). Now there will be even more pressure on the common market.

Europe's shortcomings when dealing with the outside world are increasingly evident. The EU is losing clout because it appears divided, inactive and weak. More than ever before,

the economic/political crisis causes the Eurozone states to look inward and become suspicious of each other. This has been a contributing factor in the case of the Ukraine that seemed to be slipping out of Europe's grasp. Through economic blackmail and political pressure, Russian president Putin persuaded the Ukrainian president Yanukovich to strengthen ties with Moscow and turn his back on Europe just when the Ukraine was about to sign an Association Agreement with the EU. In its divided state, Europe was not strong enough to take forceful action.

The chain of events shows that Germany is not all-powerful. Ironically, it was the first time that Germany went out on a limb to champion an EU policy in eastern Europe that was guaranteed to irritate Russia. Whereas Merkel usually gets her way, this time she – and with her the entire EU – came off worst.

A fragmented Europe also means that environmental concerns are being overruled. For instance, the EU limits on CO2 emissions were weakened considerably after intensive lobbying by large manufacturers in Germany. Likewise, one-sided and narrowly defined national interests are hampering progress towards a banking union – a difficult process in any case.

In short, the EU faces major problems at national and European level. This makes it harder to tackle the political and economic crisis. Without a doubt, more of these issues will come to light with further attempts to form a banking union, stress tests on the Eurozone's largest banks and the looming European elections. ■



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# Don't fear the taper

*Since the financial crisis, central banks around the world have been injecting money into markets through their quantitative easing (QE) programmes. The policy has boosted asset prices and, most importantly, helped keep banks solvent. But the era of easy money cannot last forever. When the Federal Reserve eventually begins unwinding their QE programmes in the coming years, how will the policy change impact corporates?*

In early 2013, UK cable operator Virgin Media prepared an issue of two bonds in sterling and dollars for a total of £2.3 billion as part of its merger with Liberty Global. It was the biggest single bond sale of high yield debt since late 2010 and, thanks to strong investor appetite for high yielding assets, secured on extremely favourable terms.

“At the time we were facing some robust refinancing challenges given the scale of what we were doing,” says Rick Martin, Group Director, Treasury and Investor Relations. But with all that extra liquidity flooding into fixed-income capital markets as a result of accommodative monetary policies, the company not only obtained a lower rate of interest but also dramatically extended their maturities. “That is a very rare thing,” enthuses Martin. “It is not every day an issuer is able to take both coupon and tenor at the same time.”

Companies like Virgin Media benefited enormously as the Federal Reserve bought up US Treasuries in the years that followed the financial crisis. Investors who were put off by the rising price of the bonds that the Fed was purchasing – by QE3 at a rate of \$85 billion a month – turned to other assets like corporate bonds, and this in turn helped to push down yields and made it cheaper for corporates to borrow. As spreads narrowed, issuance soared. By 2012, it had hit record levels. During that year, \$5.4 trillion worth of bonds were issued worldwide – a 13.1% increase on the year before according to Thomson Reuters.

## Stop the press

However, looking ahead to 2014, there is no certainty that corporates will continue to enjoy such advantageous

borrowing conditions. Now, with the Federal Reserve considering exit strategies from accommodative monetary policies, corporates, and particularly those below investment-grade, such as Virgin Media, have begun to brace themselves for rising long-term borrowing costs in the years ahead.

“When Bernanke begins to hint at tapering the bond vigilantes begin to take over. Naturally, nobody wants to be last out of a burning room, so they all rush out at once.”

Tom Byrne, Director of Fixed Income, Wealth Strategies and Management

To get an idea of what might happen in the bond markets when QE begins to be unwound we don't have to look any further than the events of the past year. As talk of a taper intensified last summer US Treasury notes rose to 2.90%. It was their highest level for two years, and the rise had an immediate impact on US sales of investment grade corporate debt. By early June, Dialogic data shows weekly sales of investment-grade corporate debt had fallen to \$4.1 billion, down from an average that year of \$23.2 billion. High yield offers also dwindled. Until the middle of May, weekly issuance was averaging around the \$8.8 billion mark. By the following month it had fallen to \$1.6 billion.

“I think investors were lulled into a sense of security that the Fed wouldn't let rates rise rapidly in their faces,” says Tom Byrne, Director of Fixed Income at Wealth Strategies and Management and author of capital markets newsletter BondSquad. “But when Bernanke begins to hint at tapering the bond vigilantes begin to take over. Naturally, nobody wants to be last out of a burning room, so they all rush out at once.”

But the panic which gripped markets proved short-lived. By mid-September the Fed, fearful perhaps of the turmoil that might ensue when tapering eventually began, backed away from the guidance it had given earlier in the year. Citing continued uncertainty surrounding the strength of the US economic recovery, Ben Bernanke, the bank's outgoing chairman delivered a speech casting doubt on the likelihood of tapering beginning before the year's end.

US Treasuries once again began to drop-off. Yield appetite didn't quite return to its former levels, however. The lowest the ten-year note fell to during this period was 2.478%; still much higher than its level at the beginning of the year and a full 1% above the record low of 1.4% set in July 2012. For corporate issuers in fixed-income capital markets the implication is that investors don't have to stretch so far for yield as they did before. For this reason, Byrne doesn't think credit spreads have room to tighten on the upper-end of investment-grade credits (A+ to AAA) because they are already very tight. “I think that credit spreads will not tighten and could even widen in lower-rated high yield credits because investors will not have to reach down to that risky area of the market to find attractive yield,” he says. “The best performing area of the corporate bond market – relatively speaking – should be the BB and BBB areas.”

If such turmoil can result from the Fed merely broaching possibility of an end point to quantitative easing, corporates will surely be wondering what will result when tapering begins for

real. A fall in treasury yields of any significance would, of course, affect the interest paid on fixed-income debt, including that issued by corporates. Byrne's assessment is that the market has already built in a \$10 billion, if not a \$20 billion reduction in asset purchases. Since perception of the risks associated with a tapering is already reflected, to some degree, in asset prices now, it would seem an exaggeration to suggest bond markets will evaporate the moment tapering begins.

There appears to be an interesting dynamic at play here, however. In a normal economy, high yield debt tends to have a very low correlation with interest rates; this is a trend which is visible in almost every single economic cycle since the mid-twentieth century. But these are far from normal economic times. Ever since interest rates began to be artificially compressed through quantitative easing, rates have begun to correlate more closely. Byrne thinks this is a trend which will persist until the Fed has withdrawn completely from the market, with the asset classes – such as high yield – that enjoyed the most credit spread tightening during the QE years seeing the most closely related movements in relation to treasuries.

## The danger for the BRICs

In emerging markets, companies might be forgiven for feeling a strong sense of trepidation as the end of QE approaches. These markets after all, have been one of the principle beneficiaries of the extra liquidity injected into the global economy over the past five years. This is because the liquidity the Fed created through asset purchases did not remain exclusively in the US, where interest rates and growth were close to zero. Instead, a good deal of it flooded into the emerging markets where the potential returns were much greater for investors. This surge in capital inflows pushed down on emerging market currencies – much to the ire of export focused nations such as Brazil – and, as in developed economies, triggered a rapid growth in dollar denominated debt.

“Every time we hear a rumour or a new forecast about what the Fed is going to do we see very high volatility.”

Mikko Sapanen, Director of Treasury, Light-On Mobile

Any tightening of US monetary policy would, it follows, create some uncertainty around the outlook of capital flows to emerging market (EM) economies. “We had a taste of that over the summer,” says Colin Ellis, analyst at the ratings agency Moody's. “In that world you would expect capital flows to partly reverse and that was exactly what we saw.” Of course, despite sharing some common characteristics EMs are not homogenous entities, and the extent to which corporates in a particular economy will be impacted when tapering begins will depend largely on the policy regime. “India is a good example,” says Ellis. If a company is operating in a country with a floating exchange rate regime, such as India, but borrows in foreign currency terms then clearly tapering will have material credit implications. “If I am an Indian company and I have borrowed in dollars then, clearly, that is going to be credit negative. But on the flip side, for a company in a fixed exchange rate regime that borrows in dollars its costs may not have moved much at all.”

As the events of last summer showed, corporates in those EMs with floating exchange rate regimes will be faced with heightened levels of currency risk. For Lite-On Mobile (LOM), a corporate that specialises in the design and manufacture of telecommunications products, increasing foreign exchange volatility has been the biggest concern since the prospect of tapering became apparent. Over the past year, the company's Singapore and Taiwan-based treasury team has had its hands full managing the risk, which is quite substantial given the company's presence in emerging economies such as India and Brazil, two economies which have exhibited a particularly high degree of sensitivity to rising US Treasury yields.

"Every time we hear a rumour or a new forecast about what the Fed is going to do we see very high volatility," says Mikko Sopenen, Director of Treasury at LOM. Even day-to-day movements have, at times, been astonishing, he remarks. At the height of the FX volatility last summer, for instance, the Indian rupee or the Brazilian real both experienced swings in the 2-3% range.

Managing this volatility is helped by the fact that the company hedges 100% of its substantial foreign exchange exposure using a mixture of forward and options contracts. In India, these risk management activities are executed locally. It has always been quite costly, says Sopenen, but the expenditure has grown even more substantially over the past year because of the taper expectations.

Like most companies, LOM is also bracing itself for rising borrowing costs in the years ahead. Right now, the company's main source of funding is a revolving credit facility provided by global and Taiwan-based banks in the Taiwan market, supplemented from time-to-time with term loans. Margins and interest rates in the Taiwan market have been exceptionally low for many years, even at the height of the credit crisis, but as Sopenen points out, that is likely to make the impact of an adjustment to US monetary policy all the more dramatic when it comes. "When you are so close to zero the only way is up," he quips. Given that even a minor rise could double the company's interest costs when starting from such a low base, the company has been quite active in the past year in hedging the risk with swaps and forwards.

But Sopenen does not expect credit to suddenly become prohibitively expensive overnight, and he adopts a philosophical tone when asked about the extent of his concern over the direction of that market. "We know that interest rates have been unnaturally low for some time now. It has been nice and we will continue to enjoy it while it lasts, but I think we will soon be getting back to 1-2%, at least."

## Managing the change

Sopenen is probably right not to overstate the risks. From the very beginning in 2009, the purpose of QE was to restore the fragile US economy to full health following the trauma of the credit crisis. If the Fed does decide the time is right to begin unwinding asset purchases in the next year, then that would imply that the US economy is once again showing signs of life and the unemployment rate has fallen below the 6.5% target.

These developments would, as Moody's Colin Ellis points out, be "strong credit positives" for a lot of corporates. Normal levels of risk appetite may well return, driving investors out of bonds and in to equities or other riskier assets. But then again, if corporates begin to see revenues starting to grow in the region of 5-6% a

year that could well be an offsetting factor to the overall health of balance sheets; particularly when compared to the anaemic GDP growth that has been perhaps the defining characteristic of most western economies for the past five or six years. But the prospect of a strong and sustained recovery for the world's biggest importer will clearly help more than just the US-based companies. It will also be hugely beneficial for businesses in other corners of the globe by providing a bigger consumer market for companies such as LOM to tap into and sell their goods. And although the prospect of rising borrowing costs may still be concerning for corporates, there is a relatively simple way for them to insulate themselves. The key to this, says Lloyd's Head of Financial Risk Yuri Polyakov, is to start thinking more long term. His advice to corporates is to begin thinking about locking in cheap fixed interest rates now while market conditions remain favourable. "That is often one of the first questions I ask when I speak to clients about their funding plans," he says. "If rates in the next three years are going to rise, then wouldn't it be more prudent to pre-fund and issue some debt today?"

"The high yield issuers are naturally more leveraged companies, so their sensitivity to interest rate changes is much higher."

Yuri Polyakov, Head of Financial Risk, Lloyds

That would seem the logical thing to do but, surprisingly, he says that currently there are very few signs in the market of companies taking that approach. Polyakov offers several reasons for why this is the case. On the one hand, it might be that companies do not foresee debt becoming prohibitively expensive in the near future, regardless of when the Fed starts to taper. The other possible reason is that companies, realising monetary tightening will coincide with improving economic conditions, are hoping that their business will be doing better and therefore they will be able to afford more. Other companies are averse to negative carry associated with adding more funding before it is actually needed.

For moderately leveraged companies this might not be a problem. Even if the company has made the wrong judgement and debt costs do rise, the risk to the business is not likely to be critical, but it could prove to be a dangerous strategy for issuers of high yielding debt. The high yield issuers are naturally more leveraged companies, so their sensitivity to interest rate changes is much higher," he says. These companies definitely need to start thinking about what the impact of the increased interest expense will be in the coming years. It is also imperative to make these calculations in the context of corporate strategy it is going to impact everything from the funding profile to cash flow. "This is why we advise our clients to do a quantitative exercise to understand what the impact of higher rates will be on the business, not just today, but two or three years out," he says.

Virgin Media's Rick Martin agrees. Although he thinks every corporation will be impacted somewhat differently, those who have planned ahead are the ones most likely to come out of the other side in good shape. "The more forward looking and proactive a corporate is with regards to managing debt, the better off it will be," he says. "I think that our activities in the bond market over the past year with our new colleagues at Liberty Global are a hallmark of that." ■

# Managing FX: identifying exposures earlier in the business process to more effectively manage risk

*When it comes to foreign exchange (FX) risk management, visibility into business units and understanding how exposures materialise are as important as hedging itself. This article looks at ways in which exposure can be identified, quantified and managed, from inception of the risk through to hedging, execution and beyond.*

Although many corporates run a sophisticated or professional FX execution desk, there are many instances when treasury has difficulty in identifying the sources of group-wide FX exposures and in some cases may still be collecting data on email or spreadsheets. There is a clear need to pay more attention to where and how currency risks arise in addition to developing suitable execution policies. Given this high degree of uncertainty there is now a clear case for focusing on those risks. It is necessary to look at how processes can be streamlined, from identification of exposures right through to hedging.

Corporates can find it extremely difficult to have visibility into all their currency risk. The problems can start as early as identification of when the FX risk is created, and may exist all the way through to how and when that risk is reported either to the regional or global central treasury. What the business does with that exposure once it has been acknowledged then becomes a challenge in terms of precisely which risk is to be hedged and how that hedge may be executed to best effect. In essence, although some businesses may have a sophisticated execution desk for FX, without a full overview of their group's consolidated exposure, they may be missing the bigger picture in that their hedging programme may miss certain risks that would otherwise be hedged, which in itself may cause other unwarranted risks if hedge transactions need to be modified or unwound before maturity.

## Steeped in history

For much of its 200 year existence, FX has been one of the defining businesses of Citi. FX at Citi can be traced back to 1897 when it opened a department to facilitate business conducted across international borders – inward investment from Europe and sales into China being just two examples. In 2007, its G10 and Emerging (Local) Market (LM) businesses were combined into a single global FX offering and today the bank trades over 140 currencies out of 83 centres. Against this backdrop of perhaps unparalleled experience, the philosophy of Citi's Corporate FX Franchise is to guide its clients from the point that FX exposure is created, all the way through the value chain to execution and settlement. As part of its stock in trade, it has created tools, risk mitigation frameworks and thought-leadership programmes based in no small part on talking to its clients about the process.

As well as forecasting errors, faced by many companies – perhaps being derived from a technical deficiency, timeliness and accuracy around their data collection processes – balance sheet exposures may be rooted in silos of information, notes Russell Francis, Managing Director, Head of North American Corporate FX Sales at Citigroup. Data, says Francis, may reside in multiple platforms, different instances of an ERP or general ledger system distributed across the subsidiaries. If these are not integrated with head office, perhaps where M&A activity has led to various legacy systems not being able to talk to each other, it will, he notes, always be difficult to gain proper oversight. Without proper oversight, FX risk cannot be mitigated effectively.

## Never take the easy option

But data is just data unless a business does something constructive with it, turning it into information. "Arguably some businesses go for the easy end of the FX spectrum where they try to hedge the straightforward elements already on their balance sheet – the accounts receivable (AR) or accounts payable (AP), for example," notes Joakim Lidbark, Director and Global Head of CitiFX Corporate Solutions. But, he adds "FX risk may sit in various other areas such as procurement – these require the same level of attention".

There are several other types of FX risk that can be managed to reduce a company's overall exposure to changes in exchange rates.

An established manufacturer in the automotive industry, for example, will know that its main currency risk exists not in its receivables over the next month or two, but in whether or not it is locking-in its sales over the next two or three years; for a new model launch, it will have researched and planned everything right down to who will be buying it; and it will be confident with its forecasts. For others it is not so clear. "It is a big leap for many corporates but it is one of the most effective ways of reducing currency risk," notes Lidbark.

But of course it is one thing to gather data on payables and receivables in the short term but quite another to gather the forecasts for two years' time, and whilst some sectors may be at home with longer-term forecasting and hedging, such as the automotive industry, for others the longer-term view is difficult, even impossible.

The ability and the degree to which a business can forecast depends on its margins and required contract flexibility to a great extent, notes Sam Hewson, Director, Head of UK and Northern Europe Corporate Sales, Citi. A business with very tight margins, one for example in the electronics industry, he says will tend to adopt very short forecasting horizons "because it cannot afford to lock-in two years' worth of FX rates as it could make it economically uncompetitive in two years' time". Conversely, the aerospace, the aforementioned automotive or even the general industrial sectors, where contracts are typically longer, can enjoy a far higher degree of forecast predictability. "Much of it comes down to the expertise and ability of the client, both in terms of technological resources available to identify and capture those forecasts – whether short or long term – and in what they do with those forecasts once they have them."

It is evident then that not only can it be difficult to obtain the right data in a timely manner, but also that considerations will then arise around whether or not to hedge the full forecast amount and how to handle forecast error within that hedging policy.

## The importance of forecasting

Notwithstanding sector variables, Holger Achnitz, Managing Director and Head of Continental European Corporate Sales, Citi, feels that many companies have improved their management and forecasting ability for exposures. "In the 2008 crisis many forecasts were called into question and ever since we have seen businesses exercising more caution in terms of the instruments they apply when they go further out."

There has been, he notes, a greater degree of interest in hedging through options, in order to maintain flexibility and to not be caught out either by changing market conditions or variations on the original forecast. As transaction-certainty rises, conversion to more symmetrical hedging instruments – forwards – becomes more evident, notes Achnitz. The lesson of the last five years or so that he takes is that corporates value the flexibility in their chosen hedge instrument considerably more than they did before.

## Technology's role

Given the difficulties experienced by many corporates, technology – or rather the intelligent application of technology – is a vital part of an invigorated exposure management regime around FX. With a large swathe of the corporate community still collecting much of the relevant data on emails and spreadsheets, led by error-prone manual processes, accuracy and timeliness may be sacrificed; two elements that can ill-afford to be compromised.

But for many businesses, the business case for IT investment lacks punch. Jodi Schenck, Managing Director, Global FX eSolutions, Citi, acknowledges that treasury is not a bottomless pit of investment and that cost of IT may be called into question. It could be that a business knows the advantages but for commercial reasons is not able to deploy a solution in all markets and has to compromise on the roll-out of a platform because it is deemed too costly to deploy in local markets or all subs. Still, others believe that Excel is the most flexible tool. Although many users admit that it is prone to error and know that there are better ways, it is likely they do not have the means to progress. "I do believe they are trying to move towards greater models of efficiency," says Schenck.

Of the systems that are in place, Hewson notes that traditionally, Treasury Management Systems (TMS) have been very good at handling the AP and AR, balance sheet and invoicing side of treasury risk management but that such systems have not necessarily been developed to tackle risk from a forecasting perspective. However, piecing together a solution can be something of a compromise in itself; anecdotal evidence (from a FTSE 100 company currently in selection mode for a risk system) suggests that risk tools tend to be very focused, in as much as there is no single offering on the market that covers the range.

## Risk tools

Post-crisis, Hewson has observed an "evolution" of how treasurers look at their currency exposures, with more quantitative methodologies, such as Earnings-at-Risk (EaR), Cashflow-at-Risk (CFaR) or Value-at-Risk (VaR), being adopted. But within this toolset there is no one-size-fits-all approach. From a VaR perspective, some corporates have a VaR threshold for their portfolio of currencies and others have a threshold for individual currencies (others having no VaR threshold at all), he notes. Similarly, a number of treasurers have well-documented benchmarks which they are obliged to meet in terms of their hedging policy, whereas others do not work to benchmarks. "The degree of best practice in the corporate space varies considerably, as does the degree of sophistication, all the way from risk identification – through to risk mitigation," Hewson comments. Variation is observable by sector, by client, by margins; "it all depends what is driving the corporate's underlying challenges or business model". Variation can also spell difficulty in meeting the needs of corporates.

However, by talking to different clients in different sectors, Citi's FX group is acutely aware of the issues of diversity around risk management and knows that not only does the one-size-fits all solution not exist, but also that it is not possible to treat everyone in

## Rules based approach to hedging utilising CitiFX Pulse's Exposure Management tool



the same way even if it did. "That means we have to try to tailor each solution to each client because we just do not believe in a one-size-fits-all solution," explains Lidbark.

### An individual approach

Risk management for Citi is thus in the first instance based on understanding each client's business model, trade flows and value chain from where the initial procurement or sale is made, all the way through the supply chain; so from where the FX risk is first created to when it first impacts upon treasury.

For Francis, this means identifying a number of timing mismatches which could exist between where risk is first created and then identified, between where that risk is first identified and subsequently reported to treasury, or perhaps between the point when treasury receives the forecast or the FX risk and when it executes the trade. "There may be a good reason for any of these but it may also be simply that the business does not have the systems, capability or the understanding to act on the information they receive," he comments.

The point is that first it is essential to understand what is driving client-behaviour, what is generating risk in the pre-trade (eg pre-treasury) space, understanding the client's risk management policy and then formulating a solution that fits the need. Opening up the conversation is the first port of call.

### Getting to the heart of the business

It was noted above that businesses have generally become more aware and interested in quantifying and managing risk since the 2008 crisis, but not all risks are self-evident. In the second half of 2013 the emerging market sector has faced a "mini-crisis of its own", notes Lidbark. As a result a number of corporates have woken up to the fact that they may be maintaining too low a hedge ratio for this sector. In one case, where risk was observed on a portfolio-basis, he reports that by collating the type of portfolio exposures the business had from a currency perspective, understanding the type of exposures the business had and how it hedged those exposures, it was apparent that the focus was on a single large exposure. This left a number of smaller exposures – many of which were in the emerging markets – totally unhedged; a stance that, given the decline of the emerging markets and the composition of the portfolio, ultimately proved counter-productive. Had the emerging markets not deteriorated, highlighting the fact that current policy had become so visibly ineffective, the conversation may not have even taken place which of course would have left that risk unmanaged. It is a sobering thought.

The motivation for the conversation around FX risk and hedging policy varies and even though a similar problem may be experienced by a number of different corporates, it is certain that not all will be trying to achieve the same end-result, suggests Achnitz. "Reduction of volatility and risk mitigation can mean a host of different things, depending on what is perceived as risk," adds Lidbark. In seeking a greater efficacy, it is thus useful in the first instance to establish what the corporate sees as the worst-case scenario, and how this might be measured. "It gives us a good insight into how to measure risk, because it can be done in many different ways," states Lidbark. The tools of the trade, such as scenario analysis and stress-testing, may have been deployed by risk professionals for many years but they are now becoming mainstream in the push to quantify risk.

In adopting such measures it is necessary for the corporate client to expose certain processes to the bank and to be honest about how it operates because only by understanding how the business operates can the bank formulate an effective response. Once the challenge has been identified and the end-point has been established, the solution design will focus on two key elements: technology and risk mitigation.

## Establishing a framework

“We are trying to put in place a framework structured around how to control risk – as opposed to concentrating on the next trade the client should be doing,” explains Lidbark. By talking to clients that have exposures in a host of different currencies, it became apparent that many of their hedging policies were written “in a world that looks a little different from what it does today”, he notes. Such a policy would most likely be G10-centric, with most sales and assets in these countries, and hence preparedness only for G10-based volatility and exposure risk. “Today it is completely different; many companies have outsourced and have assets in Asia and perhaps have sales operations in that region too. As a consequence, these businesses now have to take emerging markets into account when managing risk.”

Indeed, for Europe and US-based corporates, the emerging markets have become so much more relevant in the past few years and so they do pay a lot more attention to hedging policy and execution in those currencies, notes Achnitz. “It used to be just one of the many markets in which they sold their products, but now it has become an essential business area demanding a lot more focus on the risk management process for those currencies.”

## A single platform

On the technology side, Citi offers a web-based platform, CitiFX Pulse. The platform provides corporate treasurers with a whole host of pre-trade and risk management solutions, execution capabilities that are unparalleled in scope and a suite of post trade offerings to round it out. With CitiFX Pulse, a corporate treasury has the ability to deal spot, forward, swaps and options with access to 700 currency pairs, including restricted currencies, both onshore and through regional hubs in almost 80 different countries. Pulse has been built around the accumulated knowledge of the bank’s local markets trading business and its global footprint. A key part of the platform, re-launched in January 2013, is the revamped Exposure Management module. This functionality enables a corporate head office or group treasury to view and manage cash flow and balance sheet exposures in real-time in a visually engaging way. This data can subsequently be “sliced and diced” by subsidiary, region, country and so on. which then allows for netting and hedging across multiple entities, explains Schenck.

Getting the most out of Exposure Management begins with the client uploading details of its hedge policy; what can be hedged and how far out it wants to go, for example, by currency pair and entity, how much they can hedge and in what time buckets risk should be covered. This forms the rules for the system’s subsequent operation. All exposures must then be entered/uploaded into the system along with any associated hedges. This data is then checked against the policy which reports compliance. When hedging is deemed necessary, the platform generates signals based on actual treasury policy and, if outside of policy, clients may transact on pre-configured amounts to get back in line with predetermined policy.

The Citi team has worked with many clients to create a tailored, rules based approach to hedging. Through CitiFX Pulse, signals from some of the bank’s proprietary models can be monitored, generating additional information for corporate treasuries and taking away the discretionary ability to hedge. Over time, and informed by current hedge policy, the system will alert the user as to whether it is over- or under-hedged in a specific currency and how best to stay in line with policy.

While CitiFX Pulse is already an end-to-end solution and includes such features as streaming rates, order management (including algorithmic execution), confirmations and instructions, and end-of-day mark-to-markets on all positions, integration with the main trading and treasury management systems to deliver straight through processing is part of Citi’s roadmap for Pulse, says Schenck. The Pulse platform offers “a lot of assistance to our clients, from the beginning to the end of the process” but, she adds, Citi is committed to continuously improving the user experience and enhancing the functionality of the platform”.

Of course, adoption of CitiFX Pulse is not the end of the relationship and Schenck comments that “we regularly help clients evaluate their policies and decisions, back-test and assess how well they have managed to mitigate their risks”. Indeed, the CitiFX goal is to assist its multinational corporate clients in streamlining execution, enabling them to use their time and ever tighter resources for essential strategy discussions that, ultimately, yield better economic results from a holistic risk management process.



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North American  
Corporate FX Sales



**Holger Achnitz**  
Continental Europe  
Corporate FX Sales



**Joakim Lidbark**  
CitiFX Corporate  
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**Jodi Schenck**  
Global FX eSolutions



**Sam Hewson**  
Northern Europe  
Corporate FX  
Sales



# Are you receiving me?

*The accounts receivable function may not traditionally be associated with excitement, but get it wrong and it could cost the business dearly. Streamlining this process, especially on the collections side, should be on the agenda now and should remain there. But is there more to it than the application of technology?*

A sale is not a sale until it's paid for; so goes the traditional credit controller's mantra. No matter how successful every other function is in the business, although accounts receivable (AR) is shown in the balance sheet as an asset, the money still has to be collected. In the B2B space, better collection means lower debtor default and lower days sales outstanding (DSO – the average number of days that a company takes to collect revenue after a sale has been made) means the business is stronger in terms of working capital and can extend credit lines to customers, driving up sales; the reverse is true if the process fails.

According to a May 2013 HSBC Global Connections report, on average global companies had \$3.1 billion of cash trapped in internal working capital which, it stated, could be unlocked by reducing DSO "to within the median range for their industry". But research from working capital consultancy REL found that converting sales into cash is getting harder, with cash

conversion efficiency in Europe deteriorating three years in a row from 13.4% in 2009 to 10.6% in 2012. Almost certainly connected to this is Experian's quarterly Late Payment Index finding, issued in November 2013, that the UK's largest firms are paying overdue bills three days later than at the same point a year earlier and some 15 days later than the country's smallest businesses.

## An easy fix?

The problem with AR, and collections specifically, is that it is subject to a strong cultural and human element – even within large and sophisticated client businesses. Finding improvements will never be easy. Fragmented or missing remittance data, part payments, disputed invoices, persistent use of cash and cheques, variable payment behaviours, almost zero standardisation of remittance formatting – all

these things conspire to make the job more difficult. Being able to reduce DSO is not simply a matter of brow-beating debtors into paying on time and supplying accurate remittance data, not least because such an approach can harm commercial relationships.

In its research paper, 'Buried Treasure: Uncovering cash from your accounts receivable process', REL points out that a backlog of receivables is, in fact, "really the result of internal processes that need to be optimised". Asking how to prevent bad debts, reduce billing errors, and minimise payment disputes, it argues, "is much more promising than asking what it will take to get a particular customer to send a cheque".

## Too much, too soon

With the choice of cash, debit and credit cards, direct debit, direct credit, ACH in US, giro in the Nordics, RiBa (Ricevuta Bancaria) credit transfers in Italy, Direct Entry in Australia, wire transfer (local and international), electronic bill payments via Internet banking and online payment services (such as PayPal and WorldPay) – and a whole host of other regional and local possibilities – the distribution of remittances across multiple formats and channels can make collection and reconciliation even more difficult than it already is.

But as the green shoots of economic recovery show signs of emerging, surely the worst is over and the need to tighten up AR will recede? Not so, says John Salter, Managing Director, Cash Management and Payments, Lloyds Bank Commercial Banking. "Just because things are getting better, don't take your eye off the ball; the risk element has not gone away." Empirical evidence, he notes, shows that as many companies emerge from recession, many over-trade by launching too quickly into new markets, delivering too many new products too soon or taking on contracts beyond their capacity. "If they over-trade, they could go bust."

## Reconciling differences

One of the most difficult aspects of the receivables process to improve is the reconciliations process. This difficulty is often linked to the fact that a collection is usually initiated by the debtor and one of the challenges here is that their remittance data is sometimes incomplete or incorrect. There will always be a certain number of exceptions generated including part payments, credit notes and disputed invoices. But even with correct remittance data there may be problems such as insufficient funds being available to settle. Of course, there is a need to avoid upsetting customers with bad debt notices if there is a perfectly reasonable explanation for late or part payment but if an invoice looks like it is not going to be paid on time, the business has to make some firm decisions, especially if it is to prevent a delinquent account turning into a bad debt.

Following the release of the Experian quarterly Late Payment Index, mentioned above, Ade Potts, Managing Director for the firm's SME division, said that to increase the chances of getting paid faster, credit monitoring was a good first port of call. "This will help to differentiate between those debtors that are unable to pay, those that have the means to pay but have a track record of paying late, and those that are willing and able."

Indeed, unless a business has a ready source of receivables data to give it advance warning, even a small percentage of exceptions experienced within a large global corporate receivables programme can soon become very costly.

## Seeking a solution

A review of the receivables management process should be seen as a way of enabling the business to focus on the core pillars of its incoming capital. Finding improvements must start with an exploration of how a business is currently being paid by its customers. It will thus be necessary to consider whether or not that model is business- or industry-specific, how well it works and precisely what problems it creates. Asking what the business is trying to achieve by changing the process, and if that process can even be changed, is also essential.

A typical large mainstream retailer, for example, will take notes and coins as part of its collections process because many of its customers still use cash. Gareth Lodge, Senior Analyst at Celent, told Treasury Today in a June 2013 interview that "by the number of transactions, cash is the dominant payment type in every country in the world. It is, in fact, typically more dominant than all other payment types put together". Not least of the worries with cash-handling is staff security.

It's true too that some businesses still take (and make) a lot of cheque payments (particularly in the US and India) but cheque payment has an attendant security/fraud issue and extra processing requirement even if US-style lock-boxes are used. Both cash and cheque also typically require in-country banking support which adds to the cost. If payment format is linked to a cultural norm (or habit) it may be possible to change that process slowly over time, perhaps with certain inducements (a discount for those that opt into e-billing for example). Forcing change without a thorough analysis of the needs of the customer-base to help understand their motivations could backfire in terms of increased customer churn.

If change amongst debtors is not immediately possible, receivables and collections improvements may still be implemented but the response to questions asked regarding existing payment norms should be used to find the most appropriate course of action in terms of moulding internal processes to meet that need. For Salter, as an industry advisor, he believes that "it really is a case of understanding by industry, by customer within that industry, by geography, how they operate today".

## Automate and be done?

Although technology is often seen as the answer to every problem, if the underlying processes are poor, simply automating them will not help. But success with a broad scope of automation is possible. Thomson Reuters received Highly Commended in the Best Process Re-engineering Solution category in the 2013 Adam Smith Awards with its consolidated receivables project. This has delivered a global end-to-end solution enabling automatic allocation of customer payments to customer open AR accounts based on remit information that uses a unique number (similar to a barcode) and also auto reconciling of bank statements to general ledger accounts.

For many firms, direct debit is nirvana in terms of collections. Filipe Simão, Head of Client Advisory, Cash Management, BNP Paribas, is positive about SEPA Direct Debits (SDD) because "never before has the industry had a uniform, standardised way of collecting cross-border". Being able to centralise all DD activity certainly removes the need for in-country collection accounts which will reduce cost and improve efficiency.

The slow uptake of SDD to date is no mystery, being in part due to the greater difficulty in migrating from existing direct debit

systems. With the SEPA credit transfer (SCT) process, moving from a third party local scheme to SEPA is a technical exercise, requiring the conversion of a database of beneficiary account numbers into BIC and IBAN numbers and the capacity to generate XML-formatted payments messages. "SDD is much more complicated because of the way mandate management works," says Simão. The SDD mandate flow differs from what is in place in most countries, he explains. With SDD, the mandate and its lifecycle will be managed by the creditor. This requires the set-up of new systems and processes and is a migration that cannot be automated to the same degree as SCTs.

In its defence, SEPA is complemented by the B2B SEPA Direct Debit scheme which, if used, removes the risk of rejection of a transaction. Because it requires the debtor's bank to ensure the collection is authorised (by checking the collection against mandate information) the debtor cannot later claim a refund. "This helps tremendously with treasury forecasting because you know the direct debits are not going to bounce back," notes Simão.

Another solution in the B2B collections and reconciliations space, he notes, is the concept of the virtual account. Set up and allocated individually to a corporate client's counterparties for the sole purpose of handling incoming payments, these "dramatically improve the reconciliation rate because we know that whenever a settlement is made using a virtual account number, it relates only to a specific client and counterparty".

As a variation on this theme, collections via in-country accounts for exporters can be handled through a remote collections process allowing exporters to be paid locally without having to hold and manage a local account. An overseas counterparty pays into an account held by its creditor's bank; the bank then credits its client's home account.

## There is no panacea

So why don't all businesses just centralise and automate their various AR and collections processes? Firstly, Salter warns, "anything can look good on paper; it's the execution that's the challenge". Indeed, one of the major hurdles is the simple fact that payments and collections will always involve people and people "do not always act rationally". With direct debits, for example, he notes "it is fascinating how companies are happy to collect their money by DD but don't want another business debiting their own accounts directly". Intellectually the systems work, but in practice problems exist because "companies are run by people". As a result the level of automation is not where he feels it should be.

Secondly, some processes cannot be automated. A major UK-based high street retail client of Lloyds, when discussing working capital drivers, put receivables top of its fix-list, ahead even of payables and inventory. Many of its customers use cash, something that cannot be changed overnight. But by changing the way cash was collected and reported across all branches, its receivables could be better managed. Even something as simple as altering the time the courier arrives to collect the cash meant it could move the receivables book forward gaining one extra days' value of cash in bank which, given the sums involved, gave it "significant uplift".

Surely an electronic alternative to cash would work? Marcus Treacher, Global Head of eCommerce for Payments and Cash Management at HSBC, predicts that smartphone contactless payments "will have a huge impact in terms of cost reduction

on the cash cycle and more efficient receivables handling for bank processing centres and large retailers such as supermarkets". But Celent's Lodge counters that payments behaviour is driven by habit and convenience. "Anyone developing alternative payment systems has to compete with that." That goes for both B2C and B2B.

## A simple solution

There are fundamental principles of improvement that may be applied in terms of what a company does, why it does it and how this fits its operating model from an order-to-pay perspective. Individually, companies can tackle the problem and realise some major improvements. But there is no one-size-fits-all solution: invoices are not standard; customers may not behave as you wish them to; cash and cheque are still endemic; direct debit is feasible only if the business can handle the exceptions – the list goes on.

With customers tending remittance data through different channels, it becomes a demanding task to manipulate the data into a coherent format for ready-use as business intelligence. BIC and IBAN validation services are available for bank account numbers, and data other than the invoice number can be used by receivables systems to reconcile outstanding invoices (such as invoice amount or due-date). Customers can also be requested to quote a structured reference that includes a checksum digit (an error-detecting code) that will immediately highlight a discrepancy.

If it is possible, digitising, and by extension standardising, remittance information would be a major improvement in the straight through flow of remittance data – and Thomson Reuters has proven that it can be done. Outsourcing some or all AR processes to a bank or to another third-party provider with a broad global footprint and economies of scale in terms of technology (notably around auto-reconciliation and matching) and AR expertise, can deliver benefits but at a cost and with some inevitable loss of control.

The obvious way to remove customer error is for the creditor to take control of collections initiation (using direct debit in particular), says Simão. In the B2C space, electronic bill presentment and payment (EBPP) enables bills to be created and sent by the creditor, and paid by the debtor through their electronic banking account; they cannot change remittance data which resolves the reconciliations problem. In the B2C sector generally there has been a lack of integration of these systems so consumers have to login to a separate EBPP website for each of their suppliers, although Belgium's Zoomit (which requires a one-off registration on the creditor's website) and the multi-channel SEPAmail (developed in France but designed with the SEPA zone in mind) claim to address this issue.

For Salter though there is one significant improvement that can be applied that does not add cost, does not rely on technology nor cause any loss of oversight. "If you really want to improve your receivables, train your sales people," he states. At the front line, if sales people can encourage customers to use the preferred payment option, half the battle is won. "Good receivables always start with the sale, not with the back office trying to drive a change of process." This logical approach harks back to the opening statement that a sale is not a sale until it is paid for; it may not be popular with sales people but it must be a change for good the if it removes problems downstream and provides clear, timely and useful information that keeps a company liquid and, ultimately, afloat in a sea of uncertainty. ■



# The formula for success

## Corina Keller

Head of Cash Management



For Corina Keller, Head of Cash Management for ALTANA AG, treasury is a service provider first and foremost. But within the company's decentralised and lean structure, she has worked hard to foster good relationships between functions and everyone is comfortable saying what needs to be said. As a formula for success her approach seems to be doing rather well.

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*ALTANA AG, headquartered near Düsseldorf in Germany, is the management holding company for a global group of specialty chemical businesses around the world. The company's roots reach back to the late 19<sup>th</sup> century, the passage of time witnessing its transition from a one-man business in Berlin, via a listed conglomerate, to a focused private company.*

*Today, ALTANA consists of four divisions: BYK Additives & Instruments; ECKART Effect Pigments; ELANTAS Electrical Insulation; and ACTEGA Coatings & Sealants. Worldwide, it accounts for more than 60 subsidiaries and associated companies, employing about 5,700 people. In 2012, ALTANA generated revenues of about €1.7 billion compared to the previous year's €1.6 billion. Over 80% of group sales are derived outside of Germany.*

It is the mark of something rather special when, as Aristotle said, “the whole is greater than the sum of the parts”. In industry, if individual components can interact to produce a result that somehow has more impact than they have individually, it can be a winning solution. The products created by the four divisions of Germany-based global specialty chemicals company ALTANA are parts of recipes used in its clients’ own products. Adding small amounts of these products to the mix can make a dramatic difference to the end result, and nowhere is this better seen than in the metallic flake added to paint products used by car manufacturers to such stunning effect.

A similar impact can be seen in the way ALTANA conducts itself as a company. The emphasis is on encouraging individual employees and functions to develop and be creative whatever their role, to add value to the business as a whole. Treasury, for example, is but a small part of the business. But in combination with the other units something greater than the sum of the parts is created.

## Working together

The group is purposefully decentralised, looking to a lean structure in each division and unit to facilitate informed and quick decisions. Within this format, the intention is to leave as many of the financial functions, including treasury tasks, under local management as is practicable. Corporate treasury provides the boundaries and guidelines to which local operations must adhere (all foreign exchange (FX) deals and bank investments by local entities are ruled out, for example). Although handing over much of the day-to-day responsibility makes it “very interesting sometimes”, according to Corina Keller, Head of Cash Management in ALTANA AG, it has been a conscious decision “not to change something that is working really well”.

In fact, until 2008, ALTANA did not even have a central corporate treasury department. “We did not need it,” recalls Keller. “As a very cash-rich group in a good financial environment, the ‘itty bitty’ details of treasury were not yet priorities.” But in 2006, ALTANA’s strategy of specialisation and market leadership saw it divest its pharmaceutical division. Although the remaining group was still relatively cash-rich, the divestment depleted its cash income considerably, making it important to get a better grip on how much cash exactly the business had, distributed throughout the group and amongst banks.

## Arrival and re-build

With the company acknowledging that one of the negatives of decentralisation is lack of financial transparency, Keller was brought in as Treasury Manager in early 2009 tasked with delivering the necessary focus. Armed with six years’ cash management experience gained at petrol retailer Petro-Canada (ultimately as Head of Cash Management), by March 2011 she had assumed her current position as ALTANA AG’s Head of Cash Management.

The role has a strong focus on global bank account management; understanding precisely which accounts are held with which banks and where, and monitoring cost, performance and risk are now daily concerns for Keller. She also makes certain that accounts are being used in the most effective and efficient manner by the business units, right down to ensuring signatories are complying with approval requirements (a ‘four-eyes’ security principle is applied across the board).

Short-term daily cash planning, mid-range liquidity planning and long-term forecasts also fall under Keller’s remit, with internal reporting up to the CFO. However, daily operational matters, such as making payments, remain fully decentralised, corporate treasury only advising on payments policy. ALTANA’s treasury consists of only four people, one of them being the ‘dedicated’ trader who also manages the internal lending book and a part-timer helping with administrative work. The overarching finance unit within which treasury sits has other functions running parallel to treasury including finance and controlling, legal, tax and IT.

The structure of treasury within ALTANA has been shaped progressively since the arrival of Keller, her own role being “carved out” by the ideas for strategising operations that she brought with her. Bringing to the fore a range of new processes and procedures that would be good for the group as a whole, she oversaw their implementation, subsequent delivery and maintenance. However, she points out that in no way was this development a solo act. “It only works if there is a good relationship between all concerned. This doesn’t mean everything is always hunky dory; there are discussions – sometimes quite heated – but this is good; only if you feel passionate about something can you achieve the best goal.”

It is important that each person in the ALTANA finance team understands that they are a service provider – to the CFO, to the shareholder, to the divisions, but also to the other departments. “While we are all aware that we are service providers, everybody also tries to do their best for the department in which they work. We aspire to implement changes which overall have a benefit for the group that outweighs possible individual concerns. But, states Keller, “if treasury does not get along with the other departments then treasury is on its own and we cannot do anything; everyone is only a part of the bigger picture.”

Being realistic and grounded, she knows there are limitations to everyone’s level of expertise. Instead of struggling with the minutiae of hedge accounting or tax, for example, Keller is able to call upon the relevant experts within the business. Adoption of an open and available approach has, she notes, served her well in her career to date. By being the best treasury professional that she can be and by calling in the experts when necessary, she is offering the company the best of all worlds. This approach fits well with ALTANA’s decentralised structure because it acknowledges that local finance personnel understand their business environment better than anyone.

## Handling the crisis

As an industrial supplier, ALTANA has obviously experienced the impact of the economic crisis – at first and through its own customers and suppliers – and has taken protective measures. It has weathered the storm well to date, but the economic slow-down has taught ALTANA a lasting lesson: that it is absolutely necessary to take a more stringent approach to cash management and to know at all times the group’s exact cash position and allocation.

“We put in place something we call ‘bank monitoring’, where we look at all non-core banks on a weekly basis and monitor their rating and outlook and then inform our divisions what we think the highest acceptable positive balance limit should be,” explains Keller. In some instances instructions have been issued to close an account and select another bank from a short-list of corporate treasury-approved institutions.

## Regulatory concerns

Regulatory pressure on the banks to sharpen up will eventually affect corporates in one way or another. Where deadlines are involved, as with the Single Euro Payments Area (SEPA) (and possibly the European Market Infrastructure Regulation (EMIR)/US Securities and Exchange Commission (SEC) rulings on money market funds (MMFs)), being decentralised adds to that pressure, says Keller. Controlling all entities and ensuring they are compliant is a difficult path to tread. With SEPA, she comments on the need to instruct the entities to carry out the work and “to somehow get a status update and trust them that they have taken the necessary steps”. But, she adds, “I can’t really control it in terms of testing their work.” It is a concern “because no one wants to be in a position, come 1<sup>st</sup> February, where they cannot make payments anymore.”

In tackling SEPA, Keller believes the first issue raised by most companies was practical – could a payment file be produced out of their existing accounting system? “Having achieved this, people thought ‘we’re almost there’, only to realise that many electronic banking systems cannot handle SEPA files – and so now they need to upgrade.” For ALTANA, naturally she wants to ensure the whole group can still meet payment obligations with everything working smoothly.

Indeed, she sees SEPA as a major pain point for anyone currently working in cash management. “No one can be 100% sure it will work fine. You can be prepared – and with SEPA we are in a really good way – but I am still wary of coming up against the unexpected.” But surely SEPA will be worth the effort? “I don’t see financial benefits for the ALTANA group as we already had negotiated good prices with our banks and I don’t see that it makes meeting the value date that the recipient wants any easier because you could control that before,” Keller comments. “However, I do think it will be a lot easier for small businesses or people who are not professional cash managers because they will no longer have to worry about which process or module to use for different payment types.”

## Exploiting technology

ALTANA uses SunGard’s Integrity treasury management system (TMS), alongside a couple of online banking systems that boast liquidity planning functionality. “We also use the most popular treasury system there is: Excel. I don’t think it is possible to get around it,” Keller laughs. Version-control issues have been removed because every process that should be controlled has been moved onto the TMS or online banking platforms; if critical data is changed, the rules-based environment requires at least a second person to approve the action. “If it’s used wisely, technology can help immensely in terms of efficiency,” she states. Indeed, the more technology is used, the more it is possible to automate functions (such as MT940 downloads, reconciliations or report production) that would otherwise be very difficult to do in Excel “unless you use a lot of macros and have someone who really knows what they are doing”.

Connecting ALTANA’s finance outposts to corporate treasury is via “share points” located on its Citrix servers. Using identical pre-formatted spreadsheets (as opposed to more expensive third-party software) each location reports to head office as required, adding comments on any deviations from the norm. Data can be automatically uploaded to the TMS removing the risk of manual data re-entry. ALTANA also operates two cash pools: one for euros and the other for US dollars. All US companies must participate in the USD pool. Some companies

that are based in Europe but have significant receipts or payments in USD are also linked to that pool. Similarly for the euro pool, all companies that have their books in euro have to participate and any business outside that has a significant euro requirement can elect to have an account connected to the euro cash pool. Corporate treasury, acting as in-house bank, is the master account holder and all decisions as to what to do with the cash stem from here. Most cash is distributed within the group, paying the debts of one entity with the revenues of another, for example. With all overseas entities instructed not to enter into any treasury deals with external banks, inter-company loans go hand-in-hand with this model; getting the overnight rate (currently almost zero) on excess cash is not ideal, so the opportunity to invest up to one year with head office is often preferred.

## Finding funding

ALTANA’s funding has for some time been based mainly on equity (it has a single shareholder) and syndicated loans. “After 2011 treasury looked at alternatives to merely a syndicated facility that could be flexible and easy for a small team to manage,” explains Keller. ALTANA found the ‘Schuldscheindarlehen’. There is no direct equivalent anywhere in the world but some describe it as a German variation on the private placement theme, carrying a fixed interest rate and floating element. “It works very well. It is similar in many ways to issuing bonds, but the only takers allowed are banks and they must buy them in large chunks.”

ALTANA has recently issued a €150m promissory note loan in March 2012 through the Schuldscheindarlehen. It followed this in July 2012 with a €250m syndicated credit facility which it is yet to drawn down on. For its recent \$635m acquisition of Rockwood’s rheology business (completed in October 2013), it arranged acquisition finance, Keller explaining that this is a more flexible repayment option than the syndicated facility.

## Future in the balance

As with most treasurers, multiple issues compete simultaneously for attention and priorities must be set. Being able to complete the major projects – such as SEPA – in good time is desirable, however, notes Keller, “if you wish to maintain the level of service that you provide to the entities, you cannot neglect the day-to-day business”. It is a balancing act and, as such, the typical Keller day in cash management is characterised by not knowing exactly what is going to happen. This may sound like a source of unrest, but she states that this is part of the reason why she loves the job. “Every day is different with new and interesting challenges being thrown my way.”

The next major project will be to handle the integration of the newly acquired companies. “It is a huge undertaking to acquire a company,” notes Keller. There will be a need to get reporting online, to make sure bank accounts are set up so that treasury can function with them until it can bring the companies into the cash pooling system. There will also be a need to introduce the new companies to ALTANA’s liquidity planning and long-term forecasting methods and a host of other processes.

“It is something that is going to take lots of manpower on top of what we are already doing,” she says. With the focus on working with so many overseas operations from the centre point of ALTANA’s corporate treasury, the aim for Keller is to “be a jack of all trades within the cash management world and be as good a service provider as possible”. As formulae for success go, this is as stable a base as any business could hope for. ■



# From revolution to reform

*On the eve of the third anniversary of the Egyptian revolution, the country remains unsure of its future direction. The interim government is aiming for stability, but the people want much more. What impact has it had on businesses operating in the country?*

On 25<sup>th</sup> January 2011, hundreds of thousands of Egyptians – many organised through social media – took to the streets across the country on the ‘Day of Anger’ to demand an end to police brutality, state of emergency laws, corruption and a lack of free elections. They were fighting for freedom of speech, greater employment opportunities and higher wages. The chants that filled Tahrir (‘Liberation’) Square in Cairo spoke volumes: “Bread, freedom, social justice” and “We won’t leave; he should leave”, referring to President Hosni Mubarak.

And leave he did. After 30 years, on 11<sup>th</sup> February, Mubarak’s rule came to an end following 18 days of nationwide protests. The Supreme Council of the Armed Forces took over and dissolved Parliament. After an extended election period, in which the Muslim Brotherhood won nearly half the seats, the presidential elections took place at the end of June 2012, putting Mohammed Morsi of the Muslim Brotherhood in power.

But the inability of the government to improve the everyday lives of Egyptians culminated in enormous demonstrations on

the anniversary of Morsi’s electoral victory. As a result, Egypt’s military chief General Abdel-Fattah el-Sissi installed Chief Justice Adly Mansour as interim president. Mansour is currently leading a transitional government with ‘full powers’ until presidential and legislative elections can be held, possibly in March or April 2014. The current constitution will be amended at the same time.

Andrew Long, Deputy Chairman and CEO of HSBC Bank Egypt, believes that if the government can adhere to the proposed roadmap for a referendum and parliamentary and presidential elections, then this will be a major improvement and will have a positive impact on the business and the country as a whole.

It is clear that for many Egyptians the reforms are not moving fast enough, nor do the different governments inspire confidence that real change will happen. Tarek El Mahdy, CFO at Sphinx Glass, an independent float glass manufacturer based in Cairo, says: “We have had two revolutions in this

country – the first phase in January 2011 and the second in June 2013 – in order to change things, but unfortunately things are not changing. The government aims are to stabilise the situation and not provoke anyone. Many people hoped that they would see a revolution in economic growth, regulations, tariffs, treasury, roads, culture and the mind-set of the people – but what was started on 25<sup>th</sup> January 2011 is not yet finished.”

## The state of the nation

The tumultuous political situation has not helped Egypt's reputation in the eyes of the credit ratings agencies. On 5<sup>th</sup> July, Fitch Ratings downgraded Egypt to B- from B, with a negative outlook. Paul Gamble, a Director in Fitch's Sovereign Group, says: “This reflects a high level of political uncertainty, a very weak fiscal position and a weakening of the government's commitment to implement economic reforms. Egypt's budget deficit is the highest of any country we rate and the authorities do not appear inclined to reach an agreement with the International Monetary Fund (IMF) that will involve measures – notably subsidy reform. Government debt has risen rapidly and shortages of foreign exchange (FX) are hindering the private sector.”

On 9<sup>th</sup> July 2013 Saudi Arabia announced a \$5 billion aid package for Egypt that included a \$1 billion cash grant, \$2 billion worth of petroleum products and natural gas, and \$2 billion as a deposit in the Central Bank of Egypt (CBE), free of normal financing costs. The same day, the UAE offered a grant of \$1 billion and an interest-free loan of \$2 billion. On 10<sup>th</sup> July, Kuwait followed suit with an aid package worth \$4 billion.

But the IMF's willingness to provide a lifeline for Egypt cooled considerably following Morsi's removal. On 26<sup>th</sup> July, it stated that there were no plans to restart negotiations for a \$4.8 billion loan until the country's military-backed transitional government gained recognition from the global community. However, by this time three Gulf states had stepped into the gap.

Anthony Skinner, Director and Head of Middle East and North Africa (MENA) practice at risk analytics company, Maplecroft, says that at least the authorities know that they have the support of Saudi Arabia, Kuwait and the Emirates, which they didn't have before. “The negotiations between former president Morsi, his team and the IMF were quite difficult. However, now the Egyptian authorities feel that they don't really need to worry about the IMF and its conditions because of Gulf aid. In a sense, the authorities feel like they have more breathing room to engage in fiscal reform and stimulus to ease some of the economic pressure by generating growth. But this is misleading because painful structural reforms still need to take place.”

## Economy

Egypt's real GDP slightly improved during the first nine months of fiscal year (FY) 2012/2013, growing by 2.3%, compared to 1.8% during the same period last year, according to the Ministry of Finance's August bulletin. However, inflation has increased from 4.7% in December 2012 to 10.4% in October 2013.

Net inbound foreign direct investment (FDI) fell by 25% in fiscal year 2012/13 from the previous year, according to the CBE. Rising unemployment levels – at 13.3% in 2Q13 compared to below 9% five years ago – represent another obstacle to the government, while those living below the poverty line reached 25% in 2010/2011.

In the medium term at least, Saudi Arabia, Kuwait and the UAE will continue to provide enough aid to prevent a full-scale economic crisis. Egypt's FX reserves have hovered just under \$19 billion since July due to such support. However, although the loans and aids from Gulf countries are soft loans, with mild conditions compared to other sources of finance, they will still increase Egypt's debt. According to the budget, it is expected to reach 89% of GDP in 2012/13, compared to 85% a year earlier.

On 31<sup>st</sup> August, the interim cabinet announced an economic stimulus plan worth \$3.2 billion (later increased to \$4.2 billion), which it said is aimed at creating a 3% growth rate over the current fiscal year, maintaining social justice and creating new job opportunities. On 11<sup>th</sup> November the government announced that a second stimulus package of \$3.5 billion would be launched by the end of the year. A major share of the stimulus will be spent on infrastructure projects, such as electricity grids, roads, housing and public transport, as well as raising the minimum wage from \$106 to \$174 per month by January 2014.

In addition to shorter-term fiscal fixes, the government launched a long-term developmental vision, ‘Egypt 2022’, aimed at achieving a “sustainable and contained growth”, according to the Ministry of Planning. In tandem with the fiscal stimulus, this programme focuses on developing basic infrastructure – especially in Upper Egypt, New Valley, Sinai and the Suez Canal – in a way that serves industry, agriculture, trade and transportation.

“Having a fiscal stimulus in place is important in order for the economy to chug along, but it is just a stop-gap measure,” says Skinner. “The Egyptian economy is on a lifeline, which is being extended by Saudi Arabia, the chief provider of funds and aid, as well as the UAE and Kuwait. But by relying on this external liquidity, the authorities are just delaying the necessary economic reforms to get the economy back on its feet.”

## Banking and markets

Over the past ten years the CBE restructured the banking market in Egypt and the number of banks were brought down to 40 from approximately 60. In addition, the central bank oversaw a recapitalisation of the banking sector. According to HSBC's Long, this is why there haven't been bank failures during the period post the January 2011 revolution nor has there been any evidence of large amounts of corporate provisioning during the past two and a half years of recession. Clearly, the banks have an appetite to lend and often have an average maturity of their lending book which is typically longer than seen in countries with debt capital markets.

Very few global banks have opted to leave the market. BNP Paribas and Société Générale (SocGen) sold their subsidiaries in Egypt but this was mainly to meet new capital requirements, rather than due to concern about the Egyptian market. Two Gulf Co-operation Council (GCC) banks stepped in: Qatar National Bank (QNB) bought SocGen's National Société Générale Bank (NSGB) and Emirates NBD bought BNP Paribas Egypt. Both deals were done at the end of 2012.

However, the markets have not fared as well – since 2011 the amount of trade on the Egyptian Exchange (EGX), which has 234 listed firms, has nearly halved. As a result, the exchange is revising listing regulations, developing new mechanisms for exchange traded funds (ETF) and rights issues, and working to increase trade on its fixed income market. In addition,

there is talk of a bond trading platform that has been ten years in the making potentially starting early next year.

## Doing business

Unsurprisingly, Egypt has dropped in ranking in the International Finance Corporation (IFC) and World Bank 'Ease of Doing Business 2014' report – but only by one place. It is now ranked 128<sup>th</sup> out of 189 economies. In the 'ease of starting a business' it dropped six places, while in 'getting credit' it dropped four places in comparison with last year.

The country has faced a number of specific challenges, which has caused Egyptian business activity to shrink for the 13<sup>th</sup> month in a row, as of October 2013. For example, most of Egypt has been under night-time curfew since mid-August, when security forces broke up sit-ins of supporters of Morsi. However, the seasonally-adjusted HSBC Egypt Purchasing Managers Index (PMI) for the non-oil private sector rose to 49.5 points in October, up from 44.7 points in September and moving closer to the 50 mark separating growth from contraction.

Whether business sentiment improves, comes back to the question of the government and its vision for the future, says Maplecroft's Skinner. "It is the uncertainty of what Egypt will look like in a year or two as many businesses take a wait-and-see approach to making future investments, whereas others have decided not to push ahead with Egypt at all and are investing elsewhere."

HSBC's Long agrees. "If you are going to invest for the future, you need some sort of clarity as to what that future will look like. There is uncertainty at the moment, and this has persisted for a while, which is reflected in recent reports of the HSBC PMI which have been negative for some months. The good news is that we have seen a slight improvement in November's PMI and I hope we see more improvement in the coming months, which would be a good indication for the future."

When asked what he did to protect his business during the past few years, a regional treasury manager at a large multinational headquartered outside of the country, lists three things:

1. Tried to keep calm.
2. Obtained weekly updates from subsidiaries.
3. Obtained counter guarantees in sales.

Sphinx Glass' El Mahdy says that his company focused on controlling its cost. "It is very difficult to control revenue, so we needed to be as efficient as possible to reduce our costs through in-depth cost analysis." The company improved its working capital management by maintaining receivables as controlled and low as possible.

He explains that every time a new government minister starts to approach companies and manufacturers to get to know their problems, by the time he understands the business and what is needed, he is gone and another put in his place. Then the whole exercise starts over again with a different strategy.

## Major challenges: FX and fuel

FX is the biggest challenge facing the regional treasury manager of the multinational. At the start of 2013, the CBE imposed new monetary FX regulations, in order to help curb speculation on the

US dollar in the domestic market and maintain a low rate of inflation. It also introduced a new mechanism to provide local banks with foreign currency through periodical auctions, aimed at conserving foreign reserves.

"There are shortages of currency for importers under traditional letters of credit (LCs) and collection bills, but also for those paying by direct transfer to their subsidiary or parent," says HSBC's Long. "There have been efforts by the central bank to provide foreign currency in the market through an auction process but the availability was less than what the inter-bank market used to offer 12 months ago. I remain hopeful that the situation will improve in the near future."

El Mahdy agrees that FX is the one of the biggest issues "because it affects everything". He says Sphinx Glass exports more than 50% of its products and therefore generates its requirements in US dollars. But he knows that the banks operate a priority list of companies in "essential" sectors, such as health care or food. Companies that can't access foreign currency are forced to tap the black markets, which is costly and insecure. Although currently – specifically after the Gulf's aid package – FX is stable and the banks are providing for the needs of almost all industry sectors, the question is how long this will last?

The limited availability of gas and electricity is another major challenge. According to Maplecroft's Skinner, the government is struggling to pay companies in the oil and gas sector, where the state debt is estimated to be \$5.4 billion. The state-run oil company, Egypt General Petroleum Corporation (EGPC), has entered negotiations with energy companies to restructure the resultant state debt. "This has been a significant challenge for oil and gas companies because a lot of gas has been diverted to the domestic market rather than being exported. Although there is a restructuring programme in place, it is far from ideal," says Skinner.

El Mahdy agrees: "Energy is a problem in Egypt. Gas price, compared with other countries in the region where prices are much lower, is affecting our cost structure and our ability to compete."

Although there were many power cuts leading up to 30<sup>th</sup> June and into July, these have now stopped. "The country runs quite close to its power capacity all the time, so it is important that part of the stimulus package is earmarked for building more power stations because manufacturers need power to run their machines," says Long.

## The future

Fitch's Gamble is cautiously optimistic and believes that Egypt will become relatively more stable after a period of extreme uncertainty. "Financial inflows from the GCC should support the currency and with political tensions likely to be contained there should be a modest improvement in growth. Nonetheless, performance will be well below potential."

El Mahdy highlights the opportunities present in a market that encompasses 90 million people. But he believes there must be a robust plan in place to take advantage of these opportunities. "They talk of 2022, but what will happen in 2014? In a developing country such as Egypt there are so many quick wins that can be achieved, but we need a strong administration that can take bold decisions. We didn't lose three years of our lives in business just to go back to square one." ■



# Best practices in refinancing

*Interest rates remain low for the moment, but with the global economy showing signs of improvement higher borrowing costs may soon be a reality. As a result, companies with debt coming into maturity in the next few years are likely to be thinking about renegotiating borrowing terms with lenders and locking in cheap debt. But what is the key to securing the most favourable terms? In this article we ask two corporates and two banks what they think defines best practices in refinancing.*

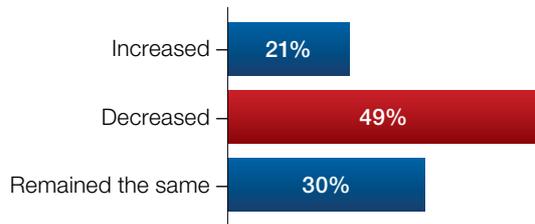
It was yet another huge year for corporate bond issuance in 2013, with the combination of artificially low long-term interest rates and strong investor demand once again pushing debt sales to record levels in European markets.

The issuance boom has resulted in a change in the corporate debt stack. In Europe, companies have traditionally relied upon bank loans for their financing needs. But today, “the loan market share of the corporate debt stack in Western Europe stands at roughly 50%, a reduction of 10% from what it was just two years before,” says Karl Nolson, Managing Director, Debt Finance, Barclays. “In the UK the decline in the same period has been more abrupt, dropping from just over 70% to just inside 50%. Now, there is a considerable amount of liquidity chasing very few deals and this has helped pricing in the loan market to regain some of its competitiveness.”

In the Asia Pacific region, the balance of the corporate debt stack moved in the opposite direction. In the bond markets, the coupons paid on debt increased for many corporates during 2013 after the Federal Reserve’s announcement of its plans to unwind its asset purchases triggered a sell-off in dollar denominated debt across a number of emerging markets. Bond issuance, which had hit record highs in 2012, declined, driving companies back to the more competitive loan market for their financing needs.

Overall though, funding conditions for corporates remain favourable across the board. In Treasury Today’s 2013 European Benchmarking Study, a majority of treasurers (79%) indicated that credit costs had remained the same or declined during the past year. In the Asia Pacific region the figure (75%) was only marginally lower.

**Chart 1: How has pricing changed in the last 12 months?**



Source: *European Corporate Treasury Benchmarking Study 2013*

Corporates know that this era of cheap credit is not going to last forever. With the global economy recovering, interest rates are set to rise sooner or later. To make the most of low borrowing costs conditions while they last, a significant number of companies with existing debt due to mature in the next few years are now entering into negotiations with their lenders to modify and extend terms.

But what is the key to successful refinancing? Every company is different and, as such, are likely to approach such negotiations in their own individual ways. However, when Treasury Today raised the subject of best practices in refinancing with corporates and banks, it quickly became apparent that there are some general principles companies can follow to secure the best possible terms from their lenders.

### Cash in on investor bond appetite

Both investment-grade and high yield corporate debt issuance have set new records in the US and Europe over the past year. But such is the volume of liquidity in the global economy at the moment that demand for non-financial corporate debt in the US private placement market is still outstripping the supply, says David Cleary, Co-Head of US Private Placements at Lloyds Bank. This supply and demand imbalance has led some US investors to attempt to differentiate themselves by offering, for instance, delayed funding or euro or sterling denominated debt. The trend might provide those corporates who have the ability to access capital markets some unique financing opportunities, whether that be for the purpose of restructuring existing debt, M&A or growth capex.

“That is one of the appeals of the private placement market to the UK or European corporate,” says Cleary. “Because investors are looking for ways to differentiate themselves, corporates issuing debt in this market can secure much greater flexibility in their financing. It gives them the opportunity to mix tenors and use different currencies and tranches.”

Treasurers evidently now have an abundance of options these days when it comes to refinancing on the capital markets. It is important to consider each of these options early on, says Cleary, referring to the core debt quantum in the business plan and considering the potential impact of any future developments such as mergers and acquisitions or unexpected capital expenditure requirements.

“Finance teams need to ensure that the finance they are putting in place today works over the life of that debt facility,” he says. And that is the case whether the company is looking

to take on debt with five year maturity from the bank market, or ten or 15 years in the bond or private placement market. “Assess the options,” adds Cleary. “Ensure that each is fit for purpose, and ensure that the terms and conditions will meet your business needs going forward.”

### Take it while it’s there

Ford Motor Company benefited enormously from taking such a forward looking approach when it restructured some of its debts back in 2006. Initially, the treasury at Ford merely intended to renegotiate the company’s revolving credit facility, but given the positive market conditions that existed prior to the onset of the credit crisis it soon turned into much more. In addition, a separate term loan was taken and a convertible bond issued securing a total of \$23.5 billion of debt for the company, of which \$12 billion was funded and \$11.5 billion was unfunded as a backstop facility.

“In a good market without a lot of debt supply coming in you need to come prepared.”

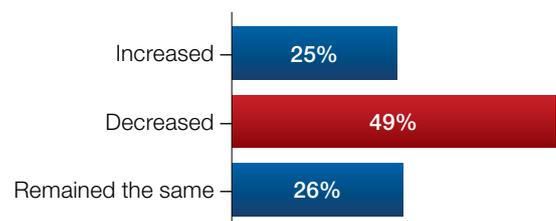
Neil Schloss, Vice President and Treasurer, Ford Motor Company

Neil Schloss, Vice President and Treasurer at Ford Motor Company did not regret for one minute that the company squeezed all the credit it could manage out of the market. Less than two years later the US motor industry was in a dire condition. With the arrival of the financial crisis, Ford, alone among Detroit’s big three auto manufacturers, did not need to request Troubled Asset Relief Programme (TARP) money from the US Government, or declare bankruptcy. And it was the mixture of secured and unsecured funding acquired in 2006 that made the difference during this difficult period.

“It was critically important,” says Schloss when asked about the significance of the restructuring to the company. “It was one of the elements that prevented us from requiring government support during the crisis and meant that, unlike our two big competitors, we didn’t have to cut back on our capital expenditure during that period.”

One of the lessons from this, Schloss notes, is that markets tend to move in cycles which do not always align perfectly with business needs at every given moment. It is crucial therefore to take full advantage of favourable borrowing

**Chart 2: How has pricing changed in the last 12 months?**



Source: *Asia Pacific Corporate Treasury Benchmarking Study 2013*

conditions when they arise. “You tend to take money when you don’t need it and don’t take money when you need it,” he says.

But in order to take advantage of favourable conditions when they materialise, corporate treasurers need to be on their toes constantly. “Availability today has much shorter windows,” he explains. Therefore, corporates who want to refinance when the market is positive need to be ready on any given day to do it. “In a good market without a lot of debt supply coming in you need to come prepared. If you come in one day thinking that the markets look great, but haven’t planned what to do then you are likely to miss it.”

## Engage early with lenders

It is for this very reason that Barclays’ Karl Nolson says it is important for corporate borrowers to engage early and maintain regular conversations with their lenders. This will allow corporates to move quickly and execute a strategy at the point which they need to. It is something which he thinks applies even in the loan market which is not as dynamic as a market for bonds. “Finance teams often tell us that they need to anticipate when the Board is going to ask the question of how much debt can be raised and at what price,” he says. “For that reason, especially in a heightened M&A environment, the conversation with banks should always be ongoing.”

Keeping in touch with lead arrangers will not only help treasurers by preparing them with the information they need to act at short notice, but also take away some of the taxing aspects of the financing process such as documentation and coordinating with other banks in the syndicate to get the best pricing.

Finally, frequent communication with the lender can help the corporate to understand better what is going on at the regional level of the loan market. Although nations are often thought of as distinct markets, there are often considerable regional disparities in pricing. Demand for credit, and therefore the cost of it may, for example, be very different in the North of England than it is in Scotland or London. “If a lender is based in Manchester and it’s their job to look after that region, given the paucity of new loan volumes in general, they really can’t afford to miss out on any loan issuance emanating from that region. So one tends to see regional pricing variations, but staying in contact with the banks regularly can help the treasurer understand how those dynamics are playing out at any one time.”

## Be transparent

Frequent communication with your banking partners is one thing, but as the experience of Royal FrieslandCampina testifies, the way in which you communicate is also important. In late 2011, the market for bank finance in Europe was deteriorating as the Eurozone’s debt woes escalated. Nevertheless, Royal FrieslandCampina managed, in spite of these very challenging market conditions, to successfully negotiate with their lenders an “amend and extend” of the company’s €1 billion general purpose syndicated credit facility.

The manner in which FrieslandCampina communicated its expectations with the banks included in the syndicate was critical to the success of the deal, says Klaas Springer, Director of Corporate Treasury at Royal FrieslandCampina. With the help of Zanders Consultancy, the company

developed a tailor made solution it calls the ‘Wallet Sizing’ model to help frame the forthcoming negotiations. Using this model, treasury were able to perform their own analysis on the profitability of the business the company was doing with each of the 14 banks in the syndicate, before reporting back to them with the results.

Once treasury had completed this analysis and ascertained that a majority of the banks in the syndicate were satisfied with their relationships with the company, it began exploring the possibility of renegotiating the terms of the loan. In addition to extending the maturity of the loan, treasury also felt that pricing should be brought in line with what other companies of a similar size and creditworthiness were paying in the market.

“They basically couldn’t say no to us,” says Springer, explaining that having the syndicate banks confirm they were happy with the relationship prior to the discussions had put the company in a very strong negotiating position. Although a few banks displayed some hesitancy, as one might expect given the broader economic climate, Springer held that the vast majority responded positively and were tremendously cooperative.

The lesson from all of this, says Springer, is that when it comes to refinancing it pays to be as transparent as possible with your creditors. “They need to understand where you are coming from,” he says. “I always say, if you treat the banks with respect you will get respect back. It certainly helps your cause if you are transparent and involve your banks in the proper way.”

## The year ahead

As the global economy improves, the prospect of higher rates is certain to increase. Any corporate with maturing fixed income debt would understandably want to refinance before the Federal Reserve reduces the pace of its \$85 billion-a-month asset purchasing programme and yields begin to rise. This, perhaps, is one of the factors that has contributed to the extraordinarily high levels of issuance in recent months and why analysts expect to see it continue at least into early 2014.

The outlook for pricing in the loan market is less certain. In the US, analysts do not foresee any rise in short-term rates until at least the beginning of 2016 while, given the Eurozone’s ongoing troubles it seems likely that policy rates there will remain low for some considerable time. Although the Bank of England has raised the possibility of a rise in 2014, it goes without saying that such a move will be conditional on the UK sustaining its recent return to growth. Instead, the biggest issue for corporates accessing bank finance is likely to be regulation, with the leverage ratios introduced under Basel III, in particular, likely to either increase – or, at the very least, put a floor on – loan pricing.

But the impact at the investment-grade end, at least, shouldn’t be too adverse says Barclays’ Nolson. The corporate with “a good ancillary story” and lots of business to share between its relationship banks will, he adds, always be able to command improved pricing on loans. On that basis, in addition to all the liquidity that is still out there, Nolson expects to see the number of deals continue to pick up as Europe heads towards the next big refinancing spike in 2015. “The number of ‘amend to extends’ has increased significantly through 2013. We expect a lot of borrowers to continue exploring and executing refinancings as we move into 2014.” ■



## THE BANK INTERVIEW

### Hugo Parry-Wingfield

Investment Director and EMEA Head of Liquidity Product



Hugo Parry-Wingfield is the Investment Director and EMEA Head of Liquidity Product for HSBC Global Asset Management. Based in the UK, he has responsibility for the development and implementation of the liquidity product strategy in EMEA. Parry-Wingfield joined HSBC Global Asset Management in August 2013 and has been working in the cash management and liquidity industry for over 15 years. He joined from Citibank's Treasury and Trade Solutions business, where he was Co-Head of EMEA Liquidity and Investment Products and Head of Liquidity Market Management. Prior to that Parry-Wingfield held senior liquidity sales, product management and consultancy positions at J.P. Morgan and at PwC.

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*Liquidity management remains a challenging area for corporates, particularly with the low interest rate environment, incoming regulatory change and new risks emerging. With this magnitude of change it is prudent to review investment policies and processes in order to ensure they properly manage risk, according to Hugo Parry-Wingfield, Investment Director, HSBC Global Asset Management.*

#### Why is liquidity a key area of focus for HSBC?

Liquidity is the lifeblood of any company, and its management has consistently topped the corporate

treasurer's agenda over the past five years, both from a risk as well as a utility perspective. In order to protect their

company's business, treasurers need to know where their cash is and how quickly they can access it. They need both visibility and control.

HSBC is responding to our clients' key requirement for effective liquidity management, by servicing them across all the markets we are present in, and providing a range of services to support their liquidity management activities. This core competency stretches across the whole Group, including HSBC Global Asset Management.

### **Based on feedback from your clients, what are the biggest challenges facing corporate treasurers in today's environment?**

The risk of a loss of principal due to a counterparty default has not gone away and, therefore, the importance of robust investment policies and processes is as important today as it ever was. Protecting a company's capital requires the ability to mitigate counterparty risk as best as they can.

A closely associated challenge is the ability to effectively diversify cash without diluting core investment principles. Today, corporates are sitting on historically high levels of cash, which clearly puts greater pressure on their investment policies and underlying liquidity management principles.

The changing regulatory environment is having a direct impact on corporates, as well as indirectly via banks and service providers. Although many incoming regulations are intended to benefit business, the pace and diversity of change is making the job much more difficult. For those corporates operating in multiple jurisdictions, treasurers are tasked with navigating complex and divergent regulatory environments.

The growing footprint of most corporate operations is another challenge. Clearly, this is a positive driver for change, as corporates are actively taking advantage of new market opportunities; however, it is creating new challenges for treasurers expanding their cash management operations into new markets and currencies. Above all, a consistent global risk-managed environment is best practice.

The low interest rate environment has also continued to be a challenge and is expected to persist for some time. Clearly this environment provides limited, if any, reward for cash. But on the other hand, it is driving best practice in terms of risk management if there is less focus on yield and greater focus on risk.

Getting the balance right in managing their access to liquidity, both in terms of meeting near-term cash flow needs and also being prudent when investing cash, due to concerns about what might be coming around the corner, is a growing challenge for many of our clients. But remember, holding ultra-liquid cash can come at a cost.

### **How do these challenges begin to change treasurers' behaviour, particularly with regards to their investment strategies and policies?**

The market events over the past five to six years have fundamentally changed the investment environment. The decisions a treasurer has to take today are not the same as they were during the earlier phases of the financial crisis, let alone before the crisis.

Therefore, first and foremost, it is important to constantly evaluate investment policy – which includes the mechanics,

process and strategy, as well as the written policy – to ensure its relevance. In addition, building a deep analysis of counterparty risk and classes of investment allocations, much more than previously and well beyond external credit ratings, is a key to success. The problem treasurers often come up against is that it is not easy for a treasury team to achieve this level of scrutiny, because they don't necessarily have the resources or expertise.

Today, treasurers are putting more emphasis on segmenting their liquidity profile. Essentially this is based on a better understanding and profiling of their own liquidity, as it relates to their balances around the world and, more importantly, as it relates to their cash flows in and out, that generate that daily position. In response, many banks have been developing more flexible products, such as flexible call accounts – which are deposit products that reward stability with higher yields but still give the treasurer access to liquidity.

On the asset management side, as an add-on to their money market fund allocations, some clients are expressing greater interest in segregated mandates to better deploy cash in line with liquidity profiles, as well as seeking incremental yield, where available, compared to shorter-term options.

We also see increased demand for alternatives to traditional deposits, such as repos. An increasing number of treasurers are interested in using repos to enhance security, using collateral to underpin an otherwise unsecured deposit. Repos also provide opportunity for different yield profiles, so a treasurer could potentially enhance their yield over a normal short-term deposit depending on the collateral used.

In addition, clients continue to look for ways to automate investments, where possible, in order to ensure they are maximising the amount of cash deployed into their chosen investment strategy, in a controlled environment. For example, some are using daily automated sweeps from cash accounts or cash pools into money market funds (MMFs). This effectively links their cash and liquidity management activities with their end-of-day investments.

### **How do you think the proposed money market fund regulations will affect where corporates place their cash?**

In the US and Europe the regulatory changes have yet to be finalised, so it would be premature to conclude how they will change treasurers' behaviour, and we should keep in mind that it may be several years until any actual implementation. That said, HSBC supports regulatory proposals that aim to deliver a more robust or secure environment for MMFs and investors. We are engaging with the regulators, politicians and governments on both sides of the Atlantic, especially where we believe the changes will achieve greater stability in the market. In addition, we are providing feedback where we think that the proposals, as written, will not achieve the goals described by the regulators themselves or in some cases, where they could even have the opposite effect.

We do not expect the proposed reforms will remove the utility value that MMFs have provided to investors; professional credit management, credit diversification, a high degree of liquidity, a competitive return compared to short-term money market interest rates, and a high degree of transparency, all achieved through one transaction. For this reason we believe that investors will continue to use MMFs as part of their

day-to-day cash investment needs. If the proposals are implemented, including any move to a floating net asset value, or a removal of external ratings paid for by the funds, then investors will rightly need to consider the implications.

HSBC is working with its clients to help them address these issues. Although we can't have all the answers at present because it remains a moving target, we do, and will continue to, provide analysis and information to help investors make informed decisions at the appropriate time, as well as develop solutions that could help mitigate some of the impact to an investment process.

## **The tough environment is also affecting the banks – what should corporates be aware of?**

As well as numerous other demands, banks require significant resources to prepare for Basel III. Basel III's new capital rules clearly influence the banks' preference for different types of deposits. Already some banks are aligning their options against the deposits that have the best liquidity treatment – which affects how they price and position specific types of deposits, and to which types of clients.

MMFs are not directly affected by Basel III, as they are off balance sheet and not a capital-based investment product. However, the industry is facing its own regulatory reform, as mentioned previously.

## **How should investors consider counterparty risk specifically?**

Most corporate investment policies remain heavily weighted towards bank deposits, which means counterparty risk must be closely managed. Yet maintaining adequate lines with the highest quality counterparties continues to be a challenge, especially at a time when corporate liquidity continues to be historically high. Investment quality should be independent of a change in size of liquidity – eg it is recommended that treasurers should not take more risks, raise limits beyond previous tolerances, or use banks they previously avoided just because they have more cash to deploy.

Many corporates have not changed their attitudes to core relationship banks and also 'national champion' banks, or large domestic banks. The historic rationale behind this is that treasurers want to, rightly, 'reward' their relationship banks with deposits, but they also might think that they have some leverage with their relationship banks should a problem arise. Equally, the logic behind using a national champion bank is the perception that they are 'too big to fail' or that there is a high degree of likelihood that the government would step in to save the bank and protect its investors or deposit holders.

Yet, the political and regulatory landscape is changing. Much of the regulators focus is on putting in place processes to allow a bank to fail. But the focus of these new 'bail in' regulations is often geared to protect retail investors, rather than institutional investors, such as corporates.

It is no longer reasonable to make the assumption that investments are safe, either due to the relationship or the national position of the bank. Therefore, investors may need to rethink and revisit their policies and ensure the counterparty selection is first and foremost based on credit quality, before the lens of relationship is applied.

## **So how are treasurers adjusting their credit analysis in order to respond to this new environment?**

Most investors active in the money markets have made great progress since the financial crisis, in enhancing investment policies and risk management. However, when assessing counterparty risk, some continue to predominantly use external credit ratings.

Although ratings are a useful reference point, analysis of a counterparty's credit quality needs to be supplemented with other inputs, for example financial statements, asset quality, historic and projected earnings, and liquidity and funding mix. These are key elements HSBC uses for selecting and monitoring our counterparties within MMFs specifically, and more generally across our investment teams.

Credit analysis is not just a one-off activity aimed solely at putting a counterparty on an investment list, but additionally, they should be regularly monitored. Once a counterparty is approved, there needs to be an ongoing assessment as to the appropriateness of that counterparty, and its corresponding limits; HSBC believes this should be done on a daily basis and adjustments made accordingly.

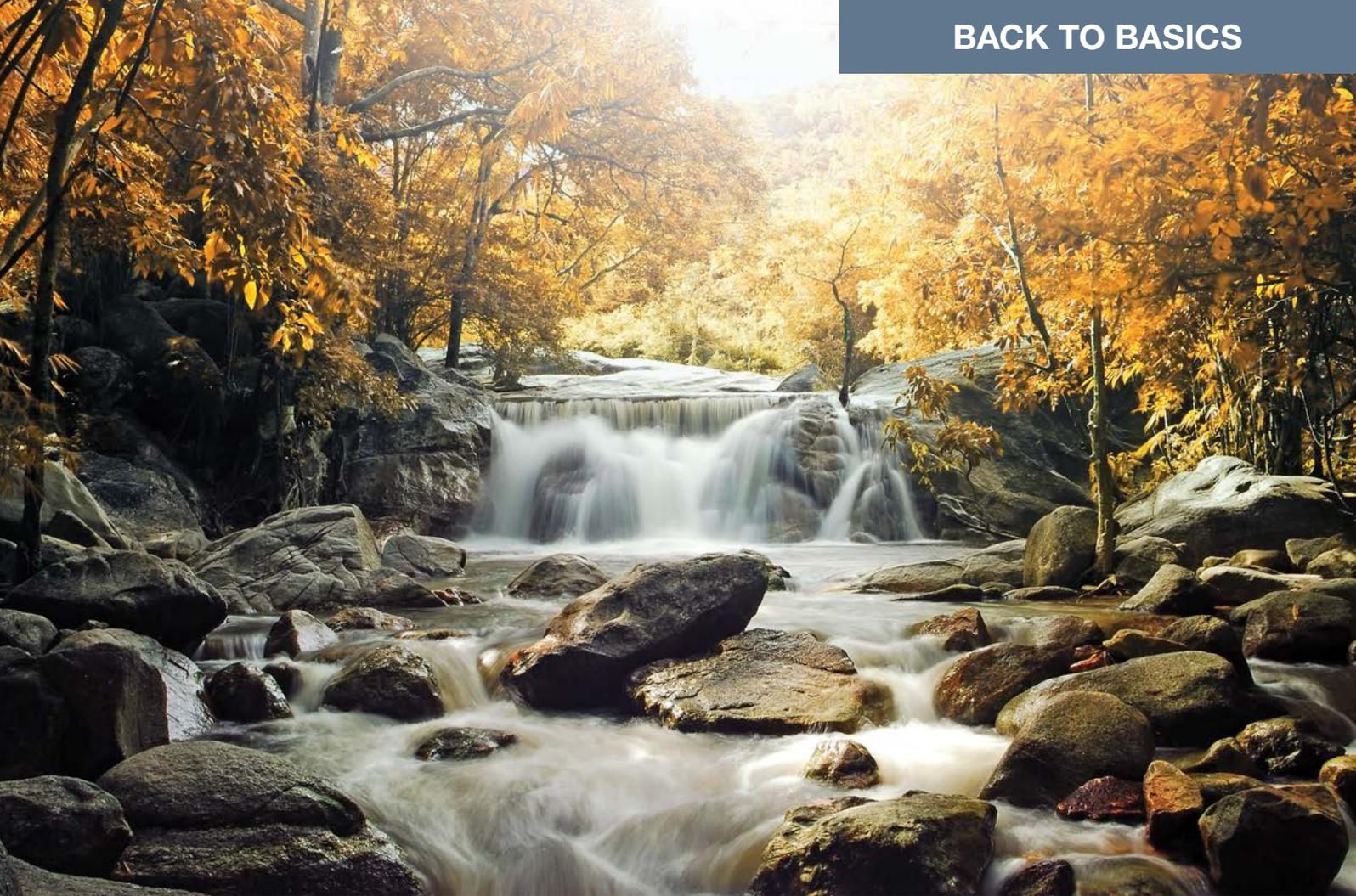
All this requires resources and expertise. Many treasurers see the advantages to using a professional investor whose job it is to manage risks and liquidity, has scale and expertise to fully understand issuers and instruments from many angles and the ability to apply their own scoring and monitoring, transacts volume in the market daily and operates within the boundaries of a robust policy with sufficient flexibility to adapt to changing risks day-by-day.

## **How can treasurers develop a more consistent global approach to their investment policy?**

A key aim of many treasurers is to have a consistent global approach to liquidity management. Moving into new markets presents a challenge in integrating the new market and currency into a controlled treasury environment, which may have been in place for many years across more established markets. Local practices can create a further layer of confusion. Therefore, a treasurer might look to leverage a global bank's presence in a new market and plug into its existing framework in order to achieve the visibility and control they desire.

This is also true on the investment side. A global asset manager that has capabilities in different markets and currencies can provide a level of consistency in a treasurer's approach through using the same underlying investment standards, processes and risk management framework that the asset manager provides in other markets. Investors are, for example, looking for more investment options in markets such as China and India, as well as across Latin America.

There is so much going on in the cash investing world, facing the investors directly and the markets they serve, as well as the banks and asset managers who provide much of the solutions. This is driving innovation – new products, currencies, and so on – and providing increasing choice; however, investors must continue to focus on the fundamentals and evaluate what they are equipped to manage themselves as opposed to where there is value in using an external manager. Either way, any decision should be a thoroughly deliberated one that is reviewed on a regular basis. ■



# Understanding your cash flows

*Cash flow forecasting has long been a pain point for corporates. In this Back to Basics article, Treasury Today canvasses the experts for top tips to take the pain away.*

Year after year corporate treasurers identify cash flow forecasting as one of the top areas in need of improvement. In Treasury Today's European Corporate Treasury Benchmarking Study in 2012, it was ranked as the third priority, behind cash management/pooling structures and banking relationships.

But what makes it so difficult? A group treasurer at a Middle Eastern airline focuses on the complexity of the task due to the variability in the amounts, currencies and timing of business cash flows, as well as the impact of unpredictable changes in market prices for commodities (eg oil and fuel prices), exchange rates and interest rates. Many treasuries struggle with forecasting in countries where there are strict foreign exchange (FX) controls. In addition, there are more intrinsic issues related to the business, its infrastructure, organisation and geographical spread.

With a myriad of different technology systems and applications, including accounting, treasury management systems (TMS), enterprise resource planning (ERP), spreadsheets and emails, having a consistent and integrated view across the company is a significant challenge. According to Joerg Wiemer, CEO of

Treasury Intelligence Solutions (TIS) and a treasurer for 12 years previously: "Even the questions 'how much cash does the company have?' or 'what is the cash flow over the past six months in a certain subsidiary, currency or customer?' can be extremely difficult for a treasurer to answer. This is because of multiple ERP systems, data sources, the thousands of customers and hundreds of bank accounts that contain the information needed for forecasting analysis. The first step to accurate forecasting is to establish a single source of truth."

Lisa Rossi, Managing Director and Global Head of Structured Liquidity Products (SLP) for Global Transaction Banking at Deutsche Bank, agrees: "Treasurers use spreadsheets and emails to share data, which creates a disjointed view between actual and forecasted positions, and does not provide for a seamless flow of information. If you don't have a complete picture or full transparency how can you undertake solid cash forecasting?"

The infrastructure challenge may be tough, but so are the internal organisational hurdles. Brian Titus, Treasury Cash Analyst at

global brewer SABMiller, says: “It is a challenge to make colleagues understand what information you need for forecasting. Sometimes they don’t fully comprehend the bigger picture and how important it is to get that information.” This isn’t helped, he adds, by a wide geographic spread which can affect the timing of the data. “If the data is out of date, it is less reliable.”

Relying on information sent by others is the main problem, according to Paul Stehman, ex-treasurer and currently an independent consultant. “The difficulty for a treasurer is that they are not 100% in control of the numbers and are effectively relying on information provided by others. They need others to send good quality data on time and in the correct format.”

## Is the gain worth the pain?

Despite the level of difficulty, a reliable and trusted cash flow forecast is hotly sought-after and is considered to be a key performance indicator (KPI) for treasury. Respondents to Treasury Today’s European Corporate Treasury Benchmarking Study 2012 indicated that it was the number one KPI for core cash management efficiency and liquidity management.

Forecasting can also be the shareholders’ principal metric. Stehman says, “I became aware of this in the private equity world, where I have been active during the past few years. Cash flow forecasting is the first metric they look at. More important than EBITDA numbers, it is the cash that they are interested in.”

For the Middle East group treasurer, an accurate forecast allows a company to be proactive in preparing for liquidity issues, as opposed to reacting to them. “This can have a significant impact on working capital costs, such as improved return on excess cash or lower funding cost on drawn facilities. In addition, it instils discipline and maintains a focus on cash throughout the business.”

Titus agrees, adding: “In the short term, it is all about cash management and ensuring that we have the right currency in the right place. If our forecast is not up-to-date, it may mean we have to go to the spot market and swap currencies when we could have planned it better. The long-term view is all about liquidity risk and whether we have covered our funding gap one or two years out.” Even though SABMiller can obtain a decent fixed interest rate at the moment, this won’t always be the case and therefore cash forecasting will only gain in importance for the company. His colleague, Alan Chitty, Treasury Controller, adds that with better forecasting, companies can also pay short-term debts back earlier and save money that way.

Successful liquidity planning, including analysing the gap between actual and forecasting, helps to better manage the company, according to Wiemer. “This will allow the treasurer to position their team as a business partner to the CFO because finally they can help the CFO to better manage the whole company. It is not just about better working capital management or optimising financial results, but also determining how important certain customers or suppliers are to the company.”

Both Deutsche Bank’s Rossi and Nancy Pierce, Senior Vice President (SVP) and Manager of the Capital One Bank’s Treasury Management Product Management Group, touched on the importance of good cash flow forecasting in risk management. As Rossi explains: “A lack of information can create blind spots – nobody wants blind spots when managing cash.”

Pierce talks of one client who used cash flow forecasting as a risk mitigation tool during the financial crisis. When a large

proportion of the company’s lending froze up, treasury had to find other sources of funding. The company had a TMS in place but realised that it was only using about 10% of its functionality, mainly as an operating system for payments and receivables. Treasury worked with the software vendor on a project to reap the benefits of its technology much more broadly.

In addition, treasury put processes in place across the company to ensure that all the subsidiaries were using the tool and knew what they needed to input, as well as the proper controls around accuracy. It also switched to a more regional-based treasury structure so that all its subsidiaries were close to a centre of excellence. As a result, treasury was able to find trapped cash throughout the company that could help with its current commitments. That enabled it to alter the balance between bank funding and utilising internal cash. “It’s a great story of what this company accomplished in an urgent situation – it was able to marshal its forces and get it done quickly,” says Pierce.

## Tools for improvement

Technology plays a critical role in forecasting, but it is also a question of process governance, according to Wiemer. TIS’ cloud-based platform, which is delivered as a software-as-a-service (SaaS) solution, includes a governance module which helps to define data collection and aggregation processes. “These need to be automated and streamlined,” says Wiemer. “Although it is possible in theory to roll out a treasury guideline and try to get people in a local subsidiary to stick to your rules, in real life they probably won’t even read them. This is why you need to roll out governance processes and technology as well. For example, TIS technology provides a step-by-step workflow that the local staff need to go through in data collection.”

Governance is hindered in many ways by the prevalence of spreadsheet usage in companies of all sizes. Christian Mnich Director Solution Management – Treasury Applications at SAP AG, spoke of a client that previously used an Excel spreadsheet globally – its subsidiaries access the spreadsheet on a single server and create rolling forecasts for the coming 12 months: “They struggled with the spreadsheet because they couldn’t see which subsidiary has already submitted a forecast or if someone has altered it.”

A client of Deutsche Bank used multiple spreadsheets to forecast their overall position, with subsidiaries sending cash updates via email on a weekly basis. The data would then have to be consolidated and evaluated. By using Autobahn’s Liquidity Manager app, the treasurer was able to take all account information, segmented in a way the team could understand and analyse so that each subsidiary’s account information was easily visible. “This meant he could see how effective their daily planning schedule was against actual payment flows – the system has a reconciliation tool that can match cash receipts and payments,” explains Rossi.

The platform also has an investment dashboard to monitor the company’s overall investment position. This allows the treasurer to understand their liquidity profile in addition to the allocation of counterparty risk, which are both important. Therefore, if a particular event is pending where he needs more funding, the treasurer can easily see where and when funding was available and accessible.

Interestingly, despite implementing a new TMS globally SABMiller still relies on spreadsheets for capturing forecasts

but they have been able to significantly improve its cash flow forecasting. As part of its ongoing 'Project Griffin', SABMiller rolled out IT2 NET, which is a remote, browser-based solution, around the regions. The majority of the subsidiaries' forecasts come into IT2 NET through a pre-determined spreadsheet which looks and feels the same business-to-business. The treasury team was able to construct the spreadsheet's rules and logic, and also prompts in terms of data ranges. Treasury also has macros embedded, so that it can pull specific information. The spreadsheet itself can't be incorrectly uploaded into IT2 NET, so it is a combination of "an easy spreadsheet for people to use, reflecting what they are already accustomed to, and more controls over that information before it is imported into the IT2 system," says Chitty.

"We could have gone down the route where they plug the numbers directly into IT2 NET screens, but in reality they would just be using their own spreadsheets, taking the numbers out and typing them in, which could introduce transposition errors. Therefore, we decided to let them use spreadsheets but have greater control over them," he adds.

It is clear that both processes and technology are critical components of improving cash flow forecasting, but where do the banks come in? A number of banks say that the answer lies in their proprietary electronic banking (e-banking) systems, but many corporates are looking to be more bank-agnostic in their relationships. Robert Pehrson, Global Head of Liquidity Products, SEB, says that the most important thing that a bank can bring to the table is experience from other clients. "We too have a tool that supports the forecasting process. However, the tool itself is not the major benefit for the customer but the knowledge that we have built up working with other corporates."

One of the first clients SEB worked with didn't have centralised forecasting at the beginning. Today, the company has a daily process in place – by 8am it has a consolidated view of the balances for all subsidiaries, approximately 300-400 accounts. It also has daily, weekly and monthly forecasts. "This means they can act during the day on securing positions based on reliable data," says Pehrson. "They also developed a rigid follow-up process for subsidiaries that don't report according to plan. This is extremely important to give feedback to subsidiaries that might report late or with poor quality information. They have also put in place KPIs so that the subsidiaries are given an incentive to improve their information."

## Ten top tips to better forecasting

When asked their advice on how to achieve better accuracy in cash flow forecasting, the experts interviewed for this article were not short of comment. Here are some of their top tips.

### 1. Use technology to your advantage

As SABMiller's Chitty says: "You must embrace your technology and make it work for you". Technology is a great enabler, but it must be calibrated for your organisation; according to Capital One's Pierce, "you could have a lot of power there that isn't used."

### 2. Integrate your systems

Once you have the technology in place, the systems need to be able to speak to one another. "Integration plays a major role, so the more operational systems you can integrate as sources the better the forecast will be," says SAP's Mnich.

### 3. Automate as much as possible

Almost everyone touched on this. The Middle East group treasurer comments: "Make sure you are able to obtain cash balances daily for all accounts in as automated a way as possible. This starting point forms the basis for forecasts."

### 4. Define your terminology

This starts with specifying the difference between short-, medium- and long-term forecasts and defining their parameters and usage. Nomenclature and formats are also critical, as well as a definition of global liquidity, which "shouldn't be underestimated in terms of effort," says Mnich.

### 5. Develop and standardise processes

"This relates to your internal information flows and accuracy, and people's willingness and ability to follow the corporate practices and policies that are key," says Pierce. "It is important to standardise processes and make sure your subsidiaries are all following the same practices and are able to capture the data needed for analysis."

### 6. Build internal relationships

The Middle East group treasurer suggests working closely with planning and budgeting to make sure both P/L and cash perspectives are understood and generated. In addition, build a close relationship with the big spenders in the business and set up a process to get their updated cash forecasts.

### 7. Get buy-in from top management

"Very often people preparing cash flow forecasting at operations level consider this to be just another task that they have to do every week or however often you require it. To have CFO buy-in helps underscore the importance of cash flow forecasting. Otherwise people won't be properly engaged," says Stheeman.

### 8. Feedback

It is important to go back to the subsidiaries with feedback as to how accurate it was and build in some KPIs into the process. "Over time you can view how well or how poorly they have done," says SABMiller's Titus. "That is the area we are looking into next – now that our colleagues are used to the process, it is all about improving it and having a KPI measure attached to it."

### 9. Make people accountable

Both Stheeman and Chitty advise making people accountable for forecasting, so that they actually make an effort with this. "If it just becomes a cut and paste job then people can quite easily carry forward mistakes," says Chitty.

### 10. Communicate, communicate, communicate

Although everyone touched on this point, Stheeman succinctly says: "Let everyone know what you are doing and its importance. Don't roll out something and just say 'this is our new cash flow forecasting tool, use it as of next week'. Make an effort to visit and educate the subsidiaries and business units."

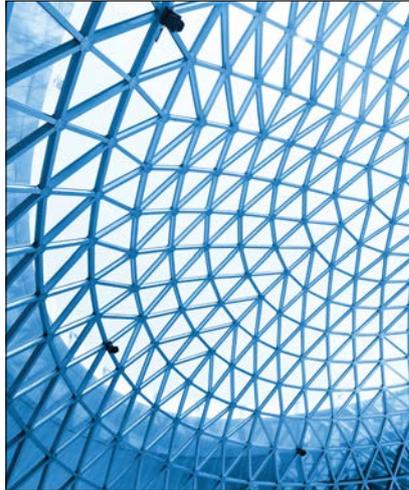
"People often talk about cash flow forecasting, and with Basel III and banks being more strategic about balance sheet, funding costs will be under even greater pressure. It is time that we stop analysing cash flow forecasting, and instead grab the bull by the horns and just apply good cash forecasting techniques using progressive technology," says Rossi. ■



INSIGHT & ANALYSIS

Mitigating FX volatility

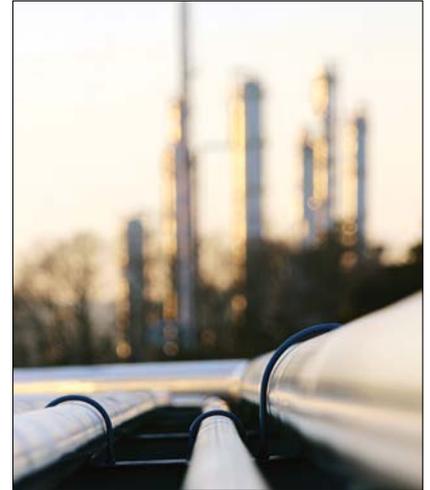
The high instability that occurred in emerging market currencies during 2013 was of great concern for corporate treasurers across the globe. A sudden shift in exchange rates and a profitable deal can lose value, or in an extreme case, turn into a loss-maker. How can corporates mitigate this risk?



CORPORATE FINANCE

Key facts about the BPO

Despite the ICC approving the basic legal framework of the Bank Payment Obligation (BPO) in April 2013, uptake has been slow. To date there are just six banks live on BPO, and these are all Asia-based. What do treasurers need to know in order to roll out a BPO programme?



TECHNOLOGY

What's in the pipeline?

Last year saw more consolidation in the treasury technology space, with Wall Street Systems picking up IT2 and Bottomline acquiring SWIFT service bureaus, Sterci and Simplex. Where is this leading the market? Are there new start-ups coming onto the scene with the 'next best thing'?

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

**Holger Achnitz**, Head of Continental European Corporate FX Sales, Citi; **Gerwin Braam**, Senior Bank Manager and SEPA Project Manager, AkzoNobel; **Tom Byrne**, Director of Fixed Income, Wealth Strategies and Management; **Alan Chitty**, Treasury Controller, SABMiller; **David Cleary**, Co-Head US Private Placements, Lloyds Bank; **Anne Croke**, Senior Treasury Manager, Fluor; **Cees-Jan Dijkstra**, CFO, Holmes Place Lifestyle Clubs; **Marie-Astrid Dubois**, Assistant Treasurer, Honeywell; **Tarek El Mahdy**, CFO, Sphinx Glass; **Colin Ellis**, Analyst, Moody's; **Russell Francis**, Managing Director, Head of North American Corporate FX Sales, Citi; **Paul Gamble**, Director, Sovereign Group, Fitch Ratings; **Sam Hewson**, Head of Northern Europe Corporate FX Sales, Citi; **Britta Hion**, Managing Director, Blackrock; **Corina Keller**, Head of Cash Management, ALTANA AG; **Jenny Knott**, CEO, Standard Bank; **Joakim Lidbark**, Director, Global Head, CitiFX Corporate Solutions, Citi; **Gareth Lodge**, Senior Analyst, Celent; **Almudena Lombardía Escudero**, Treasury Administrator, Shared Service Centre, Gas Natural Fenosa; **Andrew Long**, Deputy Chairman and CEO, HSBC Bank Egypt; **Rick Martin**, Group Director, Treasury and Investor Relations, Virgin Media; **Helen Mason**, Director, Head of Commercial Cards EMEA, Bank of America Merrill Lynch; **Christian Mnich**, Director, Solution Management, SAP AG; **Karl Nolson**, Managing Director, Debt Finance, Barclays; **Hugo Parry-Wingfield**, Investment Director and EMEA Head of Liquidity Product, HSBC Global Asset Management; **Robert Pehrson**, Global Head of Liquidity Products, SEB; **Nancy Pierce**, Senior Vice President and Manager, Treasury Management Product Management Group, Capital One Bank; **Yuri Polyakov**, Head of Financial Risk, Lloyds Bank; **Ade Potts**, Managing Director, Experian; **Michelle Price**, Associate Policy and Technical Director, the Association of Corporate Treasurers (ACT); **Maeve Robinson**, Assistant Treasurer, Omnicom Group; **Lisa Rossi**, Managing Director and Global Head of Structured Liquidity Products (SLP), Deutsche Bank; **Maia Rushby**, CEO, Diversity in Leadership; **John Salter**, Managing Director, Cash Management and Payments, Lloyds Bank Commercial Banking; **Sarah Saxby**, Treasury Director, Cash Management, Rio Tinto; **Jodi Schenck**, Managing Director, Global FX eSolutions, Citi; **Neil Schloss**, Vice President and Treasurer, Ford Motor Company; **Gabrielle Schumacher**, Treasury Manager, Expo International Group; **Filipe Simão**, Head of Client Advisory, Cash Management, BNP Paribas; **Anthony Skinner**, Director and Head of MENA, Maplecroft; **Mikko Sopenan**, Director of Treasury, Light-On Mobile; **Marilyn Spearing**; **Klaas Springer**, Director of Corporate Treasury, Royal FrieslandCampina; **Paul Stheeman**, Independent Consultant; **Lisa Tierney**, European Treasury Manager, Luxottica; **Brian Titus**, Treasury Cash Analyst, SABMiller; **Marcus Treacher**, Global Head of eCommerce, Payments and Cash Management, HSBC; **Pam Walkden**, Group Treasurer, Standard Chartered Bank; **Scott Walker**, VP and Assistant Treasurer, Tech Data; **Susan Webb**, Managing Director, Pfizer; **Joerg Wiemer**, CEO, Treasury Intelligence Solutions; **Gary Williams**, General Treasury Manager, Mitsubishi Corporation International (Europe) Plc.



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