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January/February 2023

Breaking up is hard to do

Tales from the frontline. As decoupling gathers steam, companies are seeking dual supply chains.

The Corporate View

Rene Bustamante

Staff Vice President & Assistant Treasurer, Global Cash Management

FedEx Corporation

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LATAM's digital revolution

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Volume 25/Issue 1
January/February 2023

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Annual Membership Rate £285
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© Treasury Today ISSN 1466-4224

Treasury Today is published bi-monthly
(6 issues) by Treasury Today Limited
Courtyard Offices • Harnet Street
Sandwich • CT13 9ES • UK

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Treasury Today USPS: (USPS 023-387) is published bi-monthly by Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES, UK.

Subscription records are maintained at Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES, UK.

Treasury in a changing world

Treasury is constantly subject to change and in this edition, the first of a new year, the theme of change and how best to navigate it runs throughout. Our Insight and Analysis feature reports how companies are diversifying their supply chains out of China, building a dual supply chain to better navigate geopolitical, ethical or logistical risk. "Almost all our customers want to hear that we are opening other factories outside China. This seems to be the winning formula," observes Jacob Rothman, President and CEO of Velong Enterprises, a China-based manufacturer of kitchen and household products for export. Picking up Velong's Chinese supply chain and dropping it in another country like Turkey or Mexico is far from easy, and Rothman shares his approach to this seismic change.

Technology continues to reap profound change, none more so than AI. This edition explores how treasury is using AI particularly around cash flow forecasting, optimising hedging decisions, forecasting the parameters of the markets and improving data quality, but also flags how AI doesn't come without risks or ethical considerations.

The ongoing transition from Interbank offered rates (IBOR) and evolving ESG regulation are front of mind for most treasurers. The transition to risk-free rates (RFR), or alternate reference rates (ARR) will remain a priority over the next 12 months although our interviewees report this transition is increasingly viewed as business as usual. In contrast, the climate transition is a growing risk and priority with ESG likely to have a significant impact on treasury, driven by financial institutions and corporate policies.

ESG also features high in our exploration of the key lessons treasurers have learnt during the last 12 months – and their focus in the year ahead. Alongside sustainability, black swan events, high interest rates to APIs are front of mind.

Lastly, this edition's Corporate View features Rene Bustamante, Staff Vice President & Assistant Treasurer, Global Cash Management at FedEx Corporation. He discusses his unique career path into treasury, the challenges treasurers face in today's environment, his views on emerging technology trends and the importance of giving back to the community, ringing in the new year with a loud endorsement of the importance of treasury and the career fulfilment it holds.

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Breaking up is hard to do: decoupling and how to prepare

China's role as the world's manufacturer is changing thanks to political, ethical, and logistical pressure. The founder of China-based manufacturer Velong Enterprises explains that his customers are calling for a dual supply chain. But lifting up his Chinese operation and dropping it into a new location is far from easy.

For Jacob Rothman, President and CEO of Velong Enterprises, a China-based manufacturer of kitchen and household products for export, the only way to navigate the worrying and deteriorating environment for manufacturers in the country making wares for the global market is to be proactive. "You can either sit here and wait for orders and customers to erode or you can prepare to move manufacturing to different spots around the world," says Rothman, an American who set the company up 20 years ago, speaking from Velong's Shanghai headquarters. "America's left and right are concerned about China, and China is saying it wants to focus on the domestic economy and is going after its top companies in an ideological shift that is worrying for businesspeople," he says.

For Velong's customers, which comprise renowned global retailers and brands, the current situation is a bad dream. But reality is also beginning to dawn. Velong has already set up new operations in Cambodia and India to run alongside its six Chinese factories and Rothman is now scouting new sites in Turkey and Mexico. But customer requests that the company increases safeguards and contingency in a hybrid supply chain based on production in China alongside other locations around the world are growing increasingly urgent. "Almost all our customers want to hear that we are opening other factories outside China. This seems to be the winning formula."

What's happening

A cocktail of escalating China-US tension on everything from trade, technology, and Taiwan to new US and EU sustainability rules, higher Chinese production costs, and the toll of endless pandemic lockdowns is threatening to unravel decades of economic integration between China and the west. All the while China's Dual Circulation Strategy places greater emphasis on its domestic market and targets reduced reliance on exports, driving greater independence and internal focus.

Witness how at the end of last year, ongoing pandemic restrictions upended production at Foxconn's Zhengzhou plant, a place called iPhone City. Like other Apple manufacturer Pegatron, Foxconn has now pledged to increase investment in alternative production facilities in India and Vietnam. The pandemic has taken a huge toll on Velong's 1,200 China-based staff, adds Rothman, describing how international employees have left the company, fearful of being trapped in their homes because of lockdown rules and desperate to get their children back into open schools.

Even if China unravels its zero covid strategy, the political situation makes continued decoupling likely. The US Chips and Science Act has pledged huge investment to boost domestic research and manufacturing in the semiconductor industry and comes alongside throttling back on physical and intellectual exports of cutting-edge technology. The expanding definitions of nationally sensitive industries and technologies has limited foreign direct investment and barred cross border data transfer creating a compliance risk for western and Chinese businesses, explains Amanda Chen, a Partner with RHTLaw Asia's Corporate & Capital Markets Practice who flags ride hailing app DiDi's US$1.2bn fine for violating China's data security laws as a vivid example of what can go wrong.

Add tariffs and new rules to the mix. Companies from camera-maker GoPro to shoemaker Crocs cite new tariffs and other government-driven trade restrictions as their reason for cutting production in China of goods destined for the US and shifting closer to home. Rothman says US tariffs have not been particularly damaging for his business – rather than hurting manufacturing operations in China, he says US consumers felt the pinch of tariffs most. But he notes a changing ethical tide is driving friend shoring and reshoring trends. New sustainability rules are forcing companies to have much better sight of their supply chain like new EU and US laws prohibiting the import of goods made with forced labour with implications for products made in factories in China's oppressed Xinjiang region.

Manufacturers moving out of China and softening US China trade is more drip-drip than on a grand scale and isn't impacting every sector. The US Department of Agriculture reported US farm exports to China hit a record in 2021. Textile and furniture sectors have exited China over the last decade because of costs rather than any wider decoupling trend, and multinational companies will always seek to buy the cheapest, best quality and most quickly produced goods, regardless of geopolitical noise. Still, experts confirm a steady, gradual, diversification trend gathering pace. "Step by step the chain is moving out," says Ivan Lam, an analyst at Counterpoint Research. "It's most visible in consumer electronics and smart devices."

Key considerations

India is one of the most popular destinations for consumer electronic and smart phone groups setting up new production facilities. Building manufacturing operations in India lands companies in one of their biggest markets, explains Lam. "They want to kill one bird with two stones. It's the same reason why they originally set up shop in China." Only India has a similar size population and potential labour force to be the world's new manufacturer, adds Rothman. "Demographics are the most important thing in manufacturing." But he says every new market has challenges compared to China. "The world seems to want Chinese equipment, Chinese engineering, product development, know-how and customer relations, but picking up Chinese operations and dropping them into a new location for the same price is challenging."

Japanese and Korean traditional consumer groups have set up shop in Vietnam. Like South Korea's Samsung, Vietnam's biggest foreign investor and exporter – but it has taken years. Today Samsung accounts for one fifth of Vietnam's total exports from its phones and parts factories in the northern industrial hubs as well as operations in the south where it pumps out fridges and washing machines. "Vietnam wants to be the next China, but it took Samsung ten years to build up its manufacturing base in Vietnam," says Lam.

One of the key benefits of Vietnam is lower production costs compared to China where the strong yuan and a rise in the minimum wage has pushed up costs. Jack O'Sullivan, founder of e-bike company Modmo, speaking to **Treasury Today in 2021**, said one reason for locating his production facilities in Vietnam in a factory in Ho Chi Min was plentiful, cheap labour.

Still, Lam warns that companies must balance cost benefits with the need for a skilled labour force. Manufacturers in China have benefited from a skilled, blue collar work force thanks to government investment which may not be matched in other locations. "Foxconn plans to expand its Indian operations, but they will have to rely on local governments bringing workers into the towns, and local authorities providing schools," he says.

Manufacturers' ability to source product components outside China is another challenge. Mexico doesn't produce the right steel for Velong's range of grilling and kitchen tools, timers and thermometers, for example. At its Cambodian factory, most parts are imported from China anyway, and if tensions in the region rise, shipping out of Cambodia will be challenging.

Most of the work at contract manufacturer Foxconn's Indian production facilities is focused on assembly and packaging even though the plant has been up and running since 2019. Depending on the model, Lam estimates between 40-50% of

> You can either sit here and wait for orders and customers to erode or you can prepare to move manufacturing to different spots around the world.
>
> Jacob Rothman, President and CEO, Velong Enterprises

Foxconn's iPhone components are sourced and shipped from China and assembled in India. "The whole thing needs to change. You don't want to pay shipping costs," he says. It was a similar story at Modmo. Ebike parts were shipped into Vietnam from China, sourced from diverse Chinese suppliers marketing their products on Alibaba. In contrast, many bike part suppliers in Vietnam don't even have websites.

Elsewhere, suppliers scouting new facilities must weigh the cost of land rental and tax policies. Lam notes China's tax policies have "always been favourable" compared to some countries that "charge to export." Companies manufacturing in Vietnam for European buyers benefit from its trade agreement with the EU whereby 99% of tariffs will go to zero over the next six years. Ultimately, relocation will be driven by cost factors and led by incentives from local governments, surmises Lam. "It's a very simple financial calculation that comes down to what a company can gain from shifting out."

Tools

Treasury Today interviewees report a range of strategies and tools for corporates wanting to shore up their supply chain. Echoing the same message Rothman increasingly hears from Velong's customers, RHTLaw's Chen advises corporates establish dual supply chain systems in a strategic overhaul whereby one chain supplies the Chinese market and the other customers in the west. It requires a flexible corporate structure to oversee both supply chains and should include replacement capabilities for each market separately, she says. "Establish a task force to closely track developments and share information in key markets to develop global strategies and mitigate the effects of decoupling."

Other strategies centre around resiliency. Stewart Dunbar, co-author of 'Improving Supply Chains in the Oil and Gas Industry' told Treasury Today that Maintenance, Repair and Operations (MRO) supply chains – prevalent in the energy sector where many supply chains involve replenishing equipment and services rather than making things to sell to an end consumer – can prepare for de-coupling.

The sector sources much of its spare part requirements and equipment from China and struggled to secure supplies during the pandemic. And these groups can't easily switch to near-shoring or manufacture equipment and parts close to production sites because many of the regions they operate don't have the required production capacity, labour or skills. But because oil and gas groups control their own demand, they can be better prepared by putting in place robust maintenance strategies, ensuring capacity (or spares) on hand for critical equipment failures. He also urges MRO treasury and procurement teams to not just view supply chains through a cost lens because sourcing a more durable, better-made component means it will need replacing less.

For corporates identifying new suppliers in new locations, supply chain finance is a valuable tool, says Parvaiz Dalal, Global Head Payables Finance at Citi. Supply chain finance offers new suppliers the ability to access cheaper and consistent funding by leveraging the buyer's strong credit rating and get paid cash when goods ship and are accepted by buyers. "Supply chain finance really does change the gamut around moving from one location to another. New suppliers sourcing finance on their own and putting their own balance sheet on the table is unreliable and costly," says Parvaiz who counsels stressed supply chains are not only influenced by decoupling trends. The pandemic, war in Ukraine and inflation are also to blame.

If decoupling trends gather pace, Dunbar warns against the temptation to return to 'just in case' supply chains. Back in the 1990s, the proliferation of 'just in case' procurement strategies left companies with "millions of dollars" of inventory lying around. "You will pay dearly for 'just In case'," he says. Instead, he suggests strategies like shared sourcing. In this approach, different companies use the same distributor to supply the same item, rather than each company holding inventory. This strategy could also be managed internally within the company. For example, a company could set up its own regional or global spare parts centre that feeds the locations with product as and when, keeping inventory low but ensuring constant availability from a single point.

A comparable type of shared sourcing worked for the oil and gas industry at the height of the pandemic. In some regions, oil groups cooperated sourcing health and safety goods and services in short supply by sharing contractors and equipment. "It was a case of asking your competitor to help you out. No one wants a safety failure in the industry," says Dunbar.

Companies can prepare for supply chain disruption by moving away from contractual relationships with their suppliers, he continues. Rather than have a relationship structured around fulfilling a contract, supplier relationships could be based on partnerships. In turn, companies should understand that a supplier may only have the capacity to fulfil limited customer orders and will do so according to their internal perception of the right customer to serve. "Companies need to change and view things slightly differently," he says.

Helping others is also a byword at Velong. Large state-owned Chinese companies have already diversified manufacturing across ASEAN in China-plus one strategies, visible in the spike in ASEAN exports. However, uprooting and moving production is a Herculean task for the average Chinese manufacturer. Yet these companies make most of the goods stacked on the shelves in western stores. Rothman, unlike his manufacturing peers, many of whom don't speak English and are struggling to renew passports or apply for visas because of government restrictions, is in a position to scout new facilities, figure out logistics and test pricing and the availability of raw materials and labour. It's why he's exploring new manufacturing sites in Mexico and elsewhere, not only for Velong, but for other Chinese manufacturers across an array of sectors. ■

Successful cash management in a challenging environment

Given the current challenging economic climate, how can companies improve their cash management and streamline payments and collections? In a recent webinar, experts from Bottomline Technologies shared their thoughts.

Charles Bennett

Head of Commercial Product

Kevin Grant

CRO Corporate Solutions

Leo Gil

VP of Product

Cash forecasting is often cited by treasurers as their number one pain point. And in today's environment, there is more pressure than ever for treasury teams to improve cash management by accelerating their digital transformation. A recent webinar by Treasury Today and Bottomline Technologies looked at current challenges in cash management, and how businesses can harness technology to drive improvements.

The move to automation

"Forecasting was a problem 30 years ago – and forecasting is a problem today," noted Kevin Grant, CRO Corporate Solutions at Bottomline. In today's landscape, he said, globalised supply chains and ecommerce mean that companies' cash balances and customers are both now global, rather than local.

"The challenges of cash forecasting and cash management are only going to get harder," added Charles Bennett, Bottomline's Head of Commercial Product. In the early days of the pandemic, he said, many companies found that changes in working patterns necessitated a move away from paper-based payments. With payment types proliferating in number, and the speed of those payments increasing, Bennett believes businesses that have embraced automation and digitisation have fared much better than those still relying on spreadsheets.

The trend towards digitised payments has continued since then, driven by economic uncertainty as well as by a desire for greater efficiency. As part of that trend, companies are embracing new payment types. "In the UK, a good example of that is open banking," Bennett notes. "We are seeing it as a very cost-effective alternative to more traditional payment rails like cards." Because reference numbers can be hard coded into transactions, he added, the speed and ease of reconciliation is greatly increased.

A balanced approach

Leo Gil, VP of Product at Bottomline, explained the different ways that businesses have responded to digital transformation, from adapting existing systems by combining ERPs and spreadsheets, to investing heavily in large treasury systems with long implementation cycles. By working closely with its customers, he said, Bottomline aims to take a balanced approach between the two solutions. Rather than requiring a large-scale and costly implementation, the firm's focus is on supplying tools with capabilities that meet the requirements of the business.

Gil believes that prioritising simplicity and ease of use over myriad functions and features should be the first step when it comes to adopting automation. Rather than completely reengineering their processes, and undergoing extensive and costly implementations, businesses need to take a more pragmatic approach. "We encourage our customers to leverage our SWIFT capabilities," he explained. "We can pull all of their account balances across hundreds of banks into one place in a matter of weeks."

When processes are built in a controlled and considered way, they can then be developed gradually on an ongoing basis. Starting with cash visibility as the first step, processes like forecasting, payments and reconciliation can be added later, along with liquidity management, trade finance and foreign exchange.

The way ahead

Grant explained that although high level data gathered quarterly may have been sufficient for treasuries in the past, what businesses now require is much more detailed and up-to-date information.

Acknowledging that fragmented technology platforms can result in poor visibility, he noted that when processes are intertwined, "large volumes of high-quality data can be viewed in near-real-time, leading in turn to better informed decision-making." In North America, where cheque payments are more widespread, Bottomline has seen a big drive towards digitisation and has continued to build on its digital B2B payments network Paymode-X.

While cost savings can be made by putting automated tools in place, Grant cautioned against losing in-house expertise, noting that automation should be used strategically as a way of redeploying staff from manual processes to more analytical work. "We've got tools which are simple in terms of the functionality, but they're very capable in terms of the volume of information they can handle, allowing millions of transactions to be processed and reconciled," he concluded. "You cannot do that to the same level of efficiency with an army of people." ■

If you missed the webinar and would like to hear the full recording, this is available at ***treasurytoday.com/webinars***

Treasury priorities in 2023

What lessons have treasurers learned during the last 12 months, and what will they be focusing on in 2023? From black swan events and high interest rates to APIs and ESG, here are some of the topics that will be top of mind for treasurers in the year ahead.

If a week is a long time in politics, a year is a long time in treasury. In the wake of the pandemic, treasurers may have been expecting a calmer year in 2022 – but the events of the last 12 months have brought numerous challenges of their own. As the new year begins, what lessons can treasurers take from their experiences in 2022, and what goals and challenges will they be focusing on in the year ahead?

The year that was

"I was asked 12 months ago what 2022 was going to be like, and we had a completely different 2022 in mind," says Patrick Peters-Bühler, Principal, Emerging Markets at Citi Client Advisory Group. "We had the impression that everybody would be working on the post-Covid period – working on technology, and the opportunities that were there. But it was a year that turned out to be a perfect storm for treasurers."

Peters-Bühler adds that in 25 years, he can't ever recall so many different issues happening at the same time in one year. "We see that both on the funding side, with the increases in interest rates that were quite unexpected and quite steep," he comments. "And we see it on the working capital side, because we did expect that after the scarcity of goods and commodities during the pandemic, that matters would settle down in 2022. Again, that didn't happen – not because of supply chain issues, but because of the Ukraine war, that started in January 2022."

Black swans and the new risk environment

Indeed, the experiences of the last couple of years have underlined the importance of being prepared for the next black swan event. As Peter Cunningham, Managing Director Head of Corporate, Commercial and Public Sector Sales & Marketing, EMEA at Citi, noted in a recent Treasury Today article, "A lot of unexpected things have happened in the last few years, and when we look forward, the crystal ball is fuzzier than it's ever been."

He adds that the more optionality treasurers can have in their operating models, the better – from FX risk management and hedging to having the right technology in place and working with the right number of banks to achieve the level of flexibility needed.

At the same time, treasurers will need to adapt to the new risk environment. Peters-Bühler notes that last year's events have highlighted the importance of managing FX risk effectively – "for example, the UK's currency lost 15%-20% of its value, which meant that most commodities just became 15%-20% more expensive."

Jack Duffy, Assistant Director, Treasury Advisory at Deloitte, adds that with the return to a >1% base rate environment combining with increasing FX volatility and political instability for the first time in years, "corporates are starting to look harder at their risk policies in the context of today's market, and ensuring that their technology supports them every step of the way."

He explains this can be something as simple as codifying hedge policies to ensure real time compliance, "all the way through to advanced risk metrics like value at risk (VaR) and cash flow at risk (CFaR) where corporates with a large range of exposures can take advantage of natural hedging and more insightful risk metrics effectively in turbulent times."

Harnessing higher interest rates

That said, the environment of 2023 comes with opportunities as well as risks – and for treasurers, the return to higher interest rates marks a significant shift compared to the low and zero rate environment that has persisted since the 2008 financial crisis.

"At Wolters Kluwer, every three years we reassess our strategy and develop a new three-year plan that considers market trends, competitive development, technology changes, and other opportunities and challenges," says George Dessing, EVP Treasury & Risk at Wolters Kluwer, which provides professional information, software solutions and services for sectors including healthcare, tax and accounting, and governance, risk and compliance.

When it comes to supporting the strategic plan via capital allocation, Dessing says the company tries to strike a balance between investments in the business and returns to shareholders, "all under the assumption of maintaining optimal debt leverage." From a treasury point of view, he notes, "this capital allocation is occurring within a significantly heightened interest environment, which we expect will remain in the near future."

After years of negative or minimal interest yield, he says the organisation should now be paying closer attention to everything from payment terms and money market investments to working capital for the business units.

Talent and skills

Britt Jensen, Principal, EU & UK at Citi Client Advisory Group, notes that new ways of working in the wake of the pandemic, including remote and hybrid working patterns, are presenting additional challenges. "There is also a lot of concern about future skills," she says. "All the new technology coming into the market will require an additional skillset in treasury, compared to what we've seen in the past."

As she points out, these skills are useful not only in treasury but also in other areas – "which means we suddenly see a market which is far more competitive in terms of attracting, retaining and building on those skills."

Likewise, Royston Da Costa, Assistant Group Treasurer at Ferguson plc, notes the significance of a new generation – Gen Z – entering the workplace. "As each year goes by, the benchmark for technology for new entrants into treasury inevitably goes up," he comments. "Can corporates really afford to justify not implementing technology like a treasury management system (TMS) to manage their workflows?"

Technology and APIs

On the topic of technology, David Stebbings, Head of Treasury Advisory at PwC, notes that many companies are currently looking at their treasury technology, certain of them prompted by the need to upgrade their ERP systems, and by changing requirements and needs. With potential recession on the horizon, he says, CFOs don't want to spend money on change – "unless they can save some money or solve a pain point."

There are many reasons why corporates might buy or upgrade their treasury technology. "Obviously control continues to be an important driver, but cost savings are often key," Stebbings observes. "Many cite resourcing and banking costs. but with higher interest rates the opportunities to save on interest cost by using technology to better manage cash have increased."

On another note, he says the market volatility of the past year and concerns about the impact of future black swan events have given many CFOs a better feel for the potential effects of treasury risks not being managed properly. "All in all," he notes "the business case for treasury technology is somewhat better than it was a year ago."

Where specific technology trends are concerned, the use of APIs in treasury continues to be a hot topic. Da Costa predicts that in 2023 this will be "a huge part of the Open Banking initiative taking off, with corporates taking advantage of real-time data and improving cash visibility."

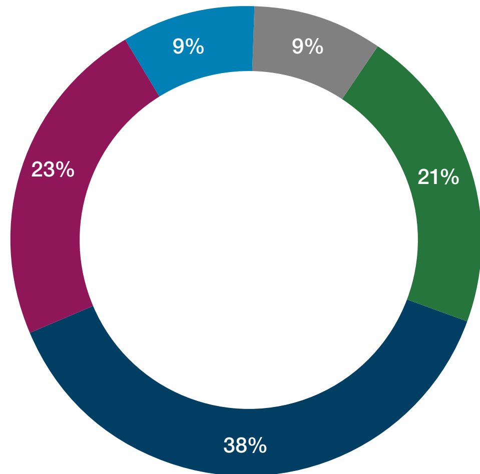
Duffy says that corporates are continuing at pace to replace file-based solutions for their statements and payments with real-time API connectivity with their banking partners. "Now more than ever, corporates cannot continue to rely on prior day information for their positioning and decision-making with regards to cash," he says. "A high inflation and interest rate environment presents very real opportunity cost for any corporates that do not have real time insight into their balances."

On the topic of payments, he notes that it is crucial for corporates to maintain a solid reputation as partner to suppliers and customers, adding that payment APIs help to ensure real-time and reliable payment connectivity to the benefit of the entire community. "The intense focus on this is highlighted on every system vendor's roadmap as a high priority going into 2023," he says.

Real-time treasury vs on-time treasury

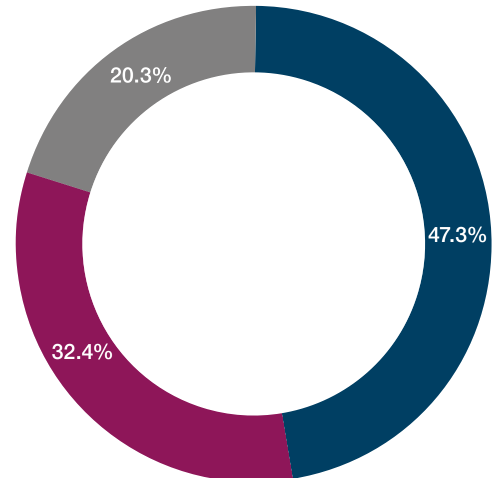
But while real-time treasury may be a hot topic, Chris Jameson, head of Product Management, GTS EMEA at Bank of America, argues that not every company is focused on the need for real-time payments around the clock.

How significant is impact of ESG on the treasury agenda?



Not important at all
Very important
Slightly important
Extremely important
Moderately important

Do you have any treasury KPIs linked to ESG?



No
Yes
No KPIs today, but we plan to use in the future

"Based on client feedback, this year our dialogue with clients will centre around 'on-time treasury', rather than real-time treasury," he says. "Many of our large corporate clients have got existing technology, infrastructure and processes geared up for batch processing of payments, a good example being that most of our corporate clients know that they're going to pay their employees' salaries in three weeks' time. So are real-time payments really necessary in all instances? An on-time payment might be more relevant, and more cost effective in the majority of cases."

For example, he says there is a growing focus on using commercial card rails to pay suppliers on time, while enhancing working capital for the corporate. "The key is really to understand the client's need, and not force real-time payments when actually that may be contrary to the working capital benefits they are looking to achieve," he adds.

Incorporating ESG considerations

Finally, no summary of topics in the coming year would be complete without a mention of ESG. Indeed, Da Costa describes ESG as "the most important topic" for corporates and treasury departments, both today and in the future. "Corporates need to improve their carbon footprint, and treasurers need to consider the various options available in the market – eg green bonds and green revolving credit facilities (RCFs) – when supporting their companies' drive to reduce their carbon footprint," he adds.

"In our new strategic plan, we plan to advance our performance and capabilities around ESG," comments Wolters Kluwers' Dessing. "On the environmental front, we continued to execute on two key programmes that reduce our emissions: reduction of our global office footprint (m2) – by over 10% in the last two years – and our cloud migration program, ie, decommissioning of on-premises servers." He adds that ESG KPIs are part of the company's senior management remuneration, as well as being included in the company's €600m multi-currency credit facility.

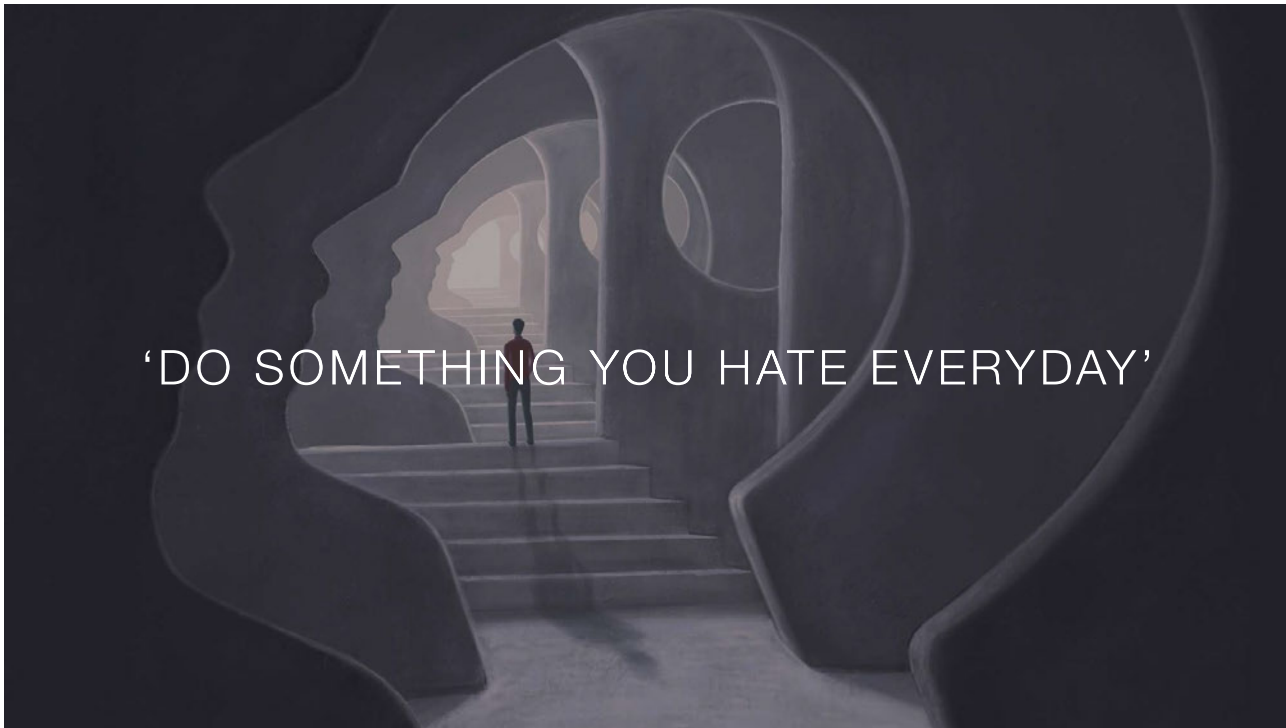
Baris Kalay, head of Corporate Sales, GTS EMEA at Bank of America, says that ESG is now "central to every client discussion we have – even on an RFP, clients are asking the bank abouts its ESG policies, because they want to make sure they are working with banking partners that are aligned with their goals."

Kalay also highlights the role that supply chain finance can play in helping companies further their ESG goals. As he points out, companies can use supply chain finance to allocate working capital to their suppliers in an efficient way, while making sure they select ESG-friendly suppliers across their supply chain. "This could be more on the 'E' side, which the industry is getting more familiar with – but there are more discussions on the 'S' side as well," he adds. "This includes making sure that women-owned or minority-owned enterprises are identified and recognised."

On another note, he says the bank is looking at different ways to incorporate ESG considerations into its products and offerings, for example by issuing commercial cards that are made from recycled plastics.

Conclusion

While the environment looks likely to remain challenging in 2023, the lessons learned during the last 12 months will mean that treasurers are better placed to overcome the hurdles that lie ahead. Meanwhile, the evolving landscape is set to bring plenty of opportunities, from higher interest rates to the latest developments in technology. ■



A newly released bestseller by David Goggins, a man who has run a 100-mile race on broken feet, outlines how it is possible to overcome adversity and achieve greatness with the power of the mind. As he explains, it is all about sucking it up and callousing the mind.

If you think you're having a difficult day, or life even, then it might be worth considering that you're not even using 40% of your capabilities; you could achieve and do so much more if you just set your mind to it.

That is the theme of a recent book Never Finished: Unshackle Your Mind and Win the War Within by David Goggins, a man who underwent a spectacular transformation himself from an overweight loser to a star Navy SEAL and ultra-endurance athlete.

This certainly isn't a 'be kind to yourself' sort of self-help book. It's more of a 'wake up call, suck up the pain and do things you hate' kind of book. It has a sweary bootcamp style, which at times makes for gruelling reading. It is also, however, an inspiring read that demonstrates anything is possible if you focus your mind and have steely determination.

That's what Goggins was able to do. In his first book Can't Hurt Me he tells a remarkable story of overcoming a childhood where the odds were stacked against him: poverty, racism, physical abuse by his father, a heart defect that required multiple surgeries, as well as learning difficulties and a stepfather who was murdered.

By the time he was 24 he was overweight and realised he was at risk of wasting his life. From there he transformed himself into a candidate for the US Navy's special operations unit and went through the brutal Navy SEAL's 'Hell Week' initiation. He managed to turn his demons into a positive force. "I'm haunted by my future goals, not my past failures," he writes.

These days he likes running super long distances and regularly finishes in the top five in ultra-marathons. He is also a Guinness World Record holder for the most pull ups in 24 hours. If you're wondering, he did 4,030 in 17 hours.

At times his account feels like a masochist's guide to working out. But he thinks that you can achieve such greatness – even if your goals or objectives are different. "The pain that you are willing to endure is measured by how bad you want it," he writes.

To transform your life, you don't need to enter a 100-mile race, and you certainly don't need to do it with fractured bones like he has done. And Goggins is not a fan of self-help books – they are only about improvement, he argues. What most people need is much more than that: you need to reignite belief, 'the flicker in the darkness' that can spark your transformation.

Goggins argues he has not accomplished what he has because of his potential. In fact, he argues, his potential was so well buried when he was younger that no one could see it. "Not only did I find it, I learned to maximise it," he writes.

His latest Never Finished book lays out his Mental Lab, a kind of roadmap that others can use to inspire them to harness the power of their mind and transform themselves. And he argues the task is an urgent one; life is ticking away by the second and should not be wasted. In fact, he argues, if you waste one of the 86,400 seconds in a day, that could change the outcome of your day – and your life even.

He urges his readers to have the mental endurance to do whatever it takes to achieve your goals. "You are the warden of your life," he writes. He also has advice on 'The Art of Getting Hit in the Mouth'. If you are preparing for New Year's resolutions and were intending to take a 'be kind to yourself' approach, then this isn't the book for you. ■

Walking the regulatory tightrope

Treasurers face a plethora of regulatory compliance obligations, many of which are focused on ESG themes.

The ongoing transition from interbank offered rates (IBOR) and evolving regulations related to environment, social and governance (ESG) are among the regulatory obligations of most concern to treasurers.

The majority of respondents in Deloitte's Global Treasury Survey – 61% – said the transition to risk-free rates (RFR), or alternate reference rates (ARR) would 'most likely' affect their work in treasury over the next 12 months. Deloitte noted in the survey that the transition is in progress at the corporate level across countries and is likely to become 'business as usual' in the near future.

ESG regulation, on the other hand, will become much more prevalent, said Deloitte. Sixty percent of respondents cited ESG as likely to have a significant impact on treasury, driven by financial institutions and corporate policies.

Treasurers in the UK should also be aware of the upcoming Corporate Reporting Reforms, says Aisling Kavanagh, Head of Deloitte's Treasury Assurance Practice. "The reforms seek to drive trust in corporate reporting and business through improving transparency and the nature of information provided," she says.

In May, the UK Government announced a revamp of the country's corporate reporting and audit regime. The reforms include the creation of a new regulatory body and the introduction of greater accountability for big business.

The regulator will be tasked to reduce the risk of sudden big company collapses, said the Government. In 2018, construction giant Carillion collapsed, leaving £7bn of debts. A £1.3bn claim on behalf of the contractor's creditors, brought by the official receiver, is under way, with the receiver alleging that Carillion's auditor, KPMG, failed to properly audit the accounting of 20 significant contracts.

There are several measures proposed within the reforms, says Kavanagh, some of which will require the support of the treasurer to implement. "One of the key measures will require directors to make an explicit statement on the effectiveness of internal controls and the basis for that assessment will be included in the annual report. As a starting point, treasurers will need to work with the wider business to evaluate and confirm the robustness of the existing risk and controls framework within treasury and will likely need to support this assessment on an annual basis."

Additionally, the replacement of the current viability statement with a new resilience statement will require companies to report on matters that they consider a material challenge to resilience over the short and medium term. "Many treasurers will already support going concern and the viability statement, however the level and nature of detail provided is increasing. Treasurers may need to provide additional support in relation to forecasting, stress tests and provision of quality data," says Kavanagh.

She adds that guidance and timelines for implementation of the UK reforms "are constantly evolving. However, given the volume of upcoming change, there are some 'no regrets' activities that a company and the treasurer would benefit from – ahead of further guidance." Meanwhile, in the European Union, the European Commission is assessing corporate reporting, with an impact assessment based on consultation scheduled to be issued before the end of the year. The assessment will cover problems with the quality of corporate reporting and compare possible options to remedy these problems.

ESG and treasury

Reporting requirements are also a significant aspect of ESG activities, particularly regarding the environmental impact of companies' activities and treasurers have a role to play. The mandatory Task Force on Climate-related Financial Disclosures (TCFD) were created by the Financial Stability Board to improve and increase reporting of climate-related financial information.

At a recent ACT roundtable, delegates heard that while ESG ranks high on the public agenda and for policymakers, as well as in conversations between treasurers, their banks and advisers, investment in "ESG-friendly vehicles" remains relatively small compared to standard alternatives. A challenge to the adoption of ESG solutions is the level of subjectivity and numerous methodologies that can be applied to achieve different outcomes, making it difficult for treasurers to assess the credibility of solutions in a consistent way or to align with their corporate sustainability objectives.

A considerable challenge is the lack of data and comparable credit ratings for ESG investment vehicles. While issuer credit ratings are widely accessible to investors, says the ACT, access to specialised ESG data remains "limited and expensive", meaning a comprehensive view on the sustainability of an issuer is the preserve of only the most well-resourced investment managers.

This issue was raised at an ACT roundtable earlier this year, where participants said a paucity of credible ESG money market funds (MMFs) and a lack of scale to support the largest investors, plus an inconsistent use of peer and investment universes for comparisons on which to base decisions, were all factors to consider.

Participants heard that while ESG has become much more prominent in business and treasury, it is not often the primary consideration for treasurers' day-to-day decision-making. When it comes to where they place their money, participants argued, a treasurer's overarching remit to preserve capital and liquidity remains the priority. What has changed, they said, was the level of visibility of ESG and the onus to report on whether or not considerations of ESG factors played a role in the investment decision-making process.

Ernst & Young's most recent CFO Barometer found that almost 55% of all companies report sustainability information, although 80% indicate that they are not obligated to. Companies want to be prepared for the future standardisation and integration of sustainability reporting, says EY, but there is still "some catching up to do, as people seem to underestimate the work that needs to be done and the time window in which to do it".

EY noted that "not every" CFO is familiar with the EU Taxonomy Regulation, which has created an EU-wide classification system that provides a common framework for identifying which economic activities can be considered "environmentally sustainable".

"First and foremost, the Taxonomy links sustainability with financial KPIs, which is why the CFO is so important," says EY. "Only in the next step does it make sense for the CFO to take a step back and for a dedicated sustainability management profile, like a Corporate Sustainability Officer (CSO), to take the reins. Such profiles exist within corporations today but to a limited extent. The idea is that the CSO works closely with the CFO, the latter acting as a financial advisor. In any case, the CFO must stay involved, for one thing, because an integrated report is needed."

Deloitte's Treasury Survey assessed the role of treasury in organisations' ESG strategies. A majority (51%) said treasury helped to promote a "diverse and inclusive workforce". The issue of sustainable debt instruments – such as green bonds, sustainability-linked loans, and social bonds – was cited by 42% of respondents.

Other ESG-related roles identified by treasurers included revisiting policies and procedures to improve sustainability, investing in sustainable investment instruments, applying ESG requirements for counterparties, following ESG requirements proposed by financial institutions, and replacing inhouse data with cloud computing. Only 15% of respondents said they were not involved in their firms' ESG strategies.

Global bank J.P. Morgan identifies nine areas of activity for treasurers in supporting a firm's ESG strategy. These include reviewing the company-wide ESG strategy to understand core ESG priorities like greenhouse gas reduction and net zero carbon emission targets and sustainability development goals. Treasurers should establish an ESG stakeholder working group to evaluate ESG priorities across treasury partners in addition to benchmarking ESG performance to understand how third parties such as rating agencies view ESG performance and benchmark against industry best practices.

Further, treasury policies should be reviewed to identify ESG factors to improve and drill-down into financial targets across daily treasury activities. Treasurers should create transparency around current and future state targets with reporting on internal metrics and external scorecards and engage with partners to regularly test whether proofs of concept have helped.

Know your customer (KYC)

Governance – the G in ESG – has particular relevance for treasury. During a European Association of Corporate Treasurers (EACT) panel discussion, Noëlle Belmimoun, Senior Legal Counsel at ArcelorMittal, said of the more stringent regulatory regimes that require more information about customers, "strangely after so many years, we still face a heavy administrative and time-consuming burden. The situation is the same as seven years ago, with many non-standardised requests for information. Financial institutions are working to develop standardised documentation, but we have seen no improvement in this area and we all struggle to accommodate bank requests."

KYC is a significant element in the fight against financial crime and money laundering, and customer identification is the most critical aspect of it. International regulations influenced by standards such as those developed by the Financial Action Task Force (FATF) are implemented in national laws. EU directives such as the AML IV and V require financial institutions to verify the identity, suitability, and risks involved with maintaining a business relationship.

At the practical level, Belmimoun said, KYC has had a negative impact on the company's relationship with its banking partners. How a bank handles KYC is now one of the criterions that the company assesses before entering into a relationship.

Séverine Le Blévennec, Global Head of Treasury, Aliaxis, believes a lack of harmonisation between banks and companies is an impediment when it comes to KYC. "We are looking at how we can automate the exchange of data and retain fewer staff to deal with the data that cannot be automated. Technology could help us even more here."

Tarek Tranberg, Head of Public Affairs at EACT, said regulators walk a tightrope between encouraging innovation and forcing adoption of standards. Regulators are looking to identify where there is scope for harmonisation and the removal of duplication in KYC rules. "Regulators realise that KYC compliance is very burdensome and that in the past there has been too much room for manoeuvre in individual EU states. They are looking to harmonise all requirements from the top down and develop a regulatory instrument across all members states to avoid the additional burden of minutely different requirements across member states. But this will take a number of years."

Threat or opportunity?

François Masquelier, EACT, recently wrote that in general, most treasurers see regulations or their amendments as a "threat and a financial and administrative risk". They might involve more expensive financing, more expensive coverage, more documents to produce more quickly and tax restrictions.

However, regulation, even if it is restrictive, can have benefits, notably that of making markets more transparent, efficient, competitive, accessible, resilient, and less subject to systemic risks. "These are positive effects that are often overlooked and yet are essential," he wrote. "Who wouldn't want a more resilient financial system that is less subject to systemic risks? We believe that any regulation can be an opportunity to revisit its procedures and processes and consequently strengthen its internal controls." ■

Delivering excellence

Rene Bustamante
Staff Vice President & Assistant Treasurer, Global Cash Management

Headquartered in Memphis, Tennessee, FedEx Corporation is an American multinational transportation, e-commerce and business services company. Founded by Frederick W. Smith, it began operations on 17th April 1973. With more than 540,000 team members, and annual revenue of over US$94bn, FedEx has grown to become one of the world's largest courier companies. According to the latest available statistics from the International Air Transport Association (IATA), FedEx is the world's top cargo airline, with over 20 billion cargo tonne kilometres per annum.

Rene Bustamante, Staff Vice President & Assistant Treasurer, Global Cash Management at FedEx Corporation, discusses his unique career path into treasury, the challenges treasurers face in today's environment, his views on emerging technology trends – and the importance of giving back to the community.

"I view myself as a very fortunate individual, being able to work in an area as fascinating as treasury," says Rene Bustamante, Staff Vice President & Assistant Treasurer, Global Cash Management at FedEx Corporation. "What I enjoy most about treasury is that it's always evolving. There is never a dull moment."

Nevertheless, Bustamante says that treasury was not the first stop on his career journey – and in fact, his career has taken him through three very different worlds: the academic sector, public service and private enterprise. After moving to the United States from El Salvador, he studied at the University of Memphis, graduating with a Bachelor of Business

Administration in Economics. It was while he was working for his Master of Arts in Economics at Memphis that he started to teach courses in economics at the university, something that he continued to do on a part-time basis until 2004.

Intent on gaining a PhD in economics – and with an interest in law, economics and industrial organisations – he chose as his graduate level dissertation an analysis of the merger between Delta and Northwest Airlines from an anti-competitive standpoint. "Given my research, and the work that I had done at the university with professors – both in economics and in the law school – I then went to work for the Federal Trade Commission in Washington, DC, as an economic research analyst in the antitrust division," he recalls.

At the FTC he performed economic and statistical analysis, supporting lead economists in antitrust investigations in a number of different industries. In addition, he conducted extensive research, writing reports on competition policy, industrial development and privatisation reform for Latin America and Eastern Europe in order to further the FTC's advisory role in those regions. "It was fascinating work," he says. "I had a tremendous respect for the people who worked there. I learned so much from them."

New horizons

Bustamante worked at the FTC for three years, initially intending to work on his dissertation and finish his PhD in Economics while he was living in Washington, D.C. After deciding to change course and work in the private sector, he gained an MBA from George Washington University, specialising in corporate and international finance. "At the time, the international finance piece was really beginning to take off. The Berlin Wall had just come down and markets were beginning to open up," he explains. "People wanted to expand their knowledge, and I was caught up in that."

Next came a spell at Stone & Webster Management Consultants in Denver, Colorado, where he worked as a financial management consultant involved in financial analysis and econometric forecasting. Then, in 1994, Bustamante received a job offer at FedEx and joined the company as a senior financial analyst in the air operations division. With the company based in Memphis – the city that he had made his home since moving to the United States in 1979 – it was a welcome homecoming for him.

After a couple of years, he took up a position in the treasury department. Having had direct experience of the aircraft operations division, Bustamante says that moving from air operations to the financing of aircraft seemed like a natural progression. He recalls: "I worked in an area of the business called structured finance. I was responsible for many of the aircraft leases and real estate leases that the corporation was doing, at a time when it was ramping up its expansion."

In February 2000, Bustamante was appointed to the role of Manager of Corporate Finance, with responsibility for the credit revolver and letter of credit facilities, secured and unsecured financings, management of banking relations, rating agencies, balance sheet and cash flow forecasting. He subsequently became Director of the group in 2007.

Present responsibilities

Bustamante started in his present role as Vice President and Assistant Treasurer of global cash management in the treasury division in 2010. "My responsibilities are the development and oversight of the corporation's global cash management structure and its activities," he elaborates. "I oversee all of the global cash flow movements, cash flow forecasting, banking services, short-term investments and foreign exchange, as well as treasury transformation and technology."

On the global cash management side, the company's treasury department is centrally located in Memphis, with a director overseeing the Americas and the consolidation of all global activities, and a director in Amsterdam overseeing Europe, Africa, Middle East and Asia. "I have a team of professionals based in several cities across the globe, working closely within those regions, to manage the day-to-day cash management activities," Bustamante explains.

Although the team is spread across the world, their activities report directly into Memphis. "This helps us tremendously in terms of how we manage our global cash positions and simplifies how we move cash around the world," he says. "It's been important to create a team culture that is agile and that adapts to the ever changing business and regulatory environment."

Bustamante is keen to emphasise the importance of his team. "The fact that I have this group of professionals that can do the work seamlessly is really an achievement in itself," he says. "Without this group of incredible professionals, I would not be able to successfully run the internal banking operations of FedEx. They are without a doubt the glue that holds it all together."

He also believes that corporate culture is crucial to the success of the business, and should be a positive experience for all. "Obviously we are not the ones generating revenue. We play a support role," he emphasises. "So I need to make sure that my team is ready to serve, and to do the things that will continue to make us a leader in the transportation logistics industry."

Turbulent times

Turning to the topic of challenges in the current market, Bustamante notes the importance of investing in both treasury technology and talent, adding that the treasury team overhauled its platform in 2018. "I'm glad that we were able to jump on those rails quickly," he says. "It has been a tremendous value-add to the team, the company and our customers. But once we are on this journey, we need to continue it – because that is where everything seems to be moving."

Global geopolitical events present another major challenge in today's market. "We have just gone through a pandemic, and are now facing other geopolitical events that are disrupting supply chains and the way that we do things around the globe," Bustamante notes. Fortunately, continually planning for the future and developing contingency plans have long been a core part of the company's culture. "It's something that is ingrained in our training," he says. "What's changed is that there are now different scenarios that you have to plan for."

With the company taking great pride in having developed a culture that looks at primary, secondary and even tertiary backups, he is keen to ensure that the treasury organisation has the same mindset. "We need to be ready to react, pivot

> What I enjoy most about treasury is that it's always evolving. There is never a dull moment.

and keep moving," he says. "That means making sure that the enterprise continues to operate by managing liquidity, and by making sure that we make payments and collect and invest our cash."

Treasury transformation

"If you really want to lead, you need to be strategic and you need to have an understanding of treasury technology and how to deploy it," says Bustamante. "And at the same time, you need to be connected and embedded into the operations of the company."

Since rolling out a new treasury management system, Bustamante and his team continue to make enhancements to the platform. By taking advantage of new developments, he says, the company can ensure it has the tools and resources needed for success. "It's critical for us to continue to invest in anything that is going to be able to help us serve the company better and to evolve," he comments.

With new developments in technology coming thick and fast, Bustamante highlights the evolution of application programming interfaces (APIs) and the rise of real-time payments as being particularly significant. Faster and more transparent data will, he believes, streamline the team's activities in the future. "With APIs delivering real-time connectivity between the bank and the corporation, data can be captured around transactions as they happen," he adds. "It's going to lead to improvements in day-to-day treasury activities – and anything that can help us serve the company better and evolve is going to be critical for us."

Strategic approach

During his time in treasury, Bustamante has seen it develop from a back office operation to a key player in decision making. "The treasurer of the future will need to continue to take a strategic approach, as well as having a seat at the table of decisions taken at the operating level," he says. "But they will also need to understand treasury technology and how to deploy it in the most efficient and cost-effective way possible."

For Bustamante, the continually evolving nature of treasury is one of the things that appeals to him the most. "Change is truly constant in our world," he reflects. "Cash never sleeps, it moves all the time. For an enterprise of our size, operating in 220 countries and territories, you can imagine the demands on just making sure that payments are being made and monies are being collected, that projects are being financed, and that there is oversight on our part."

Significant achievements

Looking back at his career, Bustamante says his most significant achievement during his early years at FedEx was the role he played in leading the financing of many of the company's wide body aircraft and major hub facilities. More recently, he was responsible for the formation of the business's global cash pool overlay in Luxembourg. Indeed, FedEx was named Overall Winner of the Adam Smith Awards 2022 in the Best Cash Pooling Solution category for its achievements in consolidating net excess global liquidity in a USD position, and allowing it to be deployed for investments and funding.

Outside his career at FedEx, Bustamante says that winning the Excellence in Teaching Award from the Fogelman College of Business and Economics at the University of Memphis had a special significance. "Teaching gave me purpose and solidified many of the things that I was applying in my day-to-day job," he recalls. "I was able to help out on a part-time basis and prepare new students for their professional journey. It meant I could give back to the university that had educated me."

Giving back to the community

Bustamante believes that those fortunate enough to be leaders should devote some of their time and energy to serving their communities – an approach that he is committed to himself. Outside of work, he sits on the board of a number of not-for-profit organisations, including the University of Memphis Foundation Board, Leadership Memphis, the Ronald McDonald House of Memphis, and the Mid South Latino Chamber of Commerce in Memphis.

But it is his volunteer work with the Tennessee State Soccer Association and an all-girls football club called Purple Rain Soccer Club that is closest to his heart. "I love going to the soccer fields and spending time with the players, their families and the coaches," he reflects. Having taken the decision 20 years ago to establish the girls football club with just six players, Bustamante has seen it grow to more than 200 young women between the ages of eight to 18.

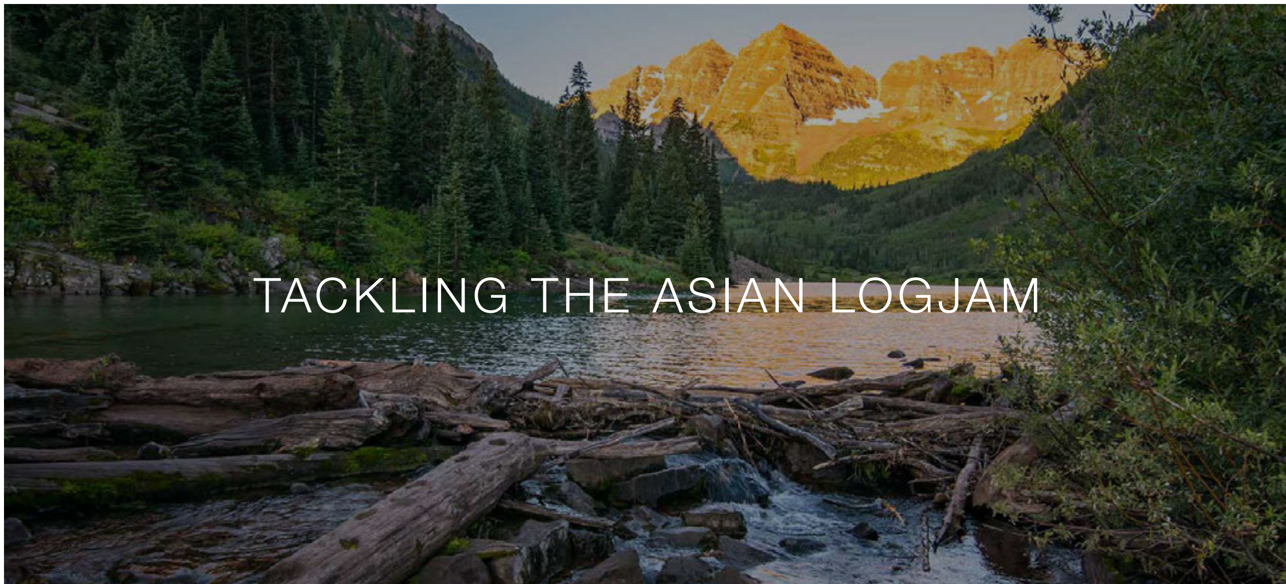
"I'm proud to say that we have the only all-girl soccer club in the state of Tennessee," he enthuses. "The demands of my job mean that I'm no longer coaching. My role these days is to oversee the operation and act as a mentor."

Having been personally involved in all aspects of the club from administrating to coaching and managing the team, he is delighted that the club now has a large number of female coaches. "Many of the players I coached years ago have come back to coach for the club," he says. "Something that I try to instil is the idea of giving back. If you're not there to serve your community, your company, your customers – what are you there to do?"

Last word

Looking back at his career, Bustamante says: "Believe it or not, this year I will be celebrating my 29th anniversary working for FedEx. It has been a fascinating journey. I always say to folks that this journey would not be possible anyplace else but here." He adds that his journey from emigrating from El Salvador in 1979 to reaching his current role at FedEx, and helping to finance the company's expansion, "has been a source of tremendous pride for me."

Finally, Bustamante acknowledges the debt he owes to his wife: "I have also been married to a wonderful partner for 33 years. She understands the things that are important to me, and has supported me throughout this journey," he concludes. ■



TACKLING THE ASIAN LOGJAM

A strategic approach to supply chain management is minimising the negative impact of ongoing disruption across Asia.

In some parts of the world it is almost possible to forget that we have just lived through the most disruptive pandemic in living memory. However, despite moves by China last week to dismantle elements of its zero-Covid policy, the manufacturing sector across Asia is a long way from a return to normal.

A recent report from Coalition Greenwich noted that two-thirds of corporates have experienced supply chain disruptions in the region over the past 12 months. In an interview with CNBC earlier this month, Joe Monaghan, CEO of Worldwide Logistics Group observed that declining container freight rates from Asia were compelling carriers to reduce services to balance supply with falling demand as recession fears increase.

Shipping firm HLS has warned clients that container capacity could fall by 5% or more next year.

However, the Coalition Greenwich report also noted that corporate treasury departments have been implementing adjustments to their supply chains that will have long-term ramifications for businesses, economies and the trade finance industry that supports commerce across the region.

The most common approach has been to diversify the supply chain by adding new domestic and regional raw material sources and alleviating reliance on individual suppliers. Corporates are also working to make supply chains more agile – investing time and capital to enhance their ability to accurately forecast demand and supply – as well as shifting to longer-term contracts with suppliers and shipping companies, increasing inventory levels, and hedging FX and interest rate risk with financial contracts.

Nigel Cole is Product Manager at Golledge, a UK-based supplier of frequency products that exports to more than 50 countries representing more than 60% of its revenue. He suggests that one of the best strategies for countering ongoing logistics and supply chain disruption in Asia is doubling down on supplier relationships, which means "learning to love long haul flights" and investing in regular face-to-face meetings.

"These meetings should be used to understand what is important to the supplier in terms of logistics and production efficiency – using them to communicate only your own needs is a mistake," he says.

Golledge's primary partnerships span 20 years. "There is an obvious temptation to change based on factors such as price, but this will not build loyalty and deliver stability during times of disruption," says Cole. "Building long-term relationships will also help you to understand the correct escalation path and who to turn to when a critical favour is required."

Another useful strategy is dual and triple sourcing. In a move away from the vendor reduction programmes of the past, having more than two suppliers for each item on the bill of materials has become more important than ever, although Cole cautions that companies should avoid spreading business too thinly over multiple suppliers.

"Stocks are of vital importance (it is not just about running lean anymore) and understanding longer-term demand is vital," he adds. "Orders cannot simply cover initial lead times – companies should share forecasts, ramp-up schedules and project lifetimes. If you have invested in the right partner and built a relationship, they will order, take risks with you and commit to reserve or place long-term orders months or even years in advance."

Cole observes that lead times have increased more than fourfold from 12 to 50 weeks. "While they are recovering slowly, companies should keep in regular contact with their partners to understand local issues and updating manufacturing resource planning systems regularly is vital," he says. "Finally, a recent trend gathering momentum is physical investment in key partners. This effectively means buying capacity and this will help to build all-important supplier relationship further." ■

More currency chaos ahead

Regular reviews of FX risk management strategy will be a vital factor in successfully navigating currency market uncertainty.

Kyriba's currency impact report for Q222 underlined the FX risk management challenge facing corporates, noting that the collective quantified negative impact reported by North American and European companies totalled US$37.3bn between April and June – a 126% increase from the previous quarter. This challenge is likely to become even greater next year according to a recent research note from ING, in which the bank's global head of markets suggested that FX trends will become less clear in 2023 and that volatility will continue to rise.

In terms of specific currencies, it has been pretty much all about the mighty dollar this year as it reached its highest level against the pound since the mid-1980s and neared parity with the euro for the first time in 20 years. What is particularly interesting from an FX perspective is the differing stories of inflation from each side of the Atlantic, and specifically that in the US it may have peaked since the country is largely shielded from Ukraine-related gas price spikes suggests Vedanta Hedging CEO, Abhishek Sachdev.

"This is what is driving volatility in GBP/USD," he explains. "We have seen a sharp increase in the cost of hedging GBP/USD beyond the 12 month point."

One of the most concerning observations comes from Michael Quinn, Group Trading Manager at Monex Europe, who refers to an underlying expectation that currency markets are being distorted by temporary factors such as the conflict in Ukraine and the hangover from supply side pandemic shocks.

"However, this expectation that markets will normalise was also there in the aftermath of the global financial crisis, but never actually materialised," he says.

So how should companies go about mitigating FX risks? Amol Dhargalkar, Managing Partner and Chairman of Chatham Financial says the first step is to get a clear understanding of exposures and underlying risks, ideally through a value-at-risk type of analysis which will help companies determine where to focus their mitigation strategies.

"Companies also need clear and early communication, especially during budget season, around new markets they may be entering into," he adds. "Those with existing hedging programmes may be entering 2023 with some rates already hedged at a better rate than the current market environment, which will buy them time, but eventually they will be exposed to the new rate environment."

He recommends that companies who currently hedge continue to do so on the basis that if you stop hedging it can be very difficult to determine the appropriate time to re-enter the market and that there is no guarantee rates will ever return to previous levels.

"Companies may choose to be a little more opportunistic in the execution of hedges to try and 'buy the dip', but even this can lead to dangerous chasing of prices that may never materialise," says Dhargalkar.

Sachdev recommends hedging more frequently for shorter durations and avoiding complex (for example, leveraged) option structures unless absolutely necessary. "It is more important than ever to keep hedging costs as low as possible, since these can quickly add up if a company is hedging a few times a year instead of buying all of their cover for one year at a time," he says.

Whether they hedge or not, corporates would be well advised to address issues such as a lack of reliable FX-related data and forecasts, manual and error prone processes, and poor or non-existent FX results analytics for both cash flow and balance sheet FX risks.

"Companies first need to get visibility into accurate FX data, which means understanding the transactional currency details of both the income statement and the balance sheet," says Scott Bilter, Principal of Atlas FX. "Where the transactional currency differs from the functional currency of any entity where this activity takes place, there will be an FX risk that needs to be monitored or hedged."

During calmer times pre-pandemic some corporates moved towards more exotic hedging products observes Eric Huttman, CEO of Milltech FX.

"In recent months we have noticed many reverting back towards the more straightforward linear products such as forwards, which are more liquid and easier for corporates to unwind should the market move against them," he says. "In our experience, corporates are also hedging a high amount of their exposure and instead of locking in rates for twelve months or more for FX forwards they are shortening the length of their hedging contracts."

The average tenor of the hedges put in place by the 251 CFOs, treasurers and senior finance decision-makers in mid-sized corporates surveyed on behalf of Milltech FX between June and July 2022 was five months, indicating that they are balancing concerns around profit erosion with the need to be nimble in the face of fragile supply chains, weakening consumer demand, and rising inflation.

In the context of the last year or more the dollar is still quite strong across the board. However, we have come off the highs quite a bit in the last two months so protection is worth considering reckons Thomas Anderson, Managing Director for Moneycorp Americas.

"The market is telling us that there will be a lot of volatility through the first quarter of next year, so preparing ahead of time is prudent," he says.

Agreeing on a budgeted exchange rate for the year will help when placing trades observes Joe Jones, Head of Sales at

Cornerstone FS. “This should be done in consultation with an FX specialist and take into account volume and timing of expected requirements, current rate(s), and an educated assumption on future rates,” he adds.

Attempting to call the absolute top of a market in any kind of consistent fashion is impossible, yet leaving a business completely exposed in these market conditions is unsustainable suggests Quinn.

“The final quarter of the year has seen perceived risks subside and a cautious optimism has crept back in to markets,” he says. “Companies have had time to adjust both cost and sale prices to account for the changing economic landscape, while governments have introduced a variety of programmes to support their domestic economies.”

Yet the precise impact of monetary policy changes can only ever be estimated. After over a decade of low interest rates and an increase in monetary supply, it is still eminently possible that central banks have over-tightened and that we could slip in to a global recession next year.

Ivan Asensio, Head of FX Risk Advisory at Silicon Valley Bank suggests the drivers for currency direction will shift away from interest rate hikes and monetary policy next year and on to economic growth. “The key question is whether central banks successfully fight inflation whilst engineering a soft landing, or we are headed for a hard landing recessionary landscape,” he says. “The latter will further aggravate volatility, dampen asset prices, and may result in a rise in the dollar as a result of risk aversion.”

Dhargalkar says companies should plan their strategy assuming the strong dollar will continue. Historically FX rates do tend to revert to the mean, but the timetable to do that is unknown and it is not always clear when we have entered a ‘new normal’.

“A lot of the drivers of dollar strength – rising interest rates, war in Ukraine, European energy costs – are not expected to be relieved any time soon,” he says. “For most companies, the danger of being unhedged and the dollar strengthening further is a worse situation than hedging now and the dollar ultimately weakening.”

According to Gary Slawther, a professional interim treasurer who works with companies with a wide spread of geographies, industries and exposures, corporates need to take a holistic view of FX risk management and recognise the importance of cash management.

“Companies that have traditionally hedged are still hedging,” he says. “Now that interest rates have increased, a lot of treasurers who might not have hedged over the last decade or so are coming under pressure from their boards to change tack, but of course the cost of hedging has also risen.”

Over the last 12-18 months we have seen spot rates rise above forward rates for the first time in many years. However, Slawther says that in his experience most CFOs are not giving in to pressure to change their FX risk management strategy on the basis that no one can predict how rates will change.

“When to comes to FX, if you are right half the time you are doing very well indeed,” he says. “My advice is to have faith in your currency management programme – in some years it will be painful, but in others you will look like a genius.”

One of the most fundamental things a company can do to protect itself against risk is to always have liquidity and this is something CFOs are increasingly telling their boards, making sure their working capital is structurally cash generative and that procurement and sales teams are not offering unrealistic payment terms.

“I have worked for five different CEOs over the last 18 months and they are all focused on improving liquidity, which is great news for treasury because this is an area where our skills and competencies come to the fore,” says Slawther.

This trend also emphasises the importance of treasurers knowing and understanding their business because this will improve their understanding of where the risks and opportunities lie and recognise the traps that can lead to lost liquidity, he adds. “This is a time of great opportunity for the commercial treasurer.” ■

Case study

International publishing company Informa has balance sheet exposures and translation of profits rather than significant FX transaction exposure given that around 80% of its EBITDA is in US dollars or US dollar pegged and that it reports on a consolidated PLC basis explains Group Treasurer, Richard Garry.

“We usually seek to finance out net investment in our principal overseas subsidiaries by borrowing in those subsidiaries’ functional currencies, primarily USD,” he says.

This policy has the effect of partially protecting the group’s consolidated balance sheet from movements in those currencies to the extent that the associated net assets are hedged by the net foreign currency borrowings. Informa monitors the effectiveness of its hedging strategy monthly and reviews any foreign exchange volatility that is coming through the income statement to take additional action where necessary, adds Garry.

“On that basis, this year’s volatility has been no more challenging than any other year as our regular processes have been effective,” he says. “We also conduct an in-depth review of our strategy annually – utilising external expertise to ensure we are taking an independent, robust and up to date view – and again, that did not bring to light any changes required tactically or strategically.”

The business has undergone significant change this year as it divested one of its divisions and this change, combined with the strength of the US dollar, also prompted a review of foreign exchange policy. But that review did not suggest any policy changes were necessary.

Futuristic AI poses unique challenges

Artificial intelligence and machine learning are becoming commonplace in the business world, but there are numerous factors that corporates need to consider before they rely on this technology and do away with the need for humans altogether.

Fans of the Swedish pop group ABBA can now see them in concert and experience them in their heyday of the 1970s, as digital versions or 'Abba-tars'. This virtual concert in London is part of a growing trend of replacing humans with artificial intelligence (AI), and now Korean pop music – or K-Pop – is doing something similar. The group Eternity recently released 'I'm real', an ironically named song that featured its 11 members. And just like the 'Abba-tars', they aren't real or human – they are virtual characters that have been created with AI.

If our basic entertainment is moving in this direction, what about the rest of the business world? Will we need humans in the future? What kind of decision-making will we leave to AI? And if we do that, what could possibly go wrong? Such are the questions of science fiction fandom, but for treasurers – and their corporations – the answers are fortunately a lot more mundane.

The use of AI and machine learning (ML) is consistently mentioned as a major trend by the treasurers that Treasury Today regularly speaks to. Dr Andreas Bohn, Partner at McKinsey and expert in treasury management, risk management and capital markets, explains that the main uses of AI by corporate treasury are for cash flow forecasting, optimising hedging decisions, forecasting the parameters of the markets and improving data quality.

Are these applications risky in anyway? Could the machines be running away with their own learning and make erroneous decisions? "There is always a risk of getting forecasts wrong," says Bohn. He comments that the issues usually relate to the data that the applications draw on. The data quality might not be appropriate, someone might have manually input it, and there might be errors. "The algorithms need to protect themselves against data errors," says Bohn. He adds that applying the human-in-the-loop concept, where AI and ML is developed with the involvement of humans, is important to ensuring that the technology is developed and used in a way where risk appetite, business needs and specifications are aligned.

As yet, it does not seem that treasurers are over-relying on these tools and heading for a science fiction scenario. "If people make mistakes it is more on the reliance of the status quo and not being able to imagine scenarios that would be outside the usual parameters," Bohn comments. For example, during the energy crisis, some were unable to even conceive that energy firms would go bankrupt or that energy prices would skyrocket. "When these algorithms are implemented it is still more in the testing phase than anything else. What I have perceived is that they are used on the treasury side as an additional tool, which is a backup and accompanies regular activities," adds Bohn.

When it comes to the riskier aspects of AI, Ben Rapp, Founder and Principal at Securys, a specialist data protection and privacy consultancy, comments that treasury's use of the tools is unlikely to be a concern. The ethical dilemmas of AI, which are becoming a hot topic for businesses and regulators alike, are more likely to be a challenge for financial institutions than corporate treasury, he notes.

More broadly, businesses are relying on AI and ML for strategic decisions. Andrej Zwitter, Professor of Governance and Innovation at the Netherlands' University of Groningen, says there are some very important considerations when implementing AI as a strategic decision-making framework. With traditional analytics and business intelligence, he explains, it is clear what is going in, in terms of the data, the process that will be applied and the different analytic techniques that will be used – and the outcome is transparent. "With automated decision making there is data scraping, and the quality of the data can often not be assured.

"Also, the process of AI is using convoluted statistics and complicated mathematics is being applied. Because it is so

complicated it is not possible to understand what the decision is based on – it is a black box." Zwitter adds, "There is no way to second guess the advice it gives."

There are numerous examples of organisations making decisions based on biased data. Zwitter points to an example of the Correctional Offender Management Profiling for Alternative Sanctions (COMPAS) tool, which was used by courts in the United States to predict the recidivism rates of offenders. However, it was later shown that this artificial intelligence had an inherent racial bias because it was based on population data from US jails, which had a higher proportion of African Americans. Also, because the software was proprietary, the judges were unable to look into how the judgements about offenders were made, explains Zwitter.

Rapp at Securys also raises this issue of the training of data, and gives the example of Amazon, which had to discontinue a recruiting tool it introduced in 2014 because its predictions of what an ideal software developer looked like used biased data. The machine was effectively learning – and then predicting – that a 'good' candidate was white and male. Rapp explains that once the tool is on this path, it becomes almost impossible to correct it, as you'd have to balance out this bias with an almost equal amount of data – on female software developers, for example – that doesn't exist.

Meredith Broussard, an Associate Professor at New York University and author of More Than a Glitch: Confronting Race, Gender and Ability Bias in Tech says, "There is a perception that using data to make decisions is more objective and more unbiased – that is not true. There is no such thing as an unbiased dataset." She gives the example of financial institutions building a solution that helps decide on who gets approved for home loans; that dataset would use who got mortgages in the past. "What social scientists know about lending is there is a history of discrimination of who has gotten home loans in the past and that past discrimination is reflected in the data," Broussard explains. She points to The MarkUp's investigation into racial disparities in mortgage applications and argues that all businesses should be doing algorithmic accountability reporting to test for bias in the data.

Rapp comments that financial institutions – and other businesses – will have to care about these issues because the European Union will soon be regulating the use of AI, which will cover issues such as transparency and the right of recourse. "There are broad questions about the power and the asymmetry of the relationship with the borrower," he says. "These regulations are going to hugely increase the scrutiny of those systems and institutions are going to be subject to much bigger fines if they cannot show they are being fair."

AI will be categorised in tiers according to its level of risk – ranging from unacceptable and high risk to low or negligible risk – and if businesses fall foul of the regulations they could potentially be fined up to 6% of global turnover.

Rapp outlines some areas that may be challenging for financial institutions. Anti-money laundering transaction screening and the profiling of customers can have a deleterious impact on customers, particularly when there are false positives and a 'good' customer is blocked out of their account based on an automated decision.

Also, there are issues with using biometrics to allow access to a bank account. This could be done through key stroke patterns, or facial features. But if a customer has hurt their finger and can't type properly, or has a black eye – or had recent plastic surgery, for example – they will be locked out of their account even though they are a genuine customer.

When asked if there is an unthinking over-reliance on these tools, Rapp says that the people working with them and implementing them are aware of the ethical issues involved. When it comes to the general public, however, especially if they have watched a lot of science fiction films – they are more likely to think that AI is more intelligent and powerful than it actually is.

Zwitter agrees. "These tools are referred to as smart and intelligent, but these words are metaphors – they have no real meaning. These tools are not intelligent or smart. They are algorithms, essentially mathematical formulas that are based on data and certain rules – there is no intelligence or smartness," he says.

Rapp agrees and says, "They are tools that are trained to do specific tasks. They can be remarkably good at that and seeming smart." In fact, he adds, sometimes when people think AI is being used to answer questions, it is actually a human in a call centre typing a response. And on a similar topic, Broussard recommends Behind the Screen: Content Moderation in the Shadows of Social Media, a book that examines the use of human moderators – and not algorithms – in evaluating posts on mainstream social media platforms.

"AI is great for a variety of applications" particularly automating boring tasks, says Broussard. "However, people run into trouble because they imagine AI can do more than it actually can. When people are imagining that AI is going to be sentient and replace humans they have to keep in mind of what it is good at and not good at – and balance the expectations. Even the name artificial intelligence and ML is misleading – it suggests there is a brain in the computer," she says.

It is easy to imagine that AI will lead us down a path where the machines have taught themselves enough, will take over from humans and the technology will be uncontrollable – the point of singularity. Is this a real danger that we need to be concerned about? Is humanity doomed? On the question of whether we will reach singularity, Zwitter says, "It is impressive what AI is able to do, but we are giving it too much credit – it is literally just zeroes and ones. There is no intentionality or agency; there is no such thing as intelligence with an opinion unless we point it somewhere. There is no reason to believe there will be a point in time where humans lose control over AI – unless we give it all the control and we outsource our moral agency to these tools," says Zwitter.

Broussard agrees that AI doesn't threaten the future of humanity. "One thing I would be concerned about though is autonomous weapons and the commercial availability of food delivery robots – and people doing things like attaching guns to them," says Broussard. She also points to the example of police in San Francisco proposing to allow police robots to kill suspects, which Broussard describes as "a terrible idea". After a similar response from the public, the proposal was reversed in early December 2022.

For corporates and their treasuries, it seems there is no need to worry about the machines taking over. The prospects of a science fiction dystopian nightmare are low, and when they see their favourite musicians they will most likely be human. For now. ■

LATAM's digital revolution

LATAM's digital revolution has transformed payments and enabled new e-commerce business models. Elsewhere a new generation of non-traditional banks have piled into financial services and shaken up traditional incumbents with new offerings for businesses and the unbanked. In an explosive pace of change LATAM is reducing cash use and formalising its economy.

Brazil is the best place to witness the change underway in Latin America's payments landscape. To the beat of samba drums emanating from the country's historic city centres, a new payments system is bringing the unbanked into the formal economy, fuelling growth in a new generation of companies and fundamentally changing the economic landscape. The central bank only launched its flagship payment scheme Pix in 2020 but the network already has an estimated 135 million users (out of a population of 213 million) and has supported around US$190.5bn transactions.

Pix supports the transfer of funds between people, companies, and government entities encompassing the payment for goods in physical stores and online, bill and invoice payment as well as scheduled payments. Small retailers that have always dealt in cash now accept Pix payments while people who have never had a bank card in their life (the IMF estimates over half the young people in Latin America have never had a debit card) can pay for things via their smartphone, using an alias or scanning a Quick-Response, QR Code. Pix is instant, available 24/7 and evolving fast. For example, more business participation, credit transactions and innovation around near field communication to make payments even faster, is all in the pipeline.

Pix's success is linked to a few key factors. Launched by Brazil's central bank rather than a private payment player, it is mandatory for certain institutions to participate. Pix is also inclusive. It has bought different institutions (around 800) from banks to fintechs and credit unions under one, all-encompassing umbrella with the same rules on participation for all. It's free to use unlike the fees attached to direct-debits or credit cards, while merchants deal with far fewer intermediaries. One of its greatest advantages is speed, writes the central bank on its website. Instead of asking for information regarding the beneficiary's account and personal data, the payer just asks for the Pix alias or QR code.

Brazil's success is being closely watched by other countries in the region. Colombia, Argentina, and Peru have launched real-time payment schemes and Chile already has an established scheme. It is also helping fuel the next level of payments innovation. For example, BNPL providers are spreading across the continent. In Mexico, Aplazo works with over 2,000 merchants to offer credit to a growing pool of customers. Through Aplazo, consumers can split their online and offline purchases into multiple instalments without needing a credit card and avoiding the debt trap. Something the company's purpose-driven founders Angel Peña and Alex Wieland see as a fundamental offering that will empower consumers in Latin America with simple, inclusive and financially responsible payment solutions.

Payment innovation is just one consequence of the digital transformation of financial services underway in Latin America led by Brazil, Mexico and Argentina. Open banking regulation in many countries now permits financial institutions to share customers' financial data, allowing non-traditional banks to participate in the financial system. Brazil's Open Finance programme went live in 2021 and already has more than 800 financial institutions participating and more than 9.6 million customers who have consented to information sharing. In Mexico, a 2018 Fintech Law was another catalyst, establishing a framework for fintech companies to legally offer services within the Mexican regulatory system.

Elsewhere, treasury conversation is littered with references to API inventories and e-wallets, the state of CBDC rollout or news of the latest VC in town and scouting for investment opportunities. In 2021, venture and technology growth investors ploughed in an estimated US$19.5bn to Latin American startups, more than in any other region.

Banks

Seismic change is happening in the banking space where, in Brazil at least, a handful of big banks have dominated the industry, long criticised for costly fees, high borrowing rates and low levels of public trust. Today, digital, so-called

neobanks, are shaking up incumbents by rolling out apps, software and other technology to offer loans, current accounts and investments, explains Philip Benton, principal Fintech Analyst at Omdia. "Real-time payments (RTP) and the growth of neobanks are the most interesting innovations in LATAM," he says, although he warns that the region's tougher economic climate visible in high interest rates, double-digit inflation, and weak economic growth, is beginning to test growth in the digital banking sector.

Challenger banks' ease and speed onboarding new customers has allowed them to reach new customers. Like Nubank, the largest neobank in Latin America, with a customer base of almost 60 million since it launched in Brazil in 2014. The São Paulo-headquartered group has attracted billions of dollars from foreign investors – and given millions of poorer citizens their first ever bank account. "Nubank is one of the most interesting neobanks in the region, globally in fact, due to the sheer scale and profitability it has managed in a short space of time," says Benton. Elsewhere, he highlights Argentina's Ualá as another successful and interesting fintech with its focus on financial education.

Acquisition

Such is the growth in digital banks, they are now taking on incumbents. In a bid to build up their customer base and tap government licenses, neobanks are buying traditional banks. For example, Mexico's Credijusto, a fintech lending to small businesses, recently acquired Banco Finterra to further roll out its offering of services and banking products to micro businesses. Mexico has 51 banks but only a handful grant most of the country's loans. "By combining our proprietary software and data science expertise with Finterra's banking capabilities, we are building a next-generation of financial services business," said Eduardo Mendoza, Executive Vice President of Credijusto. "This acquisition will facilitate cross-border opportunities for the thousands of companies involved in trade between the United States and Mexico, an opportunity that we see as an important growth driver for Credijusto." Elsewhere, Argentina's central bank recently approved digital banking startup Uala's acquisition of rival Wilobank, granting it scope to expand its financial services across the region.

In response to challenger competition, Latin America's traditional banks have deployed front-end digital infrastructure to improve the customer experience and prioritised data security. However, they have faced a significant challenge in modernising back-end operations because of high costs and the risks associated with overriding legacy IT infrastructure. This is a key impediment in their ability to match the agility of digital challengers and improve the inefficiencies and high costs that have long hindered traditional banking.

E-commerce

New forms of payment coinciding with pandemic-induced lockdowns have triggered an explosion in e-commerce across the region. Because end consumers can now pay online via credit cards, debit cards or from an e-wallet in an instant, automated payment journey it has led to a new generation of companies. Like Latin American delivery app business iFood, founded 11 years ago. "Innovation in the financial sector is generating new business opportunities for the entire production chain," says Julia Barroso, Vice President, fintech, at iFoods. "Financial solutions created by technology companies have accelerated the consolidation of online habits like ordering food and digital payment services, making it easier, and secure, to pay for goods online," she says.

In a recent innovation, iFood developed its own fintech, creating a "fintech" vertical in 2020 when it launched Banco do Restaurante in partnership with Movile Pay, part of iFood's parent company, Movile. Banco do Restaurante enables iFood's partner restaurants to access financial services ranging from banking transactions (transfers, payment of slips, and cards) and credit transactions (including prepayment of receivables by iFood) to acquiring services (POS offers and payment via QR Code) "iFood's provided more than R$700m in credit for partners seeking to strengthen their cash flow during the most critical period of the pandemic," says Barroso.

It's just the type of innovation alluded to in a recent McKinsey & Company report which highlighted the particular nature of LATAM's digital revolution. "Too many executives view transformations as one-time events with clear beginnings and ends. Our data shows that Latin American companies that have made their transformations ongoing efforts – essentially incorporating them as the new way of working – have identified up to three times the value originally planned for capture."

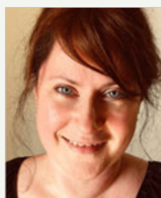
In a next step innovation is leading companies to overhaul their treasury operation. Rappi, one of LATAM's largest online delivery groups, recently adopted an API solution providing ERP connectivity to enhance visibility and control and make use of multicurrency options in some markets. Rappi's treasury function can now manage payments from initiation through to proof-of-payment and the company can process around 900 payments per minute (up from 150) across the nine LATAM countries it operates while a centralised and centrally funded treasury has transformed transparency and efficiency.

Still, the region's new generation of e-commerce companies face daunting hurdles. Getting products from the factory floor into the hands of consumers remains difficult because of challenges around last-mile logistics, returns and handling. As the market size for retail e-commerce in LATAM balloons (it's forecast to increase to US$160bn by 2025, compared to an estimated US$85bn in 2021) so it requires logistics infrastructure and specialised services across the entire supply chain. But for some companies this is just another opportunity. Like 99minutos, the logistics service group for e-commerce vendors, which uses software to create a faster, cheaper, and more accurate last mile delivery option for merchants, and is already bigger than UPS in its core market of Mexico.

Financial services in LATAM are evolving faster than any other region. The latest innovation will be data availability, say Treasury Today interviewees. Employment data or prior credit repayment data will increasingly support the ability of lenders to underwrite customers leading to an explosion of credit products from credit cards to mortgages or car loans. Digital innovation has fostered a new wave of companies amongst which regional champions are now transforming their own treasury function. Above all, LATAM's digital revolution is formalising the region's economies, offering financial services to the unbanked and reducing the use of cash by people and businesses across the continent. ■

Sustainability regulation

“How prepared are companies for new sustainability reporting rules designed to tackle greenwashing and create a single set of corporate climate reporting standards?”



Jo Holmes
Head of ESG Reporting
Marshalls plc

We’ve been reporting our carbon footprint since 2004 and we’ve been a FTSE4Good constituent for 17 years. So sustainability reporting isn’t new for us, but it’s certainly become much more complex. It is now rightly driven by data, controls and the need for transparency.

The sustainability reporting landscaping has changed dramatically over the last few years. We’re not only engaging with numerous ESG ratings agencies, but legislation and standards are also driving reporting, and developing quickly. As a FTSE 250 plc, we have a mandatory requirement to report according to the Task Force on Climate-related Financial Disclosures (TCFD). The process of TCFD reporting has been a welcome one as it gives our stakeholders a well-rounded view of our approach to climate change. We’re now anticipating the launch of the International Sustainability Standards Board (ISSB) standards worldwide and the TPT (Transition Plan Taskforce) guidelines in the UK. Though they are both going to add another layer to our reporting processes, they will also offer a much more level playing field. Stakeholders will now be able to compare different companies because we’ll all be reporting to the same standards – which we see as a positive step.

As a manufacturer and supplier of hard landscaping products like concrete paving, drainage solutions and roof tiles, we know that our carbon footprint is something we not only need to understand, but also manage, measure and report. We measure our Scope 1 and 2 emissions and we’re proud to have reduced our carbon footprint by 50% between 2008 and 2020. Our Scope 3 emissions are those from our suppliers, including cement producers, so it’s a large footprint. Though we haven’t previously reported our Scope 3 emissions, we have measured it and this year we’ll be looking at it in more detail with a view to reporting. It’s important to us to show our entire footprint, not just the part that we have a direct impact on.

Our reporting of sustainability progress is mainly in our Annual Report and our Sustainability Report, both of which are available on our website. At this stage, these reports are separate though I know the direction of travel is to have integrated reporting. This isn’t something we’re contemplating right now but as sustainability reporting becomes much more standardised, our reporting will evolve.

My advice to those in the sustainability reporting field is to keep a keen eye on what’s coming. We’ve been watching developments in the US and the EU, as well as looking at what might happen in the next few years, so for example the likely rise of biodiversity reporting. Being prepared for these developments is key and it’s driving what we’re doing internally. The other important part of sustainability reporting is materiality. Assessing and reporting on what really matters to you and your stakeholders gives a much more transparent view of your business, which is what those reading your Annual Report are really looking for.

Chris McGarry
Partner
White & Case

The European Union’s Green Deal ushered in four key pieces of legislation. First on the scene was the Sustainable Finance Disclosure Regulation (SFDR) followed by the EU Taxonomy Regulation, which together with the SFDR define what classifies as an environmental investment and a social investment. Now we have the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD).

CSRD will come into law early 2023 and will be implemented in phases. It requires companies to report the risks they face from climate change and other sustainability issues, and how their business is impacting climate change. It also requires companies to publish the policy they have put in place for Paris alignment and their exposure to carbon generated power. It entails mandatory information gathering and reporting. Larger companies will have to comply for the financial year starting 2024 but companies not domiciled in the EU will have longer unless they are listed in the EU. The detailed reporting templates within CSRD will use ISSB standards as a baseline. In the UK, which is drawing up a Sustainability Disclosure Requirements (SDR), ISSB global standards will also be the baseline in the reporting templates.

The EU’s CSDDD regulation is still being negotiated between the Council on the one hand and the Commission and European Parliament. It will require companies to publish a measurable transition plan to Paris alignment and the eradication of human rights adverse impacts. The Council of Ministers recently published its mark-up of CSDDD regulation. France has pushed back on requirements that banks

contractually impose the legislation on their borrower clients, arguing it was too much of an operational burden for banks.

Both pieces of legislation represent a paradigm shift for businesses to take responsibility for their own supply chains and to think strategically about the impact of their business on stakeholders. CSDDD will hold the most severe penalties for non-compliance since it allows penal sanctions to be imposed by member states, plus any impacted stakeholder may bring civil litigation against companies which breach CSDDD obligations. The penalties member states impose under CSRD must be effective and fines will be based on global turnover, while injunctions will be able to stop activities. It is not going to be a case of just a slap on the wrist for non-compliance. In another important element, the EU has also commented on co-opting businesses to deliver international treaty obligations which include the Paris Accords and the Universal Declaration of Human Rights.

We advise companies not to wait for the detailed CSRD reporting templates due by 30th June 2023, but to take steps to do the work now on the headline strategic, governance and operational issues which are already clear under the CSRD. Aspects of the regulation are going to apply to EU subsidiaries of non-EU businesses. There is also an element of group-level reporting, so a non-EU parent company will have to provide information. Companies don't have to be that large to be caught by these laws. EU subsidiaries with a turnover over €40m and non-EU parent companies with a turnover of over €150m or if they are listed in the EU must also comply.

George Richards

Partner, Head of ESG Reporting and Assurance
KPMG

Currently there are many different standards for sustainability reporting, and because they are mostly voluntary, there is considerable divergence in what companies report. Finding consistency and comparability amid a patchwork of voluntary frameworks and standards has proven to be a major challenge.

To drive higher-quality comparable reporting, processes for preparing sustainability reporting need to be designed and operated with the same rigour as those for financial reporting. The consolidation of sustainability reporting standards that is now taking place, notably under the ISSB, presents an opportunity to do this, and we are fully supportive of the ISSB's ambition.

New proposals on the first IFRS Sustainability Disclosure Standards, part of the ISSB work, mark the next step towards equal prominence for sustainability and financial reporting.

The proposals aim to create a global baseline for investor-focused sustainability reporting that local jurisdictions can build on and be compatible with other sustainability reporting regulations being issued by the EU and by the SEC in the US.

It looks likely the standards will be published in 2023, and a rapid route to adoption is expected in several jurisdictions. In some, the standards will provide a baseline either to influence or to be incorporated into local requirements while others are likely to adopt the standards in their entirety. This is a critical milestone in the journey towards a consistent global baseline of investor-relevant sustainability reporting. The aim is to drive transparency and enable investors to make better informed choices.

These standards are being developed at a much faster pace than IFRS Accounting Standards. Under the proposals, companies would report on all relevant sustainability topics (not just on climate-related risks) across four content areas that are consistent with the TCFD eg governance, strategy, risk management, and metrics and targets.

Reporting would be connected to the financial statements and released at the same time. Therefore, companies will need processes and controls in place so that they can provide sustainability information of the same quality, and at the same time, as their financial information. Getting ready now is critical even if the final standards may not be identical to the proposals. We know more standards will be coming along the horizon, such as those discussed at COP15 in December 2022 relating to biodiversity loss and natural capital. And sustainability reporting requirements are not just limited to listed companies. Large private companies will also need to report, initially on climate related disclosures and eventually a range of other topics.

Companies that already report in line with existing frameworks such as the TCFD and have the processes in place to produce similar sustainability-related information are likely to find reporting under the final ISSB standards easier.

Corporate sustainability reporting can – and should – start driving a different conversation in the board room such that business owners stretch their thinking and ensure, from the top down, leadership teams are making principle based and strategic decisions that take the climate, as well as broader sustainability considerations, into greater and sustained account. These conversations become less about what a company 'must' do (comply) and more about what a company 'wants' to do (bring change).

Here in the UK, we have an opportunity to build a world class reputation for sustainability reporting and external assurance and further strengthen our internationally renowned capital markets, our position as a leading business destination and reinforce our commitment to sustainability more broadly. It is critical that we seize this moment, and we are fully committed to playing our part as a firm. ■

Next question:

"How could trade finance benefit from digitisation and how much progress has been made so far?"

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

Policymakers and China risk steering economy to stagflation

After a very strong increase in 2022, inflation is finally under downward pressure. In the summer and autumn of last year, prices of energy and food declined considerably as a result of a milder winter in the west, better export opportunities to transport food from the Ukraine and Russia, and the decline in global economic growth. With regard to the latter, however, there are glimmers of hope if lockdowns in China end and Beijing is willing to stimulate the economy a little more.

Stronger Chinese economic growth could soon result in more demand for commodities. This, in turn, could lead to an end to the price declines of many commodities or even new price increases. This would exert upward pressure on inflation in the West. On the other hand, without lockdowns, many supply routes could recover, which would actually depress inflation in the West.

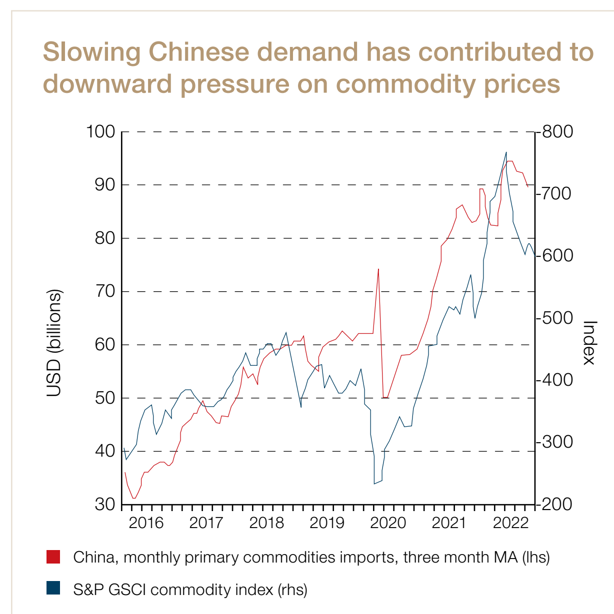
However, we are quite sceptical as to whether events will pan out like this. The coronavirus could spread very rapidly in China with the lifting of most lockdowns. Since most Chinese have not been vaccinated or have been vaccinated with a poorly effective vaccine, they have little resistance, not even against the Omicron variant. Omicron generally caused only mild symptoms in the West, but this was primarily because resistance rates were far higher here, either because of good vaccines or due to previous contraction of the coronavirus. Because of all the lockdowns, this does not apply to most Chinese however.

In short, it is favourable for the Chinese and global economy that lockdowns will be largely lifted, but we fear this could result in very high sickness rates, to the extent where the Chinese economy will barely improve, on balance.

We are also less optimistic for the longer-term, both in terms of Chinese economic growth and the commodity demand from this country. This has to do with the changed world following the outbreak of the Ukraine war. Indeed, the West has developed a very different view of the rest of the world due to Russia's behaviour. The reasoning used to be that if Russia became increasingly integrated into the Western world through the supply of a wide range of commodities to the West, it would also adopt an increasingly less hostile stance towards the West. Based on this view, there was nothing against Western companies increasingly stepping up investment in Russia. The situation with regard to China was slightly different. The West assumed that the more capitalist and richer China became, the more democratic it would become.

In both cases, however, disappointment has ensued. In turn, the above means that more and more Western companies that have invested in Russia and China or have started producing there, have started to wonder whether this is still safe. We increasingly see a Western, a Russian and Chinese bloc emerging, making it increasingly difficult for the West to continue to trade as before. Western companies in Russia and China could suddenly face major restrictions or even be shut down. At the same time, the West will increasingly restrict exports of technologically advanced products to Russia and China. In short, restrictions on global trade will harm the Russian and Chinese economies for the time being.

However, the increasing reluctance among Western companies to do business in China and Russia extends beyond these two countries too Indeed, it also applies to



Source: Refinitiv Datastream/ECR Research

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other countries with a dictatorial regime. This means that Western companies will ultimately increasingly try to produce domestically or at least close to home. However, they started producing overseas for a good reason. This happened because almost everything was cheaper there, so the repatriation of production will generally increase costs. Furthermore, it will have important consequences for the Western labour market:

- The workforce in the West will shrink for demographic reasons. The repatriation of production will tighten the Western labour market even more. This will therefore also result in additional wage increases, especially as support for more immigration (which could make the labour market less tight) is lacking.
- Globalisation has equated to a global surplus of labour. When high wage demands have been made in the West, companies have been able to relocate to emerging markets if wages rose considerably. This is how globalisation depressed wage increases in the West.

Stagflation

The above will result in the following picture, among other consequences:

- Both the US and European economies will increasingly move towards a recession and this will put downward pressure on inflation.
- China's intention of lifting of the lockdowns has fuelled hopes that economic growth in the country will soon pick up. However, we doubt this because it will be replaced with high sickness rates.
- In the longer-term, the gradual end to globalisation will be accompanied by upward pressure on wages and prices.

It is important to realise that tight labour markets will result in more upward pressure on wages and inflation compared to recent decades. This is also the reason why Western central banks have no intention of responding immediately with rate cuts once the economy and inflation decline sharply. They are afraid that inflation will rapidly rise again via additional wage increases if they hit the gas too quickly.

High debt levels will complicate the picture if the recession becomes deep (total debt/GDP ratios are at or near record highs almost everywhere). The markets are therefore increasingly assuming that central banks will pursue a kind of middle-of-the-road policy by depressing growth below potential – around 1.75% in the US and around 1% in Europe – while keeping it above 0%. Unemployment will rise when growth is below potential. This, in turn, will exert downward pressure on wage increases. Unfortunately, this process is very slow. If growth just exceeds 0% for a long period of time, it will have two major drawbacks:

- If inflation declines slowly in this scenario, interest rates will remain high for the time being. This combination of low growth and fairly high interest rates could easily trigger another credit crunch.
- The slightest internal or external shock will be enough for the economy to lapse into a deep recession.

Economies can withstand this risk, but only for a short period of time. However, as mentioned before, wage increases and inflation will only decline gradually with a growth rate of between 0% and potential growth. Low growth will therefore have to be maintained for a long time.

Our conclusion is that a growth rate between 0% and potential growth could briefly be a target, but it cannot be sustained for long. In this case, there is only one option left. This is an option that was almost always resorted to in the past, where the economy is stimulated to the point where inflation rises. In other words, the current target of 2% inflation is abandoned, and inflation is kept above this level. The major advantage of this policy is that higher inflation will alleviate the debt burden. The excuse for such a policy may well be that all manner of studies show that inflation will only have a really negative impact on economic growth if it exceeds 5%.

The result will be stagflation, which will have profound implications for corporate strategies as well as the availability of and price of credit. ■

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