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Rise of the modern treasurer

What should treasurers be focusing on in 2022?

The Corporate View

Sayan Mukherjee

VP, Group Treasurer

Nexperia

Sustainability

Materiality matters: investors pile on the ESG pressure

Treasury Talent

Top tips for developing empathy

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Treasurers decide on digital currencies

Question Answered

COP26 expectations and priorities

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COP26, shareholder conversations and crypto

As this edition goes to press, governments from around the world are gathering in Glasgow for the United Nations' climate change conference COP26. The world is waiting to hear if leaders can act together to introduce the global policy framework needed to wean economies off fossil fuels and achieve net zero by 2050.

Corporate treasury is focused on a few key issues, say respondents in this edition's Q&A feature: how new rules on carbon trading and emissions could impact treasury, particularly investment decisions and the cost of carbon-intensive imports and exports; the introduction of climate taxes to pay for governments' Nationally Determined Contributions (NDCs); new rules around investing in carbon sinks to offset emissions, and looming regulation to limit emissions in their supply chains.

Despite all the unknowns, one thing is certain. Integrating ESG is costly, and companies need their investors on side. Continuing the theme, in this issue we also explore how corporate boards can improve their conversations between shareholders when it comes to ESG. Novartis' ESG Director, Madeleine Szeluch, talks about how identifying material risks has helped gain control of the narrative and ensure powerful and effective conversations.

Crypto's bite

"This ain't going away; it's not a flash in the pan," said one interviewee in our feature on bitcoin, cryptocurrencies, blockchain and stablecoins. If companies are going to innovate in this new frontier it will likely start with treasury, and we explore the pros and cons of considering bitcoin as an investment or using digital currencies as a payment method.

Elsewhere, we look at the role of a modern treasurer – from taking on a more strategic role within the organisation to stepping up in areas ranging from ESG to M&A, their remit has never been wider. Something that resonates with our Corporate View interviewee, Sayan Mukherjee, VP, Group Treasurer of Nexperia, the global semiconductor manufacturer. He discusses how a philosophy of 'efficiency wins' is preparing the company for ambitious growth ahead. Lastly, our Market View reflects on why inflation, and interest rates, are set to rise further in the coming years.

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Materiality matters: investors pile on the ESG pressure

When it comes to ESG, shareholders are increasingly prepared to ask tricky questions of boards, vote against directors and file shareholder resolutions. Investor and treasury teams need to ensure they have a grip on what is material.

Rise of the modern treasurer

The treasurer's role has become more visible during the pandemic, with a greater focus on the importance of strategic partnership. With that in mind, what will the modern treasurer be focusing on in 2022, and how is the treasurer's skillset evolving?

The world has changed considerably in the last couple of years – and corporate treasurers have had to adapt. So what will treasurers be focusing on in 2022, and how are they expanding their skillsets to meet the needs of today's landscape? From taking on a more strategic role within the organisation to stepping up in areas ranging from ESG to M&A, the remit of the modern treasurer has never been wider.

Strategic role

The last two years have brought numerous challenges for treasurers everywhere – but these challenges have also given treasurers an opportunity to step into the spotlight. "During the pandemic, the role of treasury became more visible, just like it did during the financial crisis," says David Stebbings, Director, Head of Treasury Advisory at PwC. "So the question is – how do treasurers hang on to that and make the most of it?"

According to PwC's 2021 Global Treasury Survey, most respondents say their departments operate as either a value-enhancing (50%) or strategic (33%) partner – results which the report argues "mark a firm reclassification of treasury's role into one of business partnership." In this evolving landscape, the survey identified strategic thinking as the most important skill for the treasurer of the future, cited by 76% of respondents – ahead of functional knowledge of treasury (74%), technology affinity (69%) and business partnering capabilities (63%).

"For some time now, we've seen treasury taking a far more strategic role – and particularly post-pandemic, the treasurer's role will be viewed as more critical," says Alex Young, head of Corporates for GTS EMEA at Bank of America. "There's an enormous emphasis from the C-level on the company's overall health, while business units across companies are all looking to treasury for guidance, knowledge and best practice." As such, says Young, treasury has an integral role to play in discussions about the company's strategy going forward, and the nature of the current marketplace.

Commercial partner

Mumtaz Dole, Director – Cash and Liquidity Management and Treasury Business Partner (APAC) at Vestas, reflects that one of the lessons she has learned during the pandemic is that it is "insufficient to be the traditional treasurer doing 'treasury things' such as FX and liquidity." She adds, "The future treasurer needs to be a commercial partner who can keep up with the quick pace of the world while maintaining agility."

As Dole explains, Vestas is a company that designs, manufactures, installs and services wind turbines around the world – projects that are large scale and long-dated, especially when service is taken into account. In order to be a modern global treasurer in this setting, she says, "We need to understand the business we are in from the commercial and operational side so that together with our existing knowledge around cash flows planning, credit, capital and risk we can facilitate the business to make good decisions, prioritise and mitigate risks."

Supporting record M&A volumes

As 2022 approaches, another notable trend is the vibrant marketplace for deals against a backdrop of strong demand from private equity and the availability of cheap financing. KPMG, for example, has predicted that global M&A volumes could reach a record US$6trn in 2021, up from US$3.6trn in 2020.

As Stebbings notes, "The deals market is huge at the moment, which means many treasurers and their teams are heavily involved with such work. Of course, there may be direct deal effects on how treasury works if you lose half your team following a divestiture or gain a function following acquisition."

Young observes that treasury has a fundamental role to play in supporting M&A activity, not only because of the impact of divestitures on treasury operations, but also due to the implications for capital commitments and the need to integrate new business models. "Treasurers need to consider how quickly they can get line of sight on how new acquisitions operate – does that fit within the existing architecture, or does it need to be adapted and integrated into the current business?"

Shifting payments landscape

The world of payments is undergoing significant changes, from SWIFT gpi to the rise of real-time payments and developments in the area of Central Bank Digital Currencies (CBDCs). The modern treasurer therefore needs to have a clear understanding of developments in this area.

"In the last 18 months, there has been an acceleration in the uptake of new payment tools," explains Jennifer Wan, head of Corporates for UK, GTS at BofA. "So treasurers are not only talking about traditional high-value or low-value payments, or in-country versus cross-border payments – they are also now having discussions about e-commerce and instant payments."

As Wan explains, the adoption of new online business models during the pandemic has made it more important than ever for companies to offer customers access to the right payment

Recruiting the modern treasurer

Mike Richards, CEO of the Treasury Recruitment Company, discusses the evolving role of the treasurer and the impact of the pandemic on recruitment and working patterns.

In what ways have you seen the role of the treasurer and working patterns change during the past two years?

It's very interesting. In some areas things have very much stayed the same. For many companies changes that would have been expected – updating systems or improving processes – have been put on hold. And that's largely down to a change in priorities.

When the pandemic struck, the focus was on ensuring that everyone was able to work remotely. One of the consequences of this was that systems that should have been updated were not. As companies are coming out of the crisis, treasurers have had time to reflect, and they are questioning the need to spend extra sums of money on something that might be working perfectly well.

To what extent are companies still embracing remote working?

I would say that there is a marked difference between North America and Europe. In the US, the tendency at the moment is to bring everyone back into the office, even in those companies where remote working has been judged to be a success. In the UK and Europe, by contrast, there is much more sensitivity and flexibility in the matter. For example, I know of one service centre in Europe where the final candidates being interviewed for a position were all saying that they would only consider the job if it was full-time remote working.

Will it continue over the longer-term? There has been such a massive shift over a short period of time. It seems to be that what treasury professionals are seeking now is a balance between being office-based in their position and the working-from-home element – in other words, a blended working style.

> For some clients recruiting for a treasury analyst position, it is more important to have candidates with good systems skills than experience in – or knowledge of – treasury.

What are the trends you are seeing in the recruitment space?

In the US the market is really starting to take off. I think what has happened is that when people have left or been moved around, they haven't been replaced. There has been a reluctance to on-board people remotely, so it has been a case of 'make do and mend'.

There's always been a high demand for people with technology skills and that continues. Five years ago it would have been usual to pay for external treasury systems consultants to help implement a system. Now, treasurers have added that to their skill set. They know what to look for in terms of what is a 'nice to have', and what is a 'must have'. For some clients recruiting for a treasury analyst position, it is more important to have candidates with good systems skills than experience in – or knowledge of – treasury.

Recruiting has become much more of a challenge. The clients who are getting it wrong at the moment are the ones who assume that candidates are beating a path to their door. The pandemic has made people reticent to move. Why would someone who is happy working remotely in their current job want to move to a position requiring them to be in the office five days a week?

We're coaching our clients about what they can do to make themselves more attractive. Employees have far greater power over their working life than they probably have ever had before. Five years ago, what candidates wanted to know about a vacancy was the nature of the job, its salary and its location. Now they want to know – what's the remote flexible working policy? When do I have to be in the office?

What would you say to someone looking to change roles in the coming year?

It's a great time to be looking for a new role. I think it's important to ask the right questions and to be really curious about how the company survived the pandemic – not economically, but in terms of how their people got through it and what the company is going to do next.

> The future treasurer needs to be a commercial partner who can keep up with the quick pace of the world while maintaining agility.
>
> Mumtaz Dole, Director – Cash and Liquidity Management and Treasury Business Partner (APAC), Vestas

methods. For treasurers, it's important to have a clear understanding of what is an increasingly fragmented landscape, as well as understanding what this means for treasury activities, and their banking partners can support with implementing the right tools. "For example, if you're dealing with instant payments, does that now mean you have to do real-time funding?" she says. "Do you also need to mirror that with real-time reporting, and look at the use of AI to forecast seasonality and identify trends?"

In light of these developments, Wan points out that the modern treasurer "not only needs to have technical prowess in terms of how they navigate these different tools, but also a commercial awareness – because it's so linked to the business and how you attract customers."

Role of technology

Technology change, of course, continues to be an important opportunity but also a challenge for treasurers. "The treasury and cash technology market is evolving dramatically," says Stebbings. "There are a lot of banks and vendors out there offering all sorts of products to cover myriad solutions. It's not easy to make the right choice, and even more difficult to implement the product to meet your needs. So having a handle on what you want, and how you want to do it, is more important than ever."

While using new technology tools should be intuitive, Stebbings points out the importance of treasures having a full appreciation of their data. "Treasury needs people who can understand and analyse data more than anything else – not necessarily the actual tools themselves, but the validity of the data and the reliance that can be placed on the analysis," he says.

As Dole comments, "Treasuries have been on the digitisation journey for a few years now, and there is no doubt that technology is more important than ever. Nowadays, new technologies are able to string global processes together and analyse the data that comes out of it. Some companies have even started allowing operational treasury tasks to be performed in the background through AI and automation. We have embarked on this journey even at Vestas."

Cash flow forecasting, which has long been a challenge for treasurers everywhere, is one area where technology can drive improvements. "Better forecasting and data visualisation tools are helping treasurers connect more to the business, as well as helping them provide consolidated reporting to the board," says Young. He adds that other areas in which technology can drive benefits include in-house bank structures and the use of virtual accounts – all areas in which BofA has recently launched product enhancements.

Sustainability and ESG

The growing focus on sustainability and Environmental, Social and Governance (ESG) factors is also likely to continue in 2022. From green bonds to ESG money market funds, there are more opportunities for treasurers to manage cash in a way that supports their companies' sustainability goals. And companies are certainly becoming more focused on this topic: PwC's survey found that 42% of companies had adopted formal policies around ESG principles, with one third saying ESG is incorporated into decision-making.

"The global health crisis has certainly got a lot of people thinking about organisational health and the future of work," comments Young. "The ESG agenda is quickly becoming very important for our clients, and we are supporting them with integrating ESG into their own business objectives." In particular, he notes that treasury has an important role to play in supporting business units and helping them identify opportunities for improvement.

This growing focus was also reflected in Treasury Today's 2021 Global Sustainability Study. The survey found that almost a quarter of respondents were planning to issue a green bond, up from 12% in 2020. In addition, 47% noted that stakeholder pressure was driving their companies' ESG strategy "to some extent" – and 57% said they now include ESG metrics in their annual reports.

Building the modern treasurer

Last but not least, modern treasurers will need additional skills at their fingertips in the year ahead. François Masquelier, CEO of Simply Treasury, explains that treasurers need to understand new technologies if they are to fulfil their "broader mission" effectively, and will need to onboard colleagues with broader and more tech-oriented skills in order to adapt to the changing environment. In particular, he says, "an open mindset and diverse skills will be an absolute necessity to cope with new duties and evolving tasks."

Dole observes that in this environment, modern treasurers need to evolve and transform their skills so that alongside their treasury capabilities, they also know how to use data, technology and processes effectively. "Treasurers must also be able to understand people and be able to manage change," she notes.

As Dole concludes: "All in all, the modern treasurer will evolve into a well experienced and multi-skilled finance professional with a broad experience and knowledge, acting as a treasury business partner who has a seat at the table. At Vestas this evolution started back in 2019, and now more than ever I believe we're on the right track to build the modern treasurer." ■

mCBDC: THE SOLUTION FOR CROSS-BORDER PAIN?

Corporates are spending billions a year in transaction fees for their cross-border payments. Although there have been many solutions that seek to address the pain of the existing correspondent banking network, a recent report believes it has a better answer: mCBDC, or a multi-currency central bank digital currency network.

Ask any treasurer about the inefficiencies of the correspondent banking network and they will tell you about the high costs, the slow settlement, and not having any visibility on where their payments are. Then there are the costs of keeping funds aside while waiting for transactions to clear – effectively trapped liquidity that could be put to better use elsewhere if things were more real-time, and more efficient.

The costs of cross-border transactions are significant, and when totalled on a global basis – of all multinational corporations – the numbers are staggering. For a corporate to send funds cross-border, the average fee is US$27 per transaction. On a global basis, for all corporates, this scales up to US$120bn per year, which is roughly equivalent to a third of Singapore's GDP. And with approximately US$23.5trn of funds moving across different countries each year, it's no wonder that there are so many people exploring how this could be a lot more efficient.

There have been many initiatives that seek to address the problems, such SWIFT's gpi or Ripple's real-time payments solution. Private companies – such as Facebook – have been working on developing their own digital currency, or leveraging an existing stablecoin, while central banks are also exploring issuing their own central bank digital currencies (CBDCs). The initiatives form something of a patchwork of options that are available for treasurers. However, none of them has been global, scalable or a seamless solution that works cross-border, in many currencies and with multiple payment systems, according to a recent report from Oliver Wyman and J.P. Morgan.

The report quotes one head of cash management at a global technology multinational corporation as saying, "I'm convinced that CBDCs could bring transactional cash management to the next level from the standpoint of accessibility (being able to access liquidity in their accounts without cut-offs and cross-border delays), convertibility (being able to convert to different currencies at will, enabling them to manage liquidity in smaller sets of currencies), reachability (beyond just bank accounts) and traceability (being able to have a clean trail of funds)."

The report outlines its view of how the issues can be overcome at a global level: with a multi-currency central bank digital currency network, or mCBDC for short.

The paper outlines how such a system could be built and implemented, with the end result being a network of central bank digital currencies that is 'always on', is real-time with 'atomic settlement' – or simultaneous settlement. Transaction chains would also be shortened, with no need for all the intermediaries that currently exist in the correspondent banking network.

The report outlines the ways in which central banks and commercial banks can come together to create a network for cross-border payments where this is all possible. It's no mean feat, however, and there are many issues to consider. For the various parties to come together to create such a network, they need to agree on how the CBDCs will be minted and redeemed; what the roles and responsibilities of the central banks and commercial banks are; how the network and technology will be designed; and how such a cross-border network would be governed.

There are various ways such a network could be achieved. For example, it could upgrade existing real-time gross settlement systems, or it could leverage bilateral CBDC corridors; or it could craft a new mCBDC network. This new mCBDC model would have a single platform for a multilateral corridor which would be a shared settlement platform for multiple jurisdictions.

Naveen Mallela, Global Head of Coin Systems, Onyx by J.P. Morgan, commented on the report: "Central banks around the world who are at various stages of CBDC development are considering how to build an infrastructure where systems operate and work together with the necessary controls in place. In this report, we put forward robust design considerations for a successful mCBDC network and demonstrate how it can be practically implemented, using ASEAN corridors as an example." ■

Tapping into the power of empathy

Empathy is often misunderstood as being a sign of weakness, or being too 'soft' when, in fact, it actually comes from a place of strength. Leaders who learn to apply the power of empathy are more likely to be more fulfilled and successful in their roles.

Think of a job that needs doing at work. How long will it take to complete? Will it be done at lightning speed, or at a snail's pace? If you are a leader, and are relying on others to do the work, the difference between it being done quickly or slowly could hinge on the power of empathy.

"Empathy is the key leadership skill enabling us to really understand why people do what they do, to see the world from their perspectives and build the trusted relationships that empower people to be at their best," says Daniel Murray, Founder and Director of Empathic Consulting.

He cites the example of Gordon Bethune, the CEO of Continental Airlines between 1994 and 2004 who was credited with rescuing the company from the brink of failure and dramatically improving morale among employees. Bethune reportedly said his experience as a plane mechanic helped him because he knew how long it took to fix a plane if he wanted to fix it. He also knew how long it took if he didn't want to fix it. "The intangible factors of values, relationships and culture have a huge influence over whether we really want to fix the plane or not," explains Murray.

Empathy is a key skill for leaders to understand this gap, and Murray argues it is not a nice-to-have. In fact, with leaders working across many countries – with people of increasingly diverse backgrounds – empathy is critical to long-term, sustainable performance. "Empathy is the key leadership skill to navigate this intangible world," says Murray.

And it's not just a key skill for leading, it's also a way to form meaningful connections with others, says Tracy Brower, author of Secrets to Happiness at Work. "These connections can make us happier and more fulfilled in our careers because we'll have stronger relationships with co-workers and feel a greater sense of social fulfilment," Brower says. Also, she adds, empathy is important for success in our careers because it helps us solve problems and innovate. With design thinking – a process of designing solutions that are based around customer problems – a key ingredient is being able to empathise with the end user. "When we understand where the customer is coming from—including the internal customer of our work — we can respond most effectively to meet their needs. This will help us grow in our careers because we'll be more effective and develop credibility for our responsiveness," says Brower.

There are numerous other benefits – for companies and individuals – for those who harness the power of empathy.

Niina Majaniemi, a keynote speaker and author, tells Treasury Today that empathy "helps grow revenue, build customer satisfaction, build employee happiness, strengthen brand, increase collaboration, survive from crisis, increase innovation and grow trust."

As an empathy expert, Majaniemi is keen to point out what empathy is and isn't, and is keen to bust the myths around it. The most common myths, she says, are that empathy is only about being nice, or that empathy is a sign of weakness. "These myths can't be further from the truth," she says.

This echoes a quote from New Zealand Prime Minister Jacinda Ardern that has been doing the rounds on social media: "One of the criticisms I've faced over the years is that I'm not aggressive enough or assertive enough, or maybe somehow, because I'm empathetic, it means I'm weak. I totally rebel against that. I refuse to believe that you cannot be compassionate and strong," she is quoted as saying.

Majaniemi elaborates on what empathy actually is: "Empathy is about creating a work culture with respect and understanding. It does not mean that we need to let others walk all over us or change our decisions based on what others want. It means that we are assertive, driven, and fulfil our goals, and that we are accountable and demand others to do the same. We do it in a way where we incorporate empathy into strategy and all decisions that we make," says Majaniemi. This, in turn, translates into optimal results for a company in the long-term and ultimately helps them grow their revenue.

Majaniemi argues that it is often fear that is holding leaders back. She gives an example, from her experience as an empathy expert, where a leader had a team that was really unhappy. Despite this, the leader was afraid to hear feedback about why morale was so low – he didn't want to be badmouthed by them. "Empathy takes courage. This person was not brave enough to include empathy in their leadership strategy, but instead acted in a way that weak leaders do," says Majaniemi. This leadership style often results in uncommitted employees, reduced efficiency and productivity. "This shows why authoritarian leadership simply doesn't work anymore in today's business world," says Majaniemi.

Murray agrees that empathy is not about being soft or weak. He says that trust is the goal, and this is different from affection. "As a leader, I need to trust people and they must

Empathy is about creating a work culture with respect and understanding. It does not mean that we need to let others walk all over us or change our decisions based on what other want.

Niina Majaniemi, keynote speaker and author

trust me, but I don't have to like them. This is not to say that you can't have both. I don't need to like my dentist before she puts a drill in my mouth, but I sure need to trust her. And as much as I like my friend Neil, I would never trust him to do a root canal. Teams need trust and this is what empathic leaders foster," he explains.

Empathy isn't something that people either have or they don't have; it is something that can be developed. Murray says, "Remember, empathy is a practice. You need to work on it." And there are a number of ways to practise, and develop, empathy. Majaniemi says that listening and asking questions is important. When people gossip about others, she points out, they often say things like 'What were they thinking?!' or 'I can't understand why they would do that'. "We do not really mean that we can't understand. We mean we don't want to understand. Ask, and you might be surprised. Pause and reflect before talking," she says.

And listening is also a key skill. Brower advises to "turn down your inner monologue and really listen to what the other person is saying. Actively consider what they must be thinking — cognitive empathy – or what they must be feeling – emotional empathy," she says. It is also important to respond appropriately. Brower says that, based on what you hear, you should be ready to respond when necessary. "Offer encouragement if they're going through something challenging, or share in their celebration based on their good news. Offer your help if they're struggling with a project. Or simply keep things rolling if you're in the middle of a collaboration and both feeling good about your progress. Your response doesn't need to be complex or time-consuming, but meeting them where they are can have big payoffs," Brower explains.

When you do listen to what people have to say, it is important to let go of your unconscious biases and judgement, says Manajiemi. She gives the example that with Zoom or Teams meetings there maybe pressure to put the camera on. And while a refusal to do so may be perceived to be down to laziness – because it is assumed they are still in their pyjamas – there may be all manner of reasons why people do not like to do so. One could be disability, for example. "We can't judge and assume, we need to drive to understand. We need to give the benefit of the doubt until we know better, and this way we build more productive and profitable work," Manajiemi says.

Murray also advises about leaving biases at the door, and how it is important to challenge your own views. "We build a set of mental models that explain how the world works. Analytically-minded people are experts in understanding the rules, systems and laws that govern mathematics and finance, many are objective and indisputable. Unfortunately, our brains are not as good as distinguishing between these objective facts and our more subjective beliefs," Murray says. For example, someone yelling at home maybe interpreted differently – either as something bad happening, or people merely expressing themselves passionately. "Yelling means nothing until it is interpreted, and that interpretation is not a fact. Many times, when we work with others, we will judge their comments, opinions, actions and behaviours by our mental models. To be more empathetic, we need to challenge our initial assumptions and try to understand their mental models to really understand why they do what they do," says Murray.

In order to take these tips on board, it is also necessary to manage yourself and how you handle stress. Majaniemi comments that stress is a common element that prevents us from being empathic. "When we are busy, we become a slave to our impulses," she says. Most people can probably think of a time when they've thought, or said, 'I don't have time to listen to this – I've got my own problems', she points out.

And similar to destressing and not being too busy, one of Brower's top tips for building empathy is to be present with others. "Rather than multi-tasking – as we can all tend to do – really tune in and focus on others and what they are expressing," she says.

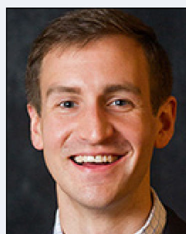
In a similar vein, Murray advises to clear the desk – or desktop. "One of the biggest inhibitors of quality conversations are distractions. We have inboxes dinging, phones binging, post-it notes hanging off our screens and social media buzzing in our pockets. While you might think these don't cause a distraction, research has shown that even the slightest noise in our environment can impact our ability to really focus and listen to other people," says Murray. "If you are meeting with someone and want to really listen, clear your desk. Turn off your phone, put it in a draw. Sleep your computer or if you are on a virtual meeting, turn off notifications and close all programmes you don't need. Really focus all your attention on the other person."

Murray is also a believer in the power of silence, especially in a fast-paced work environment where schedules are busy, and meetings filled with question and answer sessions that can feel like a prosecutor's grilling.

"Silence is often one of the most powerful tools in building a deeper understanding. When you are speaking with someone, instead of asking questions to validate your current thoughts, ask open questions and leave space after the person answers. What you will find is that people often give a shallow initial answer to a question, but with a bit of silence, they often offer a much richer and more thoughtful answer if there is space," says Murray. "This is where the gold can be in understanding. Empathy can be as simple as having the curiosity and patience to wait," he adds. ■

The future of supply chain finance

The pandemic has highlighted the benefits of supply chain finance for buyers and suppliers – and this area is continuing to evolve rapidly. So how is technology driving development, why are bank-tech partnerships important, and how can SCF help companies achieve their ESG goals? Taulia's Bob Glotfelty and Ali Ansari share their views.



Bob Glotfelty
VP of Growth

Ali Ansari
Director for Global Supply Chain and Payables Solutions

Supply chain finance has come a long way in recent years. Having risen to prominence through the 2008-2009 financial crisis, it has since become increasingly prevalent as a method of supporting suppliers. And growth has continued apace since then: BCR's World Supply Chain Finance Report 2021 found that the estimated global volume of SCF has increased from $330 billion in 2015 to over $1.3 trillion in 2020.

The arrival of the COVID-19 crisis presented supply chain finance with its first major test. But while some small business lenders have struggled during this period – as illustrated by the fate of US firm OnDeck Capital, an online lender which was sold for less than 10% of its 2015 market value – supply chain finance funding has remained available and adoption has continued to grow. Indeed, the BCR report found that SCF volumes were 35% higher in 2020 than in 2019.

In practice, the pandemic prompted a need for supply chain finance both for companies that saw sales dry up, and for those that experienced a surge in demand, says Bob Glotfelty, VP of Growth at Taulia. "For companies like consumer goods businesses that needed to produce more supply and sell more of their products, supply chain finance was a great option to get paid early, get more cash, and reinvest that into the business," he explains. "Meanwhile, companies like automotive parts suppliers found their products weren't being purchased when plants had shut down, so they found themselves in a very difficult position. Supply chain finance enabled them to get access to cash, and really secure and strengthen their businesses."

What is supply chain finance?

Supply chain finance is a type of early payment solution that offers working capital benefits to both buyers and suppliers. It enables large buyers to offer their suppliers early payment of their invoices at a funding rate based on the buyer's credit rating. As such, it gives suppliers cost-effective access to working capital, as well as providing more certainty about the timing of receivables. Funding is provided either through a single financier, or through a platform offering multi-funding capabilities.

Role of technology

Having weathered the challenges of the last 18 months, it's clear that supply chain finance has much to offer businesses. What's more, the types of solutions available are continuing to evolve rapidly, with more development on the horizon.

For one thing, technology has an important role to play in driving development in this area. Glotfelty cites the role of technology in helping to automate processes, such as invoice approval times: "The sooner an invoice gets approved, the sooner it can be paid, and the more opportunity there is to get your money faster." Likewise, he notes that technology can speed up reconciliation and the way in which credit notes are handled. There is also considerable potential when it comes to taking advantage of artificial intelligence and machine learning in order to transform the way in which risks are assessed.

Also significant is the potential that technology has in terms of bringing the benefits of supply chain finance to smaller suppliers than has previously been possible. "When supply chain finance was purely driven by banks, it was a very manual, labour-intensive process to set up every party on the solution," Glotfelty explains. "So typically, the penetration of the solution within the supply chain was very low, and it really ended up with large corporations using it between themselves." But with technology providing more opportunities for automation, supply chain finance solutions can now be accessed by small and medium-sized businesses as well, providing more opportunities for companies to provide support to the whole supply chain.

Rise of the bank-tech partnership

As supply chain finance continues to evolve, another important development is the rise of closer partnerships between banks and technology companies. Both parties have something important to bring to the table: banks have been providing supply chain finance for many years, with extensive expertise in assessing risk and providing liquidity – but what they typically lack is the ability to harness technology effectively and provide a slick user experience. "Banks are lagging behind in terms of technology, so they need tech companies to bridge the gap," says Ali Ansari, Director for Global Supply Chain and Payables Solutions at Taulia. Technology companies, meanwhile, have the ability to offer a highly automated and streamlined solution – but they may not have the existing relationships, or the deep knowledge of credit and legal structures.

As such, partnerships between banks and technology firms can provide the best of both worlds. "Technology companies can bring in experience of connectivity, data insights and AI-based predictive information in order to facilitate digital decisioning," comments Ansari. "And banks can continue providing risk assessment and liquidity for assets that are generated through this exchange of information, facilitated by technology firms."

By combining the agility and innovation offered by technology companies with banks' stability, funding and client knowledge, the rise of the bank-tech partnership offers a way for all participants in the supply chain to maximise the benefit of SCF. Announced in 2020, Taulia's strategic alliance with J.P. Morgan offers an example of how this can work well. More recently, J.P. Morgan led a consortium that provided Taulia with $6 billion in funding following the collapse of Greensill earlier this year.

ESG and SCF

Technology is not the only factor moving SCF forward. As well as providing stability for supply chains, supply chain finance also has the ability to have a positive impact on the way in which businesses behave – and that, in turn, means it can help to safeguard the future of the planet.

As companies identify growth opportunities and risks, they are focusing more closely than ever before on sustainability and Environmental, Social and Governance (ESG) concerns. Increasingly, companies are recognising that they need to look beyond their own operations and consider the ESG impact of the whole supply chain – indeed, a 2016 McKinsey report found that more than 90% of the environmental impact associated with consumer companies is embedded in supply chains.

With that in mind, there is a clear opportunity for companies to address ESG by taking steps to improve their suppliers' sustainability performance. Depending on the nature of the business, that might mean encouraging suppliers to reduce their greenhouse gas emissions, embrace more ethical practices or improve the way in which they handle waste products. In practice, however, this is a course of action that requires a clear strategy, as suppliers may not change their practices unless they have a compelling reason to do so.

One option could be to end relationships with any suppliers that fall short of the expected standards. However, supply chain finance once again offers another way forward: by using a well-designed SCF programme, companies can offer suppliers a 'carrot' for good behaviour. For example, SCF can be used by companies to encourage more sustainable behaviour from their suppliers by assigning suppliers a sustainability score, and offering the highest-performing suppliers access to financing at slightly more favourable rates.

Notable developments in this area include a supply chain finance solution developed by tire manufacturer Bridgestone in conjunction with Taulia and J.P. Morgan. The solution uses sustainability ratings from ratings platform EcoVadis to determine a sustainability-based discount for each supplier. "The Bridgestone solution has been well publicised," says Glotfelty. "We're consistently hearing from our customers and prospects about the desire to go down this path and tie in their programmes with an ESG element."

This approach is gaining momentum. "Businesses want to do the right thing – whether it's for employees or communities, or whether it's environmental factors like greenhouse gas emissions," comments Glotfelty. "And as part of that, many companies are looking down their entire supply chains and are saying, 'I want to make sure the people I'm buying from are doing things sustainably.'"

Shape of the future

What could supply chain finance look like in five years' time? For Ansari, the most interesting opportunity is the way in which technology will lead the way. "You'll see these programmes becoming more integrated, more insightful, and bringing the most efficient finance into play," he says. "While the core SCF offering will remain the same, you won't recognise these next-generation offerings as the programmes that exist today."

Alongside the rise of bank-tech partnerships, Glotfelty predicts that adoption, volumes and usage of SCF will continue to rise. "Think about it – it's an arbitrage opportunity," he says. "You're taking the creditworthiness of a large corporation, and you're extending that value to a supply chain. While some of those are also large corporates, many are small and medium sized businesses that aren't able to access financing at a low cost. So there's a natural fit for a product like that."

Last but not least, Glotfelty notes that the role that supply chain finance can play in helping companies embrace ESG is particularly encouraging. "It's really creating a reason to publicise your work around ESG, and give a very tangible solution to the problem," he concludes. "I think that's really exciting." ■

Is it time for treasury to split with all-in-one solutions?

Standalone software components may not be about to usurp treasury management systems, but even TMS vendors acknowledge that specific customer requirements demand co-operation with fintechs.

Earlier this year, J.P. Morgan Chase commercial banking published an article suggesting that many treasury and finance organisations assume a TMS can solve all their operational cash management issues and referring to the availability of niche alternatives that can alleviate the cost burden and long implementation timelines associated with a traditional TMS.

Even TMS vendors accept that standalone components make sense for addressing specific issues, which is why Kyriba has opened its unified platform to third parties. However, they also suggest that clients see software proliferation as a pain point, particularly in relation to security and data management.

In simple terms, multiple standalone components are generally seen as more relevant for large organisations which handle specific types of transactions that can be quite complex and involve large volumes.

Small and medium-sized corporates tend to handle simpler transactions with less volume and their financial resources are more limited. As a result, they are more likely to opt for a single treasury management system.

Many of the reasons for using a single TMS platform (convenience, cost, lack of internal IT skills) are as relevant now as they have ever been and likewise there have long been corporates with the motivation and resources to supplement their core TMS with specific standalone components.

"As such components become more freely available, cheaper and easier to connect, they will appeal to more corporate treasuries," says Adrian Rodgers, Director of treasury consultancy ARC Solutions. "However, the number of treasuries that need to assemble a boutique suite of applications will remain relatively small."

Patricia Hines, Head of Corporate Banking at Celent refers to two distinct trends in this space – TMS providers expanding their functionality into adjacent spaces (such as Kyriba supply chain finance); and adjacent players expanding

> The number of treasuries that need to assemble a boutique suite of applications will remain relatively small.
>
> Adrian Rodgers, Director, ARC Solutions

their functionality into TMS (for example, HighRadius receivables automation and Coupa payables automation offering TMS features, and Axletree SWIFT Service Bureau offering treasury automation).

Anil Khurmi, Manager at treasury consultancy Zanders describes the option of using a stable of best of breed standalone treasury solutions as an increasingly viable alternative to the established model of using an all-in-one TMS.

"This evolution is driven by an increasing number of fintechs disrupting the market with competitively priced standalone products, coupled with technological advances which help to mitigate the risks previously associated with running multiple systems," he says.

It is also important to note that the TMS vendor market continues to go through significant consolidation. Some of the key drivers for this include the fact that large scale clearly supports, amongst other things, the ability to deliver niche capabilities on top of the core solution.

Whilst newer, smaller vendors face challenges – not least those presented by the ever-changing regulatory landscape – the accelerating pace of technological advance is having a significant positive impact on the supply of lower cost, specialised solutions available to corporates.

That is the view of Andrew Hollins, Director of Corporate Treasury Proposition at Refinitiv, who identifies two notable trends that have emerged from these developments.

"On the one hand we have seen growth in cloud-based, full service TMS solutions targeted at mid-sized, often regional corporates," he says. "Common features of these SaaS solutions include low cost, standardisation of capability, and the absence of customisation. This can be sufficient for a company with less sophisticated, less complex treasury requirements."

It is also apparent that larger corporates are examining their deployed TMS spend far more rigorously. With a deployed system, it can be the case that multiple modules provide support across a range of critical treasury functions such as cash and liquidity management, payments, and risk management.

With the growing availability of agile, cloud-based solutions which are able to supplant certain deployed TMS modules, companies are increasingly able to make a call regarding the degree to which certain modules are 'core' to their particular

Case study

From working with a simple set of accounts and a small number of banks – taking data from a number of internal entities – Zurich North America's treasury function underwent rapid growth. This resulted in the function becoming the shared centre of excellence for cash and banking activities across the US and Canada.

The treasury function now supports numerous business divisions with cash across half a dozen core banks. This growth created challenges establishing cash positions on a daily basis and underlined the value of the payment functionality provided by the treasury management system supplied by GTreasury.

"The system has reduced our dependency on using individual bank websites and enabled us to manage corporate loans and short-term investments as well as payments," explains Sandra Telles, Treasury Operations Manager at Zurich North America.

The attraction of working with a single TMS was its ability to be a hub for cash management activities such as payments, cash forecasting, bank fees, and cash accounting activities.

"The breadth of the functionality allowed us to eliminate a bank fee vendor, import investment balances from multiple partners, and support the implementation of cash postings, all which contributed to reduced expenses and centralisation of data and processes into one simplified solution," says Telles. "We like the ability to do our treasury funding and investment payments within one system whilst also booking the activity within a single system."

As head of operations, Telles says she is regularly approached by other TMS vendors as well as fintechs offering standalone solutions. The company actively supports fintechs that have developed relationships with its TMS and ERP systems.

"Supporting new vendors through our treasury management system will make it easier to implement data feeds and/or payment files in a more cost-effective way at an accelerated pace," she says. "Most organisations have resources constraints when it comes to IT support, so being able to use a single TMS solution to support new business needs will continue to keep Zurich agile with respect to automation and reduces the work effort needed from our ERP system."

> The concept of an all-in-one treasury solution was a nice idea decades ago but that model and strategy is no longer scalable.
>
> Tracy Kantrowitz, Vice President of Market Treasury, Bottomline Technologies

operation and business model. As a consequence they may choose to replace a costly deployed TMS module with a lighter, cheaper, and more targeted alternative.

According to Hollins, hedge accounting, cash flow forecasting, benchmark interest rates transition, and even collateral management can be candidates for a lighter alternative, supporting capital markets and hedging portfolios.

"By adding an interface to the company's ERP system it is also possible to consider enterprise-wide risk analysis encompassing value at risk, cash flow at risk, liquidity/ working capital optimisation, and supply chain financing solutions," he says. "On the latter point, there is a notable trend towards the automation of receivables and supply chain financing leading to a growing number of disrupter platforms supporting this workflow."

Where they are available, APIs simplify setup and are lower cost connectivity channels. Finastra uses APIs to connect its treasury management solution with FX dealing platform 360T and its confirmation matching service, for example.

The use of APIs enabling data sharing between systems has had some impact on the resources required to manage interfaces between these individual treasury solutions according to Hines, who notes that SAP has improved its connectivity tools and SaaS-based TMS providers including Kyriba and GTreasury are beginning to launch API portals.

There is a tremendous opportunity for those solutions that support open banking given that they can leverage APIs to incorporate data from multiple solutions into a single dashboard suggests Manoj Mishra, Vice President of Consulting Services at CGI. "Institutions able to leverage APIs to provide a unified experience using niche fintechs wherever it makes sense will emerge as the ultimate winners," he says.

But API readiness still varies by bank and technology provider, creating a general lack of global standardisation and maintaining demand for channels such as SWIFT. In addition, the buyer will still be working with multiple suppliers for installation, integration and ongoing product support cautions Ken Lillie from treasury consultancy Lillie Associates.

"Every system project and requirement definition is different, so corporates need to complete a thoroughly researched requirements definition," he says. "They should also look at the market to see what products are available to meet those requirements – including TMS and standalone – examine each option for functionality and efficiency, and compare the overall price and ongoing cost of ownership."

When asked whether the lower cost of using an all-in-one system outweighs any compromise involved in using systems that don't deliver all the required functionality at a time, Khurmi says corporates need to balance total cost of ownership against functional fit.

"The use of multiple solutions is often assumed to be more costly and cumbersome, although recent developments – such as SaaS cloud deployment, single sign-on and the use of APIs for data integration between systems – means this may no longer be the case," he says.

Additional considerations in the choice of approach include training requirements, user experience, vendor support and relationship management. "These are all areas that are adversely impacted when using multiple platforms, so it is important the benefits of enhanced functionality outweigh these factors," adds Khurmi.

In some cases it makes sense for TMS vendors to expand functionality, for example in areas such as cash forecasting where ION Treasury has applied machine learning to its treasury forecasting capability. In other cases, providing integration with specialised solutions will be the preferred option, such as if a company is looking for greater automation of its investment activities.

Specialised solutions put pressure on treasury management providers to strengthen their own functionality in those areas, says Steve Wiley, Vice President of Treasury Solutions at FIS.

"In evolutionary terms, treasury management systems which have received continual investment over the past 20 years have evolved to a point where they can do most or all of what specialised or best-of-breed solutions can do," he explains. "Newer treasury management systems struggle and are forced to partner with ecosystem players to establish stronger integration."

Treasury management providers are focusing on both building and partnering according to Tracy Kantrowitz, Vice President of Market Treasury at Bottomline Technologies.

"The concept of an all-in-one treasury solution was a nice idea decades ago but that model and strategy is no longer scalable," she suggests. "Treasury management system providers must invest in both core treasury functionality and digital services that allow them to integrate and cooperate with other solutions."

Treasury management systems need to support wider functionality as the market trend amongst banks, TMS providers and fintechs is to aggregate and consolidate financial services offerings with the systems used to support the business, adds Eric Aillet, Product Manager Fusion KTP at Finastra. "The distinction between each will reduce over time as the value chain is consolidated," he says.

The trend for fintechs to develop solutions focused on specific treasury functions might suggest that treasury management systems need to offer wider functionality, but that is not the only factor in purchasing decisions. Hines concludes that a corporate might choose a standalone component because of its lower cost of ownership. ■

Efficiency wins

Sayan Mukherjee,
VP, Group Treasurer

nexperia

Sayan Mukherjee, VP, Group Treasurer at semiconductor manufacturer Nexperia, discusses how he is positioning the company for growth and his key treasury priorities.

Nexperia is a global semiconductor manufacturer headquartered in Nijmegen in the Netherlands and owned by Shanghai-listed Wingtech Technology. It has front-end factories in Hamburg, Germany, Manchester, England and Newport, Wales, and back end factories in Asia. It is the former Standard Products business unit of NXP Semiconductors, once part of Philips Semiconductors. The company's product range includes bipolar transistors, diodes, ESD protection, TVS diodes, MOSFETs and logic devices.

Sayan Mukherjee, VP, Group Treasurer at semiconductor manufacturer Nexperia has been a constant source of stability during phases of change and growth at the company. He is a steady hand in a firm working in a sector buffeted more than most by cyclical ups and downs and currently in the grip of fiercely tight supply. The company has also been sold twice during his tenure.

In 2017 Netherlands-based NXP Semiconductors divested its standard product business unit to a group of private equity investors who named the new unit Nexperia. Two years later, Nexperia was sold to Shanghai-listed Wingtech Technology. Under Wingtech's ownership, Mukherjee is now overseeing Nexperia's group treasury function and an ambitious growth trajectory.

Mukherjee arrived as head of treasury at one of Europe's fastest growing tech companies when Nexperia's former CFO offered him the opportunity to carve out and establish a global group treasury function, persuading him to leave his job as finance director and controller at NXP's Manchester operations. Four months of immediately thrilling, and instinctive, learning the ropes at NXP's Netherlands-based treasury followed. "They were long days with lots of challenges, but I loved it from the start," he recalls.

Once at the helm, his first priority was getting a handle on cash forecasting and the company's cash position, ensuring Nexperia could begin its journey smoothly as a new company, "We were a new company; it was essential we could meet our stakeholder commitments and establish credibility." Control of the company's cash position enabled an early treasury win. Nexperia refinanced within the first year of operating, significantly slashing interest payments on its debt and raising US$800m. With a tailwind of keen bank support and an emerging brand, the inaugural refinancing was well oversubscribed. "It was the first big ticket item that I led with our CFO, legal team and banks," he says.

Leveraged buyout

It wasn't long before the next challenge appeared on the horizon. Nexperia's private equity investors sold the company to Wingtech Technology, one of the world's biggest contract manufacturers of mobile phones, intelligent devices and 4G/5G intelligent terminals via a US$5bn leveraged buyout. Mukherjee oversaw a huge round of bank fundraising and set up a revolving credit facility to put a US$1.5bn financing in place. "We borrowed money at the lowest possible level," he says, detailing how the process once again optimised cash and brought down the company's debt. "Our tag line in the company is efficiency wins."

It isn't just efficiency that has reaped success. Mukherjee attributes much of the credit of both those early transactions when the company was sold, and then sold again, to the trust his small team had with Nexperia's changing stakeholders and management team. "There was a lot of confidence from the CFO and management team in our treasury."

Semiconductors

Today, cash is king once again, as he readies treasury to support the company's growth ambitions. Most recently visible in Nexperia's purchase of Newport Wafer Fab, Mukherjee is primed and ready to support more growth head. "We have a lot of dry powder." He adds that the company has come out of the pandemic in a strong position. Production continued, and with inventory on hand when demand spiked in 2021, revenue and cash are rolling in. "We had confidence the market was going to come back; the sectors we play in are all in long-term growth."

Keeping your pencil sharp

Liquidity is also fundamental to treasury's ability to support Nexperia's diverse customer base and supplier relationships. Nexperia sources wafers from foundries in Asia as well as its own front-end factories in Hamburg, Manchester and now Newport. Long-term relationships with these suppliers, as well as customers, are grounded in strong partnerships that hold steady through the industry's ups and downs, recently accentuated by the pandemic.

For example, treasury must be ready to step in and provide liquidity to suppliers like pre-payment support or new payment terms when needed and his team is in constant collaboration with both internal procurement and external stakeholders. "Treasury has a role nurturing long-term relationships to help manage our supply," he explains. "You need to understand the levers in treasury, and how these can be used to support customers and suppliers. It requires being alert and conscious of the risks." He adds that supporting customers and suppliers is a live, constant conversation. "I can't just wake up one morning and provide support – you have to keep your pencil sharp."

Banking relationships

Nexperia currently has around 14 global banks in its lending and services group, offering a mixture of cash management, FX services and financing. Should he need to tap financing in the future, he says he has strong relationships and support on hand, describing the company's bank relationships as steeped in "mutual trust and growing confidence in Nexperia's credibility and ability to support growth." He adds, "People want to partner with us; we are well known in the banking space."

Hedging

Mukherjee oversees a range of hedging policies including P&L hedging and interest rate and balance sheet hedging – including a euro-denominated loan. Strategy is shaped around "total analysis" of the risk whereby Mukherjee anticipates every

I am hopeful that in the next five years we will have credible software that can testify the assumptions we are making in our cash flow planning. With AI, we will be able to improve the way we work and keep our 'house' well organised.

possible scenario using processes and techniques engrained during his studies. From this, the in-house team designs a hedge that works "no matter what the turbulence" which banking partners then independently review. "Of course, you can't capture all scenarios, but if you do enough due diligence, you can cover 90-95% of cases. If you only look at one specific risk, then you don't look left or right."

He also advises on keeping focused on the purpose of the hedge and what risks treasury is trying to hedge. He is wary of the costs of hedging long-term, hence his preference for programmes with roll over hedges. "We design a hedge from a pure treasury financing perspective," he concludes. "It's particularly important to review how it shows up in the financial statements – these are high value hedges and if you don't give them the right treatment, it can create significant accounting issues."

Rising inflation and interest rates have raised the profile of the hedging programme. "It's not about taking risks," he says. "We hedge to protect ourselves against losses." His primary concern is that the US Federal Reserve and other central banks, worried about repercussion in the economy short term, have been slow to react to inflation. It could mean sharp rate rises ahead that threaten economic growth. "If we pursue incremental growth using leverage, if interest rates go up it could backfire in a big way unless we are protected with a hedging programme. We don't want to find ourselves in a challenging situation in five years. My fear is the unknown, not the known. You can plan for the known."

Tech investment

Liquidity is also essential to finance Mukherjee's ongoing tech investment, something he views as a key tool to creating efficiency, minimising risk, and improving the quality of reporting. The company's TMS automates all cash flow reporting and bank reconciliations, and he is poised to roll out a large scale, next-step SAP transformation. On a smaller scale, he keeps an eye out for opportunities to work with fintechs, particularly around using AI. Indeed, his treasury preference is to leave well alone if technology can do the job. "We are constantly looking at ways we can optimise technology. Where a transaction doesn't need to be touched, it shouldn't be."

He is particularly enthused by big data and AI opportunities that promise to transform analysis in areas like suppliers' account data and smart accounting, as well as predictive cash flow planning. "I am hopeful that in the next five years we will have credible software that can testify the assumptions we are making in our cash flow planning. With AI, we will be able to improve the way we work and keep our 'house' well organised."

Mukherjee qualified as a chartered accountant in India and later picked up various financial qualifications in London. He worked in a variety of roles in India at HCL Technologies and IT and services group CSC before joining NXP in Manchester in 2008, just as the semiconductor group spun out from Philips. All his previous roles offered him the opportunity to apply the finance he'd learnt from textbooks to the real world, he says. "I don't believe it's always necessary to have done something before. If you go through the process, new challenges are entirely possible."

It's indicative of a self-belief he credits first to his parents, subsequently nurtured by teachers, and then memorably cemented by his former CFO, who encouraged him to take the group treasurer job at Nexperia. "He thought it would be a good challenge for me – if it was not for him, I would not have got this opportunity." More recently, Wingtech Technology's gruelling due diligence process which singled out his treasury for praise, has been another source of professional pride.

Mukherjee believes a successful treasury depends on always "trying to do more than is required," a healthy dose of patience, working with strong partners and adopting a pragmatic approach when things go wrong. He says good relationships with all stakeholders, particularly legal teams for their "different perspective" and senior managers in relationship banks, are also essential, as is close cooperation with in-house colleagues. "Our senior finance colleagues are always my first point of call to discuss things and check that I am doing the right thing," he says, adding he also works closely with finance colleagues in Wingtech's own treasury team.

Amid all he's achieved, he is most proud of building up a young, motivated treasury with intellectual curiosity to learn and a diversity that reflects his own. "I am a British national, born in India; my wife is Greek, and we live in Hamburg," he laughs. Indeed, the diversity and social side of the job is one of the aspects he enjoys most. "I can speak to people representing five or six different cultures during the course of the day." It has given him a cultural fluency and ability to read the most diverse of meeting rooms.

He concludes with a nod to the importance of intellectual curiosity and collaboration. An appetite "to learn on a continuous basis" is vital in treasury given fast changing regulations and technology while collaboration is fundamental to building networks and relationships. He also loves Nexperia's can-do culture, free from bureaucracy and where it is possible to approach anyone within the organisation. "We are a big company, but we have the culture of a start up." As for relaxing, he increasingly seeks out green spaces alongside spending time with his family. "It's been an amazing opportunity growing a global company," he concludes. ■

Materiality matters: investors pile on the ESG pressure

When it comes to ESG, shareholders are increasingly prepared to ask tricky questions of boards, vote against directors and file shareholder resolutions. Investor and treasury teams need to ensure they have a grip on what is material.

A recent conversation between executives at asset manager AllianceBernstein and Swiss multinational food and drink group Nestle offers a window into the types of discussion companies now have with their shareholders. Speaking at Bernstein's Pan European Strategic Decisions Conference, Bruno Monteyne asked Nestle's CFO François-Xavier Roger how, given some of Nestle's mainstream food and drinks are still not "healthy enough," Nestle planned to balance growth and health ahead.

When the conversation turned to Nestle's recent sale of a US water business to a private equity group, Monteyne suggested it amounted to "passing the moral buck." Long in the sights of environmentalists who argue water businesses in the region drain natural water supplies to bottle and sell it at a profit, he said "disposing doesn't really solve the issue for society."

A growing cohort of investors now believe that climate change and broader sustainability issues are a material risk and can damage returns either through physical or transition risks, such as regulation and carbon pricing. Nestle's Roger's insistence that the company was not taking an "easy" route but was facing the "challenge" and "responsibility" of sustainability shows how ESG sits alongside performance and outlook in corporate conversations with their shareholders, prepared to ask tricky questions of boards, vote against directors and file shareholder resolutions.

All the while the conversation often leaves corporate teams frustrated and overwhelmed by the ESG noise and information out there. Anecdotally, corporates say their shareholders often don't ask the right questions, honing-in on a particular ESG risk that is not as material or relevant as others to seize the narrative and muddy what should be a powerful and effective conversation.

Shareholder power

Shareholders are growing increasingly vocal and emboldened. Companies which don't engage with investors regarding sustainability risk escalating, collaborative shareholder engagement. Like activist investor Engine 1, which only held a tiny stake in Exxon Mobil but argued that the oil giant has been too slow to recognise the transition, endangered their portfolio and destroyed investor capital, managing to persuade other investors including pension funds

and asset managers BlackRock, Vanguard and State Street Global Advisors to back their campaign for different leadership at the top. "In the most polluting industries, investors are realising that climate risks pose a short-term, existential threat to the viability of entire business models," says Simon Rawson, Director of Corporate Engagement at pressure group ShareAction.

Beyond climate, investors have shunned businesses with unsustainable labour practices as employee health and safety, now a key topic for SASB (the Sustainability Accounting Standards Board which identifies the ESG issues most relevant to financial performance across industries) increasingly pushes centre stage because of the pandemic. Fears of a legal challenge regarding gig worker rights contributed to Deliveroo's IPO performing well below expectations and caused M&G, Aberdeen Standard Investments and Aviva Investors, which collectively oversee more than £1trn in assets to drop out. In another example, fast fashion company Boohoo saw its share price tumble as allegations emerged of exploitative labour practices.

Investor benefits

On the flip side, companies that have strong sustainability stories reap the investor benefits – like a reduction in the cost of capital. Research from ratings agency MSCI shows that across both debt and equities, advanced and emerging economies, companies with higher ESG ratings have a lower cost of capital by up to 40 basis points. "The relationship between ESG scores and the cost of capital was the strongest in the US, where the lowest-ESG-scored companies faced significantly higher cost of capital than the highest-ESG-scored companies," said Ashish Lodh, Vice President, MSCI Research. "In Europe and Japan, the relationship was not entirely consistent, although the cost of capital for the lowest-rated companies remained significantly higher than for the best-rated ones." Elsewhere, research by Aegon Asset Management finds that companies in the most polluting industries have shrinking investor bases.

When German logistics giant Deutsche Post DHL Group published its accelerated roadmap to decarbonisation in March this year, it saw a significant rise in its share price, said Adam Pradela, Executive Vice President Corporate Accounting & Controlling and Klaus Hufschlag, Senior Vice President, CREST Finance Business Intelligence & Analytics in an interview with Treasury Today. "Importantly, our stock price went up at the same time as we announced plans to spend €7bn on sustainability by 2030 – the world of investment is going in this direction. Investors appreciate what we are doing." The company has cut carbon emissions by 37% since it started its CO2 reduction programme, and carbon is now the most relevant KPI for the company's investors, they said.

"There are a couple of risks posed by not working with investors," says Madeleine Szeluch,

ESG Director, Investor Relations at Novartis, speaking from the pharmaceutical group's Basel headquarters. "The first risk is that not engaging with shareholders could be reflected in a lower share price in the long-term for corporates. Secondly, investors could divest in favour of companies that prioritise sustainability, thus resulting in corporates losing out on a growing segment of sustainability-minded investors."

Materiality

Novartis was the first pharmaceutical company to hold an ESG Investor Teleconference in 2014, now grown into an annual ESG Day for investors with the CEO, Vasant Narasimhan. "We wanted to create an opportunity and a platform for engagement between our senior management and investors on issues that have been increasing in importance for a number of years, both for us as a company and our investors," says Szeluch, one of two full-time ESG directors sitting within the investor relations team.

For treasury and finance teams wondering where to begin improving their ESG dialogue with investors, Szeluch suggests a good place to start. Novartis's Materiality Analysis is central to its approach to ESG and involves a process that allows all stakeholders, including investors, to contribute to the most material risks that define the company's value creation potential ahead. "We conduct our Materiality Analysis every four years, engaging with several thousand internal and external stakeholders to identify the most critical areas that we want to focus on from an ESG perspective." The most recent analysis revealed patient health and safety, access to health care, innovation, and ethical business practices as the most material.

The fruits of the analysis were evident in investor enthusiasm for the company's first Sustainability Linked Bond last year, structured so that bondholders receive a higher interest if Novartis fails to meet targets around expanding access to innovative medicines. "We were encouraged by the strong investor feedback that we received. Our SLB was recognised as innovative and industry leading." She adds that Novartis's commitment to being carbon, plastic, and water neutral by 2030 has also been "very positively received by investors."

Similarly, corporate finance and treasury teams' conversation with ESG-focused shareholders will be much easier if they have a firm grip on what ESG issues are most material to their business. By identifying just a couple of the most material around energy use, supply chain management or how a product is made, corporates can get back in control of the narrative, guide investors on what matters most and position the company in the market, allowing the investor story to flow.

The need for materiality is even more important given the debate is set to get more complicated. Investors are increasingly drilling down into companies net zero pledges and commitment to being carbon neutral by 2050. They are honing in particularly on companies that are not decarbonising, opting instead to compensate via carbon offset initiatives. "Leading practice amongst investors is now starting to interrogate the credibility of these plans in the short, medium, and long-term," says ShareAction's Rawson. Biodiversity loss and other impacts are also pushing centre stage. "They are asking questions about how companies are taking these related issues into account in their planning and how they measure and account for their impacts."

Many corporates' teams expect ESG conversation with their investors to get more discerning as investors hunt down truly compelling green stories in the years to come. Today, most companies are playing on the transition, arguing they are on the path to net zero and greener endeavour, just not wholly green yet. But in the years to come it should only the greenest companies that attract the easiest and cheapest capital. ■

Niche or normal? Treasurers decide on digital currencies

Cryptocurrencies, stablecoins, central bank digital currencies are hot topics in the financial industry, and they are quickly becoming mainstream. Treasurers need to think about the implications of digital currencies now and decide what they need to do to get ready for a wave of change that is coming their way.

If you were facing the biggest disruption that financial services had ever seen, what kind of treasurer would you be? One who embraces innovation… or one who ignores it? That is a question treasurers could be asking themselves in the face of digital currencies and whether they have the potential to completely disrupt treasury services as they are currently known.

Treasurers differ in their mindset when it comes to digital currencies, comments Brad Yasar, Founder and CEO of EQIFI. There are those who have a positive outlook, who are exploring opportunities even if they are not getting involved in them right now. And then there are the more old-school types, who do not want to touch any of it. Of cryptocurrencies, these treasurers have typically heard J.P. Morgan CEO Jamie Dimon "bashing crypto" and see Tesla's maverick CEO Elon Musk investing in it, and they look at crypto as something that will disappear, says Yasar. "But they have been looking at it as a 'scam' for the past 12 years. It has not disappeared, and it keeps growing. I do not think that camp gives it the time and attention it needs. Some people are completely anti alternative investments," he says. And that is a missed opportunity, adds Yasar, who is a serial entrepreneur, and also founder of EQIFI, which is positioning itself as the leader in decentralised finance, and offers a single platform for banking, trading and lending for fiat and cryptocurrencies.

"This ain't going away; it's not a flash in the pan," says Luke Sully, Co-Founder and CEO, Ledgermatic, on the topic of digital currencies and digital assets.

And treasurers are well placed to take advantage of digital currencies. In fact, if corporations are going to innovate with Bitcoin, cryptocurrencies, blockchain, stablecoins and the like, the natural place for that innovation to start is with the treasurer.

The first step is to perhaps consider Bitcoin as an investment. Earlier this year Tesla invested US$1.5bn in Bitcoin, and when that news broke, Sully –whose company Ledgermatic enables treasurers to manage their traditional and digital assets in one place – said he received a lot of calls. Although other companies, such as business intelligence Microstrategy and payments company Square, have also invested in Bitcoin, the uptake hasn't been what some thought it would be. "We have not seen many companies put it on the balance sheet – that did not really take off, for a variety of reasons," says Sully.

And for treasurers, there is a lot to consider. Michael Aandahl, Head of Digital Treasury at Ingka Group, the largest IKEA franchisee with 392 stores in 32 countries, has looked into the multi-faceted topic of digital currencies. The first question he asked was whether the group's customers would be interested in this as a payment form. "We did not identify any immediate customer demand that is specific to our industry," he tells Treasury Today. The experience of retailers, however, is likely to be different from corporates that are already in the financial chain– such as consumer payments companies – where digital currencies are already a hot topic and have more relevance in the near-term to their customer base, he comments.

Aandahl explains that Ingka Group also considered Bitcoin as an asset class. "We have had that discussion and we decided it is not for us for various reasons," he says. He adds that Bitcoin as an investment does not fit into the classic treasury mandate. It was ruled out, especially given the environmental concerns about the mining process. From an ESG [environmental, social and governance] point of view, it was "not going to fly", considering what the company values are, he says.

With Bitcoin as an asset, it's not just the ESG concerns that treasurers are grappling with. Reporting Bitcoin on the balance sheet is a sophisticated accounting problem, says Sully. Also, there are the practicalities of managing a portfolio of crypto investments. If corporates do hold Bitcoin, it is likely to be held in siloed wallets on various exchanges, with little visibility – or controls, for that matter – about who can move it there. A "half-sophisticated" investor has probably got five to six different accounts on various exchanges, explains Sully, all of which aren't related to anything else they are doing. This leaves a treasurer logging into one account at a time. "We

thought this is a disaster for crypto hedge funds. Someone will want to know their position and it will take an hour to figure that out."

Also, there is the issue of the changing value of crypto. As Yasar points out, "Crypto is continuous – the value continuously changes. It may change 20% in a day."

Brett Turner, Founder and CEO of Trovata – an open banking platform that companies use for real-time cash forecasting, cash reporting and cash flow analysis – explains how it has helped one of its largest customers, Square, with its cryptocurrency holdings. Trovata's platform enables it to know its cash position in real-time. Unlike traditional treasury management systems, which were typically designed over 20 years ago, Trovata leverages cloud technology, big data architecture and APIs to deliver real-time cash reporting to treasurers. When it comes to managing Bitcoin as a digital asset, treasurers would not normally be able to see this as part of their overall cash position. With Trovata's solution, however, they can see the real-time value of the Bitcoin and know what the US dollar equivalent is at any point in time.

Square is unusual when compared to the typical company and most treasurers are still wary of investing in Bitcoin. "Because of the volatility concerns, very few treasurers are wading into it," says Turner. Some treasurers, however, are updating their treasury policies so they can buy it. They are considering Bitcoin as a hedge against inflation, especially in a low-interest rate environment where they are searching for yield and rethinking their options.

There are still ways for treasurers to explore these options at arm's length. They may want to have exposure to a fund of a fund that is invested in crypto, such as Pantera Capital or Galaxy Digital, for example, explains Yasar.

In terms of persuading people who are reticent, Yasar says, "Think of crypto as an insurance policy. Do not look at it as 'I'm going to make money this is a solid investment'… If it is a complete scam, you paid your premium and nothing happened. But what happens if it disrupts your business? If you have invested – you have disrupted your own industry," he says. And to EQIFI's institutional partners he says, "Do not try to make a meaningful investment. Do a small investment and do it for the long-term – as an insurance policy."

There are some corporations out there that are more forward-thinking than this. Another way to explore the potential of crypto, is to invest in an internal lab or exploratory group. Some companies may even put aside US$10m or US$20m for such a project, comments Yasar. This could include exploring how to mine Bitcoin themselves, which gives them certainty over the cryptocurrency's provenance and knowledge that it has not been associated with illicit activity in the past.

So far, much of the focus on digital currencies has been on Bitcoin as a store of value, comments Turner. In terms of its function as a payment mechanism, Turner says there are inherent problems with transferring funds this way, "It can still take a few hours to settle," he says of Bitcoin transactions.

Given this slow time to settle, it's unlikely that Bitcoin would be used as an alternative payments network for a corporate's regular transactions. For consumer-facing companies, however, they may need to consider Bitcoin as a payment form so that they can accept it from their customers. Yasar

> This ain't going away; it's not a flash in the pan.
>
> Luke Sully, Co-Founder and CEO, Ledgermatic

points out that it is possible for companies to accept Bitcoin payments from customers without holding it on the books and carrying the risks of volatility. There may be risk while the customer has items in their online cart, but once they check out – paying in crypto – companies can quickly divest out of it, explains Yasar.

When it comes to digital currencies as a payment method, there has also been a lot of interest in stablecoins, which are digital coins that are backed by a regular fiat currency to make them 'stable' and smooth out any volatility.

Turner expects to see stable coins being used more widely, especially as a means of payment. Private companies could effectively issue their own currencies. Sully expects to see the same. "People are doing a lot of building this year," he says, adding it won't take long before the most well-known brands are issuing their own coins. Such stablecoins could be used for loyalty schemes, for example, or perhaps an alternative to retailer-branded gift cards.

Meanwhile central banks around the world are making plans to introduce their own digital currencies, which would, in effect, be digital versions of money they issue. The biggest pain point for treasurers, comments Turner, is cross-border payments, which can still take several days to settle across an outdated and complex system. With central bank digital currencies, however, there is the opportunity to change that. "With the digital coins you can architect modern technology from the ground up and everything else – all this existing technology – becomes obsolete and you get a chance to have a complete reboot of all that," says Turner.

For now, it seems that the central banks are still working out how these currencies would actually work in practice. And what about treasurers who say they don't need to think about digital currencies yet? "They should invest time in understanding the dynamics and the evolution of this market. If any of this takes off in a serious way it will have a significant impact," says Aandahl. "This has the potential to impact the whole financial world, and customers need to be prepared upfront if that happens," he says.

Also, Aandahl adds that he's not just considering the outlook for digital currencies in his role as a treasurer, but also in terms of what it means for the business he is supporting. In many respects, he takes on the role of a translator who explains what these latest technologies are and what their implications could be.

So, when should treasurers get their systems ready for digital currencies? "The time is now to start thinking about your technology and systems environment. People are still using Excel – they need to start thinking about next-generation technology. They need to think about open banking and how their bank can help them with these changes," says Turner. "People need to start being ready," he adds. ■

COP26 expectations and priorities

> *What will be the most important implications for treasury teams to come out of COP26 in Glasgow; what would you like to see and how should corporate treasury prepare?*

Silke Goldberg
Partner
Herbert Smith Freehills

I am expecting COP26 to address the carbon markets, loss and damage, and nature-based solutions to absorb CO2, at a more technical level. There is huge public interest in the conference, and I'm hopeful for progress.

One of the tricky issues is Article 6 of the Paris Agreement, the stepping-stone to international emissions trading. Article 6 currently provides a loose framework for countries and companies on how to achieve a carbon price, and how trading of carbon credits could happen in the future. Carbon trading and emissions has a potential impact on treasury, particularly corporate investment decisions. For example, if a business is subject to carbon pricing, it may view energy intensive investments differently, factor in a carbon price or seek a different type of financing.

The UK, Europe, and China – as of last July – have emissions trading. There is now a proposal in the EU for a Carbon Border Adjustment Mechanism (CBAM), which is related to the impact of the EU's emission trading system and which will have treasury implications. For example, a company needing steel and importing Australian steel (where there is no carbon price on steel) into the EU will have an advantage over an EU business using EU steel that is subject to a carbon price.

There is now a proposal about how to address this with a tax on imported goods so that the delta on the price applied in, say, Australia, versus the carbon price in the EU is then applied to the import. From a treasury perspective, this is important. I expect to see noise and discussion here with treasury teams needing to price in what the CBAM will do to the price of imports, exports and set money aside. The CBAM requires a degree of internal due diligence, especially for companies in energy intensive industries like steel, plastic, and cement. Imports into the EU will likely to be subject to additional carbon pricing. And of course, this all foreshadows a global carbon price and how it might work. People are watching this space closely.

COP26 will also focus on nature-based solutions and there are treasury implications here. Companies that are not subject to carbon pricing often offset their emissions by investing in woodland and other carbon sinks. The rules here are likely to be debated with new technical provisions, given the wide range of varying standards for offsets and the fact that nature- based solutions may offset but in and of themselves do not lower emissions.

COP will also debate the loss and damage side of climate change, essentially the extent to which industrialised nations should pay more for climate change than developing countries because they have polluted more. It could involve a mitigation mechanism and technology transfer that acknowledges industrialised nations' larger contribution that could have treasury implications. Nationally Determined Contributions (NDCs) may result in a local climate tax or levy on business that treasury will have to manage, this will however depend on the climate change strategy of each individual government.

Parvaiz Dalal
Global Head Supply Chain Finance, Treasury and Trade Solutions
Citi

Five years ago, we only had a handful of conversations a year with our clients about sustainable supply chain finance. Now it is one of the first things they want to talk to us about, and COP26 will accelerate the conversation. I expect more, large corporations will come out with statements about reducing emissions and hitting further ESG goals embedded in their supply chain, triggering a waterfall effect. If world leaders signal support for stronger reporting requirements on indirect emissions it will lead to corporates introducing reduction targets across their value chain, including identifying suppliers which are helping them to deliver their ESG goals, creating a bigger role for supply chain finance by offering better terms linked to cutting emissions to their suppliers.

In regards to visible banking solutions linked to sustainability, transaction bankers have started playing a critical role embedding sustainable standards in working capital solutions. Now, rather than only prioritising large, strategic investments or capital markets deals, I would say treasury's focus is on how to embed ESG into day-to-day operations in their working capital flows. Companies want to embed sustainability not only into how they buy and sell their goods but across their entire working capital flows and more so when they are sourcing inventory – like reducing electricity usage. COVID has further shaken up operations and turned the focus on sustainable supply chain flows. The just-in-time supply chain and cost is no more the top priority that it used to be. Getting goods on time and sustainability in supply chains have risen to the top of the priority list.

Companies are linking financing tools to sustainability, and deciding their counterparties based on sustainable

parameters. One of our aims is to incentivise our clients' suppliers to conform to ESG standards of certification by offering a lower level of financing, like we did in August, working with McCormick & Company, a global leader in food flavours, and the IFC providing suppliers of McCormick's herbs and spices with financial incentives linked to ESG improvements. Suppliers qualify for discounted rates on short-term working capital financing when they meet sustainability standards accepted by McCormick – the higher the suppliers' performance level in meeting these standards, the more they save. We are witnessing multiple requirements by many clients asking us to deliver better terms to suppliers which are compliant to their sustainable goals which are linked to Paris Accords or the UN's SDGs.

At this stage, companies are not being forced to do this, it is not punitive. Although this could begin to change if COP policymakers encourage the introduction of legislation to make businesses more accountable not only for their own direct emissions, but also their counterparties.

Marcelo Bacci
Chief Financial and Investor Relations Officer
Suzano

I have high expectations about COP26. If we want to leave a better world for current and future generations, we can no longer delay defining bold, coordinated and effective measures for change. Above all, COP26 must agree on the implementation of an international regulated carbon market linked to the Paris Agreement, establishing an economic instrument that is capable of driving concrete action to remove carbon from the atmosphere on a global scale.

Joining the global Cap and Trade model (which Suzano strongly advocates) will offer a viable alternative for reversing the carbon emissions curve. It will also facilitate a mechanism to honour public commitments, or Nationally Determined Contributions (NDCs), and accelerate the decarbonisation of the global economy. At the same time, it will help drive an agenda of global investments in decarbonisation, with significant implications for sustainable social development worldwide.

At Suzano we hope COP brings immediate action and progress on a carbon market before we reach a point of no return for the environment. The capture of carbon dioxide by trees is part of this equation, and Suzano, as a natural capital company, understands the important role it plays in protecting and generating value from trees. The company also has potential to generate carbon credits and is climate positive – meaning that besides offsetting greenhouse gas emissions from its own operations and its value chain, the company removes more carbon than it emits.

The adoption of an international carbon market could generate diverse opportunities for low-carbon assets and products. It could turn Brazil into a champion in this market, generating income, attracting investments for preservation efforts and creating sustainable development alternatives for local communities, including the people living in the Amazon region.

The expansion of our forest bases, whether for planting or for conserving native forests, plays an important role in the company's ability to increase carbon sequestration from the atmosphere. At the same time, we are committed to reducing our equivalent emissions: the more Suzano produces, the higher its positive impact on the world will be.

Will COP help change corporate behaviour? I would argue consumers are changing corporate behaviour. Society is increasingly concerned about its role in building a more sustainable future and this is driving changes in corporate behaviour. People are concerned about consuming products from renewable sources, especially recyclable and biodegradable materials which cause less impact on the planet and this is mobilising companies, governments, investors and society as a whole.

Suzano is on the right side of the equation since our products are developed from trees planted for this purpose. In other words, a raw material derived from renewable resources that can replace fossil-based products. We want to offer ten million tons of products from renewable origin by 2030 to help replace petroleum-based products. We are also constantly pursuing new avenues for developing products from planted trees, including textile fibres as alternatives to cotton. ■

Next question:

"What does China's money market fund landscape look like today, and what developments are likely in 2022?"

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

New central bank targets

Many major central banks changed their targets not long ago. To make sure central banks don't tighten monetary policy too early, monetary policy will be tightened only when actual inflation will exceed the target of 2% for some time. In addition, the Fed wants to stimulate growth to the extent where the labour market tightens and wage increases end up at distinctly higher levels. Hopefully this will reduce inequality.

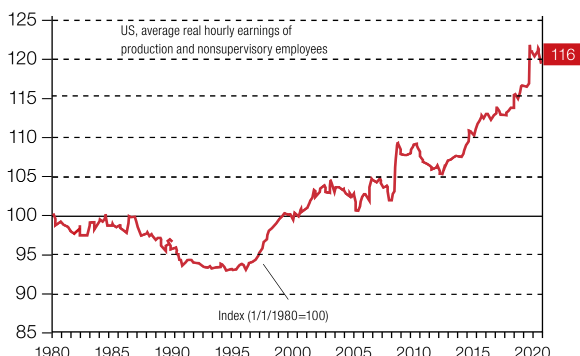
Globalisation has created a massive divide in the West. Those who are directly or indirectly affected by competition from low-wage countries – most notably China and the rest of Asia – have experienced a stagnation in real wage growth for many years. The introduction of new technology generally has the same effect.

By contrast, those who facilitate globalisation, or those who are not faced with competition from low-wage countries, have enjoyed significant gains in real disposable income. In addition, this group generally owns shares and/or property, and, thanks to a very loose monetary policy, prices of these assets have been going up for many years.

This has resulted in a growing divide. Many central banks in the West regard this as a very precarious situation. Indeed, people who are well off mainly vote for the centrist parties, while those who lag behind generally vote for extreme and radical parties on the left and right side of the political spectrum. This forces the moderate parties to shift in this direction, as otherwise they would lose too many votes.

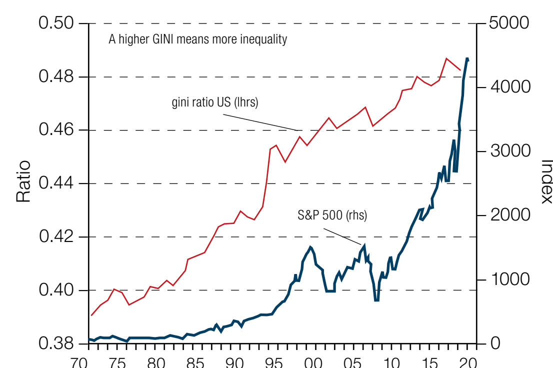
Research shows that higher wage growth mainly benefits employees whose real disposable income has been stagnating for a long period of time and this suggests higher wage growth is one of the most attractive strategies to reduce inequalities. This is why central banks want wage increases and inflation to be at excessively high levels, before they hit the monetary brakes in earnest. Until then, the economy should continue to receive stimulus.

Chart 1: In the past decades, average real wages of us production workers have hardly risen



Source: Refinitiv Datastream/ECR Research

Chart 2: There sems to be growing disconnect between have and have nots due to rising asset prices



Source: Refinitiv Datastream/ECR Research

Message from the markets

The question is whether central banks have the courage to crack down on excessively high inflation. This question is particularly important at the present time, as both inflation and wage increases are under upward pressure, while monetary conditions are still more or less the same as during the low point of the corona crisis. Monetary policy may therefore well be too loose for the current circumstances, as a result of which financial markets may lose confidence that central banks will prevent inflation from spiralling out of control, resulting in rapidly rising interest rates and declining asset prices.

It is therefore quite likely that central banks will not be able to delay tapering and/or rate hikes for much longer. Tapering means that they will reduce their massive bond purchases. And then just enough to prevent inflation (expectations) from rising too rapidly, while ensuring that the economy does not fall into the abyss.

Long-term interest rates have not risen significantly. This also shows that the markets do not expect inflation to rise substantially. It is more likely to fall back according to the markets, otherwise the average inflation expectation for the next ten years would not be far lower than the current inflation rate. The markets therefore believe that the spread of corona will gradually be curbed more effectively, as a result of which many bottlenecks will disappear and inflation will fall back. However, we have a slightly different view.

ecr research

The past is no guarantee for the future

Economists have too often extrapolated the past too much into the future. In the early 1980s, for example, they did not see the transition from higher to lower inflation coming and almost nobody anticipated the 2008 credit crunch.

We strongly assume that we are witnessing another important turning point. Certainly, after the credit crunch broke out in 2008, the great risk was deflation rather than inflation. This is why, since then, central banks have made considerable efforts to stave off deflation and achieve higher inflation. They have pulled out all the stops for this, however, inflation stayed well below 2% until recently.

Corona has driven inflation well above this level, but it is generally argued that the old situation will return as soon as the pandemic is under control.

A great deal has changed

We do not share this view because the situation has changed dramatically.

- Under the current central bank policy, wage increases and inflation will have to have reached excessively high levels before central banks take proper action. However, it is generally the case that inflation tends to keep rising once it is in an uptrend. As changes in monetary policy only have an impact after four to eight quarters, this means that the monetary brakes will ultimately have to be hit fairly hard. Asset prices will immediately plummet in this case, which entails the risk of another credit crunch. It is therefore doubtful whether central banks will dare to crack down on rising inflation. All the more so because rising inflation has its advantages. It will alleviate the debt burden and produce higher nominal interest rates.
- The time of globalisation is over. A growing number of political parties in the West want to protect themselves against foreign competition – via import restrictions, for example.
- The major problem following the credit crunch was that debts had risen to excessively high levels – to the extent where most parties did not want to step up borrowing, and many banks were reluctant to supply credit. Hence, more money was created than the economy was able to absorb, which subsequently flowed to the asset markets, driving up prices there. This should ultimately lead to more credit supply and therefore to higher growth (and inflation). However, more and more surplus money was required to boost asset prices to even higher levels, and ever higher asset prices were required to maintain credit supply. This is why inflation never really went up.

  The situation is different now because public deficits have increased dramatically and are financed with surplus money created by central banks. The surplus money no longer sits in the banks waiting to be supplied as credit, but it ends up directly with consumers and companies via the government. As a result, central banks are far better equipped to stimulate the economy.
- Needless to say, corona has led to abnormal amounts of government expenditure and therefore to exceedingly high deficits. This will gradually be scaled back. However, it will not be scaled back to any great extent because politicians do not feel enough pressure as long as central banks are willing to finance the deficits and keep borrowing costs extremely low.

It is a tough way back

In conclusion, we believe that central banks will have their way this time, and that wage increases and inflation will indeed end up at higher levels. The timing depends on developments in terms of corona (and the flu), but central banks will ultimately achieve their goal.

However, once central banks have gone down this road, the way back will be fraught with difficulty. Of course, a central bank can always combat excessively high inflation by raising its rates far enough. However, if this entails a collapse in asset prices, the cure will be worse than the disease. In practice, central banks will choose to let inflation rise further. This is why we expect long-term rates to rise further in the coming years. ■

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