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HSBC

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While the treasury environment is never static, one area where it has become particularly dynamic of late is liquidity management. Multiple drivers have combined to create a situation where continuous (re)evaluation and evolution have become almost mandatory. Lance Kawaguchi, Managing Director, Global Head – Corporates, Global Liquidity and Cash Management at HSBC examines these factors and how they are affecting the process of liquidity management.

Change drivers

Macroeconomic factors

One of the most striking changes in corporate liquidity in recent years is its sheer volume. In the aftermath of the financial crisis, corporate treasuries worldwide put huge efforts into freeing up cash from within the business and have continued to do so. More recently, the global economy has also been picking up, with global GDP growth of 3.2 per cent in 2017 (up from 2.5 per cent in 2016) and some commentators forecasting growth of 3.3 per cent for 2018[1]. As a result, the level of cash on corporate balance sheets has now reached exceptional levels: USD1.8trn in the US and EUR974bn in Europe, the Middle East and Africa, while collectively the 25 most cash-rich corporates globally hold just under USD829bn of cash[2].

At the same time, interest rates in various countries have started to rise. The US is the most prominent in this respect with the Fed Funds rate now at 2 per cent[3], up from 0.25 per cent in late 2015[4]. In addition, the Federal Reserve has signalled that it will raise rates to 2.5 per cent in 2018, 3 per cent in 2019, and 3.5 per cent in 2020[5]. A diverse mix of other countries are also forecast to raise rates by Q2 2019 including China, Brazil, Mexico, the UK, India, Canada, South Korea, Indonesia and Japan[6].

Therefore, treasurers now have high cash levels, plus the opportunity in a growing number of countries to obtain better yields on that cash. This combination is a strong reason to revisit and update their existing liquidity management practices.

Mobilising liquidity: instant payments

Other factors are also giving treasurers more reason to undertake this now. As instant payment systems proliferate and the velocity of cash movement continues to rise, multiday clearing cycles are rapidly becoming a thing of the past. There are now 45 instant payment systems in production globally, with a further 11 being planned[7]. The near-instant capabilities of these systems are opening the door to new investment opportunities: treasurers will be able to invest cash for the short term that previously would have taken too long to mobilise, and/or be able to access longer, better yielding tenors. Individual transaction limits are a hindrance here, but these are becoming less of a problem. For instance, the UK's Faster Payments system ran successful tests in July 2017 with 16 participants with GBP20mn payments and is expected to increase its transaction limits during 2018[8]. Elsewhere, the new instant payments system in the Netherlands, which is due to go live on May 1 2019, will process unlimited amounts[9].

A further consideration is that instant payments currently operate on a nationwide basis, but it seems likely that they will continue to evolve to the point where they also function cross border. Taken to its logical conclusion, this could mean that treasuries would be able to mobilise balances in unrestricted currencies globally in near real time at minimal cost, which compares favourably with alternative mechanisms such as correspondent banking.

Internationalisation

Corporate business strategies have been another important factor driving the need to review liquidity management. International expansion of businesses means that many treasuries are continually having to accommodate new countries and currencies into their liquidity structures, or remove them in the case of disposals. They also have to do this while complying with local regulation (such as thin capitalisation rules) and business practices (such as credit periods taken by customers). An inkling of the pace of this international expansion can be seen from Eurostat's data on foreign affiliates[10] (FATS): between 2008 and 2015, the number of FATS in Europe rose by almost a third, an increase representing nearly 70,000 FATS entities. In developing Asia, foreign direct investment (FDI) has risen from USD406bn in 2012 to USD476bn in 2017[11]. Combining the pace of this geographic corporate expansion with the external drivers outlined earlier makes frequent review and revision of liquidity management structures and processes a priority.

[1] https://www.telegraph.co.uk/business/2018/03/14/boom-back-world-economy-put-strongest-spurt-since-financial/
[2] https://www.gfmag.com/magazine/september-2017/cash-piles-keep-growing
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[9] https://home.kpmg.com/nl/en/home/social/2017/12/instant-payments-instant-benefits.html
[10] Eurostat defines a FAT as: "A foreign affiliate as defined in inward FATS statistics is an enterprise resident in a country which is under the control of an institutional unit not resident in the same country." http://ec.europa.eu/eurostat/web/structural-business-statistics/global-value-chains/foreign-affiliates
[11] http://unctad.org/en/PublicationsLibrary/wir2018_en.pdf

Solution: revisit, revise, futureproof

These revisions may have to be extensive, when one considers that some very large corporates have essentially been using the same liquidity structure for 25 years. A further internal imperative for treasury (in addition to all the other drivers) to revisit this sort of heritage structure is the governance angle: e.g. is the structure in line with any corporate policy changes and does it comply with regulation such as PSD2?

While updating obsolete liquidity structures and processes may be essential, the pace and persistence of change means that doing this alone is insufficient. Any changes made must also incorporate a degree of flexibility, so that when future change is needed (which is highly likely) treasury can make it quickly and easily with the minimum of effort and cost. Agile thinking and processes are key here to ensure sufficient future proofing.

This is definitely not a trivial task, but it can be considerably easier if undertaken with the support of a banking partner that has the necessary expertise and resources. Given the international nature of today's liquidity management environment, a global banking network is an important factor here, as are qualified process consultants in technologies such as ERP[12], TMS[13] and SWIFT. Furthermore, this expertise must be consistent across the whole end to end liquidity management process, from accounts receivable to investment of surplus cash and all points between. The same applies to any solutions the bank may provide. If treasuries are to futureproof their liquidity management effectively, they will need consistency of systems across collection, aggregation, movement and investment of cash – plus optimal visibility on all these activities.

It is all too easy to lose sight of the big picture here and not cover the entire spectrum of the liquidity management process. A good example of how this can happen is when setting up bank accounts in a new country. The first step is to establish a local corporate entity, which in many emerging markets will involve dealing with a local partner who will handle the incorporation. A common problem then is that the local partner will often default to opening the new entity's bank account with a local bank. While this may be acceptable from a day to day transactional perspective, it is definitely sub-optimal when that account needs to participate in a liquidity structure. A far better alternative is to use a suitable global bank instead. Then, when a local account is being opened, it can be automatically integrated into the corporate's liquidity structure as part of the account opening process. Then the account will be immediately visible from central treasury and its liquidity (assuming it is not in a restricted currency) immediately accessible at an enterprise-wide level.

[12] Enterprise Resource Planning
[13] Treasury Management System

Facilitators

Millennials

Demographic changes in the workforce are an important reason why corporate treasuries may find revisiting, revising and futureproofing their liquidity management easier than they might in the past.

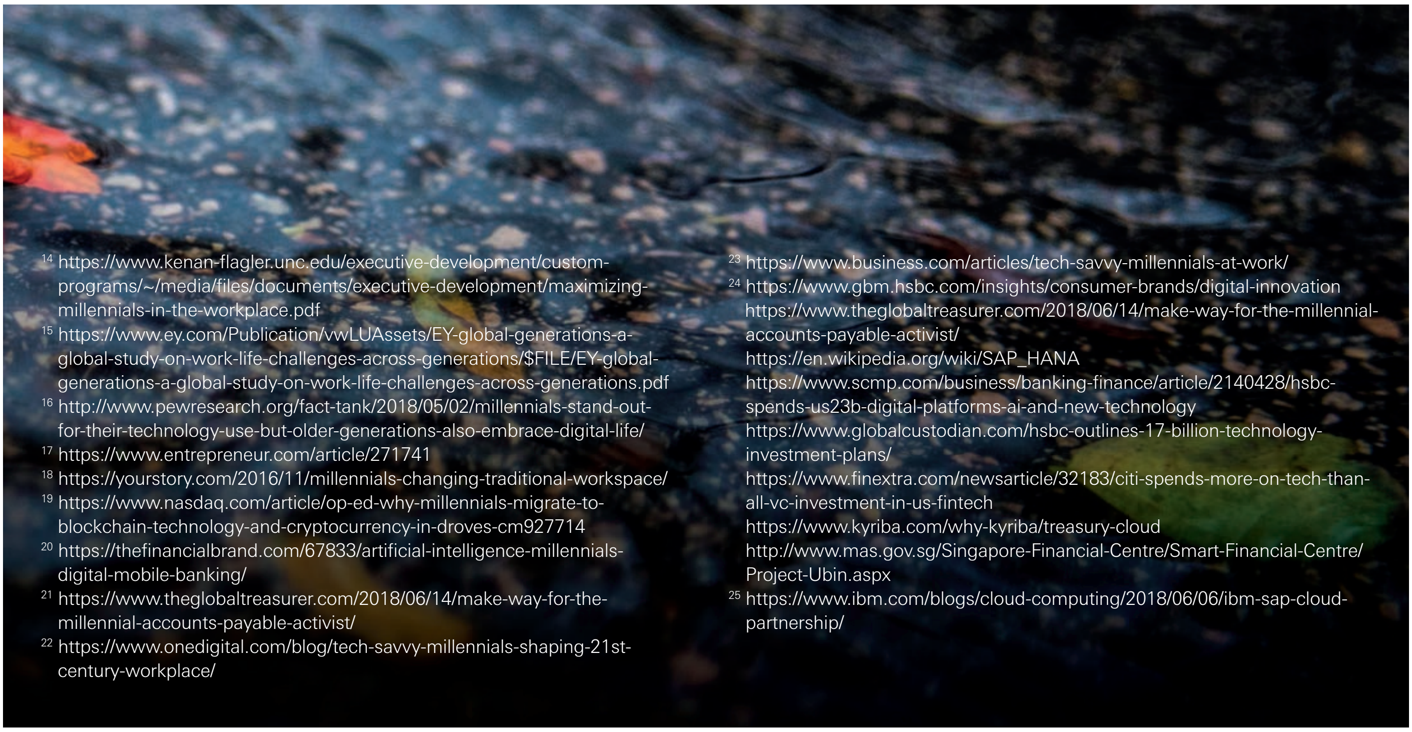
By 2020, nearly half (46 per cent) of all US workers will be millennials[14] and by 2025, this will also be true of 75 per cent of the global workforce[15]. Millennials stand out for their use of technology[16] and their willingness to adapt to (and drive) change[17]. They are technically and psychologically well suited to the sort of liquidity management reengineering and change that many treasuries now need to undertake. Digitisation, blockchain and artificial intelligence are all technologies with which they are comfortable[18,19,20].

Even though they may still mostly be in relatively junior positions, millennials may already be having an influence on treasury behaviour[21]. For instance, HSBC has recently seen a corporate treasury processing a multibillion dollar transaction using a mobile phone[22], something that would previously have been unthinkable. Millennials' technological capabilities also mean that as their treasury careers progress they will be expecting their banks to show a serious commitment and investment in technology[23].

Vendors

One of the main reasons that blue sky thinking for treasury has for so long remained just that has been the lack of alignment among the third parties with which treasurer's deal. Happily, this is no longer true: banks, ERP and TMS vendors, cloud computing providers, fintechs and clearing systems are currently well-synchronised in terms of capabilities and delivery[24]. The level of co-operation and partnership among these entities is also strong, with SAP's recent announcement of SAP Cloud Platform private edition in collaboration with IBM Cloud being just one example[25].

Therefore, the historical problem of a single missing jigsaw piece derailing a project may no longer apply. Today, treasuries embarking on re-engineering and futureproofing their liquidity management may be able to do so with far more ease and confidence than might once have been the case.



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Conclusion

A rapidly changing environment is driving the need for treasuries to review, revise and futureproof their liquidity management. The good news is that this is now far less of a challenge than it would have been just a few years ago. Technological innovations ranging from instant payments, to digitisation, to AI, to cloud computing, all enable more to be done with less effort, at lower cost and at greater speed. At the same time, the millennial workforce is ideally suited to implement change[26], while vendors are well-aligned in terms of their capabilities and mutual collaboration. There could hardly be a more propitious time to act.

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