



Effective cash management for the here and now

In light of current economic concerns, treasurers looking to manage their liquidity are focusing on risk more closely than ever. How is this risk-conscious approach to liquidity management affecting corporate deposit behaviour and what scope is there for treasurers to enhance yield on deposits in the low interest rate environment?



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A risk-conscious approach

For corporate treasurers, risk is a greater concern than ever before. While the overriding goal of recent regulatory reforms, such as Basel III and the Vickers report, is to reduce risk in the banking system, the threats arising from the Eurozone crisis have meant the management of an organisation's cashflow and liquidity is of even greater importance than in previous times. Given their concerns around counterparty risk, companies looking to balance security, liquidity and yield are therefore prioritising security.

This risk-conscious stance is affecting businesses' investment behaviour and is leading many to update their treasury policies. Increasingly companies are also placing greater emphasis on their banking relationships, ensuring they have appropriate support in place. But while risk is a top concern, innovation in the world of bank deposits is offering companies some new opportunities – most notably the ability to improve yield by drawing on the more flexible products on offer.



As the external backdrop continues to change, treasurers require products that have the ability to flex to their requirements on an ongoing basis.

21% of treasurers have formally modified their investment policies in the past six months – and 15% plan to do so in the next six months*.

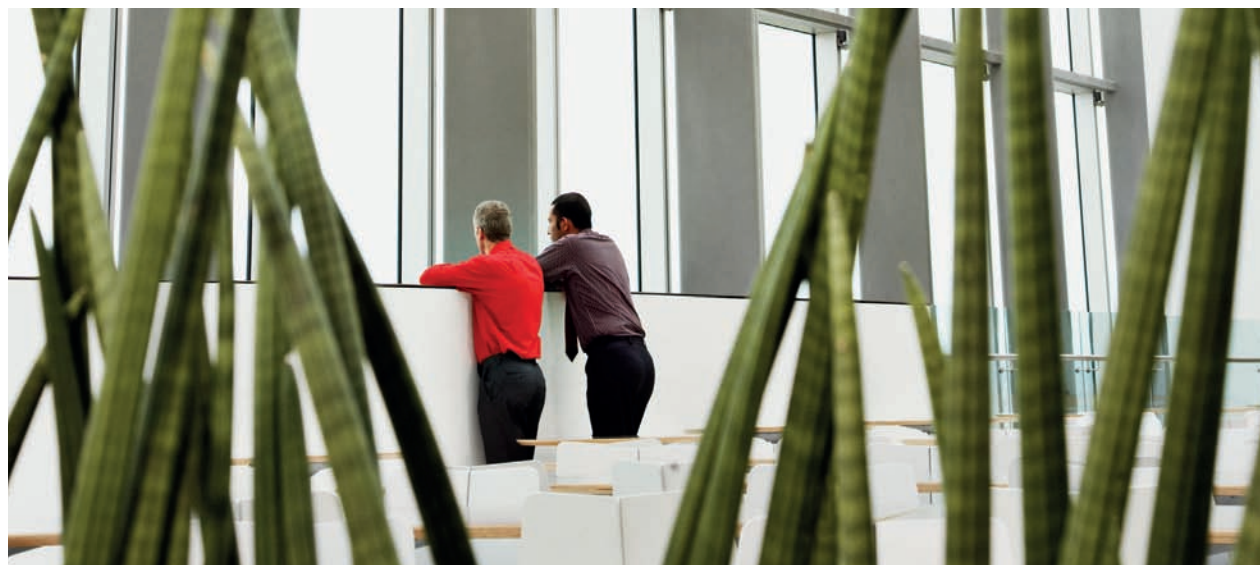
*Source: Treasury Strategies UK & Eurozone Corporate Cash Briefing, May 2012.



Treasury policy: a three-pronged approach

Whether a business is a FTSE 350 corporation or a medium-sized business, there are three areas of focus that need to be considered when reviewing the cash management strategy and treasury policy: financial exposure, systems exposure and liquidity exposure.

In order to determine their strategy in these three areas, companies typically ask the following questions:



Assessing financial exposure

- Where are balances being held?
- What are the associated risks in the areas of payables risk, bank risk and sovereign risk?
- What levels of risk are acceptable?

Reviewing systems and identifying contingencies

- What platforms are being used?
- What payment systems are being used?
- What technology is the company dependent on?
- What backup systems or processes are available for different types of payments if something goes wrong with the usual systems or processes?

Forward planning

- Where is money needed in the next 6, 12, 18 or 24 months in order to support medium-term business planning?
- Where does cash sit in the bigger corporate equation, e.g. how is equity and debt structured?

The answers to these questions can be used to define more closely what the cash management strategy should look like.



Placing deposits: what do businesses want?

When looking to place deposits, companies will focus on a number of different criteria. The current emphasis on counterparty risk is leading companies to look more closely at where they are placing deposits, depending on the nature of their business flows, payment obligations and geographical footprint. Many clients are then placing their structural cash surpluses into a banking location of choice, based on their treasury policy and risk appetites.

Counterparty risk is not the only factor determining where deposits are placed – and neither is price. In these challenging times, other factors have come to the fore.

With £737 billion in deposits, companies in the UK are currently holding near-record levels of cash*.



*Source: Treasury Strategies, June 2012.

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Relationship

In the context of changing cash management requirements, businesses are looking to build strong relationships with their banks. Banks who can demonstrate a solid understanding of their clients' requirements and business environment are better placed to support a risk-conscious cash management policy.

Service

Service quality is a top priority for the majority of companies and many are making more strategic decisions based on service, technology, reporting and management information.

Global coverage

We are also seeing a growing focus on banking at a regional level. Most larger businesses work with local banks to some degree, and domestic and international banks do need to complement each other. In China, for example, foreign banks can only open a very limited number of branches. In order to ensure they have coverage where they need it, companies

should question the partner banking capabilities of their existing or future banks in regions of interest. Banks can differentiate themselves by showing they are able to join up with good quality partner banks, enabling them to provide the quality of service that companies are looking for in a coordinated manner, ideally through single, or a very limited number of points of contact.



Product innovation brings flexibility and yield opportunities

Yield may be a lower priority for treasurers than security and liquidity – but in the low interest rate environment, opportunities for additional yield are worth considering. Most treasurers aren't willing to lock in funds for 12 months, so product innovation from banks has focused on offering more flexible solutions that match enhanced yield to the behaviour of the account. Interesting examples include:

- notice accounts, where companies can access funds subject to a notice period such as 35 or 100 days
- accounts that offer instant access but pay a bonus at the end of a year or other period if the average balance has stayed within a pre-agreed range, such as Barclays Flexible Interest Bearing Current Account (FIBCA)
- tiered accounts. For example, if £100 is held in an account, £30 of that is available for instant access, £30 is available at 90 days and the other £40 has to be held to term, with the different tranches attracting different levels of interest



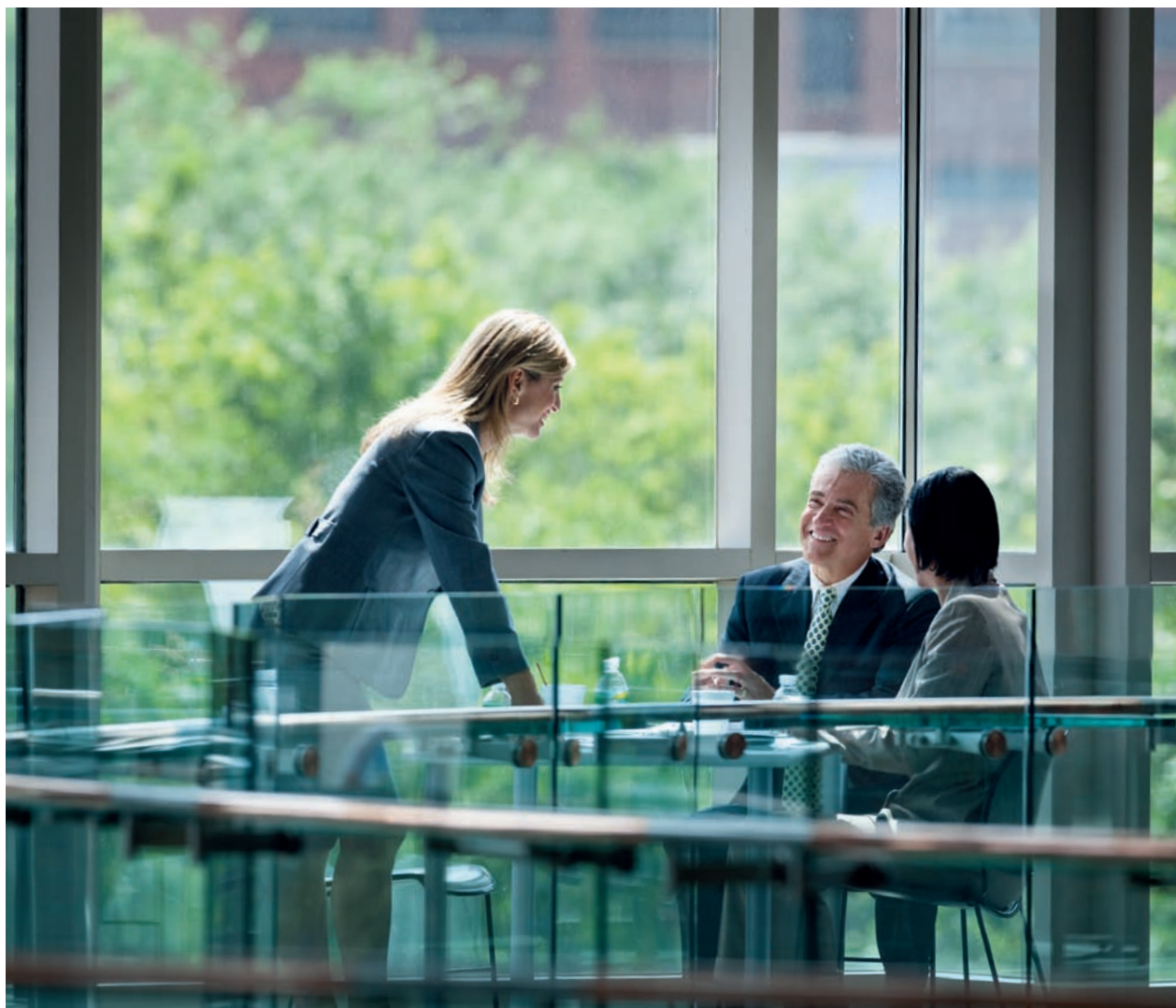
Such products benefit from favourable treatment under Basel III: the element of commitment or longer-term balances included in the products means that they don't attract the same capital requirements

as shorter-term balances. For financial institutions and for the corporation, such products offer a way of improving yield while retaining the required level of liquidity.



Risk tops the agenda

In these challenging times, companies are continuing to prioritise security and liquidity over yield when choosing the best place to hold their deposits. The current concerns are not going away but companies – whether they are FTSE 350 or other large and mid-sized corporations – are continuing to focus resources on reviewing the risks that their businesses face and adjusting their treasury policies accordingly. Meanwhile, innovation from banks has resulted in a new breed of flexible deposit products which allow treasurers to manage their liquidity whilst balancing their security and yield requirements.



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