

Liquidity management in times of turmoil

In a new era of economic uncertainty, treasurers can directly influence and enhance their companies' competitive position through disciplined liquidity management practices. By Michael Botek, Joseph Mauro and Handan Sert, Citi Global Liquidity & Investments

Without a doubt, 2011 marks a new era of economic uncertainty and complexity. S&P's downgrade of US debt in early August, the first of its kind, rekindled fears of a global recession and caused major market jitters. The potential for additional market gyrations and sovereign debt downgrades hangs in the air.

Economic growth prospects are decidedly mixed. According to Willem Buiter, Citi's chief economist, "the picture is increasingly bifurcated between sluggish growth in many advanced economies and strong growth in many emerging markets, especially in Asia" (Citi Economics: Global Economic Outlook and Strategy, 20 July 2011). The shift towards emerging markets-led growth presents treasurers with a host of challenges - for example, restrictive capital controls and regulatory constraints around FX, repatriation of profits and intercompany lending.

In short, the current landscape presents multi-dimensional risks to be managed.

Cash was, is and will be king for a while

Following the market meltdown three years ago, a common mantra was 'cash is king'. Since then, the perceived urgency to build cash buffers may have subsided, but the sentiment to remain liquid has not. For their treasury cash buffers, companies continue to stay on the short end of the curve, with preservation of capital still at the top of the agenda.

The latest market volatility has treasurers again emphasizing good liquidity planning, with an emphasis on testing against the risk of downside scenarios.

Tools for managing liquidity risk

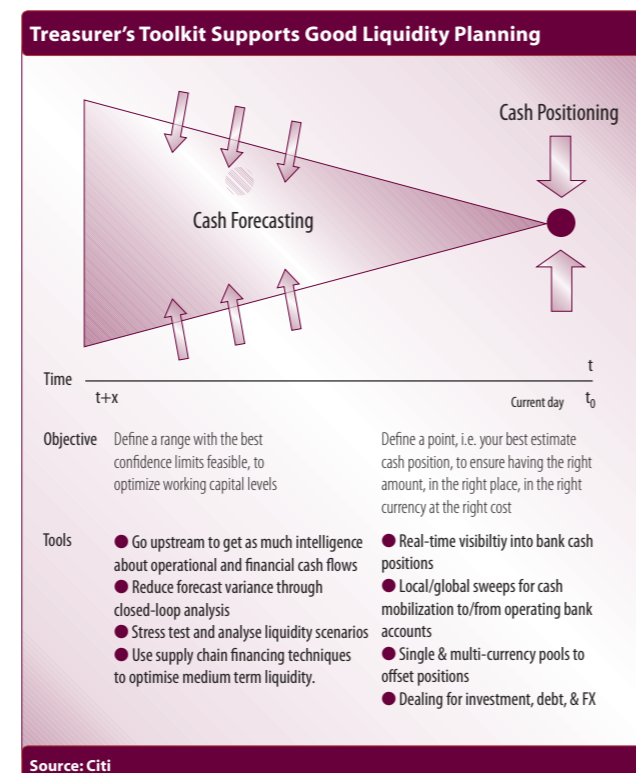
There is no silver bullet to right-sizing liquidity levels, diversifying and optimizing sources of funding, or monitoring and controlling risks. Rather, the 'treasurer's toolkit' is a multi-dimensional system that helps treasury plan well to meet liquidity risk objectives. Some of the key tools include: good cash flow forecasting processes, a disciplined approach to liquidity stress testing, tools and technologies to deliver visibility into cash positions, and the ability to mobilize liquidity easily.

● **Cash flow forecasting:** Reliable and timely forecasts are critical to determining how much cash a company actually needs, to maintaining appropriate cash buffers and to keeping liquidity from getting trapped in pockets across the enterprise.

Getting a clear picture of how much cash is needed, as well as when and where it is needed, involves assessing material sources and uses of cash, across countries and currencies, and mapping them to their respective cash conversion horizons. Internally, having the right processes and systems in place frees treasury resources to focus on analysis.

The most important, and difficult, aspect of cash flow forecasting involves understanding what is driving the operating business. Treasury staff need to ensure that this understanding is reflected in the cash forecasting process and methodology that they establish, regardless of whether the numbers are extracted from the enterprise resource planning system, input by accounts receivables and accounts payables teams or extrapolated from past flows.

● **Liquidity stress testing:** Increasingly, companies are taking cash flow forecasting to the next level by stress testing them to create a blueprint of actionable responses to various risk scenarios. This begins by developing a complete picture of accessible cash positions and cash flow forecasts under normal conditions and developing 'what-if' scenarios to assess disruptions - for example, to the operat-



Citi Treasury Diagnostics – Operational Liquidity Management Index

Citi's Operational Liquidity Management Index (OLMI) is a gauge of the use by companies of best practices around four key aspects of liquidity risk management: cash visibility, physical or notional pooling, cash flow forecasting and liquidity/funding risk analysis. The index is based on data captured in Citi Treasury Diagnostics, a proprietary treasury benchmarking program conducted with multinational corporates.

OLMI shows a 13% improvement from 2009 to 2011, demonstrating the focus companies have placed on improving key aspects of liquidity risk management. In particular, there have been marked increases in the proportion of companies that have migrated to best practices in visibility in cash and short-term investments, and in the use of pooling structures to enhance access to global cash. Cash forecasting, another component in the index, has shown only slight improvement. Finally, liquidity/funding risk analysis, is the only component in the index that has shown a decline in the number of companies that have migrated to best practices – although this is largely due to the criteria underlying the definition of 'best practice' becoming more stringent from 2009 to 2011.

ing business or to financial market access - that could impact the firm's sources and uses of cash and, consequently, its liquidity needs.

What can be striking is how quickly even a company with strong liquidity positions under normal conditions can run into serious trouble.

● **Increasing visibility, ready for action:** In sync with keeping a pulse on factors that impact liquidity is keeping a watchful eye on the cash in accounts. "If you can't see it, how can you manage it?" An effective liquidity management framework calls for adequate systems and infrastructure to ensure visibility and control of positions enterprise-wide. This includes visibility into positions by currency, counterparty, owner and location.

Many companies think it is difficult to achieve a consolidated or real-time view of their cash positions without a global enterprise resource planning (ERP) system or treasury management system (TMS). In fact, applications such as Citi's TreasuryVision online portal provide centralized multi-bank reporting and aggregation of cash, debt and liquidity across multiple jurisdictions and currencies. Citi's solution offers, for example, an easy-to-use dashboard and reporting, forecasting and analytic tools. What's more, it can be used as a standalone solution or as a complement to existing ERP and TMS, making it easy to jump-start cash visibility initiatives while waiting

for a large-scale single backbone solution to come online.

● **Mobilizing liquidity:** In the end, establishing a corporate cash discipline that facilitates having liquidity when and where it is needed requires laying the groundwork for mobilizing liquidity. Implementing a global liquidity structure allows a company to centralize and deploy cash across the enterprise as and when needed - reducing the level of cash required to run day-to-day operations and providing much greater funding flexibility.

Key steps are to rationalize back accounts to clear the runway for the free flow of liquidity and then establishing global pooling structures to automate the flow of funds through the streamlined account structure in a regulation- and tax-friendly manner.

The scope and automation of pooling structures vary based on a company's business profile, enterprise systems and banking providers. Even though major banks offer automated pooling capabilities, some firms still use their TMS to mobilize cash. To speed up balance transfers and squeeze additional liquidity from their processes, treasury staff should determine if their banking partners can automate accounting and reconciliation on their end. Bank-offered pooling provides the latest possible cut-off times, ensuring the maximum value - ie, the end-of-day value - is mobilized and no liquidity is left behind.

Understand, manage and measure

In a new era of economic uncertainty, treasurers can directly influence and enhance their companies' competitive position through disciplined liquidity management practices. Treasurers equipped with reliable data and sound insights, policies and technology are in the best position to understand, manage and measure their company's liquidity and mitigate related risks. More important, they can support and further their companies' strategic goals and optimize their liquidity through the ups and downs of the marketplace and their business cycles.

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