Oracle Financial Services

The Evolving Role of Banks in Corporate Liquidity Management

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INTRODUCTION

In an era where consumers expect to do business anywhere anytime and corporate houses are becoming more global and diversified, it becomes increasingly important for banks to help their corporate clients have clear visibility into their global cash and liquidity position. Market conditions have increased the need to minimize liquidity risk, reduce costs and maximize financial flexibility. Liquidity management may be the key to a company's survival in today's highly regulated and globalized economy, especially when it is becoming more and more difficult to secure external funding.

Recurring financial crises in the last decade have compelled corporates to examine systems that allow immediate access to information regarding cash balances, foreign exchange, as this helps them with better cash flow, working capital management and cash centralization. These are key components of Liquidity Management today. An efficient utilization of global liquidity can help corporations grow in a controlled and sustainable fashion.

In this scenario, banks must be in a position to offer the best of liquidity management strategies for their clients to meet the requirements of an increasingly complex and globalized world. Banks should reassess their capabilities and adapt to the new and radically different liquidity management landscape. An effective liquidity management solution from banks can give a competitive edge to their clients by helping them avoid a liquidity crunch during tough market conditions such as the recent financial crisis, or helping them reap richer rewards during times of growth. It is often observed that companies today are quite dissatisfied with their cash visibility and cash centralization. Therefore banks must use a solution which is comprehensive and at the same time one which is flexible to meet unique requirements of every multinational corporation. An effective liquidity management solution should cater to, not just the present needs of the corporate, but also be scalable for future needs. Systems should be able to predict the cash positions for future dates. It will help eliminate the element of surprise and future-proof the companies providing the leeway for course corrections.

Advances in technology is driving liquidity management strategies, where it allows real-time access, global view of cash at any given point, faster processing, and enhanced capabilities to use cash pooling and other important mechanisms for cash flow management. It is the right time for banks to provide companies with these evolved systems, and significantly improve their relationships. In a future where uncertainty and volatility is likely to be the norm, having systems in place which enable most efficient and effective cash flows will be a necessity rather than a choice.

BUSINESS IS GOING DIGITAL

Corporates are diversifying, either organically or through acquisitions, driven by an aspiration to expand channels, garner new segments, serve international customers and expand geographical footprint. Corporates need to find a pathway that enables innovation and agility to allow them to adapt quickly and service customers who expect to do business anywhere and anytime. What corporates require is an approach to digital transformation, one that allows them to leverage their existing business infrastructure while transforming their business and technology landscapes.

Figure 1: Global Industry 4.0 Survey, PwC

According to a survey conducted by PwC, Global Corporates are planning to invest US$907 bn per annum by 2020 [1] to transform into a Digital Enterprise. A major focus of these investments will be on digital technologies like sensors or connectivity devices, and on software and applications. Disruptive digital business models are focused on generating additional digital revenues and optimizing customer interaction and access. In the next five years, the companies investing on digital transformation are expected to increase annual revenues by an average of 2.9% [2] and reduce costs by an average of 3.6% annually.

With corporations investing heavily on digital technologies, banks must assess as to how digitally aligned are they with respect to their corporate customers. A corporate customer will expect its bank to be digitally capable to offer suitable products in the most convenient ways. They may expect banks to offer services through APIs, greatly reduce waiting times, decrease the number of interactions and importantly remove the need for corporate personnel to visit a bank.

The presence of FinTechs is slowly increasing in the corporate segment even as they are limited to a few areas such as FX, trade finance and cash management. FinTech progress is clearly much slower in the areas of corporate banking when compared to their success in segments of retail banking. Nevertheless, banks must recognize that the benchmark for customer service quality is on the rise and sustaining relationships is now getting linked to technology and its performance. Standardization and regulations are also playing a key role in embracing digital across many markets. With increasing standardization, it is easier for corporations to switch from one bank to another when they see a drop in the quality of service offered as they will be less tied to a particular bank's system and technology.

Digital disruption coupled with changing customer expectations has increased the level of operational complexities in the corporate world and has triggered a radical reshaping of the banking landscape and the ways corporate interact with banks. Therefore banks must ensure they get closer and align themselves perfectly to the requirements of their corporate customers and if possible even play an important role in the corporate's digital transformation efforts, especially in the areas of cash management, foreign exchange exposure, and investments.

CHALLENGES FACED BY GLOBAL CORPORATES

Liquidity Management, Working Capital Management and FX Volatility are currently the most important areas of focus for corporates around the world. Their increased prominence can be attributed to key shifts in the financial world caused by globalization, financial crises, and other economic factors.

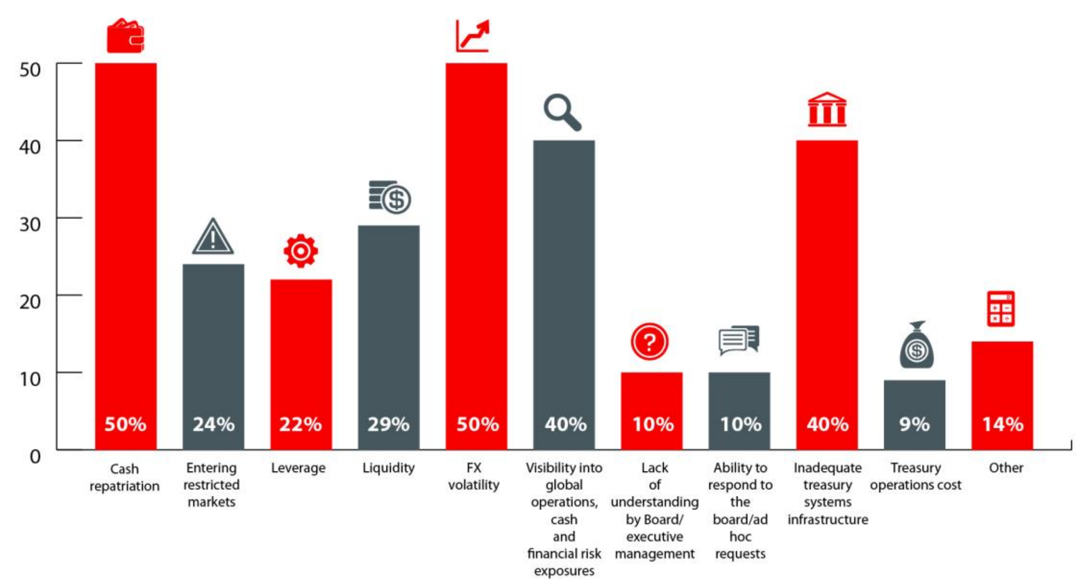

Figure 2: Strategic Challenges for Global Corporates (Source: Global Corporate Treasury Survey – Deloitte)

Liquidity management is perhaps the key to a company's survival in today's highly regulated and globalized economy, especially since it is becoming increasingly difficult to secure external funding. Global corporations are beginning to take note of liquidity management, working capital management and FX volatility ranking as the most important areas of focus for treasuries around the world [3]. By any litmus test, it's clear that liquidity management is top-of-mind for companies of all shapes and sizes.

KEY LIQUIDITY MANAGEMENT TRENDS AND THE ROLE OF BANKS

The importance of real-time information cannot be emphasized enough as it directly impacts the ability of corporates to identify global cash position, quickly utilize surplus cash to pay down debt, and even redeploy cash to provide financing for new initiatives. Such information enables corporations to accurately forecast cash requirements, and make better and faster investment and borrowing decisions. The need to deploy faster, integrated and more efficient solutions has become increasingly important for banks to help their corporate clients have clear visibility into global cash and liquidity position. This has necessitated banks to allocate more time and resources to improve their liquidity management capabilities. Banks will need to enable business efficiency by measuring and monitoring to ensure that corporates can reduce risks that affect their finances. Banks should enable real-time access, global view of cash at any given point, faster processing, and enhanced capabilities to use cash pooling and other important mechanisms. The time is now for banks to invest in technologically advanced solution which provides an enterprise-wide, global, and a real-time view of cash movement and liquidity position.

As liquidity becomes a more important and complex function to manage, several new trends have emerged over the last few years. Stable and successful corporations incorporate most—if not all—of these evolving trends into their day-to-day operations, which is imperative if sustained growth is to be achieved. These trends indicate a clear shift in the way banks should look into corporate liquidity management and some of the key examples are outlined below.

Globalization:

Corporates have been expanding globally, either organically or through acquisitions, driven by an aspiration to expand channels, garner new segments, serve international customers and expand geographical footprint. Banks should play an important role in corporate's globalization efforts especially in the areas of cash management, foreign exchange exposure, and investments. Banks can address these challenges by managing liquidity distributed across markets, currencies, and businesses, along with the need to meet with regional liquidity nuances and regulatory issues.

Automation:

Often a buzz word today, automation is vital to liquidity management systems that aim to improve user experience. Visibility into global cash position is invaluable to corporates and banks should be able to provide this information in real-time. With automation, a real-time insight into cash positions is readily available without having to pull this from limited human resources. Banks can also reduce operational complexity by automating process and back-end systems. Corporates are leaning on banks to bring about this change. Furthermore banks should think about creating segmented, tailored, and bundled offerings that are flexible and effective for each customer.

Basel III:

The most significant regulation affecting liquidity management is Basel III. It is changing the relationship between business customers and their banking partners. It is also as a critical regulation affecting availability of certain types of liquidity management solutions such as notional and physical cash pooling. Banks should start working closely with corporate to understand their short-term liquidity needs and to identify appropriate self-funding options. Technology innovation from banking partners will be critical to overcoming the challenges arising under this regulatory environment.

Negative Interest Rate Environment:

Regulatory developments like Basel III will continue to have a significant impact in corporate liquidity management. Equally consequential are wider economic pressures and policy approaches, notably recent monetary policy efforts which have resulted in an unprecedented landscape of negative rates for many currencies. In this negative interest rate environment, management of liquidity distributed across markets, currencies and business units are becoming more complex and increasingly challenging. Negative Interest rates & tax changes in some countries have made it expensive to place large deposits / liquidity positions in those currencies, imposing operational risk for banks.

Diversified Banking Relationships:

With corporate globalization, arises the need to have diversified banking relationship. In an increased risk environment having the right banking relationships and account structure can make the difference between survival and success. Corporations today are keen on diversifying their operating bank accounts to mitigate bank counterparty risks. Corporates will look for the right partner(s) and take advantage of efficiencies in banking technology which can help them to manage and control liquidity.

BANKS NEED TO OFFER COMPREHENSIVE LIQUIDITY MANAGEMENT CAPABILITIES

Banks can address the liquidity management requirements of companies using several techniques. To improve liquidity position, research indicates that companies favor cash flow forecasting, centralized funding and pooling as instruments of choice. However, banks can offer a combination of these techniques to optimally manage cash as per the requirements of individual companies.

Some of the commonly used methods of liquidity management which banks should look at offering to their corporate customers are described below:

- **Cash concentration**, is an important technique offered by leveraging real-time information using a modern liquidity management solution. In the absence of a capable solution, it becomes difficult for banks to enable companies move funds into a central account on a real-time basis for cash consolidation and maintain minimum cash balances overall. Any inefficiency may in turn lead to a shortage of funds for the company’s short-term investments. Banks must enable companies to centralize all functions and pooling of all cash into a concentration account, from where it can be invested and managed. Cash concentration eliminates balances from the local accounts across geographies and gives high flexibility as to how surpluses are used, or how deficits are funded. This structure not only aligns well with investment income optimization, but also an increased control over the accounts payable part of the working capital. Generally, banks offer cash concentration to meet the requirements of larger firms.

- **Cash pooling** is a technique offered by banks to companies who pay and receive in foreign currency, who look to aggregate buying, increase monitoring of currency exposure and improve governance. Since notional pooling does not involve any physical transfer of cash, it leads to interest optimization without the risk of foreign exchange. Through cash pooling, banks can create numerous benefits to companies such as reduction in financing costs at a global level, economies of scale improving investment return, ease of liquidity management on local level, reduction of external banking costs due to centralization and so on. Cash pooling requires a strong relationship between banks and corporates only facilitated by capable liquidity management solution. Based on research, about 40% of companies do not have a cash pooling structure in place.

- **Sweeping** the excess funds into short-term investments is one more capability offered by banks to centrally manage funds with the help of a capable liquidity management solution. When done efficiently, it offers a powerful tool to optimize a company’s liquidity position. Sweeping involves automatic balance transfer and automated transfer of funds, again very beneficial to large organizations. It rationalizes the fund transfers between accounts and optimizes the liquidity position. This capability offered by banks enables a company to easily manage investments and minimize interest costs.

KEY ATTRIBUTES OF A LIQUIDITY MANAGEMENT SOLUTION

With these trends in mind it's important to take a step back and evaluate what this means for the liquidity management landscape as a whole. How can banks help corporates take the appropriate next steps in effecting change geared toward globalization, automation, tighter regulatory environment and more diversified banking relationships than ever before?

It begins with the decision to opt for a global solution to manage liquidity. The solution should provide an enterprise-wide framework that is malleable enough to adjust to market conditions, but stable enough to act as a central hub for all liquidity management activity.

Corporates will expect Banks to offer solutions that improve the efficiency of their cash management and working capital management across the global enterprise. These automated solutions will centralize information, provide real-time information, reduce costs, will be simpler and more effective, overall. Banks should provide liquidity solutions that will provide customers with an overview of their global multicurrency cash and investments. The solution should enable information to be extracted in multiple ways while delivering more granular and time-sensitive information. The solution must have the capability to provide liquidity positions in all of the currencies in which the bank conducts business and capture all sources of liquidity risk.

The solutions will not only be efficient and effective, but they will also drive emphasis on UX (user experience) and present information in a convenient and actionable manner. Furthermore, to help minimize cost companies are increasingly exploring low-cost deployment models – like cloud. There is a move across the industry towards reducing capital expenditure and taking on more operating expenses, leading to a proliferation of cloud-based, SaaS solutions, in all areas including liquidity management.

CONCLUSION

In a dynamic and globalized economy, business organizations must cope with both external and internal changes. Businesses may expand or contract, go through mergers and acquisitions, enter new markets, invest in new resources, or drastically alter their business models. For any of these, a company's cash management strategy needs to be fundamentally sound. No wonder, liquidity management, as a function, has started to gain more attention in boardrooms compared to the past. After illustrating the prevalent trends and transformations in liquidity management, it is clear banks need to invest in solutions that improve the efficiency of their liquidity management capabilities for global enterprise.

As liquidity management continues to gain prominence, banks should provide faster, integrated and more innovative offerings in order to manage the ever-increasing complexities of global corporates. Banks can enhance their existing liquidity management system or replace it with more specialized and advanced solution. Either way, the banking solution will have to play a dominant role if corporates are to make the right decisions with real-time access to relevant liquidity information.

To help businesses remain competitive and grow steadily despite all odds, Banks should offer the right solution which will enable access to liquidity, significantly reduce costs, optimize investments and improve the ability to control and manage Liquidity.

SOURCES

[1] - Global Industry 4.0 Survey, PwC

[2] - Global Industry 4.0 Survey, PwC

[3] - Global Corporate Treasury Survey – Deloitte

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White Paper The Evolving Role of Banks in Corporate Liquidity Management
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