



Your banking wish list

It is all too easy to get swept up in the mainstream media's criticism of financial institutions. Whilst there are obviously areas where banks can improve, many are investing heavily in order to deliver the services that their corporate customers truly want – or rather, think that they truly want.



The Corporate View

Christophe Liaudon

Group Treasurer
Neopost



Risk Management

When inflation eventually returns, those record cash reserves are likely to become quite a headache for corporates. How well do you understand inflation risk, and do you have a strategy in place?

Cash Management

Dynamic discounting: on the rise

Country Focus

Exploring Estonia

Back to Basics

Choosing a treasury model

Question Answered

Treasury benchmarking

treasury**insights**

A large, multi-tiered iceberg is the central focus, floating in a dark blue body of water. In the foreground, a large, irregularly shaped piece of ice is partially submerged, its surface rough and textured. The background shows a range of snow-capped mountains under a sky with scattered clouds.

Discover the
underlying
treasury issues

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Fraud: the pitfalls of growth

It's no secret that companies are firmly focusing on growth again. Yet, at a time when market volatility is high, geopolitical stability is being rocked, and international regulatory regimes are growing ever tighter, growth can be tricky to find.

So, as corporate managers are being pushed harder by boards and shareholders to find new revenue streams, concerns are mounting that some companies are not only taking a disproportionate amount of risk, but also encouraging unethical behaviour. UK supermarket Tesco overstating its profits by £263m, as discovered in late 2014, is just one such example. More recently, US bank Wells Fargo has been accused by (and is being sued by) the City of Los Angeles of pressuring employees into committing fraud in order to meet growth goals.

Documents lodged with the court reportedly suggest that the retail bank's employees felt under so much pressure to perform that they believed their only option was to be fired, or to commit fraudulent acts as a means to reach the over-ambitious sales targets they had been set. Speaking at a news conference in early May, City Attorney Mike Feuer said that "in its push for growth, Wells Fargo often elevated its profits over the legal rights of its customers."

Wells Fargo has said that a handful of rogue employees are to blame, and that these few have been either disciplined or let go. Nevertheless, the bank's performance quota system that supposedly led to fraud being committed in the first place apparently remains unchanged.

Just as unattainable growth targets can foster internal fraud, companies moving into high-growth markets (often without doing significant local research) may also be opening up their ranks to an increased risk of fraud, bribery and corruption. According to EY's Europe, Middle East, India and Africa Fraud Survey 2015, 61% of respondents in so-called rapid-growth markets believe that bribery and corruption are widespread in their country. The five countries with the largest perceived bribery and corruption risk were: Croatia (92%), Kenya (90%), Slovenia (87%), Serbia (84%), and Portugal (82%).

Since organisations across the globe lose approximately 5% of their revenue to internal fraud each year, and among the most common departments for fraud to occur in are finance, accounting and purchasing, employee fraud should be high on the treasurer's watch list. Granted, the potential for internal fraud comes in many different guises – from straightforward theft through to opportunistic crimes whereby a procedural loophole or a weakness in the company's systems is exploited – that it can be very hard to guard against. Nevertheless, it is part of the job description of every responsible treasurer to ensure that the risk of internal fraud is managed as effectively as possible.



What do you really want from your bank?

Times are tough for banks and 'bank bashing' has become a favourite hobby of some in the media. But banks, like it or not, are a vital partner to the corporate treasury. The question therefore is: are banks currently providing the right services for their clients and at the right cost? Treasury Today investigates.



When prices rise

After a period of little or no inflation in many of the world's leading economies, it appears we could now be approaching the point where prices finally begin to tick higher. What type of inflation environment can we expect going forward and how should corporates analyse and quantify their explicit and implicit inflation risk?

Estonia: a digital economy



Since gaining independence from the Soviet Union in 1991, Estonia has emerged as a successful independent capitalist country. The country is also very forward thinking and has embraced digital innovation like few others to become an attractive business location. In this article, Treasury Today explores the Estonian business environment and analyses what it can offer the corporate treasury.

Smarter Treasury

Dubai: your gateway to Africa

Setting up a regional treasury centre in Africa is a historical investment process. This is especially relevant for corporates that have decided to move different route into the continent. David Dabbs, managing director, treasury, at Citi, discusses the opportunities and challenges of setting up a regional treasury centre in Africa.

David Dabbs

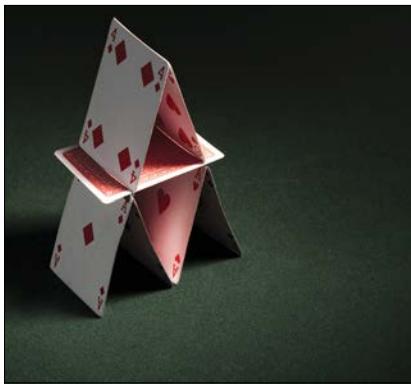
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Treasury insights

Setting up a regional treasury centre in Africa is a historical investment process. This is especially relevant for corporates that have decided to move different route into the continent. David Dabbs, managing director, treasury, at Citi, discusses the opportunities and challenges of setting up a regional treasury centre in Africa.

Dubai: your gateway to Africa

Africa is a continent with enormous potential, but it also presents significant challenges for treasurers. Establishing a treasury centre to cover the region is therefore becoming a must for any corporate with material interest in the continent, and Dubai is emerging as a promising location to do this from.



THE BIGGER PICTURE 27

Nick Leeson: the original rogue trader

This is the story of how one ambitious investment broker singlehandedly bankrupted one of the oldest and most important banks in Britain – and how this episode taught the banking industry the need for proper internal controls and channels of accountability.

CASH MANAGEMENT 30

Discounting for the 21st century

Seven years on from the global financial crisis, the famed 'fortress balance sheet' of the corporate big boys still exists. But change is in the air and these corporate heavyweights are slowly beginning to soften, seeking a return on their cash buffer. Introducing a dynamic discounting scheme may be one such way that a corporate can look to achieve this.

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20 The Corporate View

Christophe Liaudon
Group Treasurer



Some people are driven by the urge to find and experience new things; for them, standing still for too long is uncomfortable and is to be avoided wherever possible.

This is certainly the mentality of Christophe Liaudon, Group Treasurer at Neopost whose treasury career has been motivated by travel, the discovery of new cultures, and the drive to find new and better ways of doing things.

BACK TO BASICS

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Closing the gap: treasury models

Today, control and visibility over cash are what corporates of all shapes and sizes are seeking. As such there has been a renewed focus on centralisation, but is this a treasury model that can suit every business? Treasury Today analyses the pros and cons of popular treasury models.



These pages contain edited versions of a few of the Treasury Insight pieces written in the last month. The full versions are posted on treasurytoday.com as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at treasurytoday.com

Russia, sanctions and the loan market

Corporate finance professionals have all had to get increasingly sanctions-wise over the past year. Sanctions are not an entirely new experience for international businesses, of course. But what happened to Russia last year was something very different. This was the first time that sanctions had been levelled by the US and European Union (EU) against another G10 economy; an economy which by definition is of enormous significance to international trade. And for that reason alone, we all saw the collateral impact that sanctions can have on companies and financial institutions on the outside trying to do deals in Russia, particularly when it comes to issues such as financing.

There has been some talk of late that the sectorial sanctions levied last year against certain banks and other Russian entities by the EU might not continue for much longer, even though the reasons that brought their original imposition remain. The sanctions are due to expire in just one month's time and with some countries in southern Europe (chief among them Greece) now advocating a softer stance, the required approval of all 28 EU member states for a renewal of the sanctions is by no means guaranteed.

Speaking at the recent Loan Market Association (LMA) Developing Markets Conference in London however, Bruce Johnston, Partner, Morgan Lewis, told delegates that although while a veto on the continuation of sanctions was possible, he doesn't think it to be likely.

"It will be interesting to see if Greece uses its present financial troubles as a tool to try to get co-operation by threatening to veto the sanctions," he said. "Italy and Cyprus are not 100% clear about whether they would too. But my prediction is that we will see EU sanctions against Russia extending out into the future."

For that reason, coupled with the fact that the US is not showing any signs of wavering, it appears that sanctions will remain an issue that any company looking to do business in Russia will need to be cognisant of moving forward. The problem though, as many corporate finance professionals have discovered, is that the wording of the rules around such sanctions is often full of uncertainties and vagueness (which Johnson points out is, at least in the case of the US, an open tactic to encourage over-compliance).

The issue of over-compliance

One area of significant tension between borrowers and lenders arises from US sanctions and the fact that a lot of EU-based lenders decide to comply voluntarily with US sanctions, as a matter of policy. As Catherine Robert, Of Counsel at Hogan Lovells says, there is no easy way to resolve this issue and often it will come down to the respective risk appetites of the concerned parties.

"From a borrower's perspective, it may feel unfair if the lender has the right to stop drawdowns or require the borrower to pre-pay just because sanctions have been imposed against the borrower and the lender has decided to comply on a voluntary basis with those sanctions, but it wouldn't otherwise be illegal for the lender to continue dealing with the borrower," she says. "On the other hand, the lender may well say that, in light of the potential penalties for breaching sanctions, it should be entitled to comply with US sanctions if it feels that's the appropriate way to manage its sanctions risk."

Ryanair the latest victim of Dyre Wolf malware?

It must be every treasurer's worst nightmare. Cyber crooks have somehow managed, undetected, to insert fraudulent requests in the company's payments system, and successfully made off with a six figure sum.

This is the dreaded scenario which seems to have befallen the finance team at Ryanair. Although a full and detailed account of the incident has not yet surfaced (as is often the case with such incidents), the Irish Times reported recently that Dublin-based budget airline had recently fallen victim to hackers who had managed to siphon off \$5m from one of its Chinese bank accounts using electronic funds transfer. The fraud apparently came to light after the Criminal Assets Bureau in Dublin was asked to assist in recovery of the funds (now said to be frozen) via its Asian counterpart.

It is rare when incidents such as these occur for the names of companies that have been defrauded, or specific sums, to be revealed. That does not mean that such incidents occur only infrequently, however; indeed, independent research has come to our attention in recent weeks which indicates that attacks targeting corporate bank accounts are a growing problem and that one particular campaign – known as Dyre Wolf – is exhibiting a very formidable success rate.

What treasurers need to know

According to a report by IBM, Dyre Wolf is a sophisticated malware campaign that is directly targeting corporate bank accounts where it is thought to have already stolen upwards of a million dollars (not including the possible Ryanair heist). Dyre Wolf may not be

the first type of malware campaign to target corporate accounts, nor the last. The thing that makes this particular one noteworthy, however, is the nefarious group behind it. With what IBM describes as highly sophisticated infrastructure, manpower and knowledge of banking systems this group would seem to be particularly adept at stealing large sums of money. They are even known to use additional tricks, like social engineering via phone calls or denial of service (DDOS) attacks, to further the deception.

Phil Huggins, Vice President of cyber security experts Stroz Friedberg says it is the thought that has gone into each respective stage that has made Dyre Wolf a particularly difficult threat to defend against. "It's been fairly high value transactions and pretty sophisticated cleaning of the money," he says. "Once the money is gone it can be extremely difficult to call it back again. Clearly it has been very carefully thought through: somebody is taking it start to finish and it has actually become quite a sophisticated attack. And one which there is no silver bullet to protect against."

Even so, there are steps treasurers and other finance staff can take to at least make life that little bit harder for the cyber crooks. An elementary first step is introducing two-factor authentication for all treasury transactions. That won't offer absolute protection from a scam like Dyre Wolf which uses social engineering deceptions, but by having it in place treasury can at least be assured they are not handing over their accounts on a plate.

Educational programmes might also be advisable. This could entail experienced cyber professionals sitting down with every member of the treasury team, talking to them about the different types of malware campaigns – like Dyre Wolf – to look out for and explaining, for example, what they should do if a banking website they are using looks slightly different.

Addressing the reputation of supply chain finance

It's not uncommon to find certain large companies accused of unilaterally extending payment terms and hurting small suppliers' working capital, a technique supposedly used to squeeze smaller suppliers out. But according to David Blair, Managing Director at treasury consultancy Acarate, "that isn't SCF – that is just throwing your weight around."

Rather, SCF is typically introduced by large companies to help their smaller suppliers by giving them access to the buyer's often higher credit rating. "When done right, therefore, SCF can allow both buyer and seller to improve their working capital, bringing down costs holistically across the entire supply chain," says Blair.

Surrounding confusion

Part of the problem is the fact that SCF can be linguistically confusing. "We need to be careful in the use of terminology," explains Blair. "SCF covers a plethora of different techniques that can be applied to both accounts receivable (AR) and accounts payable (AP) sides of business." He adds that SCF techniques are sometimes equated with simple tenor extension (extended payment terms), which actually has no financing element at all. Rather, SCF involves using a bank, or other financier, to introduce extra capital into the supply chain. Extended payment terms, on the other hand, just push the capital utilisation around the supply chain.

There are certainly cases of large companies imposing extended payment terms. In fact, various European authorities, including the EU itself, see this a big enough problem that they are imposing maximum payment terms – normally 60 days. "My point is that this problem is not SCF," states Blair.

Who benefits from SCF?

So, if it isn't the problem, how can corporates hope to benefit from embracing SCF? Well, in many industries, the driver for SCF has been the desire to help smaller suppliers. Larger companies are often concerned about supply chain risks as failure of a single small supplier can generate large costs – production delays in case of non-supply of even minor components, for instance. Recognising that smaller suppliers tend to have weaker balance sheets and that large companies often have better credit ratings and access, many large companies see SCF as a way to support their smaller suppliers to ensure supply chain sustainability.

This leads to the recognition that SCF can benefit both sides. Namely, the supplier accepts longer terms combined with invoice discounting that gives them effectively shorter terms from a cash flow perspective. "Costs are typically split using pre-existing terms as a baseline," Blair continues. "For example, if the base terms are 60 days and they are to be extended to 120 days with the supplier being paid in 30 days, then the supplier will pay 30 days' costs (corresponding to 30 days earlier payment) and the buyer will pay 60 days' costs (corresponding to 60 days later payment)." The result: an equitable win-win arrangement that benefits the whole supply chain. ■

Longer versions of these articles are available at treasurytoday.com/treasury-insights



Adam Smith Awards 2015

in association with



Record number of nominations

The judges for the 2015 Adam Smith Awards, sponsored by Bank of America Merrill Lynch, have been facing their most challenging task yet, with many truly exceptional submissions to choose between. A record 210 nominations from 23 different countries were received.

After much cogitation, the Adam Smith Awards judging process has now concluded. The successful corporates have been individually advised and the full winners' list has been made publicly available.

Now in their eighth year, the Adam Smith Awards are firmly established as the ultimate industry benchmark for achievement in corporate treasury. These awards recognise the very best in class across the whole industry.

All overall and highly commended winners will be invited to attend the prestigious Adam Smith Awards Gala Presentation Lunch in London on Thursday 18th June.

Highlights from the 2015 nominations

Over half of all Adam Smith Awards entries received in 2015 were global in their geographic reach. In terms of the areas in which most benefits have been achieved by the nominated projects or solutions, cost savings, process efficiencies and risks removed/ mitigated were the most frequently cited. Many submissions also demonstrated the importance of accelerating the delivery of such benefits, with some very impressive timelines being achieved.

This year's nominations also saw a record number of entries for the Top Treasury Team accolade, again demonstrating the multi-faceted projects corporates have been working on. But there can only be one winner and Treasury Today's Top Treasury Team for 2015 is Hyundai Capital America. On learning of the award, Eric Senay, Vice President and Head of Treasury said:

“Receiving this year's award for Top Treasury Team is truly an honour for us at Hyundai Capital America, especially considering the premier calibre of the Adam Smith participants and the industry forum created by the Treasury Today magazine. While our young team is humbled by the recognition, it is a validation of the core belief we all share: a successful treasury organisation must earn a seat at the table helping drive sustainable business growth. To do this, we found the courage to profoundly change the treasury function at Hyundai Capital America. We did so by assembling and developing a team capable of playing both tactically and strategically. Our collective experience has been second to none, which makes us incredibly excited to share what we've learned with our peers and help create more opportunities to advance the treasury function.”

A benchmark for the industry

Elsewhere, the 2015 Adam Smith Award nominations illustrate some interesting trends happening within the industry. For example, from the submissions received, it is clear that the use of cloud technology is rapidly gaining ground and a number of companies have also deployed eBAM.

Judging by the nominations in the Best Financing Solution category, there has also been much activity in the debt capital markets space. Companies have also taken the opportunity to review their financing arrangements with several restructuring their debt maturities and instruments.

The banks and technology vendors continue to respond to their corporate clients' needs with some impressive solutions across the entire corporate treasury domain. That said, a number of submissions received this year again demonstrate that some very innovative 'DIY' solutions are also being implemented, with several 'in-house builds' proving this point.

Winners

Best Cash Management Solution
Intertek Group Matthew Clarke

Best Liquidity Management Solution
Baker Hughes Inc Debbie Donovan

Best Working Capital Management Solution
Google Ronni Horillo, Saif Ashraf and Rohit Sharma

First Class Relationship Management
Merck Rando Bruns

Best Trade Solution
Microsoft Anita Prasad, Jayna Bundy and Shreyas Kulkarni

Best Card Solution
Capita Travel and Events Joy Knapp

Best Financing Solution
Intellectual Ventures Christy Barwick

Best Foreign Exchange Solution
Google Peter Chau

Best Risk Management Solution
Sanofi European Treasury Center Wolfgang Weber

Best in Class Benchmarking
Emirates Global Aluminium PJSC Toby Shore

Harnessing the Power of Technology
Honeywell Séverine Le Blévennec

One to Watch
Microsoft Marlena Luczak

Best in Class Treasury Solution in the Middle East
Abu Dhabi Department of Finance
 Salah Mohamed Al Weswasi

Best in Class Treasury Solution in Africa
Google Ronni Horillo, Kristen Clavel and Kwesi Buabeng

Judges' Choice
Health Care Service Corporation
 David T. Deranek

Treasury Today Woman of the Year
Christine McCarthy The Walt Disney Company

Treasury Today's Top Treasury Team
Hyundai Capital America

Highly commended

Best Cash Management Solution
Dong Energy Anne Heidemann and Kim Japp
Firmenich SA Philippe Farine
SITA Andrea Sottoriva

Best Liquidity Management/
Short-Term Investing Solution
Bunge Finance B.V. Marc Verkuil
Toyota Financial Services Darren Marco
Flextronics Petra Rosenauer

Best AP Solution
Hudson Advisors Europe Ltd Conleth Fay

First Class Relationship Management
Brocade Communications Systems Inc
 Angie Qian, Yun Kong and Chris Hanson
Cerner Beth Hull

Best Financial Supply Chain Solution
Siemens Financial Services
 Friedemann Kirchhof

Best Card Solution
Ericsson Ragnar Lodén

Best Financing Solution
Electricity Supply Board Cathal Marley
General Cable Lluis A. Homé
Merz Pharma Group Karsten Kabas

Best Foreign Exchange Solution
Upwork Elizabeth Tse
Emirates Global Aluminium PJSC Toby Shore

Best Risk Management Solution
Dow Corning Corporation John G. Coon
eBay Inc. Debdatta Banerjee
SABMiller plc Alan Chitty

Harnessing the Power of Technology
ConocoPhillips Judy Bouchard
Cigna Scott Lambert
Novartis Brice Zimmermann

Best in Class Treasury Solution in the Middle East
Basrah Gas Company Jean Vacqué
Etihad Airways Adam Boukadida

Best in Class Treasury Solution in Africa
Kenya Airways Jane Kiboi

Judges' Choice
Larsen & Toubro R. Govindan

Treasury Today Woman of the Year
Dana Laidhold The Carlyle Group

Treasury Today's Top Treasury Team
SWIFT Patrick Holemans

Treasury benchmarking

“ How is treasury benchmarking evolving? With increasing use of technology, are there any new measures which should be used to benchmark the performance of treasury departments? **”**



Liam Ó Caoimh
Associate Director, Zanders
Treasury & Finance Solutions

Earlier treasury benchmarking exercises focused on the organisational elements of the treasury department: the number of full time employees (FTEs) in the treasury team, how much time was spent on risk management in comparison to cash management, how many FX trades were done on a monthly basis, for example. Over the last decade, as treasury has been thrown into the spotlight, more questions have been asked of the treasurer as to the activities undertaken by the treasury team – and more importantly how well (or not) the team performed in managing these activities. In parallel, the increased usage of treasury management systems (TMS) by corporates and the increased capabilities of these TMSs have also significantly enabled the evolution of more operational treasury benchmarking.

The next step in the treasury benchmarking evolution is the measurement and subsequent benchmarking of the ‘value’ treasury is adding to the organisation. Treasury value can be aligned with the creation of shareholder value (SHV) or economic value added (EVA) as introduced by Stern Stewart & Co. in 1982. EVA, however, measures the value of the organisation as a whole and therefore to understand the treasury value a split between business value added (BVA) and treasury value added (TVA) is required.

BVA can be created by focusing on the core business activities: sales growth, profit margin and investments. This is the most important SHV component of a successful company. However, no organisation can be consistently successful without the strategic and operational support from its treasury department. Therefore, TVA can be created by optimising treasury operations, risk management and corporate finance – but this can be easier said than done! Calculating the total TVA for a large multinational can be extremely challenging and treasurers should focus on what drives treasury value.

Here, key indicators can be of assistance and are typically defined based on risk (KRIs), performance (KPIs) and value (KViPs). These will help guide the treasurer to quantify the overall total benefit and purpose of the treasury department.

KRIs represent early warning signals and limits risk in which treasury needs to operate. The focus is on how corporate treasury manages risk. Examples include: financial covenants, hedge targets and ratios, counterparty limits, financial headroom,

risk bearing capacity, earnings-at-risk (EaR) or cash flow-at-risk (CfAr), or rate sensitivity. They can also focus on how well treasury has control over its operations – hedging performance or the overall risk reduction of the organisation, for instance.

KPIs aim to measure operational excellence of the treasury processes. Examples include: cash flow forecasting accuracy, target weighted average cost of capital (WACC), and speed of account opening and percentage and timing of confirmation accuracy. KPIs generally measure how well treasury is able to perform its day-to-day activities.

KViPs are the metrics by which the added-value of the treasury function is measured. These are typically based upon the discretionary mandate it has been given by the company. Besides ‘traditional’ operations such as the realised hedging result, treasury can act as a consulting partner to other business units. This ‘intangible’ added-value can be measured in a treasury value scorecard, enabled by technology and reporting from the TMS.

Previously, it was difficult to benchmark different types and sizes of treasury organisations on a specific treasury area but a three-stage approach of: i) gaining control ii) optimising performance and iii) achieving strategic objectives, can help. This allows true ‘value’ benchmarking of a best-in-class treasury, irrespective of type and size.



Rudolph Janse Van Rensburg
Treasury Technology & Director,
TreasuryOne

With the rapid adoption of treasury technology, benchmarking has become a key focus for treasurers. Treasurers are now able to switch their focus to becoming more strategic in their organisations and they have the ability to be more proactive – and benchmarking is a large part of this.

Looking at our corporate clients specifically (we are based in South Africa), the need for cash visibility has been a big agenda item because most of them already have a large footprint across the rest of Africa, or are looking to expand their Africa operations. Typically, the first benchmark that they want to improve is the number of existing bank accounts vs the number of daily reported bank balances. This might seem a simple task for European treasury professionals, but in Africa this is easier said than done. At TreasuryOne, we

regularly benchmark client X against client Y to let client X know whether they are ahead of or behind the curve when it comes to cash visibility enjoyed by their peers.

Another trend that we see quite a lot is treasuries benchmarking each other on the number of bank accounts that they have in the group. This is a bit trickier as you need to have two clients in the same or similar industry for this benchmark to make sense. This is especially useful for a client that is currently running a decentralised model to compare to treasuries that are already enjoying the benefits of centralisation.

There are many so-called 'mathematical' benchmarks that are widely used, specifically with FX, where treasuries measure their intraday execution in terms of the daily high/low for a specific currency that they trade to measure effectiveness of daily FX trades executed. These mathematical benchmarks are relatively easy to measure if you have the correct tools. The benchmark that we find is of the utmost importance is visibility of FX exposures. These exposures are sometimes kept in disparate systems and sometimes even spreadsheets, and what we have found is that treasurers are not happy with the regularity with which the exposures are measured against hedges. We found that in most organisations where spreadsheets are used, this happens at most once a week. This is only possible if volumes are low, and is unmanageable on spreadsheets when volumes are high.

What we have successfully implemented for a number of treasuries is the ability to integrate the treasury system with the source system where exposures are generated, be it an ordering system or ERP software. In my view, benchmarking exposure visibility is one of the key benchmarks with which treasury performance should be managed, especially on the FX side. Most treasurers are responsible for compliance to board policies relating to exposure vs hedges, but without accurate and timely visibility over exposures this task is extremely difficult and in some cases almost impossible without the use of the correct technology.



Bruce Meuli
Global Business
Solutions Executive,
Global Transaction Services,
Bank of America Merrill Lynch

To understand how treasury benchmarking is evolving, it helps to look at both the objectives and the methods. One overriding objective is to gain an understanding of your performance against a peer group on predefined factors. This information can be used to identify performance improvements and even inform

your strategic direction, as part of a regular review process, or to gain buy-in for a specific transformation opportunity.

Other types of benchmarking that complement this external peer group benchmarking can be overlooked however, in particular, internal benchmarking. Often the greatest value from a comprehensive exercise comes not from a relative score against peers, but from identifying areas of underperformance and better understanding the factors creating that underperformance. Good benchmarking can result in useful insights which have identified areas for real improvement.

In this regard, the next step in the evolution of treasury benchmarking is using external benchmarking in conjunction with a structured analytical improvement programme that utilises a range of techniques and tools. The external benchmark may tell you where you are against your peers, but it does not provide any insight into how to improve and manage performance.

There are many different benchmarking methods, from online surveys and in-person interviews to corporate forums and structured diagnostic workshops. It can be difficult to obtain accurate and applicable peer information, and the information obtained should be applied in accordance with its validity and accuracy. Here, the evolution of treasury benchmarking has meant changing the content and direction of survey questions. However this can be constrained by the need to maintain data consistency and create valid comparisons over time.

Technology has had a dramatic, though not always direct, impact on treasury and this is reflected in the content of benchmarking. For instance, because shared service centres have emerged to enable operational centralisation and to implement and manage standard processes, data standards and ERP, they have become a standard factor in benchmarking surveys. The increased use of technology has also directly resulted in greater benchmarking content on data and system security, technical infrastructure and system delivery such as the cloud and SaaS, and the total cost of ownership and integration with banks and other internal systems.

What is currently under-represented in benchmarking content is the role of treasury in e-commerce. This is a core competency of treasury but is sometimes underappreciated. Greater benchmark information would better highlight this area and demonstrate the added strategic value treasury can provide to businesses.

There are many other areas related to technology that could gain more focus in benchmarking. The management of third party vendors is one, as is the ability to manage across a geographically-dispersed organisation. Exception handling and STP rates could be better incorporated, as could metrics around the interoperability and flexibility of treasury's operational capability, and the level of technology and process expertise. What is clear is that technology – both directly and indirectly – has significantly changed treasury benchmarking and will continue to do so in the years ahead. ■

The next question:

"More and more Western companies are looking at using the RMB to carry out and settle cross-border trade deals. What are the benefits and challenges of trading in RMB? Also, have there been any recent changes which will make RMB trade settlement easier?"

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

China to pull up a chair or overturn the conference table?

As China continues its march to reclaim the top spot on the global power pyramid, can it really co-operate with the US, or will it simply rub the West up the wrong way? Also, what are the implications for free trade and globalisation if China is no longer content to play second fiddle? ECR answers these questions and more.

Xi Jinping is the most powerful Chinese leader since Deng Xiaoping. Xi's strategy has four pillars: economic growth, nationalism, repression, and the control of information. His authoritarian leadership and his role as reformer have a big impact on the world.

China thinks it is completely normal to be the largest show in town. The economic historian Angus Maddison calculated that China has been the biggest global economy for two millennia. In 1820, it accounted for a third of the world's GDP. Viewed from this angle, China is simply on its way back to the top spot where it feels it belongs. However, the average Chinese citizen will lag the average US consumer for a long time to come with regard to spending power. Whether both countries will ever reach the same height is an open question.

Equally unclear is whether it will be possible for China to continue to advance in the global hierarchy without huge upheavals. Ideally, equilibrium should be reached whereby China adapts to international structures as the international community makes room for Beijing at the table and allows China to help shape global institutions, frameworks, and etiquette.

On the one hand, China is being given more opportunities to leave its mark on the international order. On the other hand, countries are sending out signals that point to distrust and a wall of resistance against China. In some ways, China is trying to act as a responsible partner and stakeholder on the global stage. For instance, it has started to take part in peace missions.

There is also no doubt that Beijing has been successful in launching the new Asia Infrastructure Investment Bank (AIIB). The membership of the bank has proved very attractive. It already has around 60 (prospective) members including Australia, Russia, South Korea as well as the four largest EU economies.

But this is meant as an alternative to the World Bank. And as such, the Americans have been sceptical about the AIIB initiative and the run of interest in membership clearly took the

US by surprise. In political terms, the AIIB has turned out to be a spectacular piece of propaganda. Whether the bank will be equally successful as a driver of investment and projects in Asia is a moot point.

Power struggles

In other areas, the Chinese advance has been far from smooth. The Americans and Chinese are trying to steal a march on each other with their plans for trade blocs: the US with the Trans-Pacific Partnership (TPP), while Beijing is putting its money on the Regional Comprehensive Economic Partnership (RCEP). Most observers believe that the TPP and the RCEP boil down to macho behaviour and power politics between the US and China.

On the one hand, China is being given more opportunities to leave its mark on the international order. On the other hand, countries are sending out signals that point to distrust and a wall of resistance against China.

Understandably, Western media like to depict such power games as a struggle between liberal democracy and authoritarian state capitalism. Up to a point, this may be correct but it is in China's interests to adhere to, and maintain, the basic rules and elementary conditions for capitalism. No other country has benefited so much from free trade and globalisation. Beijing will not quickly try to impose state capitalism on other countries. At the same time, it is increasingly noticeable that many states are becoming less convinced that the liberal economic model is essential for economic prosperity and other leaders may well study the ways of the Communist Party on the assumption that economic success could go hand in hand with an iron grip on power.

China's increasing power fuels the rivalry with the US. Leaders on both sides may reiterate that the two powers can collaborate harmoniously at the top of the global pyramid. However, in the past millennia, the ruling hegemony has often found it hard to offer opportunities to – let alone make way for – other emerging superpowers. Meanwhile, the latter do not hesitate to seek confrontation.

Nonetheless, Beijing will probably continue to play second fiddle for a little while yet as the US continues to keep the time with the baton. The US has many faithful allies, its military superiority is unparalleled in history, and its economic scope is such that it is bound to be the dominant world power for years to come.

The bigger picture

Yet the trend is unmistakable. After all, the baton is not glued to the hand of the conductor – and he will find it increasingly hard to keep the orchestra under control. The US and other Asian countries have responded uncomfortably to China's tempestuous 'coming of age'. In combination with the Chinese yearning for recognition and additional growth, this could lead to painful situations, which could divide the West and undermine free trade and globalisation.

In many respects, China will want to conform to the established international order. The shared rules that govern relations between countries (which have evolved since the Peace Treaties of Westphalia in 1648) are useful to China.

Some of the countries bordering on China are worried about the security commitments of the US. The American pivot to Asia was supposed to shift the focus to the area around the Pacific Ocean, away from Europe and the Middle East.

However, partly because of the Ukraine crisis and the failure of the Arab Spring, the pivot has not really taken off. As a result, both America's Pacific allies and its partners in Europe and the Middle East have started to harbour doubts about its preparedness to step into the breach, if necessary.

That said, we think Beijing will shy away from creating too much unrest. Its foreign policy needs to be contained within a domestic framework that entails sufficient economic growth, structural reforms and the consolidation of the CCP's absolute power. Regional stability is part of the plan to realise these objectives.

In many respects, China will want to conform to the established international order. The shared rules that govern relations between countries (which have evolved since the Peace Treaties of Westphalia in 1648) are useful to China. As are the resulting concepts of sovereignty and the balance of power.

In 1914, the global economy collapsed because the then superpowers declared war; whereas today, it is precisely the aversion of the (Western) countries to war that could lead to the unravelling of the global economy.

However, down the centuries, the international order has largely been shaped by the West and, since WWII, most of all by the US. Institutions, procedures, and conventions that are embedded in this system are often favourable to the West, whereas emerging economies are put at a disadvantage.

Rethinking the system

But things could get bumpy if China is convinced that the current international order acts as a gigantic bureaucracy that aims to guarantee the dominance of the West. This is where German sociologist and political economist Max Weber comes in. Anthropologist David Graeber paraphrased him, saying: "The only real way to rid oneself of an established bureaucracy, is to simply kill them all, as Alaric the Goth did in Imperial Rome, or Genghis Khan in...the Middle East. Leave any significant number of functionaries alive and, within a few years, they will inevitably end up managing one's kingdom."

Whereas we are not predicting a destructive world war, China could gradually become convinced that a complete rearrangement of the international system is required if it is to expand its power and prosperity.

In 1914, the global economy collapsed because the then superpowers declared war; whereas today, it is precisely the aversion of the (Western) countries to war that could lead to the unravelling of the global economy. Western fears could push the world over the edge because there is nothing to stop countries such as China from pushing their luck.

Over the coming years, we expect China to change tack repeatedly. Sometimes it will adapt to international order; other times China will try to adapt it – either internally or externally. Should tensions rise steadily, its focus will increasingly be on the latter. ■



Dubai: your gateway to Africa

Setting up a regional treasury centre in Africa is a notoriously intricate process. This is precisely why informed multinationals have been looking for a more efficient route into the continent. Could Dubai's geographical proximity, favourable business environment, and significant technological and infrastructure investments, provide the solution?



David Aldred
Head of Sales for Middle East, North Africa, Pakistan and Turkey, Treasury and Trade Solutions, Citi



Geoffrey Gursel
Head of Sales for Sub-Saharan Africa, Treasury and Trade Solutions, Citi

Earlier this year, Dubai International overtook London Heathrow to become the world's busiest international airport. Whilst passengers have been travelling from Dubai to all four corners of the globe, there has been a noticeable uptick in traffic to Africa. In fact, Dubai-based airline, Emirates, is now the largest carrier in Sub-Saharan Africa and the main non-African airline into the continent.

Whilst this snapshot of the aviation industry highlights an interesting micro trend, it is also illustrative of a much bigger shift that is impacting the way in which multinational companies do business, and where they do it from. "Dubai is fast becoming a centralised hub, not just for conducting business in the Middle East and Asia, but also for doing business in Africa," notes Geoffrey Gursel, Head of Sales for Sub-Saharan Africa, Treasury and Trade Solutions, Citi. "Just as airline traffic has increased, the payments flows between Dubai and Africa have also rocketed in recent years."

A rising star

"Although Dubai has been a strategic port for millennia, what we are now seeing is something of a perfect storm," adds David Aldred, Head of Sales for Middle East, North Africa, Pakistan and Turkey for Treasury and Trade Solutions, Citi. "The more traditional drivers for Dubai as a strategic business hub – such as its favourable taxation regime, comparatively easy operating environment, local talent pool, stable political and economic backdrop, and geographical proximity to Europe, Asia and Africa – are now being supported by significant domestic and regional advancements in technology and infrastructure," he explains.

Indeed, the Dubai government has promised to invest over \$8.1bn in new infrastructure in order to host the World Expo 2020. The aviation industry is set to be a primary beneficiary of this investment, as the emirate looks to further open its doors to both businesses and tourists. Another key initiative that is boosting Dubai's attractiveness is the Smart City vision. The aim is to use the latest advances in technology – such as fibre optic wireless internet – to create a model for providing government services that are easily accessible, quick and efficient, using smart devices. These will include business-related services from ports, customs and bourses.

Elsewhere, the well-documented shift in global economic power is also working in Dubai's favour, says Gursel. "Since Dubai enjoys a strategic location on the new Southern Silk Road, it is well poised to take advantage of economic activity into and among the world's high-growth emerging markets (EMs), such as Africa, as part of the evolving South-South trade corridor."

Being an emerging economy itself, and therefore familiar with the challenges of transitioning into a developed economy, Dubai is leading the way in terms of EM-to-EM connectivity, he says. And as Africa also becomes more sophisticated, connecting, integrating, travelling and speaking with the continent from Dubai is becoming easier and easier.

"Numerous Chinese banks and corporates have already realised this and are now leveraging Dubai as a means to access the African markets," confirms Gursel. "Many other Western and Latin American companies – across all sectors – are also becoming increasingly interested in Dubai's potential as the gateway to Africa."

Treasury matters

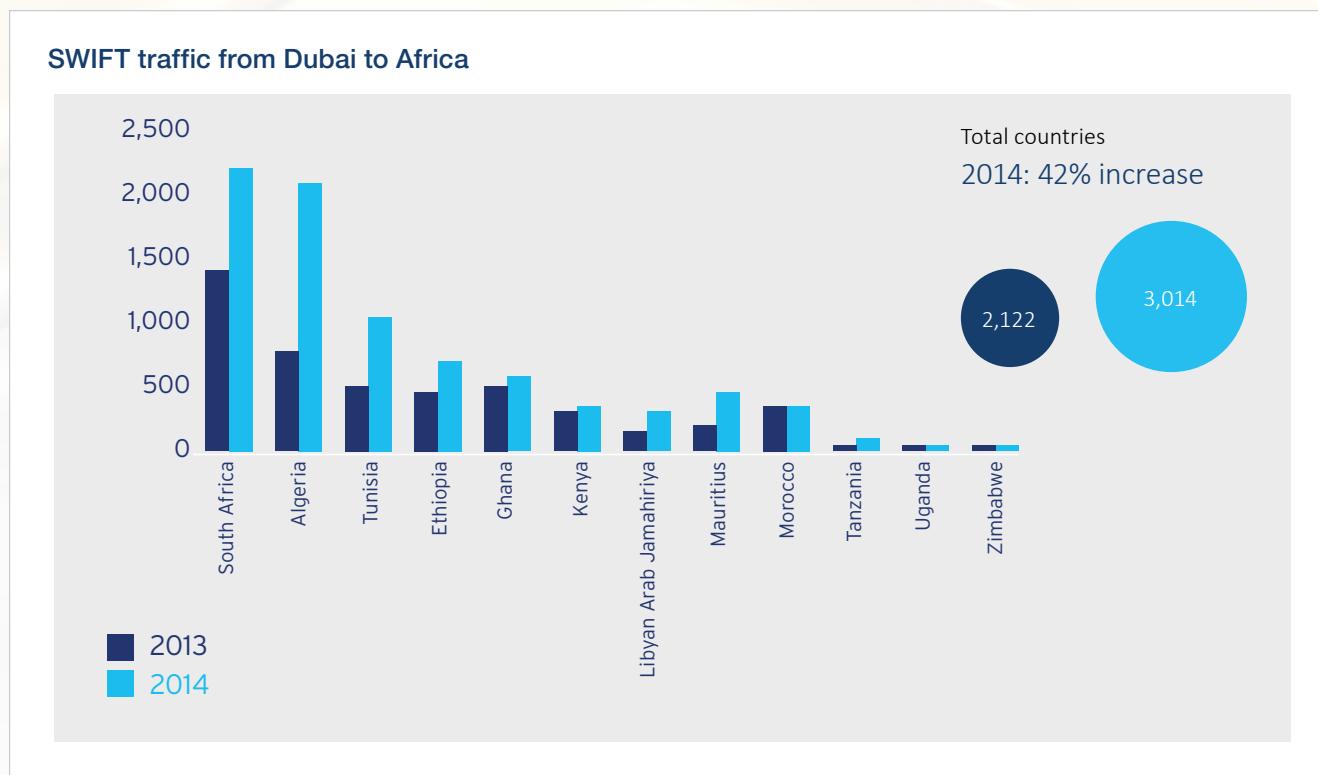
For treasurers, the beauty of all this is that it is now possible to run African treasury operations from outside of Africa, whilst achieving the desired level of visibility and control. As Aldred explains, "With the ongoing drive towards centralisation and bank account rationalisation, the days of having seven treasury centres around the world are, to a large extent, behind us. Having an on-the-ground finance presence in every continent, or in some cases country, simply isn't practical; neither is it necessary in the digital age."

"That said, to achieve the right level of governance, it is important for multinationals to be in tune with their local markets. So, increasingly, we are seeing global corporates cut back to having two or three regional treasury centres. And if the Middle East and/or Africa is part of the company's growth agenda, then Dubai is a great place to locate a treasury hub."

Whilst deciding to locate the regional treasury centre in Dubai rather than in Africa might provide numerous strategic advantages, it does not de facto solve the cash management challenges that treasury in Africa involves. Citi's 2014 Treasury Diagnostics results reinforce that corporate treasurers have a "need for speed" real time treasury management, continued centralisation (efficiency and control) and an acute focus on risk management. As a result, real time and quality data analytics to help clients manage their business and assist with bank account rationalisation, control and visibility are critical. Aldred adds "Citi believes that mobile and tablet technology combined with integrated FX Payment solutions will drive value, efficiency and be extremely relevant for our clients as the treasury organisation continues to centralise and become even more efficient. This view is supported by our clients and the key treasury trends that we see."

According to Gursel, some of the most common questions asked by Middle East corporates looking to do business in Africa revolve around: enhancing visibility with real-time balances; managing FX, country and counterparty risk; centralising payments and trade finance activity; domestic and regional cash concentration structures; compliance and control; and last but not least, connectivity standards and formats, such as XML and SWIFT.

"There is no one-size-fits-all approach to overcoming these concerns," he adds. "The answers or solutions will certainly vary from company to company, and while I would encourage corporates to of course maximise their bank's physical network, today it is critical to understand how SWIFT connectivity and sophistication is changing the tide with 'virtual branches' and how banks are enhancing the connectivity for our clients. And don't settle for a piecemeal solution. Yes, achieving the right level of local capability is important, especially in Africa, but it is also important that your bank can deliver platform consistency across the region. Otherwise, the integration and efficiency benefits of setting up the regional treasury hub will be severely diminished."



Seizing the opportunity

Embracing digitisation will also be key to making the most of the African markets, says Gursel. "After all, digitisation is changing the way everyone – businesses, governments, and consumers – handle financial flows."

"Mobile banking, for example, has revolutionised financial inclusion, and trade dynamics, in Africa: in February 2015, mobile network operators in Kenya facilitated 80,000,000 payments to m-wallets, compared to 2,500,000 ACH payments via banks. Therefore, consumers, corporates and banks are all in an era of technology-adaptation in Kenya. From a treasury perspective, mobile payment approvals and authorisations are now available across Africa. And with electronic banking also available in every country, real-time visibility is achievable, and on a multi-bank basis in many instances."

"As digitisation takes hold across Africa, the reliance on traditional bank branches is being challenged. Bricks and mortar presence is no longer a must-have and electronic formats are making for a much more efficient financial infrastructure," explains Aldred.

"Treasury centres have a similar opportunity to rationalise and streamline their operations, whilst also leveraging technology and innovation to gain visibility and manage cash and trade flows across Africa – all from the unique vantage point that Dubai affords."



What do you really want from your bank?

Bank-bashing is a favourite hobby of the unenlightened. But what do those who know and understand the role that financial institutions play think of the service they get? Treasury Today assesses the lay of the land.

Bank customers may get the feeling sometimes that financial institutions are run on the kind of principles espoused by Mr Bumble in Charles Dickens' Oliver Twist. In order to discourage paupers from asking for relief he suggests giving them "exactly what they don't want; and then they get tired of coming."

Indeed, companies faced with a range of issues that variously includes managing currency controls and the volatility of FX and commodities markets, the upheaval of centralising processes, the threat of geopolitical instability and a raft of new regulatory and central bank reporting demand, and even the threat of cyber-fraud, will necessarily seek help from their banks. But whilst the banks fully understand that they have a

vital role to play in oiling the machinery of commerce, do they really deliver the goods and services required or are they dodging the issues faced by their customers?

Back in December 2013, a meeting of Chris Skinner's networking group, the Financial Services Club, led by Colin Tyler, CEO of the UK Association of Corporate Treasurers (ACT), pondered whether banks were indeed meeting their corporate customers' needs. According to Skinner's summary of the event, the conclusion was 'not really'.

Most corporates, Tyler suggested, want banks to show them how to get the most from their assets, enhance and unlock shareholder value, improve their working capital and ease the

supply chain. "What they tend to get is product sales-focused bank relationship managers, who focus upon the bank's needs rather than the customers."

The issue of whether banks are meeting corporate needs is certainly not a Euro-centric discussion. EuroFinance's Cash and Treasury Management Asia 2014 event, held in Singapore, witnessed one lively discussion entitled 'The customer will define the bank of the future'. Scott Engle, Group Treasurer for Hong Kong-based insurance company, AIA Group Limited, pulled no punches when he told delegates that "banks significantly overvalue their value to a corporation," adding for good measure that "the only reason I need banks is because I pay money and I collect money."

"Not every corporate has the necessary level of experience; they look to banks to bring that knowledge to the table."

Kerry Saunders, IT Lead for Treasury, Constellium

A year is a long time in the financial services sector, so has anything changed? Seemingly not. In March of this year, delegates at Fundtech's 'Insight EMEA' conference held in London listened as Chris Donohoe, Assistant Treasurer, EMEIA, for the global diversified industrial company, Ingersoll Rand, told of his experience to date. "Too often we've seen banks come to us with off-the-shelf products that don't really meet the needs of a complex business," he said. "What I'd like to see is banks taking the time to really get to know us." In taking the time to understand a client's strategic goals, technical and technological capabilities, Donohoe believes banks have the opportunity "to align with customer expectations."

Know your customer

Over the years, banks clearly should have accumulated a great depth of experience and knowledge about what works and what doesn't; in theory, they should know where the "sweet spots" are, commented Donohoe. As such, he'd like to see more of an educational approach from them, enabling clients to get the most effective use of a solution. Under the guidance of local regulators and tax authorities, financial institutions should also try to support the changing structure of a product throughout its lifespan. They should not just "put it in and walk away." Indeed, he is adamant that banks should become more proactive in their delivery of strategic and relevant advice.

Adam Boukadida, Deputy Treasurer of Abu Dhabi-based Etihad Airways, also speaking at the Fundtech event, agreed. "They have to understand our business and become a strategic partner rather than just looking at us as a sales opportunity," he stated. With Etihad operating in more than 75 countries it has a complex business approach; banks must be able to understand the fundamental processes of their clients' businesses as well as its technical treasury function.

Know your product

Boukadida's fellow panellist, Kerry Saunders, IT Lead for Treasury at Constellium, a global producer of aluminium semi-products, naturally looked at bank service from a

technology perspective. She noted that whereas some banks have a very structured approach to what should be a 'commoditised' IT project such as a SWIFT implementation, with others "it feels like we are the first customer to ask for it." But she said banks should not only be alerting treasurers to the benefits of structures such as SWIFT, but also then helping them through the implementation. "Not every corporate has the necessary level of experience; they look to banks to bring that knowledge to the table."

Banks are in a position to understand certain aspects of a client's business, such as its overall payments activities, better than the client itself, simply because the bank has access to so much more data. Armed with that data, rather than waiting to be asked, banks should be proactively helping corporates (especially smaller and mid-sized firms) to better manage their process costs and efficiencies.

Are banks attracting the right people?

To be able to deliver the right services, banks rely on bringing in the right people of which education is an important factor. Most bankers have undertaken a business or finance-related degree such as accounting, business or economics, prior to entering the financial sector according to Emolument.com a 'salary benchmarking site' which recently surveyed more than 700 London-based bankers. Whilst this route represents the highest proportion (34%) of the banking population, business graduates are not the best paid. At director-level, banks value mathematics and statistics graduates over their business, finance and accounting colleagues, the former earning on average around £398,000 pa versus the latter's £265,000 pa. This may reflect the aptitude for more scientific minds to rise to the technical challenge of structuring deals or trading in an environment using increasingly complex financial products. It may equally indicate the current value banks are putting on individuals with the capacity to get to grips with this complexity.

Commenting on the differences, Thomas Drewry, CEO at Emolument.com, said that in the last few years, with mounting pressure for efficiency and the capacity of young bankers to hit the ground running, banks have tended to favour candidates armed with technical degrees. After all, he noted, spending time teaching an analyst about yield curves, balance sheets and volatility is a costly exercise so from an HR point of view at least it makes sense to opt for the individual with three years of relevant study under his or her belt. However, Drewry does point out that trading floors and corporate finance departments "are likely to keep becoming less diverse when it comes to education," the impact of which is yet to be revealed.

Right to reply

The London Fundtech panel did give the banking community the right of reply, lining up a brace of seasoned experts. "I think banks do need to have a better understanding of how their clients operate," admits Des Twort, Treasury Specialist, Bank of America Merrill Lynch (BofAML). It should not be a case of the bank turning up with its line of products and services and hoping that the client will buy something, but about understanding where the client sits on the spectrum of sophistication, where its challenges and needs are, and whether it needs a strategic or tactical solution to meet those needs.

Jonathan Parker, VP Cash Management Sales, Global Transaction Services, Santander, acknowledged that banks must have an openness to the client's objectives and what the

pressures and demands are on treasury within the organisation. "It requires building up a fact base so that we can position the right services to the business at the right time and present a view of what is coming down the line by way of services, functionality and trends in the market." But Parker believes there is a responsibility on the treasury's part to be "open and communicative" with its bank so that the bank has the ability to react when it needs to and with the appropriate speed.

In this respect, Twort observed that "eight times out of ten you never get to speak to an IT person" when going through an RFP for an integrated banking solution. When it gets to the implementation, he observes that it will often fall down because the IT people "straight away see that what has been bought will not work in the existing infrastructure." The key for the corporate then, said Etihad's Boukadida, is to align all project stakeholders and contributors, including the bank and the system and service providers. In this way, the process becomes transparent "and everyone understands the end goal and is working towards it."

A shared experience?

Compliance is a concern for banks, with KYC and AML rules for example requiring constant attention. It is a bank issue in that they are the ones that are fined and take the reputational hit if something goes wrong. In this respect, an interesting observation raised by ACT's Tyler at the aforementioned Financial Services Club meeting was the notion that banks are increasingly asking their corporate customers to help them with the regulators. "The regulators should be focused upon the corporate needs but rather than this being the case the corporations are being caught in the bathwater being thrown out by the regulator in their sweeping changes to trading operations." This effect had been previously noted at a Nordic Financial Services Club meeting. The very idea that banks are asking their corporate customers to help them face up to the regulators is something that Edward Harkins, an independent consultant specialising in the public and not-for-profit sectors, felt compelled to comment on Skinner's blog that it "somehow gives me a queasy feeling."

Not so for Ingersoll Rand's Donohoe who feels that compliance should be tackled as a partnership and believes the responsibility ultimately lies with the corporate to ensure the correct procedures are followed. His company manufactures compressors for the oil and gas industry that will at times be sold in countries with a very dynamic geopolitical climate. "It's hard to say to the bank that it owns the sanctions when we are responsible for who we are selling to and who will pay. Of course, there is a limit to what Ingersoll Rand can know about the eventual user of its products but it has a highly active compliance department to prevent transgressions as far as possible."

It is true that trade compliance and financial compliance can be two very different matters; a firm can sell its product in a certain country but might not be able to receive payment. It may be that, for example, a bank from the US may not be permitted to handle a contract for a deal in Cuba whereas a European bank will have no such issue. Because compliance tends to be very fluid, with policy changing quite quickly, Donohoe said there has to be an ongoing relationship between bank and corporate and that the corporate has to take ownership of who it sells to and who it is paid by. Indeed, few companies want money arriving in their bank accounts that will cause a major compliance issue. But banks

must keep clients up to date on sanctions matters and where bank policy potentially affects the handling of payments.

Earn your keep

What corporates really want from their banks, it seems, is a more up-front approach. Corporates will engage more than one banking partner but when a bank wins the business it can't just sit back; it has to earn its fees. To win and retain a share of wallet requires proactivity where banks come forward with business solutions and propose opportunities for greater efficiency. The appearance of more ex-treasury personnel in the bank consultancy line-up is, he feels, a sure sign of progress. "We select the topics we want to discuss, but if that is offered, we will definitely take that up," stated Boukadida.

For Saunders, knowledge is the key to banks offering value-added services. Having worked with two mid-sized corporates she noted that it is relatively easy to switch banks, SWIFT allowing an almost bank-agnostic state to prevail. "Banks need to make us want to stay with them, bringing their knowledge and tools so they stand out from the crowd, because for us it looks like a very level playing field."

The ideal situation for Donohoe is to have someone at the bank that feels as if they have actually worked for the team for years before moving to the relationship bank. "Sometime treasurers can be afraid to mention they are working on a certain project because they know they will be inundated with bank sales people. It's about getting the right person that knows and understands your business and who is proactive and will talk to you about relevant issues."

In offering his view on corporate requirements from their bank, the ACT's Tyler presented the following list:

- Fairness: more open and transparent.
- Clarity: plain language and clear communications.
- Relevance: tailored to the needs of the business.
- Innovation: continual delivery of next generation financial management.
- Choice: recommend and provide the best.
- Keenness: proactive service.
- Respect: do your research.
- Confidentiality: keep it quiet.
- Future-proof: ensure the bank covers the long term.

Banks may have progressed in their quest to meet the needs of their corporate clients but in reality that quest is never-ending as corporate needs keep changing in their own ongoing struggle to accommodate the push and pull of the commercial world.

Treasurers are looking for a banking community that is ready, willing and able to co-operate not just when diagnosing problems and offering solutions but also by improving connectivity with and accessibility to information held by those banks.

In the final analysis, Damian Glendinning, the Singapore-based treasurer at multinational computer technology company, Lenovo, amuses with his trenchant remark made in a recent conversation with Treasury Today. As a treasurer of significant experience he is still drawn to comment that "nobody has ever accused the banks of understanding what corporates want." ■



When prices rise

After a period of little or no inflation in many of the world's leading economies, it appears we could now be approaching the point where prices finally begin to tick higher. What type of inflation environment can we expect going forward, and how should corporates analyse and quantify their explicit and implicit inflation risk? In this article, experts from banks and leading risk consultancies discuss these and other important questions.

"We think inflation right now is at a nadir," says Adam Chester, Head of Macroeconomics, Commercial Banking at Lloyds Bank. That's right. After many long months of subdued inflation across the most G7 economies, signs that change is now afoot are now being picked up.

Concerns over disinflation – or even deflation – are beginning to ease in America. By late April, the US ten-year "break-even" rate, which measures average market expectations over the same time period had recovered from a 1.53% low in January to 1.92%, its highest point since November 2014, and a reflection of the higher core inflation now being recorded in the US.

Meanwhile in the UK, price indexes may, despite the recent slip into negative inflation, also be about to move higher. In the past year plunging energy prices, combined with aggressive high-street discounting and a period of sustained strength in

sterling weighing on imports have together produced months of flat headline inflation figures. But the significance of these factors is now waning. Brent crude is back up at around \$65 a barrel. There is too some evidence that high-street discounting is starting to slow compared with the frenetic pace we saw in 2014. Exchange rate movements have been more mixed – sterling bounced back slightly post-election – but dollar/sterling is still well below where it was in the early part of last year.

"The falling out of the base effects of those three things will I think cause inflation to move higher as we move into the second half of this year," says Chester. "We have headline inflation at the end of this year back at 1%. In the medium term, the key driver will be the underlying dynamics of the UK economy, and in particular how wage growth materialises. There are some tentative signs that wage pressures are starting to emerge as the labour market tightens, and we think that will continue."

Then there is the Eurozone. Just a few months ago, we were hearing talk (unfounded though it seemed) that the single market may be entering a deflationary 'lost decade' akin to what Japan is only now gradually emerging from. But even here the picture is changing. At the end of April four months of declining prices in the euro area was officially declared over. Inflation in the Eurozone now stands at an annual rate of zero, a sub-target level that highlights the fact that there is still some way to go. However, with the European Central Bank's programme of quantitative easing set to stimulate prices further up until its conclusion in the autumn of 2016, it would be tempting to conclude that a corner has now been turned.

One does not need to be an investor or central banker to understand that this turnaround represents good news for the global economy. Inflation is not intrinsically good or bad. But like GDP growth and industrial production increases, a moderately higher rate of inflation can be taken as a sign that a recovery is under way. For businesses the contrary scenario, as recently played out in Japan, would have been very harmful. Deflation drives up the real cost of debt, depresses asset values and, ultimately, defers consumer consumption. Whatever business you are in, everyone west of the Urals should be relieved that scenario no longer looks likely to play out.

However, the return of inflation also raises risk management questions for corporates. In this still uncertain environment, corporate treasurers – even those at companies without any direct linkages to inflation on the balance sheet – should consider defining an appropriate strategy to understand the risks they are facing and reduce the impact on their business of uncertainty related to market movements and central banks actions. Perhaps it's time to recap on the basics.

Different impacts

The answer to the question of what higher inflation will mean for corporate risk managers ultimately hinges upon the company and the nature of the business they are in. While inflation impacts all companies to one degree or another, the impact tends to manifest itself differently across sectors. How it does, precisely, will often determine both the feasibility and usefulness of risk mitigation strategies.

Firstly, there are those with direct linkages to inflation. This category includes companies, like utilities firms, who have tangible linkages to inflation in both revenues and the asset base. It could also include any commercial real-estate owners, companies with commercial offices or indeed retail outlets on long-dated leases that are also linked to inflation.

These two broad groups of corporate clients, because they have an explicit link to inflation in their business, tend by virtue of that to be the main users of inflation-linked hedging products. Like any hedging exercise the objective here is to foster greater stability in cash flows and the balance sheet. "An investment into a utility company is akin to investing into an index-linked bond in that the return is 100% inflation linked, to the extent that the corporate doesn't hedge any," says Aled Patchett, Director, Financial Risk Advisory at Lloyds. "As a result of that linkage they tend to hedge a large proportion of their inflation risk."

Understanding the implicit

Then you have the other – much bigger – set of companies, those that have exposures that are more implicitly linked to inflation; that is revenues or costs that broadly, but not exactly,

track inflation over time. Hedging inflation risk is difficult for these types of companies and because of that many opt to simply ignore the risk. There are a number of reasons why it is difficult, beyond the obvious point that it is harder for companies to work out precisely which costs are linked to inflation, which revenues are linked to inflation and where there might be a natural offset or hedge within the business.

The first relates to the accounting treatment of any potential hedges. "It is not straightforward for them to hedge their implicit exposures because won't get good hedge accounting unless they can point to an explicit underlying inflation contract," explains Patchett.

Hedging inflation exposures with certain types of derivatives might prove dangerous if ones projections are not spot on. Hedging is simpler when a company has something that is contractually linked to inflation, all one has to do is purchase an inflation swap linked to the performance an index like the Consumer Price Index (CPI). But try to use an index to hedge an exposure that is only implicitly linked to inflation would expose themselves to basis risk, that is the risk that the inflation hedging strategy will not experience price changes entirely matched (eg opposite directions from each other) to the underlying inflation exposure.

"If I have a cost base that roughly tracks inflation, but not perfectly, I will have basis risk between how the cost actually moves and how the inflation index moves," says Ivan Harkins, Director of Debt and Hedging at risk management consultants JC Rathbone Associates. "That would be quite important in the building trade, for example. In recent years, particularly in London there has been huge inflation in building costs that has completely outpaced the consumer price index." Harkins points out that companies with risks of this nature would be advised to consider their hedges very carefully before proceeding. "Hedging exposures, where there is a significant basis risk, with an instrument like a swap can be dangerous because you can incur a liability under the hedge that does not match the underlying you are trying to hedge."

For these reasons, those that hedge implicit linkages to inflation are few in number relative to the utilities and energy companies who tend to dominate the inflation linked derivatives market. Even those treasurers who decide not to actively hedge inflation risk still need to be mindful of their company's exposures, however, especially given the fact that a changing inflationary environment often reflects changes in other financial exposures.

"What is really important to understand is that the three main factors which will drive higher inflation – energy prices, aggressive discounting, and the strength of sterling – means that for a much broader set of companies who historically think that inflation is not their biggest risk, the drivers of higher inflation can be very meaningful to them in terms of their exposures to financial markets," says Yuri Polyakov, Head of Financial Risk Advisory, Lloyds Bank. "For a treasurer looking at the dynamics of inflation, they really need to be thinking about what the direction of oil prices or the weak sterling means for their business, for example."

Cost or revenue sensitive?

Determining what types of exposures one has, explicit and implicit, is the first step. The next is determining where the exposures reside and quantifying them. One method that Commerzbank's corporate solutions team uses to assist clients

with this employs an inflation sensitivity matrix; on one side sits a cost sensitivity metric and on the other side is a revenue inflation sensitivity metric. Companies that exhibit a high correlation of sales to inflation may benefit from monetising their exposures through for example, issuing inflation linked debt, while firms that demonstrate sensitivity to cost inflation would typically benefit from executing hedges against higher inflation.

"Hedging inflation is the final part of a process," says Satu Jaatinen, Head of Corporate Solutions at Commerzbank. "To figure out a company's exposure to cost inflation is not always completely straightforward." How Commerzbank approaches it is by using a mix of measures that they believe denote cost inflation sensitivity for a corporate. One of these is comparing EBITDA growth to inflation growth, with a negative correlation between the two indicating cost sensitivity. Others include the inverse of EBITDA margin and percentage of fixed costs of total costs. As Jaatinen explains the EBITDA margin can be helpful in determining where the more significant exposures reside.

"If you have a very low EBITDA margin, you are more exposed to for example, wage inflation moving higher than if you have a high EBITDA margin. We use this mix of measures ("cost inflation indicator") also in our pension exposure analysis to see how much inflation cost exposure companies have already before the additional inflation exposure stemming from pensions."

Again it is important to note that there is a sector angle to this. Precisely where a company appears on Commerzbank's inflation risk matrix will to some extent be determined by the business they are in. One can imagine how utilities companies' revenues are naturally linked to inflation (sometimes through an explicit inflation to price linkage) and they typically benefit from a higher inflation environment. Service sector companies however, will have a higher concentration of wages on their accounts and will be more likely to suffer from higher inflation. As such, revenue sensitive industries, as measured by the correlation between their revenues and inflation, appear to mainly reside in the oil and gas, utilities, basic resources, travel and leisure and to a lesser extent, food and beverages sectors. Meanwhile, companies that seem to be more cost than revenue sensitive in the matrix (applied to Eurostoxx companies) are more likely to be operating in the telecoms, technology and automobile industries. The matrix sometimes reveals individual companies' dislocations compared to industry average too as exposures do vary from company to company.

As an interesting side note on Germany, when the cost sensitivity is measured by fixed costs as percentage of total costs, only one industry in the DAX – technology and telecommunications – was deemed to be more sensitive to cost than revenue inflation. Within MDAX however, a whole lot more industries (eg healthcare, industrial goods and services, chemicals, oil and gas, retail and technology) showed up as being more cost- than revenue-sensitive to inflation. This could be explained by a higher percentage of domestic labour force as well as higher operational leverage in the MDAX vs DAX industries, Jaatinen explains.

Finding the right hedge

Identifying whether your business is cost or revenue sensitive is of crucial importance when it comes to evaluating the suitability of different hedging strategies. For example, companies in sectors that are more revenue than cost sensitive could see benefits from hedging their inflation exposures through inflation linked debt issuance. Inflation linked bonds offer companies a means of offsetting the volatility in their sales revenues with the

cash flows incurred through debt payments. There is but one problem with this strategy. "The challenge in the inflation linked investment market is that it is finite," says Lloyd's Patchett. "There are a small number of investors who will buy inflation linked paper. That means a corporate cannot go to the market and issue an indeterminate amount of bonds any given year."

Consequently, alternative strategies are sometimes pursued. One of these, Patchett explains, would be to issue a normal fixed-rate bond before embedding an inflation swap which transforms the fixed bond coupons to inflation. "The other option is to create [the inflation link] through the derivatives market," he says. By doing that companies can obtain "cash flows that exactly match what an inflation linked bond would look like." The other relates to the accounting treatment of any potential hedges. "As hedge accounting is really only achievable if a corporate can point to an explicit underlying inflation contract," explains Patchett.

On the other hand, for companies with inflation exposures in their cost base, utilising the purchase of inflation linked derivative contracts is more often the better strategy. A company with exposure to inflation through rental contracts, for example, might choose to create a pay-out in with an inflation swap that exactly matches the inflation increases set by their landlords. Liquidity in this market can also be lacking at times, but it is said to have improved a lot since the market's infancy in the early 2000s. Today, it is proving particularly useful means of hedging for companies with inflation cost sensitivities. "If you've got a 20 year inflation linked lease so that every year the rental payment increases by inflation obviously there is a huge amount of uncertainty around what your rental costs may be over a 20 year period," says Patchett. "But you can forgo that uncertainty by entering into a hedge, the bank pays the uncertain component and they swap that for a known payments schedule over the twenty year contract."

Everyone's concern

Whether one decides to hedge inflation with a derivative, monetise it with a bond or simply just decide to tolerate it, it is evident that no risk-conscious corporate treasurer can afford to ignore inflation entirely. Forecasts suggesting that inflation is ripe for a rise should unquestionably be noted by treasurers as any rise in prices will have implications for almost every aspect of their work.

Take, for example, cash management and the growing levels of liquidity on corporate balance sheets. Last year a research report, professional services firm Deloitte found that the 1,200 listed companies in the region have built up their cash reserves by €47bn over the past year, bringing total cash reserves to €963bn. This represents an increase of around €250bn on the reserves recorded in 2007.

The reserves now swelling corporate balance sheets underline just why treasurers need to be cognisant of inflation, even if it is not deemed to be a risk worth hedging. "A lot of people forget that when they hold large cash balances, for whatever valid reasons that may be, in an environment where there is high inflation those cash balances lose purchasing power to inflation every year," says Lloyds' Polyakov. "It is not just negative yields on corporate cash balances, it is actually how much money you are losing to inflation. So that is something corporate cash and portfolio managers clearly need to consider." ■



Motion detector

Christophe Liaudon
Group Treasurer



Motivated by travel and the discovery of new cultures, Christophe Liaudon, has always sought an international outlook in his work. Although he has held his current position for well over a decade, his arrival in an industry that by definition is all about movement seems entirely appropriate. His approach to treasury carries a similar restlessness, always seeking out new and better ways of moving forwards.

Neopost is a France-based global leader in physical mail, digital communication, supply chain and e-commerce-based shipping solutions. It sells into more than 90 countries with a direct presence in 31. The group, which is serviced by more than 6,000 employees, posted full-year revenues for 2014 of €1.1bn, up 1.6% year-on-year. Europe is its largest market, closely followed by North America, but Asia Pacific is growing fast. In terms of group contributions, digital and shipping solutions play an increasingly important part, now accounting for 21% of all business. Neopost is not rated (except by the NAIC following a US private placement) but since 1999 has been listed in Compartment 'A' of Euronext Paris (indicating capitalisation of more than €1bn) and is currently part of the SBF 120 French stock market index.

Some people are driven by the urge to find and experience new cultures and ways of doing things; for them, standing still for too long is uncomfortable and is to be avoided wherever possible. It may be more challenging to translate this imperative into working life but finding an opportunity to operate on an international stage seems like the ideal basis

for exploration not just of the physical and cultural world but also of the ways in which the commercial environment may be constantly reshaped to reflect its dynamism. The way in which such a notion is awakened in the individual is perhaps as surprising as some of the discoveries made on the journey.

A final year specialisation in European business processes whilst studying at the independent Parisian business school, ESLSCA (Ecole Supérieure Libre des Sciences Commerciales Appliquées), was the key to broadening the international commercial horizon of Christophe Liaudon, Group Treasurer at Neopost. Despite the realisation that this was his calling, initially the quest for a global outlook had to take a back seat as he plied his trade in Paris, building up essential knowledge and understanding of finance and treasury.

Starting out

The first financial role for Liaudon came in 1993 as Credit Manager, looking after the receivables of a company that eventually merged to form the French energy services company, Dalkia. Exposure to treasury activities within this organisation subsequently saw him move roles, deciding that his interests would be best served by the proactive engagement and broader scope of internal and external contact that this position offered. Having accumulated five years of immersive treasury experience, a new environment beckoned with a move in 1998 to the treasury seat at a business unit of Valeo, a multinational automotive supplier also based in France. Here he got to grips more with reporting requirements, especially around cash positions, budgeting and forecasting.

Deeper exploration of the treasury world followed a year later, this time with an opportunity to understand the workings of the public sector, taking on treasury duties at Etablissement Français du Sang, the French national organisation for blood donors and transfusion services. His first challenge here was to set up a treasury operation, starting from scratch and building up banking and cash management structures. Despite the different objectives of the public sector, Liaudon comments that in terms of cash, indebtedness and financial results, the needs are the same: "You still have to be efficient." Coming as an extra challenge at this time was the switch from franc to euro, his new treasury function very much at the forefront of this momentous occasion where not least of his concerns was the adaptation of existing finance and accounting software to the fledgling currency.

Having overseen the set-up and growth of one new treasury operation, Liaudon decided in May 2002 that the thrill of the new was for him. He took on the same 'from scratch' challenge at the larger, more complex and, importantly for him, international organisation that is Neopost. With around 80% of its business coming from outside of France, it certainly seemed to fulfil his requirements and he confirms that the welcome challenge in the early days was to adapt his own knowledge and experience to meet the demands of international trade.

Today, Liaudon reports directly to the group's CFO and has three lines of personal responsibility. Firstly, he deals with daily liquidity matters such as cash management and loans to subsidiaries. Secondly, he handles market risk, particularly interest rate risk and foreign exchange (to date around ten different recurring 'non-exotic' currencies are used including US and Australian dollar, euro, sterling and yen). Thirdly, and currently consuming increasing amounts of his time, Liaudon tackles group debt management which he explains is perhaps the most interesting challenge of the moment.

Indeed, as at the end of January 2015, the group had a leverage ratio of 3.0 and net debt of €962m which is quite substantial given the size of the company (debt primarily finances a leasing portfolio of €781m and group renting activity). In reality, debt management is not tackled in isolation;

it necessarily draws upon other disciplines. "When you are indebted on a group basis you must have efficient daily liquidity management in order to perfectly match available cash with that indebtedness and ensure less cost of carry," Liaudon notes. He adds that in managing market risk, interest and FX rates too are inextricably linked with debt management.

Building a base

As a 'greenfield' treasury site, the first task at Neopost for Liaudon was to organise cash management. With most commercial activity being conducted beyond France, the 'overseas' subsidiaries had been locally organising their own daily cash in- and outflows and even had separate accounting systems. Liaudon's plan was to increase centralisation, to minimise cost of carry, to improve cash visibility and, ultimately to facilitate the group plan to increase the strength of its acquisition strategy. The second task was the centralisation of FX risk. "At the time I joined the group, the subsidiaries were doing their own deals," he explains. "It was not that they weren't doing it properly, but when you ask someone who is not a treasurer to deal with FX, they do not have the same skill and knowledge to negotiate with the banks." The desire to bring increased efficiency to every aspect of the function is clear. In fact it was no more apparent than in Liaudon's approach to technology.

Part of the centralisation project involved the progressive development of a SaaS-based solution. With a grand plan to remove company reliance on spreadsheets, a new solution would allow HQ to manage group cash (collecting statements, processing local payments and so on) by accessing subsidiary accounts located in the main operational countries. Kicking off in 2009, the SaaS development route was taken because Liaudon "is not a fan of proprietary bank technology." He feels it creates "too much dependency on one bank."

Following a detailed mapping of requirements, the solution that came out of this need is based on SWIFTNet FileAct connectivity via a service bureau, a single bank and Kyriba's SaaS TMS platform. The latter is customised at the holding company in Paris and is being rolled out across the group to allow subsidiaries to access it remotely across the web. Another vital part of the technology set-up is the Oracle Hyperion BI system used for consolidation reporting and treasury reporting. In 2014, the team set up FX risk management reporting in this system, allowing all subsidiaries to report their positions and the central management of all FX market deals. "Today we still use the telephone," says Liaudon of his trading activity. He likes the personal contact it brings to a deal but admits that as volumes of FX increase he has an eye on developing a platform for simple deals such as spots and swaps "to help us be more time-efficient."

A third challenge faced by Liaudon upon arrival at Neopost concerned the increasing expansion of the group and its rising indebtedness which is related, in particular, to the growth of the leasing portfolio. This required a new approach to funding efficiency, especially as the loan markets have become less reliable sources over the past few years. It just happened that Neopost did not require heavy funding during the most "restrictive" period of bank lending during the economic downturn, but Liaudon says banks "have never closed the door to us."

Nonetheless, on the evidence of what happened to other companies during this period – particularly French companies

that were seen by some overseas investors as too risky – Neopost “learnt a lesson” and now seeks just 20% of its debt from traditional bank facilities having found a means of diversification. Indeed, Neopost has become “one of the most active companies in terms of disintermediation,” a truth borne out by the realisation that the company secures the remaining 80% of its debt from private placement markets including those of the US, France and Germany. “Even if the banks are there for us we prefer to keep the bank facility as a back-up plan.”

Exchange trip

The advantage to Neopost in having made its presence felt in the private placement market over the years is that investors – predominantly the large institutional players such as insurance and pensions companies – know the name and understand the business and its challenges. Even if an investor chooses not to subscribe to a placement on one occasion, when Neopost returns to the market at a later date, the preliminary meetings have already taken place and the awareness of and confidence in the company is raised. Despite Liaudon’s experience in handling the private placement market, he says the banks still have a role to play. They help with the introductions to new investors and in explaining Neopost’s business model to prospects. “Our P&L can sometimes be difficult to understand because we mix a traditional industrial business with a leading-edge technology business,” he says. “Similarly, to analyse our balance sheet one must understand the fact that we need to finance the equipment placed at our clients under leasing or rental contracts. A bank that has been with us for many years knows us and can explain what we do.”

A deep knowledge of how treasury works, and the capacity to explain the function to non-treasury personnel is an important part of Liaudon’s role too. Being able to relate the treasury angle to the rest of the business, especially in the midst of a volatile economic environment, is certainly appreciated within Neopost’s boardroom, he says, but then he feels treasury is very much based on teamwork and co-operation anyway. He believes that treasury is the common link that exists between everything that happens in the company and its subsidiaries, from funding production and development, to setting up new business units, to handling cash for simple payments and collections, to ensuring funding is in place for acquisitions. “Teamwork is the key to success; we must be open to everything that happens within the company, from top to bottom. We cannot work in an Ivory Tower.” The spirit of co-operation is not just about internal connections, adds Liaudon. He feels it is vital that knowledge is shared with external partners; there needs to be an open dialogue with Neopost’s banks, for example, so that each has an acute awareness of the issues that inform the development of products and technology.

It would be fair to say that the banking community in the past few years has had a rough ride from many quarters. Contrary to popular ‘bank-bashing’ statements, Liaudon reports a good level of communication regarding practical treasury matters in recent times. If this had not been the case he most certainly would have raised the issue, being quite forthright in his expectations. “I’m not looking for silent partners. I am looking for banks that are able to propose new ideas to help us become more efficient; the proactive approach is essential for me.” The Neopost ultimatum is simple: failure to engage in two-way communication means that bank cannot be part of the group’s panel.

Preparation is the key

In the light of the favourable banking experience to date, it is interesting to note that Neopost chooses not to take its FX and interest rate cues from its banks. Instead it organises its activities – including subsequent negotiations with banks – around one independent non-bank treasury advisor, Forex Finance, which has a strong presence in the French market. “This company is really helping us to develop our strategy in terms of FX,” says Liaudon. This strategy, revisited as and when required, avoids bargaining around individual FX trades and instead focuses on deals based on a longer-term defensive position. Indeed, for more than a decade of using this firm Liaudon says he has seen “no surprises” regarding Neopost’s position at year-end. Forex Finance is retained on an annual contract and also advises on other matters such as IFRS fair value measurement of various instruments, avoiding the need in this example for Neopost to implement “expensive specialist software” to crunch the numbers.

Being prepared for duty is something that Liaudon is very clear about but sometimes external events take over. As the reporting requirement for treasury increases, especially around regulation-driven needs, such as the defence against corporate fraud, he recognises that this aspect of the job becomes ever-more time consuming. On a daily basis he receives requests from banks seeking more information on, for example, a payment request which in turn demands further communication with the beneficiary, generating yet more documentation and delays. The number of these requests is not yet sufficient to warrant development of a fully automated response, he says, but handling them is becoming an issue that is “sometimes difficult to anticipate.”

It’s all about the journey

Just as Neopost has developed into a more complex international business over the years, so treasury under Liaudon’s guidance has evolved to meet the challenges presented by such growth. The treasury office itself has necessarily expanded from a staff of one (Liaudon) to a team of three, the most recent recruit being brought on board to manage back office processing activities and the middle office link between treasury and accounting.

The way in which the company and the treasury department has progressed in that time filters through into Liaudon’s advice to any newcomer to the firm and to treasury in general. He stresses the importance of nurturing a curiosity about new processes and technologies that can deliver efficiency. Whilst this approach is evident in the current architecture of treasury tools within Neopost, he is quick to assert that this should never be about technology for the sake of it but technology as means of maintaining order and serving the role for which it is intended.

Given this insight, his personal philosophy – one that has clearly served him well in his career – is unsurprisingly based on keeping it simple. From his early days of study, Liaudon has been able to move forwards in his career, accumulating knowledge and expertise at each turn, following a clear path that was well-signposted for his interests in life. As someone who is inspired by the constant discovery of the new, he says he may well have found himself in the travel industry. In a sense, he has done just that anyway. Neopost is a business characterised by constant movement – of packages, parcels and messages – within which he has been able to stretch out in a role offering discovery and, of course, truly international scope. ■

Estonia: a digital economy

Situated in Northern Europe, Estonia has gained recognition for its resilience throughout both the Eurozone crisis and ongoing periods of weak regional growth. Treasury Today takes a look at how the country has achieved this stability, whilst embracing digital innovation, to become an attractive business location.

Since gaining independence from the Soviet Union in 1991, Estonia has emerged as a successful independent capitalist country. The strong consensus against the preceding regime, in the government and local populations, proved robust enough to outlast inevitable deprivations and instil a sense of purpose.

To this day, as Juris Paegle, Head of Cash Management in the Baltic countries for Nordea identifies, the country's "political stability and, in a way, political will, leads to financial and tax predictability – a factor often mentioned as a strong reason why international treasurers typically favour Estonia over its Baltic neighbours."

Emblematic history

Fruitful structural reforms, and the country's economic boom in the early 2000s, have also helped its appeal as a business location, and resulted in the country being named one of the 'Baltic tigers'. Estonia embraced advantageous memberships – including joining the EU in 2004 and seizing connectivity with the Baltic Sea region – which helped boost the country's credibility and popularity with foreign investors. The country experienced rapid economic growth in 2000-2008 with an average annual growth rate of 7% per year. Furthermore, by 2001, 75% of GDP came from private companies.

While Estonia was not immune to the financial crisis of 2008, the country's reaction, was impressive. Budgetary discipline included new labour laws that implemented wage cuts and rapid employment adjustments. In fact, "the country was able to maintain an AA- rating during the global crisis period," explains Tõnu Palm, Chief Economist for Nordea Bank AB's Estonia branch.

Austerity measures – such as a 16% decrease in the public administration workers average pay – may have been less successful had more political resistance been experienced. But the Estonian population endured the economic hardship (many young unemployed people did migrate elsewhere in Europe, however). Today, stable economic policies and open markets fostering sustainable growth, investment appeal and entrepreneurial activity continue to be typical for the nation. In fact, with an average GDP growth rate of circa 2.4% year-on-year during the last two quarters (Q4 2014 and Q1 2015) Estonia posted the highest growth in the euro area.

Trading effects

The country benefits from a strategic location between European, Nordic and Russian markets and the economy has managed to assert itself with remarkable aptitude on the international stage – foreign trade plays a major role in the

Key facts

Population: 1.3 million (2015)

GDP annual growth: 2.1% (2014), 2.2% (2015e)

Ease of doing business rank (2015): 17th

Index of economic freedom (2015): 8th

International memberships: EU, OECD, NATO, Eurozone

economy, the export of goods and services exceeds 95% of GDP.

Manufacturing volume now exceeds the 2008 pre-crisis level, driven by exports (70% of volume). Yet, due to the challenging geopolitical situation related to the Russian-Ukraine conflict, lower energy demand, and the still sluggish recovery of Estonia's key trade partner – the euro area – exports have been expanding only modestly. Total goods exports were up just 3% year-on-year in Q1 2015, following a 6% growth rate posted in H2 2014.

Nevertheless, the overall outlook for the euro area and Estonia remains positive, in the form of a cyclical recovery, which needs to be backed up by investment into productivity. "Growth continues to be generally slow in Europe but we expect it to pick up. In Estonia, the main long-term engine of growth has always been and will continue to be exports of goods and services as the domestic market is small," explains Nordea's Palm. Expected strong growth in important export partners, for example, Sweden (accounting for 18% of merchandise exports), coupled with a slow recovery in Finland (15%) in the coming years should help to revive exports demand. The EU accounts for 72% of Estonia's exports. Palm also predicts that improved sentiment in Germany and growth in Scandinavia will boost Estonian exports.

In March 2015, Nordea's Palm predicted that "a temporary soft patch in exports will be followed by a gradual pick-up in H2 as Euro-area demand recovers." According to research by SEB, during this 'soft patch', favourable economic conditions – including strong household incomes (wages and salaries have been increasing to the largest extent amongst the Baltic states) – that encourage robust private consumption are ensuring Estonia's resilience to external uncertainty.

Peer comparison

Against this backdrop, Estonia is expected to be one of the fastest growing economies in the Eurozone in 2015,

despite Swedbank's revision for the country from 2.9% down to 2% growth.

"It's important for a country's progression how competitive their economy and business environment is," explains Palm – and Estonia is ranked 29th globally in 2014's Global Competitiveness Report. The country scores highly for its macroeconomic environment (fiscal and monetary indicators, savings rate and sovereign debt rating) but receives its worst score for market size.

In comparison with its regional neighbours, Estonia holds its own. The World Bank Group's Doing Business 2015 guide benchmarks economies against the 'frontier' – the best regulatory practice observed by the guide since 2005 – where Estonia scores 78.84, 2.37 points closer to the frontier than the regional (OECD high income countries) average on the ease of doing business. Globally, Estonia ranked 17th for its ease of doing business in 2015.

"Estonia has transparent policies and effective laws that establish clear rules. The investment-friendly tax system, in addition to the environment of economic and politic stability, are good reasons to consider doing business in Estonia," explains Kristel Truu, Head of Cash Management Sales at Nordea's Estonia branch.

Estonia's stable business environment also attracts competitive foreign direct investment (FDI). In 2013, the average FDI (as % of GDP) for the EU was reported at 1.8%, whereas Estonia received 7.4%. In that same year, the country had the lowest level of sovereign debt to GDP in the EU, at 10% compared to a regional average of 87%.

Euro implications

Although euro adoption in 2011 contributed to the country's increased competitiveness, ensuring the trust of foreign investors and receiving better loan conditions, "the implementation of SEPA was a drawback from a speed point of view," explains Irene Usvasalo, Head of Cash Management at Pohjola Bank. Her colleague, Rita Kernumees, Senior Advisor for Cash Management, explains that prior to SEPA, Estonia had been one of – if not the – fastest country for payments processing.

Given that less than half of the country's population had a telephone line at the time of gaining independence, Estonia has since developed impressive technological capabilities and embraced the digital way of being.

On the positive side, Eurozone membership means private companies that import or export goods have benefitted. They no longer have to pay for euro currency exchange commissions and have the opportunity to reduce administrative workload.

E-economy

Payment processing is not the only area where Estonia has excelled. Given that less than half of the country's population

e-Estonia key facts

- Eighty percent of the population aged 16-74 years uses the internet.
- Eighty three percent of households have internet capabilities.
- Rapid Wi-Fi internet connections are available in more than 1007 public places (largely free of charge).
- Ninety eight percent of banking transactions in Estonia are conducted through the internet.

Source: Statistics Estonia, 2013 and 2014

had a telephone line at the time of gaining independence, Estonia has since developed impressive technological capabilities and embraced the digital way of being.

In 2007, for example, Estonia was the first country to permit online voting in a general election, boasts one of the fastest broadband network connections and free Wi-Fi is commonplace. "Estonia has benefited from the ability for faster information technology (IT) development by not being hindered by an outdated and overly extensive infrastructure," explains Hannes Kaadu, Country Manager for Pohjola Bank.

Back in 2005, the Estonian IT sector contributed to 9.2% of the country's GDP but, as Priti Alamäe, CEO of software company Nortal, explains: "it has been the fastest growing sector in the country by far and now generates closer to 15% of GDP." Furthermore, the wide uptake of IT solutions provided indicate the eagerness of Estonians to use innovative solutions in all fields of life – education, employment and health care, for instance. Aptly, Estonia boasts high cybersecurity levels, rated fifth in the world by the Global Cybersecurity Index (GCI); online security is "a strength the government continues to invest in," explains Palm.

The development of an IT-driven economy is led by the Estonian government's strategic choices. For example, the government has increased the availability of integrated e-solutions with its national ID card. The chipped photo ID stores digitised data about the user – "this card can then be used for identification, for logging into an internet bank, accessing public and financial tax services and for signing agreements electronically, for example," explains Kernumees and more than 80% of the population possess the ID card. In Estonia, a digital signature is just as valuable as one in ink and using e-signatures saves the Estonian economy approximately 2% of GDP each year. Moreover, "people spend very little time filing their tax returns and identifying themselves with service providers and banks," says Veiko Räim, Head of Investor Relations and Treasury for Eesti Energia.

In 2014, "as the first country in the world, Estonia launched its e-residency services to people outside of Estonia," says Usvasalo. As part of Estonian government's national Open Government Partnership (OGP) commitments for 2014-2016, after approved face-to-face identification by the authorities, non-residents can receive an Estonian ID card (officials have now rolled out identification services that can be handled by the country's embassies abroad). E-residency provides access to digital services, wherever the user is in the world – and regardless of whether they have a business or other relation with Estonia as the country does not require businesses to set up in bricks and mortar in order to operate there.

"It is an innovative idea, making the most out of the IT infrastructure that the country has developed over the years," explains Räim. According to Paegle, it is evident that Estonia's "e-environment" is a strong driver for investments and will remain so in the future. The uptake of Estonia's e-residency, however, has been slow.

Payments and banking sector

- **Payment cards.** The use of payment cards has become increasingly popular in Estonia. It is estimated that 1.45 million debit cards and 347,944 credit cards were in circulation at the end of 2013.
- **Credit transfers** are widely used in terms of both volume and value – payments from corporates are mainly conducted by credit transfer. On 1st February 2014, SEPA credit transfers replaced all predecessors.
- **Direct debits and standing orders.** 1st February 2014 also marked the replacement of the legacy domestic direct debit system with an e-invoicing based standing order service. SEPA direct debits apply for cross-border services.
- **Cheques** have always lacked popularity in Estonia. Now, their use for day-to-day transactions has been largely phased out.

Truu explains that Estonia's banking sector is relatively "young and, therefore, has been able to skip some steps." For example, according to Truu, the disregard of cheques is indicative of the demand for paperless solutions. "You can say that Estonians are not going to the bank – rather they are choosing to log into banking services electronically."

Estonia's banking sector comprises nine licenced banks and seven branches of foreign banks (which all are from the EU). "The banking sector is well capitalised and the country has the lowest public debts in the EU," says Palm. It is dominated by the Nordic banks (according to the Estonian Financial Supervision Authority [FSA], Swedbank, SEB and Danske controlled 77% of bank deposits in the first half of 2014), but all of the banks operating in Estonia "offer competitive solutions that are needed for both growth domestically but also for international companies," explains Truu.

Eesti Pank, the central bank of the Republic of Estonia, is a member of the European System of Central Banks and oversees the country's financial sector. The main functions of Eesti Pank include: to participate in the formulation and implementation of monetary policy in the euro area, ensure financial stability, operate reliable settlement systems, regulate cash circulation and advise the government on stable economic development.

"Estonia relies on bank-based financing rather than capital market-based funding," says Räim. "What is missing – due to a combination of the market being too small and liquidity too low – is capital market financing," explains Kaadu. Corporates can, of course, tap into the international markets but, according to Kaadu, "that isn't a very attractive choice – especially considering the availability of local bank financing." While the banking market "sometimes doesn't have the most sophisticated products available," according to Räim, "this is an exception rather than the rule."

Treasury appeal

"The emphasis placed on e-Estonia (having enhanced digital services and networking) is important in the corporate sector,"

says Palm. Technology, of course, is helping the country gain increasing global recognition as a viable corporate landscape but the business environment is supported by several other factors. Euro adoption in January 2011 certainly helped by simplifying capital investment and FX hedging processes.

Further factors include the favourable tax system, for example. Kaadu explains that "Estonia has a unique taxation system where profit is taxed at the moment of distribution and not at the moment of earning the profit. Profit distributions (dividends) are taxed at a rate of 20% (calculated from gross payment). As long as no dividend payments are made, no corporate tax will apply."

On a daily basis, if you want to reinvest your profits then there is no corporate tax payable, explains Alamäe. Additionally, since 2000, Estonia's strain of e-services (of which selected are now also available to non-residents) has included an e-tax office so all reporting requirements are submitted and filed electronically. The new coalition government, according to Palm, is set to "continue the past course with a simple and transparent tax system but has plans to make further adjustments to the taxation of dividends to attract more treasury offices and holding companies to the country."

Moreover, setting up operations in Estonia has low associated risks. Estonia has the second lowest score for money laundering financial risk globally in the 2014 Basel Anti-Money Laundering Index. "The country's stable foundation, history of conservative economic policies, continually improving IT systems and business friendly environment over the last 20 years all make a case for why international companies have set up business operations in Estonia," explains Palm.

Yet one area of concern is Estonia's labour market. The country boasts an educated, skilled and multilingual workforce but the population is small and ageing. Besides the ageing and limited labour supply there is a challenge to accelerate value-added growth explains Palm. However, according to Räim ageing population creates another challenge of "how to keep people working for longer and to re-train employees to meet labour market requirements."

Investment potential: a favourable outlook?

Investment in Estonia is somewhat a case of whether you see the glass as half full (corporate capital investment has increased by 60% from its lowest level in 2010) or half empty (current investment only makes up three-quarters of its pre-crisis volume). The country's competitive economy is hindered by lingering uncertainty in nearby countries. Growth prospects and geopolitical concerns for important export partners are also somewhat blunting the appetite for investment.

Nevertheless, Nordea's economic review from March 2015 reports that investment will recover in 2016 "with a pick-up in exports and a rise in the share of EU co-financed state investments."

Investors appreciate predictability and stability. Looking ahead, with the "government set to continue with a structural budget balance policy," according to Palm, Estonia's market-driven economy should demonstrate further resilience to external risks. "The country's pragmatic approach will continue and ensure that although GDP per capita will catch up fast, competitive factors will remain attractive for foreign investors," explains Kaadu. ■



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ING Commercial Banking

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Nick Leeson: the original rogue trader

This is the story of how one ambitious investment broker singlehandedly bankrupted one of the oldest and most important banks in Britain – and how this episode taught the banking industry the need for proper internal controls and channels of accountability.

When senior executives from Barings Bank arrived at the Singapore branch one February morning in 1995 to talk to Nick Leeson about the gaping hole which had suddenly emerged in the bank's balance sheet over the past several days, their star trader was nowhere to be found.

Unbeknownst to his bosses, Leeson had already fled the city and was now holed up, with his wife Lisa, in the five-star Regent Hotel in Kuala Lumpur. A short note left on his desk must have made for very ominous reading for his colleagues. "I'm sorry," it simply read.

Little by little, the reasons behind Leeson's apparent remorse began to emerge. Since 1992 Leeson had been hiding trading losses. As the bad bets he made on the Nikkei Index began to stack up in the first few weeks of 1995, Leeson followed a strategy that has been the ruin of many a gambler and doubled up. It was dangerous. It was against the bank's rules. And he lost. By the time he absconded less than a month later, his losses totalled more than \$1bn and Barings Bank, the oldest merchant bank in Britain and one of the country's most reputable financial institutions, was on the brink of collapse.

In the city

There was very little in the early years of Leeson's professional career that would indicate this was a man who would one day rise to eminence in the world of investment banking nor, moreover, cause the demise of one of Britain's most famous banking institutions.

Leeson first landed a job in finance in the late 1980s, when he was hired to work as a clerk for Morgan Stanley, arriving in the City of London in the immediate aftermath of the 'Big Bang'. London's Stock Exchange had not long been deregulated, an event which coincided with the advent of screen trading, and the City of London was beginning to emerge as a leading centre of international finance. It was the era of young, ambitious traders in red braces; of Gordon Gekko and "greed is good." In this world, Leeson looked very much like the others who occupied it at the time; just another unremarkable young man from the suburbs who, despite a modest background and a markedly average academic record, believed he could make a successful career (and fortune, of course) as a trader in the financial markets.

The realisation of that ambition did not come immediately. In his two years at Morgan Stanley he moved from the

position of clerk to an operations assistant which had allowed him to acquire some familiarity with the workings of financial markets. But after his application to move to the trading desk was declined, he decided to pursue his ambition elsewhere.

He went to work at Barings Bank, a bank of considerable regard principally because of a client list which included the very cream of British society (even the Queen is said to have held an account with them). By the time of Leeson's arrival, however, a sweeping transformation was taking place within the walls of this venerable old institution.

The influence of the old guard of conservative-minded merchant bankers who had long controlled the bank had been diminished by the Big Bang. As was the case nearly everywhere else, investment banking was now very much the vogue. Six years earlier Barings Securities had only a small team of stockbrokers. But when Leeson walked through its doors the investment arm accounted for nearly half of the bank's revenues. This brought about a cultural change of some significance at the bank. Controls and good bookkeeping were no longer considered to be of fundamental importance; in the eyes of many of the young traders now building careers at Barings Securities these sorts of things were deemed a nuisance, a mere hindrance in the quest for greater and greater returns.

The 88888 Account

Barings made Leeson a trader and sent him to Singapore to oversee the bank's futures trading activities at what was then called the Singapore International Monetary Exchange (SIMEX), located in the heart of the city's financial district. It was a dream job. However, in this highly pressurised environment, it didn't take long before Leeson began to feel the strain. During the summer of 1992, the futures markets began to fluctuate wildly, and Leeson and his team began to make mistakes. Trades were incorrectly executed. Sell orders were confused for buy orders.

But there was no way that Leeson, having worked so hard to fulfil his ambition of becoming a trader, was now going to quietly go back to his old job as a clerk. So he made a decision which was breathtaking in its recklessness. Instead of informing head office, he hid the trades.

Doing so was surprisingly easy. Leeson used an obscure error account – Account 88888 – in the bank's antiquated back office system, which went to different managers from the house account. He then altered the software so nobody

in London could see what he was doing. There he began to hide the worst losses he and his team had begun to make. His only remaining problem after that was making the margin payments on the futures in his possession. To settle these margin payments he had to take a gamble. He called head office in London and told them he needed money for other future contracts he had bought on behalf of clients, which his bosses accordingly sent to him without further question. In reality, the futures didn't exist, and the years of deception that would eventually culminate in Barings' collapse had begun.

"The first time I do anything, I'm not expecting to survive more than two days," he later recounted. But head office kept sending the funds needed to cover margin payments and Leeson began to understand that he could successfully hide his mistakes. "As you get past the two day period, then you start to get more confidence because it isn't being found. To me it's obvious, if they can't see it after two days then they are not going to see it after 200 days, 500 days, 1,000 days. It's easy."

Leeson has always maintained that the initial reason for his deception was to conceal, and ultimately recoup, the losses he was making (not for personal gain). And he did in fact succeed in doing that, at one point. In the space of a few months he had, by doubling up his trades, turned a £6m loss hidden in Account 88888 into profit. "I was so happy that night that I didn't think I'd ever go through that kind of tension again," he wrote in his autobiographical best-seller 'Rogue Trader'. He was wrong. In fact, as soon as he returned to work the following Monday morning he began using the error account again. This time around though he was not so fortunate. Now he had entered into something of a vicious circle. As he declared more profits, he became an ever bigger star at Barings and in the investment banking community more broadly. Each time he did that though, his losses grew. He had become trapped by his own fake success.

"The first time I do anything, I'm not expecting to survive more than two days. As you get past the two day period, then you start to get more confidence because it isn't being found."

The truth would eventually out. By 1994 a series of chaotic global events, including an earthquake in Japan, were pushing the markets against him (see Chart 1). Like before, he doubled up. But this time, it didn't work and the losses continued to grow. By the end of the year the deficits hidden in the 88888 account amounted to around £160m and, finally, his bosses in London were beginning to grow suspicious.

The blame game

That Leeson was able to successfully hide such substantial losses for the length of time he did was one of the immediate questions raised in the post-mortem following the collapse of Barings. By his own, naturally self-serving, account, Leeson said it was the mistake of management in allowing him to remain chief trader while also being responsible for settling his trades that made the deception possible. "I was in a bizarre situation, in that I had one foot on the dealing floor," Leeson

recalled. "But I was also in charge of the girls in the back office, who would carry out any of my requests. I was probably the only person in the world to be able to operate on both sides of the balance sheet. It became an addiction."

"People were focusing on the money that was being made. It was never about control systems... Barings had risk managers and compliance officers, but they were never in a position of authority to challenge 'The Untouchables'.

Some blame might also be apportioned to the state of the bank's IT systems. It is well documented that in the early 1990s Barings operated on a mishmash of systems, heavily reliant on manual processes and, by consequence, was all but incapable of assessing risks accurately. Had there been effective IT systems in place allowing information to be shared across the organisation, together with proper internal controls and channels of accountability to ensure such information is acted on, some commentators argue the opportunity for Leeson to 'go rogue' might never have arisen.

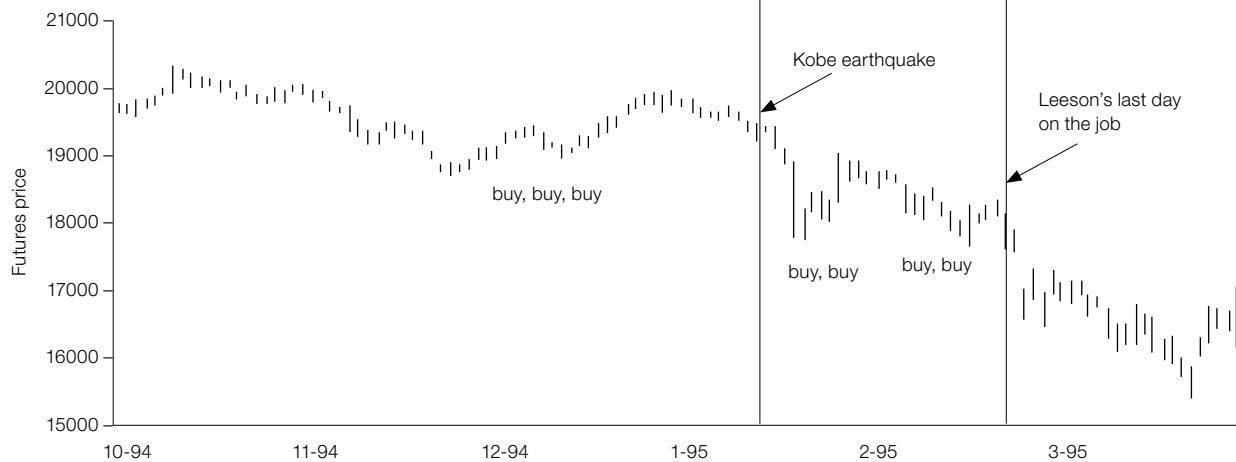
Of course, it is difficult to separate these shortcomings from the cultural change spreading through both Barings and global banking more broadly during that era. As Leeson himself later noted, it was that "failure is not an option" mind-set, in which all considerations were subordinate to profits that had brought Barings to this point. "People were focusing on the money that was being made. It was never about control systems... Barings had risk managers and compliance officers, but they were never in a position of authority to challenge 'The Untouchables'. People in those compliance positions needed to understand the business and what really went on. They clearly didn't at Barings."

Crime pays

Corporate failings of this magnitude do make the concept of individual accountability something of a grey area. But whatever pressures drove Leeson to commit his crime, whatever the failings at Barings that allowed him to get away with it, the bank's collapse nevertheless resulted from a choice he made personally and one that could have been made differently. Whether this truth has ever been fully acknowledged by Leeson remains a matter of some debate.

On the one hand, Leeson has always seemed at great pains to demonstrate he is not shirking the responsibility, stating recurrently in interviews that he believes nobody other than himself should be accountable for the Barings collapse. His public protestations of regret have not convinced everybody, however, former colleagues especially. Nicholas Edwards, who worked as a senior investment banker in the London office of Barings in the same era, and met Leeson again as part of a BBC radio programme three years ago, is among those who have doubts. "I was rather struck by his lack of remorse," he said. "He was resolute – yes, he was sorry it had happened but it was very matter of fact. He seemed to blame the system, as opposed to the fact that he is a ruthless, unscrupulous cheat and liar. That's what it boils down to."

Chart 1: Leeson and SIMEX Nikkei futures



Source: SIMEX tick database and Leeson (1996)

Such sentiment is not discouraged by Leeson's behaviour subsequent to serving time in a maximum security prison in Germany. Just months after his release from prison in 1999 he delivered his first after dinner speech. It would be the first of many. Since then he has been regaling after-dinner audiences – for a handsome fee of course – with his honest reflections on the world of finance and the behaviour and misbehaviour of finance professionals.

He's not done too badly from the media either. Every time there is a financial scandal of some kind (be it Libor manipulation, the London Whale, or the so-called 'Flash Crash') Leeson is always on call, ready to offer journalists the wisdom of his unique experience to an ever obliging press. He has also authored two books; one of which, the autobiographical 'Rogue Trader' was made into a film of the same name starring Ewan McGregor and Anna Friel. Liquidators personally chased him for £100m and, for a while, he was limited to earning no more than £3,000 a month, after which they would start to take a cut. They stopped chasing him in 2005, however, and now his after-dinner speaking and other various activities earns him around £80,000 a year.

To some, all of this leaves a rather unpleasant taste in the mouth. After all, is this not a man whose greed and mendacity contributed heavily to the downfall of a famous banking institution and, in doing so, cost ordinary honest professionals their jobs, their pensions and fortunes? Is it right that he be allowed, after his crime, to make a decent living out of the notoriety it brought him? Or should we accept that this is now a man who has served his time, and not let his actions distract from the factors that allowed him to get away with it in the first place?

Perhaps there is something to be said for the latter. Vilifying individuals, whether it be Nick Leeson or another figure of notoriety like Bob Diamond, often does have the tendency to mask underlying problems that may exist within an institution or even an industry. It must only be natural, however, for former colleagues and everyone else who lost jobs or money because of Leeson's crime to wish to see a greater display of public penitence, beyond the short note he left on his desk that February morning in Singapore. But all the while he is travelling the after-dinner speaking circuit, picking up big cheques, it is difficult to know just how 'sorry' Leeson is or ever was. ■



Discounting for the 21st century

A number of misconceptions exist around dynamic discounting. Here, we aim to dispel these myths and get to the heart of why dynamic discounting can be beneficial for both buyers and suppliers.

Seven years on from the global financial crisis and the famed 'fortress balance sheet' of the corporate big boys still exists. In early 2014, a Deloitte study reported that a third of the world's largest non-financial companies are sitting on a \$2.8trn gross cash pile. But change is in the air and these corporate heavyweights are slowly beginning to soften, seeking a return on their cash buffer.

With the current low, zero and even negative interest rate environment making that task all the more challenging though, treasurers have to evaluate innovative methods to put their excess cash to work. Introducing a dynamic discounting scheme may be one such way that a corporate can look to achieve this, effectively leveraging their own balance sheet to generate additional purchasing discounts. Such a set-up also

has the added bonus of providing suppliers with an earlier injection of cash and improving their working capital metrics.

But what exactly is dynamic discounting and how does it work?

Understanding the premise

Dynamic discounting is a simple concept – the supplier offers a discount for an early payment and the earlier the payment the greater the discount. It is also by no means a new concept as John Keating, European Managing Director at Taulia explains: "The principle of offering a discount in return for an early payment has existed for a long time. The issue is that these schemes traditionally have been static." For example, the 2/10 net 30 – a commonly used discount in the US – can be negotiated into a

contract and offer the buyer the opportunity to pay a supplier on day ten, instead of day 30 and in turn receive a 2% discount. Yet this is not necessarily a great deal for suppliers: "because the discount is fixed within the terms of the contract, suppliers often feel that they have no control over it," adds Keating. "Because of this they are often not keen to sign up to such an agreement unless there is a desperate need for the cash."

Aside from the lack of control, the deal was often unfavourable to suppliers financially. "If a supplier is being paid on day ten and giving a 2% discount then they are essentially borrowing at 36% APR," says Chris Dark, President International at C2FO. "Most suppliers, even today, will be able to borrow from a traditional lender for less than this." While some corporate buyers tried to sweeten the deal and pay even earlier for a slightly larger discount, the APR remained at 24% and "eventually this just gets pushed into the cost of goods," he adds.

Dynamic discounting is therefore the next step in the evolution of discounting and addresses some of the issues with the traditional model. Flexibility is key, in most cases the solution (generally speaking) allows buyers to choose an APR and offer this to their suppliers on a sliding scale based on how early they are paid. The APR can therefore fluctuate and is not tied to 24% like traditional models. Buyers have control because they are able to segment their suppliers based on a number of metrics and decide who should be offered what discount. Suppliers on the other hand also have an element of control because they are able to decide on a case-by-case basis if the deal offered suits their needs. As Drew Hofler, Senior Director, Solutions Marketing at Ariba puts it: "a dynamic discounting solution is like an ATM for SMEs."

It is worth noting that not all dynamic discounting solutions are the same. C2FO for example gives the suppliers the power to name their rates, not the buyer. "The supplier can change this daily to meet their ever changing cash needs," says Dark. "In doing so we have created a marketplace that ebbs and flows constantly and the aim is not to charge high APRs and only have a small amount of players participate but have more players participate and charge less."

Drivers of the solution

Despite the obvious benefits, dynamic discounting cannot yet be seen as a mainstream solution, as C2FO's Dark comments "there is a lot of noise, but still only a small number of companies have a large dynamic discounting solution." But it is a solution that is gaining traction, not just because of economic necessity from businesses, but also because of advancements in and the rise of automation.

"To make dynamic discounting worthwhile there needs to be a convergence of opportunity and capability," says Ariba's Hofler. Firstly, let's look at the opportunity. To make dynamic discounting work there has to be an opportunity for an early payment. "If it takes 30 days to clear an invoice then there will be no room for early payment," he adds. "This means that best practice has to be introduced to the invoicing process, it needs to be automated, cleaned up and exceptions will need to be eliminated." To do this, some companies have turned to e-invoicing solutions, and while these are not a necessity to ensure dynamic discounting works, it certainly helps in making sure invoices are approved as soon as possible.

The capability driver comes from making the solution automated and integrated. "Buyers don't want to go through

and make manual offers to thousands of suppliers, they want to set the parameters of what makes a good offer and then automate these to be sent to suppliers as soon as the invoice is approved," says Hofler. "Suppliers then should be able to log-in to the portal and select if they want to take the offer or not, based on their current needs."

There is also a political driver that has become more visible over the past few years. A number of governments have now introduced initiatives that seek to encourage buyers to pay their suppliers early – or in the case of the UK's Prompt Payment Code to pay them on time. The most prominent of these initiatives is perhaps 'Supplier Pay' in the US, a programme mandated by the Obama administration that seeks to strengthen small businesses by increasing their working capital, so they can grow their businesses and benefit the economy by hiring more workers. Corporate heavyweights such as Apple, AT&T, Coca Cola, IBM and Lockheed Martin have all pledged their support.

However the role that government has to play in encouraging such behaviour is contested. "Nobody argues that there is a big need for suppliers to receive more financing," says C2FO's Dark. "The debate stems from who should be solving this problem; while governments may launch these initiatives that pressure companies to pay early, they are unlikely to legislate on payment terms." And when they do, as was the case with the EU who tried to legislate 60 day payment terms, there are often loopholes. "It therefore is corporates and their treasury teams that have a key role to play in pushing the solution, not governments," adds Dark.

The business case

Of course, as is the case for any solution, there needs to be a business case for corporate adaption to occur. With dynamic discounting the main benefit for buyers is clear: paying early and receiving a discount is a way risk-free way to earn a return on cash that cannot be found elsewhere in the current low interest rate environment. In fact, this can be a considerable amount, Taulia estimates that dynamic discounting generates returns 50 times that of money market funds (MMFs) or T-bonds.

But there are other benefits for buyers that can supplement this. The implementation of a dynamic discounting solution can offer the treasury a chance to reevaluate its entire working capital strategy and move away from post-crisis thinking. "If used correctly it also can be used as a way to fund large initiatives such as bringing all suppliers onto a P2P network," says Ariba's Hofler. "One of our clients, for example, funded their entire P2P solution suite from the gains made from dynamic discounting."

There are also reputational benefits that large corporate buyers can gain from supporting their supply chain. With the political pressure and negative press around how corporates have acted in respect to paying their suppliers later and later, adopting such a solution can go some way to reverse the perception that large corporates are 'bullies'. Also, by adopting the solution corporates can help to ensure the security of their key suppliers.

For sellers, the fundamental business case is also clear, access to cash when needed. But again there are other benefits. "Certainty and control are two things that all business crave around cash flow," adds Hofler. "Suppliers are no different and the ability to have the control to access cash and the visibility over when this will arrive is invaluable when it comes to forecasting."

Barriers to adoption

As previously mentioned, dynamic discounting is by no means a mainstream solution and there have been and, in some cases, remain barriers to adoption. One friction point in particular, and one that still many corporates struggle to see past, is the impact of paying a supplier early on important working capital metrics such as days payables outstanding (DPO) and the overall cash conversion cycle (CCC). "These are still important metrics for many corporates," says C2FO's Dark, "and it goes back to the crisis. The issue is that in many cases the board will have asked the treasury and finance department to improve these metrics, so in the past when we have come in with our solution some treasurers have balked because it touches these metrics. This is changing however as corporates are beginning to understand how dynamic discounting can be extremely flexible in helping to manage these metrics, in addition to adding to profitability."

"Certainty and control are two things that all businesses crave around cash flow. Suppliers are no different and the ability to have the control to access cash and the visibility over when this will arrive is invaluable when it comes to forecasting."

Drew Hofler, Senior Director, Solutions Marketing, Ariba

There are ways that a corporate can implement a dynamic discounting solution without touching its DPO, he explains. "We offer an enhanced discounting solution," says Taulia's Keating, "this provides the corporate with third-party cash (from institutional investors such as banks, pension funds and hedge funds) that can be used to make the early payment. This is an extension of traditional supply chain finance (SFC) and means that corporates' DPO metrics are not impacted."

Ariba's Hofler approaches this debate from a different angle, however, and argues that – contrary to popular belief – a dynamic discounting solution can actually improve a corporate's working capital metrics, including DPO. "I have had the conversation around working capital metrics with lots of corporates over the years and there is a recurring pattern," he says. "They will often have hundreds of different payment terms with their suppliers. Some of these will be short and others long. But armed with dynamic discounting, treasurers have the opportunity in many cases to extend their payment terms with all their suppliers, based on the fact that they can use dynamic discounting should they have an issue with cash flow," he says. "So if payment terms are extended to 45 days with 75% of suppliers and 25% accept early payment, 50% will still be on 45 days, so what we normally see is that corporates are able to increase their DPO by four to six days net."

Working capital metrics, however, are not the only hurdle. There may also be a challenge on-boarding suppliers to a dynamic discounting programme, especially those who have had issues with static discounting in the past. Also, if the relationship at the supplier is with the sales department, it is likely that the contact will not be motivated by cash flows, but by price. Treasury will therefore need to find a counterpart at

the supplier who speaks the same language in order to really 'sell' the solution to them.

Also, there can be tax and accounting issues based around VAT. Nevertheless, dynamic discounting vendors generally recognise this and have teamed up with tax specialists to provide assistance, or in some cases have worked with the tax authorities to streamline the process for corporate clients.

A dynamic future

Dynamic discounting, just as its name suggests is a solution that is constantly developing, with a number of providers approaching it in slightly different ways. So what does the future hold for the solution?

Taulia's Keating expects its popularity to increase as businesses' attitudes change and more corporates adopt the solution. "With critical mass it has the potential to revolutionise the early payments space," he says. "What will get us there is education. The level of familiarity with the solution is lower in Europe compared to the US and this needs to change." Keating also highlights dynamic discounting solution providers are only just beginning to harness the data that created with the solution. "There is huge potential for this moving forward to impact profoundly how corporates approach relationships with their suppliers and allow them to make smart and informed business decisions."

Similarly to Keating, Ariba's Hofler also expects the solution to grow in popularity. However, he expects it to be just one cog in a large revolution around payables. "There currently are lots of discrete solutions that are used in the payments process," he says. "And this has been fine for a number of years, but as business are becoming more intimately networked many organisations are seeing the benefits of marry all of these on a network. We are working to get invoicing, tied with discount and third party financing and then tying this with the execution of the payment so everything is automated, seamless and all the data is rich and fully visible to all parties involved."

"There is huge potential for this moving forward to impact profoundly how corporates approach relationships with their suppliers and allow them to make smart and informed business decisions."

John Keating, European Managing Director, Taulia

While again, unsurprising, thinking the dynamic discounting market will grow, C2FO's Dark believes that it has the potential to develop into a vibrant marketplace, similar to the stock market. "Working capital should be a very tradable commodity," he says. "It should be able to be securitised just like many other financial assets." Also, Dark believes that smaller suppliers can offer the solution to their suppliers. "If the solution becomes ubiquitous then this will have a profound impact, and cash will flow down supply chains in seconds rather than the few years it currently takes. This could add trillions of dollars to global GDP." ■

Closing the gap: treasury models

Centralisation, automation and cost reduction remain the major trends when it comes to structuring the treasury function. With many companies intensifying efforts towards all of the above, it is pertinent to reacquaint ourselves with the basics of treasury models, asking the question 'does full centralisation really suit every business'?

It is no secret that since the financial crisis, treasurers increasingly want to know where the company's cash is and how quickly they can access it. Treasury Today's European Corporate Treasury Benchmarking Study 2014 found that cash management and cash pooling structures are the top priority for corporate treasurers, demonstrating no change from 2013. Moreover, addressing cash flow forecasting and improving visibility over the company's cash comprised two of the top technology issues – the study concluded that on these points, there is still room to improve.

But what impact do these concerns have on treasury models? Certainly, emphasis on visibility and control is considered one of the drivers behind intensifying interest in centralisation. Moreover, technological advances have made it easier and cheaper to centralise. Technology is no longer the preserve of large corporates.

Operating a centralised structure is not always straightforward however and, as every business has individual requirements, it is important to determine (and periodically re-evaluate) the degree to which centralisation is beneficial and practical from a specific company's perspective.

Levels of centralisation

Broadly speaking, there are three levels of treasury structure: decentralised, partially centralised and fully centralised. Although full centralisation may be the ultimate goal for most multinational corporations, many companies end up with a partial or decentralised structure simply because it is too impractical for them to operate in any other way. It is to these two that we first turn:

- **Decentralised.** Treasury policy-making, decisions and activities are conducted by individual subsidiaries. Typically, only a small team is retained at group level to provide advice and support. Subsidiaries may have their own local banking arrangements, will organise their own funding and handle cash management (including short-term borrowing and investments) locally. Payments to and from the parent company will still occur.

Decentralised structures work well when the subsidiaries are independent and autonomous units with limited complimentary needs. Local treasury units' enhanced local operational knowledge and risk awareness is advantageous

– especially when the business needs to adapt to unexpected events. However, they face issues with limited automation (no central processes), and potentially lack the leverage or ability to offset surplus cash positions against borrowings elsewhere, among other potential problems of multiplying, rather than minimising, efforts.

- **Partially centralised.** Arguably a 'best of both worlds' approach, a partially centralised model usually involves individual subsidiaries following the treasury policy as outlined by group treasury – often they will also receive advice or instruction. Individual subsidiaries, however, will be responsible for executing deals themselves via their local banking partners. Back office operations may be undertaken at a local level or they may be centralised. Partial centralisation delivers more control while enabling subsidiaries to maintain a degree of autonomy within the front office function. It can also help to increase uniformity in treasury policies and procedures across the group and allows key decisions to be made at a global level with a comprehensive view of cash flow – whilst also retaining local expertise.

A common approach to partial centralisation is the regional model. With treasurers rethinking their approach to banking and funding since the financial crisis, the one-bank approach is no longer seen as a viable option. So, with treasurers giving more consideration to regional banking relationships, a regional treasury model is also being mooted as an equally prudent option.

- **Fully centralised.** With a fully centralised structure, a global treasury centre or regional centres (on behalf of subsidiaries across a specific region or across the group) will undertake policy-making decisions and most, if not all, banking and financial activities. These centres may offer 24-hour services to ensure round-the-clock coverage for all subsidiaries. The organisation of centralised treasury is increasingly built around two objectives – debt capital and risk management – with the aim to source and secure a strong cash flow by placing key decisions at the centre.

Centralisation ensures group treasury has standardised operations, greater control across the company with streamlined bank accounts and improved transparency of cash flow. The natural hedge created by matching of financial positions can also result in better margins.

Moreover, the concentration of knowledge and experience typically leads to improved results with fewer people and a reduced risk of error.

Costs are also likely to reduce – if basic processes of payments and collections are centralised, the cost of those processes decreases; it is a simple economy of scale. Centralisation can, however, lead to a lack of local banking expertise and a loss of responsibility may lead to either (or both) a lack of interest and resistance at the local level.

Centralisation developments

Technological advances have been making it easier to centralise treasury operations, lifting both practical and financial barriers. Technology has come to be seen as a key enabler in the implementation of treasury centres and integrating company platforms with those provided by the company's banking partners, therefore, a key success factor. Furthermore, some regulatory initiatives favour the adoption of centralised treasury structures – SEPA, for instance. The persistence of general economic and geopolitical uncertainty means more corporates with global operations are looking at streamlining their treasury management into full centralisation.

The advent of cloud computing is also opening up new possibilities for treasury centre locations. Access to data sources and solutions in the cloud means that it increasingly doesn't matter where the treasury centre is situated. This development means that labour costs have emerged as one of the primary factors in determining location. In this regard, the Czech Republic, Slovakia and Hungary have emerged as locations for European treasury centres.

Of course, labour costs shouldn't be treated as the sole arbiter of location. Technology and communications infrastructure, time zone considerations, political stability and the local regulatory environment, should all be considered as part of the selection process.

Issues for consideration

However, it certainly isn't a case of one size fits all. Some responsibilities of the treasury department can benefit more obviously from centralisation – increased visibility of information, for example. Centralised information enables a business to 'think globally and act locally' ensuring sound management and the ability to prevent problems from a comprehensive group view – without having to compromise people on the ground managing both local risks and local opportunities.

Whilst other areas of focus consistently offer savings when centralised (for example payment processes), in some instances companies must question whether the process involved would be handled better locally. Certain commodities hedging or transactions requiring reporting to central banks provide two examples.

When deciding on a treasury model to operate, the following points outline some issues to consider:

- **Cost and cost saving.** The financial implications of initial expenditure and ongoing costs must be weighed against the benefits and potential savings for each model.

- **Group-wide support.** The chosen model must gain full support at management and board level; the understanding from employees at both group and subsidiary levels is also required.
- **Legal, regulatory and tax implications.** The significance of changing structures and establishing centres in different regional locations (with potentially different tax, regulatory and legal requirements) should be investigated.
- **External relationships.** Relationships with any banks and vendors impacted by any changes should be managed well – this involves negotiating advantageous terms and handling the declaration of any loss of business appropriately.
- **Technology.** What steps are required to progress to the desired system infrastructure? Of consideration here is whether legacy systems are able to migrate or integrate – this could have an impact on costs.
- **Operational aspects.** Any transition procedures, project management and staffing issues should be addressed with minimal adverse impact on daily treasury activities.

The treasury centre

Where a centralised structure is chosen, a treasury centre will be encountered. These are centralised treasury management functions, legally structured as a separate group entity or branch. Treasury centres are normally located in a tax-efficient environment, reducing the bill on transactions and profits associated with the entity. Also of importance is the location's possession of highly developed banking infrastructure and a wealth of financial services expertise. Moreover, technology and communications infrastructure, time zones, political stability and local regulatory environments should all be considered when choosing where to locate a treasury centre.

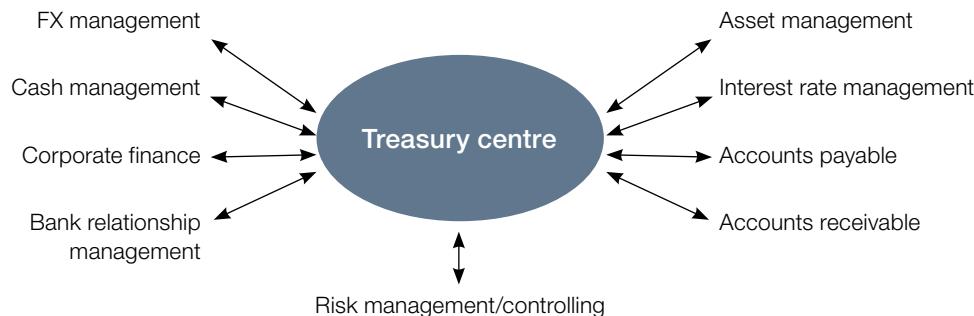
A treasury centre will provide financial management and transactions services for the other group entities including, but not limited to:

- Internal and external payment services.
- Cash pooling.
- Asset management services.
- Financial markets research.
- Monitoring and financing capital requirements of group companies.
- Risk management analysis and monitoring.

It is important to be aware that the capabilities and activities of a treasury centre are defined by each individual case. In some instances, responsibilities may be best managed locally as not all countries where group companies are located will necessarily permit the concentration of all treasury centre activities.

Nevertheless, operating with a centralised treasury can lead to numerous improvements, including: governance improvements (co-ordinated and central database, group-wide reporting, standardised procedures), cost reductions (higher volumes and fewer transactions, reduced financing requirements) and efficient tax management (optimising global tax position).

Chart 1: Typical centralised treasury structure



The structural framework

Policy/guidelines

Information flow/
liquidity planning

IT environment/
organisational structure

Tax/legal requirements

Source: *Treasury Today's European Cash Management Best Practice Handbook 2014*

The organisational structure of a treasury centre

Depending on the group's management philosophy, the treasury centre has a choice of two models to adopt:

1. The treasury centre acts as central agent, operating all financial transactions for the group companies in their name, compensated on a cost plus basis.
2. The treasury centre acts as the group's central in-house clearing bank, either on a shared service centre basis (which means that the group entities have direct relations with the treasury centre) or in competition with third-party banks.

Both models centralise the treasury know-how of the group. In addition, the in-house bank (IHB) operates the group's financial management as its own business. Cost savings, as well as additional income earned, arise at treasury centre level.

If a treasury centre is organised according to an IHB model and is competing with other third-party banks, it will usually operate as a profit centre. The group companies' financial needs are met on a price level applicable to a third party.

The question of whether a treasury centre operates as a cost, service or profit centre has a direct impact on where the treasury centre is located. Indeed, a treasury centre acting as a profit centre has a clear advantage if operating in a low tax jurisdiction.

In-house banking structures

IHB structures are typically established by medium-sized businesses upwards. An IHB acts as the main provider of bank

services to all group subsidiaries. This may be established on a global scale or on a regional basis. Instead of using local external bank partners, each subsidiary channels its cash flows through bank accounts held at the IHB. The bank then nets out the resultant debit and credit balances across the group. The IHB may also use a netting process for foreign exchange (FX), as well as for the payable and receivable amounts owed between the subsidiaries.

It can be noted too that the IHB may organise inter-subsidiary lending. When all the internal transactions have taken place, any remaining investment, financing and hedging needs are fulfilled by external banks chosen by the IHB from its preferred group of relationships. Some multinationals have restructured their inter-company loans to repatriate cash and achieve tax efficiency. In the US, for example, there are strict 'arms-length' rules on interest charges which, according to Ernst & Young (E&Y), "should reflect the interest rates on loans between unrelated parties with similar terms, including duration and credit standing of the borrower."

However, as an example of what can be achieved through such a structure and practice, Toyota Financial Services (TFS), the finance and insurance brand for Toyota in the US, built an inter-company lending facility for global affiliates and achieved a \$25m saving through reduced interest expense alone.

Centralised treasuries may operate an IHB within their overall model. However, an IHB can also be used to enhance operations whilst keeping a decentralised structure.

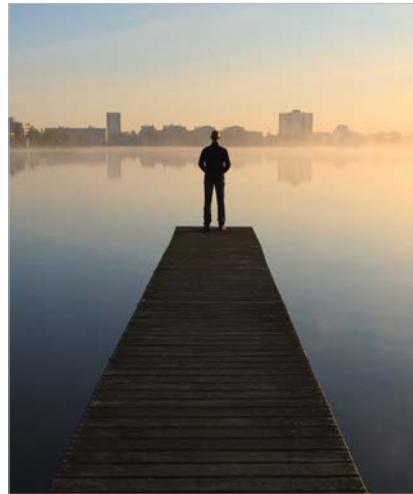
*To find out more about treasury models and structures, see *Treasury Today's 2014 European Cash Management Best Practice Handbook*. ■*



INSIGHT AND ANALYSIS

Future of the European financial market

To some observers, Europe's vision of a single and stable economic union is on the brink. With troubles in Greece again, a 'Brexit' back on the cards, and a number of Europe's smaller economies also reconsidering their EU membership, what does the future hold for the European financial market? Moreover, is regulation driving further cracks?



CORPORATE FINANCE

M&A situations

With M&A activity back on the cards for many corporates, Treasury Today looks into trends around the financing of deals. We also look at the global M&A landscape, the various requirements for treasurers' involvement in M&A, and analyse the legal considerations around mergers and acquisitions.



REGULATION

SEPA: what now?

After years of debate, confusion, delays and hard work, SEPA is now largely considered business as usual. The question for many corporates now is: what next? How can SEPA solutions be optimised and will there be any upcoming regulatory surprises as SEPA evolves? We answer these questions and more.

We always speak to a number of industry figures for background research on our articles. Among them this month:

Priit Alamäe, CEO, Nortal; **David Aldred**, Global Infrastructure Head & EMEA Sector Head Energy, Power, Chemicals, and Industrials, Client Sales Management, Citi Transaction Services; **Adam Boukadida**, Deputy Treasurer, Etihad Airways; **Adam Chester**, Head of Macroeconomics, Commercial Banking, Lloyds Bank; **Chris Dark**, President International, C2FO; **Chris Donohoe**, Assistant Treasurer, EMEA; **Thomas Drewry**, CEO, Emolument.com; **Scott Engle**, Group Treasurer, AIA Group Limited; **Damian Glendinning**, Treasurer, Lenovo; **Geoffrey Gursel**, Sub-Saharan Africa Treasury & Trade Solutions Sales Head, Citi; **Ivan Harkins**, Director of Debt and Hedging, JC Rathbone Associates; **Drew Hofler**, Senior Director, Solutions Marketing, Ariba; **Satu Jaatinen**, Head of Corporate Solutions, Commerzbank; **Rudolph Janse Van Rensburg**, Treasury Technology & Director, TreasuryOne; **Hannes Kaadu**, Country Manager, Pohjola bank; **John Keating**, European Managing Director, Taulia; **Rita Kernumees**, Senior Advisor for Cash Management, Pohjola Bank; **Christophe Liardon**, Group Treasurer, Neostep; **Bruce Meuli**, Global Business Solutions Executive, Global Transaction Services, Bank of America Merrill Lynch; **Liam Ó Caoimh**, Associate Director, Zanders Treasury & Finance Solutions; **Juris Paegle**, Head of Cash Management, Nordea; **Tõnu Palm**, Chief Economist, Nordea Estonia; **Jonathan Parker**, VP Cash Management Sales, Global Transaction Services, Santander; **Yuri Polyakov**, Head of Financial Risk Advisory, Lloyds Bank; **Aled Patchett**, Director, Financial Risk Advisory, Lloyds; **Veiko Räim**, Head of Investor Relations and Treasury, Eesti Energia; **Kerry Saunders**, IT Lead for Treasury, Constellium; **Kristel Truu**, Head of Cash Management Sales, Nordea Estonia; **Des Twort**, Treasury Specialist, Bank of America Merrill Lynch; **Colin Tyler**, CEO, UK Association of Corporate Treasurers; **Irene Usvasalo**, Head of Cash Management, Pohjola Bank.

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