

# **The Covid-19 pandemic and the liquidity management ecosystem: where to go from here**

EBA Liquidity Management Working Group

July 2021

## Introduction

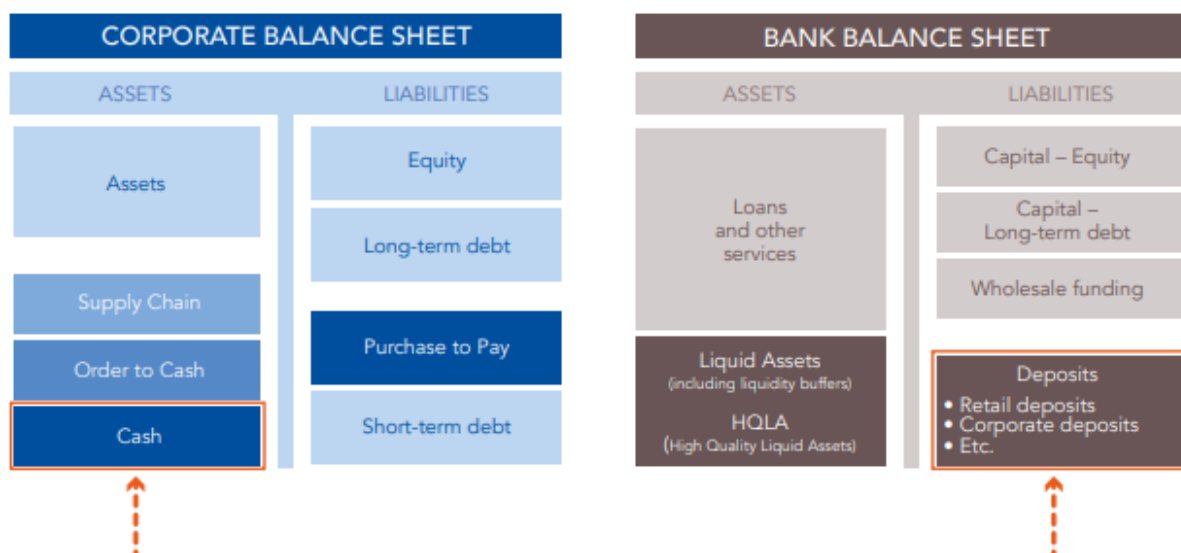
To ensure that their organisations have sufficient liquidity, corporate treasurers need to understand the dynamics of their incoming and outgoing cash flows, both short-term and long-term, to optimally use their liquidity. While treasurers can manage the timing of their payment outflows, they have less control over payment inflows, which largely depend on less predictable customer behaviour. When the Covid-19 pandemic hit in early 2020, it added unprecedented unpredictability to the already complex cash flow forecasting.

Months of lockdowns and restrictions worldwide triggered a global recession with far-reaching consequences for corporates, including declining sales, supply shortages, and changed customer behaviour. To be able to predict their cash flow in the pandemic environment, treasurers needed greater visibility and more frequent access to their cash positions. In addition, they needed to be able to authorise transactions and manage risk and liquidity while working remotely.

**As corporate treasurers had to address the immediate concerns in a new environment, they also began thinking beyond the pandemic: how to achieve real-time cash visibility, how to improve data management, how to take their liquidity management infrastructure forward and how to build more resilience into their cash and liquidity strategies in general – these are some of the issues that corporate treasurers and their financial institutions need to tackle long-term.**

This short paper highlights the major trends in the liquidity management ecosystem that the pandemic helped crystallise and outlines the questions that financial institutions will have to address as they continue to support their corporate clients.

**Figure 1: The liquidity management ecosystem**



## 1. Initial corporate response to the Covid-19 crisis

When weeks of lockdowns and restrictions turned into months, many companies suddenly found themselves to be short of cash, or even in financial distress. And, although there were some exceptions, notably in e-commerce and food retailing, most companies were faced with the task of having to meet committed costs with evaporating revenues. To meet these obligations in such harsh operating conditions, companies had to increase their focus on cash (liquidity)<sup>1</sup>, specifically on available cash. According to the Association for Financial Professionals' (AFP) 2020 Strategic Role of Treasury Survey "a majority of organisations is placing a greater emphasis on cash management and forecasting, and liquidity and cash planning during the Covid-19 crisis than they did in the past three years".<sup>2</sup>

In the face of growing and longer-term economic uncertainty throughout 2020, most organisations placed a greater emphasis on solidifying their liquidity and funding positions. Because they expected lower sales and delayed payments to disrupt cash flows, treasurers would revise their cash flow forecasts, often on a daily basis.

**For some treasurers, more frequent revision of the cash flow forecasts was essential to anticipate their organisation's and any subsidiaries' immediate liquidity needs in order to be able to deal with potential financial distress.**

Based on these forecasts, they would calculate whether existing external and internal funding sources would be sufficient to meet the predicted needs.

**Figure 2: The components of liquidity**



Insight comes from cash visibility, which in turn enables control, via techniques such as pooling, and the ability to reduce liquidity risk, via access to solutions including supply chain finance. If companies know their liquidity position, they are able to use it more efficiently.

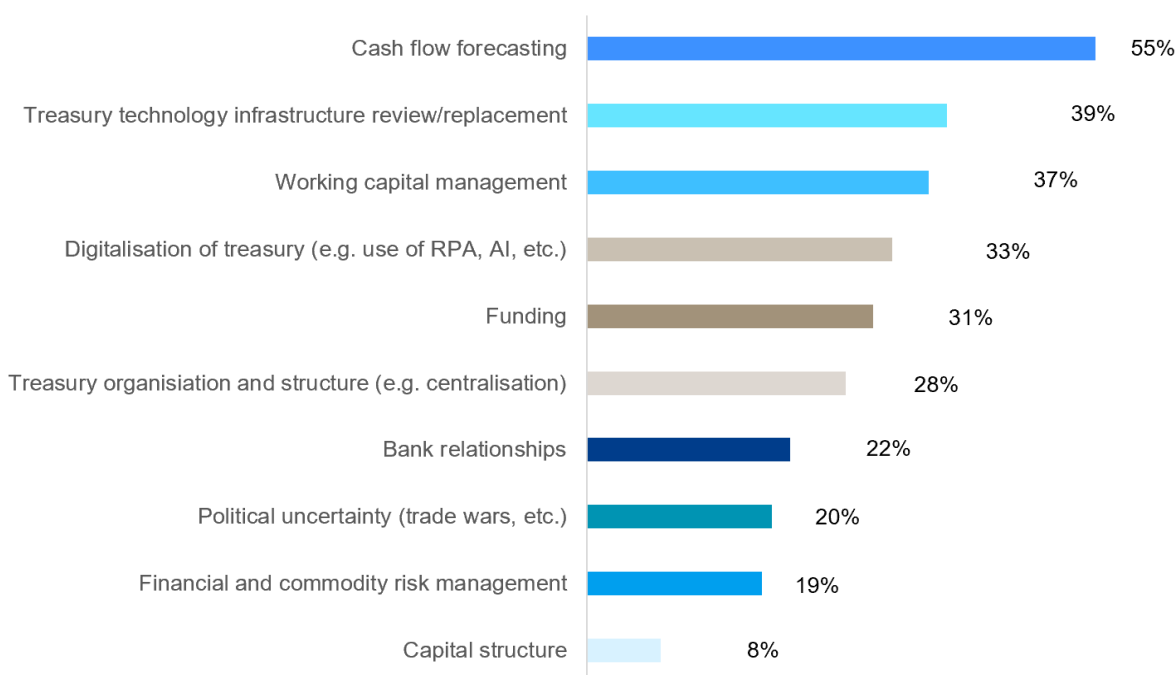
<sup>1</sup> This paper uses the IFRS definition of cash, i.e., as a measure of liquidity on a balance sheet, rather than simply notes and coin.

<sup>2</sup> [2020 AFP. Strategic Role of Treasury Survey Report. Key Highlights](#), p20.

If additional resources were required, treasurers investigated the following:

- how to increase the frequency of gaining visibility of liquidity holdings and to understand the dynamics of future positions
- whether they could improve access to cash, either by accelerating their cash conversion cycles, via the use of supply chain financing or other techniques, or by releasing some previously trapped cash
- whether they could reduce the need for liquidity, either by reducing the cost base (costs tend to be less flexible in the short term) particularly by reducing capex and maintenance expenses, or by delaying certain payments, without jeopardising any commercial relationships, to prioritise business-critical payments
- whether it was possible to refinance or restructure their companies' debt by, for example, leveraging their existing shareholders to provide debt or by holding committed, rather than uncommitted, credit lines
- how the organisation could benefit from government-guaranteed loans, bearing in mind the conditions attached to those loans
- how best to support the business on an ongoing basis, in particular by monitoring ratings agency actions and their impact on their organisations' ability to access financing or their eligibility for governmental support programmes
- how to protect the value of cash flows, given the increased volatility of hedging instruments and derivatives

**Figure 3: Treasury priorities over the next 12 - 24 months**



"Cash flow forecasting is the highest priority for treasury, indicated by 55% of respondents, continuing a longer-term theme, and reflecting the importance of liquidity management during the crisis", according to a 2020 survey by the European Association of Corporate Treasurers.<sup>3</sup>

<sup>3</sup> <https://eact.eu/articles/covid-treasury-insights-2020-survey/>

Treasurers in organisations that found themselves with excess cash had to invest this cash in a way that ensured both security of the principal amount of investment and liquidity when required, at a time when counterparty creditworthiness was more difficult to assess.

Corporate treasurers and banks also started to consider how to build more resilience into their cash and liquidity management strategies. How could they take advantage of multi-bank data

aggregation services to obtain earlier visibility of cash, rather than remaining reliant on reporting cycles? How could they improve their management and use of data to better understand cash, both through data aggregation and the use of data analytics? How could they become less vulnerable to future economic shocks? Should they hold larger cash buffers and/or more committed credit lines as a protection against the effects of any future market volatility?

## 2. Accelerated liquidity management trends

The immediate corporate response to the impact of Covid-19 had the effect of accelerating two liquidity management trends:

- achieving real-time cash visibility
- a greater scrutiny of cross-border intercompany loans

### 2.1 Achieving real-time cash visibility

Having a real-time or near real-time understanding of a company's financial position is vital. By producing a real-time view of the liquidity position, it is possible to achieve true cash visibility in support of being well-positioned for crisis decision making. As the Covid-19 pandemic evolved, finance directors and treasurers recognised that they needed to upgrade the technology they relied upon, particularly in the underlying data management (or forecasting) processes, in order to provide:

- standardised API access to every bank account held by the organisation on a multi-bank basis to increase visibility and control. Achieving standardised API access at the client level might be a challenge since the provision of APIs by banks may vary

- access to core business and other data that capture cash flow items, with a focus on the likelihood of timely collections/ receivables
- the ability to visualise the liquidity position, and any underlying dynamics such as volatility of cash flows and market prices
- a real-time cash position to enable treasury to respond more quickly to rapidly changing market conditions and predict future positions via scenario analysis, in normal and under stressed conditions
- the opportunity to use the improved cash visibility to optimise the company's liquidity management structure via cash pooling techniques

**More generally, companies sought to accelerate the process of digitising their treasury organisations, to allow them to move away from static positions towards dynamic data as the basis of decision making.**

## 2.2 Scrutiny of intercompany loans

Multinational companies have been under pressure from tax authorities to demonstrate that they are not using intercompany loan structures, including cash pools, to avoid tax via base erosion and profit shifting (BEPS).<sup>4</sup> Specifically, where multinational companies took advantage of emergency government Covid-19 support, their treasurers may be required to demonstrate how and where that support has been used within their organisations.<sup>5</sup> Similarly, where a group entity has provided guarantees to group entities in other countries, tax authorities will want to see that an appropriate interest was charged. This may create a need for more granular data at corporate level.

Real-time cash visibility and intercompany loans are just two examples of the way Covid-19 magnified ongoing challenges for corporate treasurers.<sup>6</sup> Companies responded by adopting technologies, such as to improve forecasting, that, for the most part, were already available to them.

**However, the Covid-19 crisis has shown that, going forward, corporates need technologies and services that can be more readily adopted or more easily adapted to handle unforeseen situations.**

To be able to support their corporate clients with such technologies and services, the financial services industry needs to continue to innovate.

## 3. How the financial services industry can continue to innovate

Covid-19 has certainly caused disruption to the liquidity management ecosystem. Many banks now hold a greater proportion of provisions for bad debt on their balance sheets, year-on-year, as some of their corporate clients lack the free cash flow necessary to service the loans.

But Covid-19 has also catalysed banking innovation and, by leveraging this innovation, banks are well-positioned to support their clients through both present and future structural and business changes. For example, banks cannot create the required free cash flow to service the debt; however, they can, along with other technology providers (including enterprise resource planning (ERP) and treasury management system suppliers), supply integrated solutions to help their clients understand their own cash flow better, and to use it more efficiently. (How banks can partner with technology providers is the subject of a previous paper by the EBA Liquidity Management Working Group.)<sup>7</sup>

Banks have a large role to play in the corporate liquidity management ecosystem. The question for banks is whether they are able, alongside new entrants, to innovate and respond to the changing environment in a way that continues to support their corporate clients.

To understand how the ecosystem is changing, the following questions could be useful:

- **In what ways can companies be supported to reduce their liquidity risk?** Both cash pooling and the provision of virtual accounts can help companies to manage existing liquidity more efficiently. Improved access to a range of alternative funding sources (including committed credit lines, supply chain finance, such as receivables discounting, and trade finance - including letters of credit) will help companies to generate additional liquidity.

<sup>4</sup> <https://www.oecd.org/tax/beps/transfer-pricing-guidance-on-financial-transactions-inclusive-framework-on-beps-actions-4-8-10.pdf>

<sup>5</sup> Note that some governments require Covid support funds to be placed in separate accounts, outside any pooling structure.

<sup>6</sup> <https://www.mckinsey.com/industries/public-and-social-sector/our-insights/navigating-the-post-covid-19-era-a-strategic-framework-for-european-recovery>

<sup>7</sup> [How banks can harness technology for the benefit of the corporate liquidity management ecosystem](#), EBA, April 2019.



- **In what ways are needs of corporate treasurers changing, and how can the financial services industry respond to and meet them?** Fundamentally, banks need to foster strong relationships with corporate treasurers to be able to understand and anticipate their clients' needs.
- **Can the financial services industry develop appropriate solutions that will anticipate future demands triggered by the next disruptive critical event?** Cooperating with clients and other technology providers will reduce much of the cost associated with interfacing with multiple solutions. Working towards the adoption of standardised APIs and ISO 20022 will improve the exchange of data and will aid the digitisation of internal processes which, in turn, will enable clients to react more quickly to future events.
- **How can corporate treasurers obtain complete insight of their liquidity positions with all their counterparties?** Corporate treasurers want cash visibility, so banks need to ensure the information they provide is as accurate as possible. They also need to ensure that the information can be provided via a single access point (whether via API or otherwise) into multiple banks. As the use of instant payments grows, banks must ensure their systems have the capability to provide timely updates to customers, ideally in real-time.
- **If companies want to manage liquidity as a central asset, is there an ideal way to structure their treasury organisations?** There is no standard, "one-size-fits-all" answer available; each company's approach depends on its business, corporate structure and jurisdictions of operation. That said, banks should still aim to be able to provide treasurers with access to the information they need, in real-time<sup>8</sup>, irrespective of the structure of their treasury organisations, and with tools to help companies to centralise treasury activities, such as virtual accounts, to manage and control liquidity centrally.
- **As more activities are performed in real-time, how can companies access reports in real-time?** Understanding the impact of real-time banking is key. While the focus is on instant payments at present, there are much wider implications for the whole financial infrastructure from the shift to real-time. As new RTGS and instant payments infrastructure is developed with 24/7 capability, banks will need to offer customer portals with real-time, 24/7 functionality, which will only be possible when banks move from batch to real-time processing of their core activities. As examples of the impact of greater use of real-time activities, FX risks will alter and intra-day credit risks will change, creating demand for amendments to FX spot settlement processes and intra-day compensation of risk, respectively. More generally, companies will be looking beyond payment processing to improving efficiency along the whole financial supply chain as part of a wider digitisation of processes.
- **How will the emergence of new FinTech solutions, especially in payments, impact the corporate liquidity management ecosystem?** As part of their demand for increased cash visibility, treasurers want greater visibility of, and certainty over, the timing of payments, especially cross-border, to improve the quality of their forecasts and, consequently, the efficiency of their use of cash. Enhancements to payment system infrastructure provides banks with the opportunity to offer additional services along with payments, strengthening the relationship between bank and corporate clients.

<sup>8</sup> According to a 2020 survey by the European Association of Corporate Treasurers, "52% of respondents expressed an interest in real-time information, and 47% in both real-time liquidity and real-time payments and collections." <https://eact.eu/articles/covid-treasury-insights-2020-survey/>

## Conclusion

The Covid-19 pandemic affected the liquidity management ecosystem both in the short and long term. Cash flow forecasting, already a complex process, became even more of a focus during this time of unpredictability and also raised long-term questions for both corporates and banks.

As they move forward, companies will continue to prioritise liquidity management, from improving cash visibility to increasing control of cash with a view to reducing their future liquidity risk. And, as the ecosystem continues to evolve and technology

is improved, banks have a large role to play to support companies in achieving their liquidity management objectives.

Future shocks will occur and may result in a shortage of liquidity and/or disruption to supply chains; the challenge for banks and their corporate clients is to understand how they can become more resilient to those shocks, both individually and collectively as part of the corporate liquidity management ecosystem.

## Imprint

**Euro Banking Association**  
**40 rue de Courcelles**  
**F-75008 Paris**

**Contact**  
[association@abe-eba.eu](mailto:association@abe-eba.eu)