Building a Liquidity Management Strategy

Whether your business is building capital or in a growth cycle, strategically managing excess liquidity is critical at every stage.

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Whether your business is building capital or in a growth cycle, effectively managing excess liquidity is vital to a successful cash management strategy.

Numerous solutions are available to meet both short- and long-term operating and investment needs, but it’s important to start with a broad, holistic view of business goals and the tools that best support them. Because liquidity requirements are complex and variable, optimizing excess cash requires a mix of both traditional deposit accounts and longer-term investment models.

Leveraging these resources to build a diversified strategy can enable your company to maximize and stabilize earnings across business cycles—especially when paired with the support of a strong banking team.
USE SEGMENTED GOALS TO BUILD A COMPREHENSIVE PLAN

Cash requirements for operating expenses—such as rent, payroll and insurance payments—must be readily accessible at frequent intervals, which means the period of return on operating cash must be very short-term. Reserve funds, which may be used to cover emergencies or other unexpected costs, can be placed in short- to medium-term models. Strategic funds are used to support business growth through capital expenditures, new ventures, mergers and acquisitions (M&A), etc., and may be used in long-term strategies without threatening the ability to cover day-to-day operations.

The cash requirements and return expectations of each segment are different. Yet, these categories should not be treated as disparate assets, but rather as elements of a single cash management strategy.

As a business changes, liquid assets will exist on a continuum that spans banking and investment functions. Banking partners can help your company grow by providing easy access to your mission-critical capital. Investment professionals can help you invest business earnings to optimize returns until your company is ready for its next growth step. Integration between these two teams is key, as an effective cash management strategy requires connectivity between solutions and expertise on both sides of the balance sheet.

To make the most of liquid assets, your banking and investment teams must not only work closely with one another, but they need to understand the cross-functional interactions of short- and long-term solutions. This high-level strategy perspective can allow them to create a comprehensive plan that meets your needs at every stage.

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Building a liquidity optimization plan starts with an understanding of business operations and goals—and their timeframes. Business expenses can be broken into four segments: operating, reserve, strategic, and restricted. With the exception of restricted cash, which is ineligible for certain investment products and must be set aside, each segment corresponds to a period of time on the liquidity spectrum.

Liquidity Investments Spectrum

**Short-Term**
Typically Lower Return with Lower Risk

- DEMAND DEPOSIT ACCOUNTS
- COMMERCIAL MONEY MARKET DEPOSIT ACCOUNT (MMDA)
- MONEY MARKET FUNDS
- REPURCHASE AGREEMENTS (REPO)
- PERFORMANCE CHECKING ACCOUNTS

**Mid-Term**

- TIME DEPOSITS
- MONEY MARKET FUNDS
- SHORT-TERM SECURITIES LIKE COMMERCIAL PAPER AND TREASURY BILLS
- ESCROW

**Long-Term**
Potentially Higher Return with Higher Risk

- BONDS
  - CORPORATE
  - GOVERNMENT
  - AGENCY
  - MUNICIPAL
- TREASURY NOTES

**OPERATING FUNDS**
Easy access
Ability to collect & aggregate access to receivables

**RESERVE FUNDS**
Easy access if needed
Cushion to cover seasonality in cash flows or unforeseen operating expenses

**STRATEGIC FUNDS**
Building to execute a future strategic transaction such as M&A

**RESTRICTED FUNDS**
Cash held to meet regulatory or business requirements

**INVESTMENTS**
Earn yield on idle funds, diversification of assets, safeguard
“While cash to cover operating costs should be kept in short-term, low-risk products, long-term strategic capital may be able to endure greater fluctuations.”

**IMPACT OF CURRENT MARKET CONDITIONS**

A successful liquidity management strategy depends not only on identifying the timing of specific cash needs, but also your firm’s appetite for risk. An integrated banking team can help distribute risk both on- and off-balance sheet to ensure funds are put to the best use while still maintaining access to day-to-day capital requirements.

While cash to cover operating costs should be kept in short-term, low-risk products, long-term strategic capital may be able to endure greater fluctuations. Accordingly, solutions are available to accommodate a variety of risk profiles, ranging from traditional bank depository products to increasingly complex capital markets investment options.

Whether the return is higher on the banking or capital markets side is determined by market conditions and the corresponding rate environment.

**Under current economic conditions, capital markets solutions offer more competitive rates, but the market is approaching a flat rate environment equilibrium—after which point, those roles will reverse.**

A banking team with expertise that spans the treasury and investment spaces will be aware of these market shifts so they can invest liquid assets according to your organization’s tolerance for risk.

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**Fed Funds vs Stocks - Current**

**Stock Market Forecasts**

**Bond Market Forecasts**

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Source: Thomson Reuters Datastream, UMB Investment Management
TRADEOFFS OF AN AUTOMATED APPROACH
As automated programs become increasingly prevalent in the treasury and investment management spaces, businesses must consider the tradeoffs of algorithms versus human advisors as they evaluate investment options. For businesses chasing yield, automation isn’t the answer. Building an investment strategy that yields consistent returns requires a deep understanding both of current market factors and of a business’ unique identity in terms of goals, special requirements and risk appetite. Working with the right financial partner provides what automated systems lack: aligned teams of experts who know your business well enough to create a custom plan, and can evolve that plan as your company grows.

FINDING A PARTNER TO BUILD A STRONG INVESTMENT MIX
Optimizing liquidity is a complex task that requires the right partner. You need a team who understands your business’ unique cash requirements and objectives, and has diverse capabilities to meet those objectives. Working with a financial partner that offers the expertise and solution set you need can help you leverage unused cash, maximize earnings, and take a more strategic approach to your company’s short-term needs and long-term growth objectives.

Your Excess Liquidity Strategy Requires a Deep Understanding of Many Factors

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