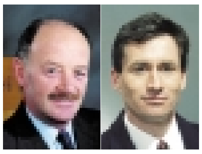
FINDING WORKABLE SOLUTIONS



AENGUS MURPHY AND **PAT LEAVY** OF FTI LOOK AT WORKABLE CASH MANAGEMENT SOLUTIONS THAT COULD BENEFIT SMALLER ORGANISATIONS.

Over the past several years many multi-national companies (MNCs) have been overhauling their cash management solutions, driven by a range of different factors. Treasurers are aware that they can derive a lot of value from rationalising the cash management solution which, in many cases, has emerged indiscriminately often as a result of acquisitions during the mid to late 1990s.

In these instances, each entity within the group may have its own solution, with its own banks, and there is no consistency in practices or in control. There may be significant financial loss from uninvested cash lying around in the system, expensive local borrowing and simultaneous borrowing and depositing in the group. The continuing focus on corporate governance and control is driving companies, especially US firms subject to the Sarbanes Oxley Act, to focus on control over cash. Hence overhaul will be in fashion for some time.

At the same time, the provision of global cash management services has been dominated by a small number of banks, perhaps six, namely US Banks Citibank, JPMorgan Chase, Bank of America, and European-based banks ABN-AMRO, HSBC and Deutsche Bank. These have developed their cash management products and invested hugely in technology and infrastructure to support their offerings. Some of them have their cash management product as one of their primary offerings, indeed in some instances the primary one, to the corporate sector. They use the quality of their solution as a main competitive differentiator.

Yet, while companies have definite needs and service providers have definite products, these do not match well for every company. In this article, we examine why this is so and we put forward a proposed solution.

SMALLER COMPANIES. In cash management terms, 'smaller companies' does not really mean small, it means those companies that do not meet the size criteria or are not on the named list of preferred customers of the global cash management banks. In other words, they will not command attention or services, or receive preferred status treatment from these banks. But they are not small – many of them are MNCs with a turnover of up to €5bn. Failure to achieve 'selected' status is driven by a combination of the fee potential not being considered high enough to command interest and an increasingly conservative view of credit risk.

This can create a significant problem for MNCs in this category which need a solution for their global business in Europe, the Americas, Middle East and Asia Pacific. Their choices are narrow and narrowing. Those companies whose business is mainly domestic often have sound local cash management solutions from strong domestic banks.

A TYPICAL APPROACH TO SELECTING A SERVICE PROVIDER. The most common approach followed by companies to date has been to present a fairly open-ended specification of requirements for a cash management solution to a selected list of banks thought to be good in the cash management area. Usually the list of banks would include the global cash management service providers. In some cases this approach has led to the 'selling' of each bank's own product to the company, each as the best solution. The treasurer who hoped this process would result in a good solution for the company – where the banks' combined offering would in some way drive a good solution – may have been guilty of wishful thinking. This is because the optimum outcome may have been igrnored by each bank, naturally, wishing to capture as much of the business as possible under its product. The result is that, on occasions, companies have struggled to implement the solutions, some have never been fully implemented, and some are even being dismantled because of dissatisfaction with the solution 'sold' to them.

RECENT DEVELOPMENTS THAT IMPACT ON SMALLER COMPANIES. In recent times, there have been two significant developments:

- The three big US global cash management banks have become more selective and more rigid as to their listings or categorisations of preferred customers. Unless you are a significant long-term credit customer of one of these banks, so

FIGURE 1
TAKING A MULTI-BANK APPROACH.

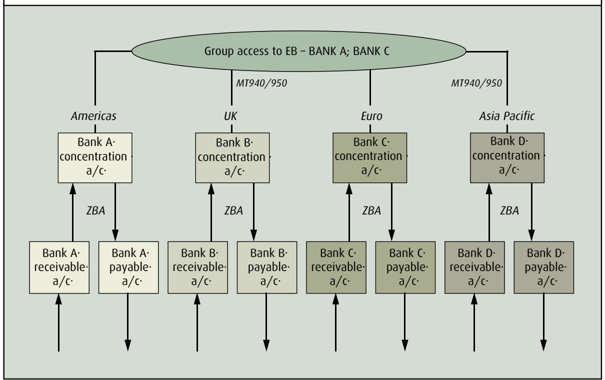
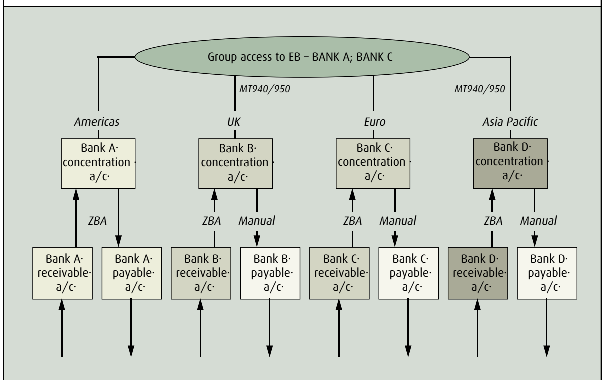


FIGURE 2
PAYABLES AND RECEIVABLES.



that they have to maintain the relationship, or are on their target list, they will not always be interested. Indeed, they may frequently choose not to respond to requests for proposals.

- Some of the European banks that have some global capability are following suit and have begun to reduce the customer size in which they are interested.

Some companies previously utilised cash management solutions with these banks and have now found themselves outside of the bank's target customers and have been forced to develop alternative solutions. Therefore, certain companies are finding that good global cash management solutions from these largest providers are either not available or are not workable. In addition, reliance by an MNC with widespread geographic cash management needs on a single bank provider can represent a flawed solution. It places too much dependence on a single bank, given the uncertain nature of banks' status and business strategies. This can result in a significant strategic financial risk for the company. In any event, what about the company's other key relationship banks? Do they not merit some of the cash management business and fees?

SOME GUIDING PRINCIPLES. FTI has significant experience working with its clients on cash management solutions, and to follow are some guiding principles that it believes are useful for the treasurer in such projects:

- Set clear corporate level objectives – these drive the type of solution. Objectives usually relate to control, visibility, having cash regarded as a corporate resource, maximising the cash resource, maximising cash available to reduce debt levels, return on surplus cash, cost of liquidity financing, or cash management system/services costs.
- Take time to gather comprehensive specific information and data about the business and needs of the group entities, so as to have a proper basis for devising a solution and approaching the bank providers.
- Get the local entities and especially the local controllers on board at the outset – you need their input and their support. Senior corporate management support is a must.
- The treasurer should drive the solution and the project to deliver it as far as possible, rather than the bank.
- The treasurer should devise, in detail, the solution that will work for the company. The banks can only present their proprietory products. The treasurer should define exactly what is required and ask the banks to respond.
- The key word used so far is 'solution', not 'system', not 'product'. Solution means it must work for you and be directed to your specific needs and objectives.
- Consider key relationship banks in the proposed solution. Each company will have a policy regarding banking relationships and this should be observed.
- The treasurer should be prepared to take responsibility for the project and work with it. All phases of it – information gathering, solution design, provider selection, implementation planning and actual implementation – otherwise it will not happen.

SOLUTIONS. There is no generic solution. Each company's circumstances and needs – the treasury facts – will be different. The unique solution is what has to be worked out – each solution is customised to meet the clearly identified objectives. However, the type of solution that we find works for the smaller companies focuses on a number of key fundamentals:

- **Number of banks.** A multi-bank solution is most likely, focusing on regional banks which have good coverage and capability across countries in each region (see *Figure 1*).
- **Balance reporting.** In a multi-bank environment, balance reporting can be achieved through Swift messaging, using MT940s/MT950s to capture balance and transaction information on a single electronic banking platform (see *Figure 1*).
- **Payables and receivables.** There may be a need to separate the payables and receivables banks, especially where the regional bank does not have coverage in the desired location, does not have access to local clearing, or cannot facilitate local payment processing (see *Figure 2*).
- **Electronic banking systems.** The service provider's electronic banking (EB) platform is usually selected to support the company's needs, not necessarily because it offers the best, or most advanced technical solution in the marketplace.
- **Optimisation.** The basic structure allows for further optimisation where there is a clear advantage to the company. This might take account of domestic pooling opportunities, euro cross-border pooling capability, lockbox facilities, offshore

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collection and deposit accounts, foreign currency payment processing, inter-company financing and others.

IMPLICATIONS OF WORKABLE SOLUTIONS. Workable solutions may be pieced together, but in a rationalised way, using the group's existing key relationship banks. Consideration of *Figures 1* and *2* will clearly show that there are many variations to these examples. While the objective is to design a solution that meets the objectives in the best way possible, it does have some implications.

- **Automation.** Generally, solutions for smaller companies must compromise on the level of straight-through processing (STP) achievable. Swift messaging offers prior day balance information; both payables/receivables separation and a multi-bank structure requires manual funds transfer; at group treasury, more than one electronic banking platform may be necessary; centralised reporting for multi-bank balances must be constructed; accounts receivable/accounts payable and payroll interfaces may have to be constructed across different EB platforms. Certainly, there are treasury management systems available that support and ease this process.
- **Organisation.** Since these types of solutions tend to have less automation, they will require manual intervention by the treasury to move funds as required. This will command more resource than more automated solutions, but it gives more control in every sense. The most significant issue arising from an organisational perspective is the degree of centralisation required and how the solution is operationally delivered. This in itself can sometimes influence the solution design. Nowadays, outsourced solutions are available to manage and operate cash management systems.
- **Bank relationships.** The choice of service provider should be made within the context of the group's policy towards bank relationships. It can be inappropriate to select a provider who can deliver a technical solution but is not positioned to meet the broad banking needs of the group.

GOOD PRACTICE. In our experience, the success of a cash management solution is dependent on the treasurer taking responsibility for and driving the solution design and the implementation project. Relying on the banks to deliver all of this for you is a not always the most effective choice.

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