Back to basics

WILL SPINNEY EXPLAINS WHY GOOD CASH MANAGEMENT PRACTICES STILL MATTER.

Executive summary

Whatever the definition of cash management adopted, good practice can still bring big benefits, such as the creation of marketable sums, better control of financial risk, a reduction in borrowing needs and a boost to financial credibility.

With the bank market for lending so poor, many treasury departments have been focusing heavily on how to fund themselves. As a result, basic treasury issues such as cash management may have been relegated as less urgent. But getting the cash management basics right can help corporate financing, in particular by reducing pockets of cash and ensuring that the drawdown of borrowing facilities is done as late as possible, thus reducing the need for borrowing overall.

CORPORATE DEFINITION OF CASH MANAGEMENT It is useful to consider exactly what cash management is. Non-financial corporations often differ from banks in how they view it. A very simple definition for such companies is that cash management is about the effective planning, monitoring and management of liquid/near-liquid resources. This definition describes the traditional role of the cash manager, and the requirements of such an approach are summarised in Box 1.

In addition to the core functions described in Box 1, depending on the company, a number of other tasks may be performed by the cash manager, including: medium and short-term cashflow forecasting; monitoring and assisting with risk management; short-term foreign exchange and hedging; managing cash management bank relationships; netting; cross-border liquidity management; trade finance; account reconciliation; receivables management; payables management; and selecting and implementing cash management systems, interfaces with ERP systems, etc.

Although the terms cash management and liquidity management are sometimes used interchangeably, it is important to distinguish between them.

Cash management focuses on the effective use of cash in all its forms, or as Michèle Allman-Ward defined it in her Globalization and the Cash Manager article in the Journal of Cash Management May/June 1992: "Having the right amount of money, in the right currency, in the right place, at the right time." To which we should add "with the right information".

Liquidity management refers to ensuring that the company can meet its current and future obligations when they fall due in as timely, efficient and cost-effective manner as possible. It includes forecasting the cash position, having access to sufficient credit lines and liquid assets, and using techniques that enable company-wide liquidity management. Part of the cash manager's responsibilities is to ensure the company always has access to sufficient liquidity.

BANK DEFINITION OF CASH MANAGEMENT Traditionally, bankers have defined cash management a little differently. The following definition was drawn up by a group of 15 banks, which represent the largest in the global and pan-European cash management markets: "The provision of products and services to corporate customers including bank accounts, deposit and withdrawal facilities, information on bank accounts and positions, money transfers and collection services, investment facilities (interest bearing and money market deposits), financing facilities, pooling and netting."

While for most banks the selling process has evolved into a solutions-driven approach, the core elements of cash management solutions remain transactional products, the most fundamental of which is the standard bank account. All companies need at least one bank account and the ability to collect funds into it and disburse funds from it. Moreover, they need a bank to perform these transactions quickly and accurately. They also need a way to track balances and transactions, and manage surpluses and shortfalls.

These are the basic cash management functions, and more sophisticated products are all derived from this simple model.

THE TWO DEFINITIONS COMPARED The major difference is that the corporate definition is a functional one, whereas the banking definition describes cash management in terms

of products. Interestingly, both companies and banks agree that electronic banking is neither a cash management function nor a product, but a delivery mechanism.

A concern frequently expressed by companies is that banks do not understand corporate cash management and only want to sell products, whether or not they fit the buyer's needs. Conversely, banks are often right in thinking that many companies do not understand banking processes and how money moves.

Increasingly, banks have recognised that their customers are looking (and willing to pay) for solutions and efficiencies rather than products. Consequently, they are replacing their e-banking and money transmission departments with more customer-focused cash management divisions that offer a consultative approach and tailored solutions-based services.

THE BENEFITS OF GOOD CASH MANAGEMENT The major benefits of good cash management include:

- **Creation of marketable sums** If companies left their cash in more local arrangements rather than trying to concentrate it in a treasury centre, it is likely that the amounts would be small and command little return from local banks. When all those sums are concentrated, however, the amount can quickly become marketable.

- **Opportunity for profit** In the current business climate, few functions will survive unless they ultimately contribute positively to the bottom line. Good cash management can reduce costs and enhance financial returns.

- **A good example** Better cashflow is usually an aspect of business performance that is emphasised as much as profitability. But it can be demotivating to management if the cash generated is then not used efficiently by a central treasury. If treasury shows enthusiasm for exploiting cash for its maximum gain, then operating management will push to generate more.

- **Better control of financial risk** Even a profitable company can go bust if it runs out of cash, and at all stages of the cash cycle it is important to understand what is going on with cash. Good cash management techniques can identify when particular parts of a company are generating or consuming cash at other than expected rates. There is something immediate, transparent and clear when cash records are involved that can sometimes be missing from the slow production of management accounts.

- **Increased confidence in the company** Well-managed cash positions are important to customers, suppliers, lenders, shareholders and other stakeholders. Good management of cash helps convince customers that a company is very serious about its profitability, can fund its existing processes, invest in new technology to maintain quality and competitiveness, and offer reliable supply. Good management of cash also helps convince suppliers that their payments will be taken very seriously. Lenders will be impressed if the cash management techniques of the company are up to scratch. And shareholders want the company they are investing in to be using all its assets efficiently, and that includes maximising return on any spare cash. They also want to know that debt is being minimised and that management takes cash generation seriously. After all, cash generation funds their dividends.

- **Eliminating the borrowing spread** The spread between borrowing and deposit rates is near all-time highs, so the treasurer who can avoid placing cash and borrowing at the same time can make substantial savings for the company.

- **Reducing the borrowing need** Perhaps the most important reason of all to have good cash management is that every pound, euro or dollar squeezed out of the company reduces the need to borrow and raise facilities. This is more than about the actual cost of borrowed funds; it is about being able to borrow any funds in the first place. The lower the need for borrowing, the greater the chance of being able to meet those needs. Lenders will respect this approach by companies.

While there are many reasons to be distracted from the cause of good cash management, including funding pressures and pressures on staff resources, good treasury starts with good cash management. If you are not on top of cash, you can't be on top of the company and its finances.

Box 1: Core cash management functions

Day-to-day cash control Having the information to monitor balances and the tools to manage liquidity to ensure the company has enough cash or near-cash reserves to meet its short-term obligations. This control needs to extend to as many subsidiaries and countries as possible.

Bank account structure Having an efficient account structure that minimises borrowing costs, maximises interest earned and facilitates liquidity management. Again, this needs to extend to as many subsidiaries and countries as possible.

Receipts Having an efficient account structure for collections and concentration, and managing items in the course of collection.

Payments Controlling liquidity and making payments efficiently. This also includes managing balances in the course of disbursement.

Short-term investments Optimising the use of surplus funds through bank and money market deposits, money market funds, government instruments and so on.

Short-term borrowings Procuring cost-effective credit facilities including intraday, overnight and short-term overdrafts and the ability to draw funds from longer-term facilities, such as revolving credit facilities with drawdown notice periods of one to three days.

Will Spinney is ACT technical officer for education.
wspinney@treasurers.org
www.treasurers.org