Making cash pay

VIVEK RAMACHANDRAN ON HOW TREASURERS CAN BEST CONTROL CASH.

As has been said many times during the recent financial crisis, “cash is king”. This has been the catalyst behind the drive in the increasing importance in the role of the treasurer and how the treasury function plays a far more important role within the business today, with greater involvement in any business decision which affects finance. Concurrent with this development have been the enhancements in technology and banking services that are available.

Together, these have helped treasurers to maximise the effectiveness of the treasury function and achieve greater control of the cash that is available within the business. In addition, the role of the treasury function has now become more important to the whole business, as the treasurer is more involved in the process of making financial decisions that are influential to the organisation, even at board level.

The cash management priorities for a treasurer have also evolved with an increased focus on the need for more effective liquidity and working capital management. This, together with optimising the use of technology and using the new payments infrastructure, will help to improve business processes. In addition, there is greater emphasis on risk minimisation, organisational inefficiency and of course the availability of short term credit lines, particularly with credit becoming more difficult to arrange.

What remains of utmost importance to any business is the need for visibility of cash positions wherever they are held and the effective management of these cash positions. This supports the universally recognised view that the effective generation and management of cash drives the success of the business.

Bank relationships have also become more important. With the scarcity of credit in some quarters, every business needs to ensure that sufficient credit lines are in place to meet its needs in both the short and medium term.

Banks are therefore challenged not only in developing and enhancing existing solutions to help maximise efficiency for day to day operations, but also the need to provide balance sheet support and expertise in helping the treasurer meet the demands of the board.

LIQUIDITY MANAGEMENT

Effective liquidity management has certainly come to the fore over the last two years, with greater emphasis on making sure that cash is available in the right place, at the right time and in the right currency. The trend towards centralising liquidity management is not new, but what has changed is the fact that it is now the focus for corporates of all sizes, not just the largest multinationals.

Visibility is, of course, key – not just end of day, but intraday cash positions as well. Many corporates have achieved tangible benefits through the effective management of intraday liquidity positions. In addition to interest benefits, there are benefits such as maximising group cash and being less reliant on bank lending. In some cases this can reduce the amount local credit facilities or remove the need for a local borrowing facility altogether.

One of the principal tools to manage cash positions is cash pooling – either offsetting credit and debit account positions or concentrating cash. This could be organised locally, regionally or centrally, depending on the strategy of the business.

For many years banks have recognised the importance of cash pooling and most banks offer a range of solutions, typically by country. However, single-country pooling solutions are becoming increasingly unacceptable, with corporates needing multi-country solutions. Recognising this, the more forward-looking banks, including Barclays, have developed new and enhanced services, including cross-currency notional pooling and cross-border, cross-currency cash concentration arrangements.

These solutions provide the treasurer with a better overview of the group’s cash position in order to minimise interest expense and maximise interest income, even in a low interest rate environment.

MANAGEMENT OF WORKING CAPITAL AND FUNDING

One of the factors which has driven the greater emphasis on cash position management has been the worldwide recession. With some weaker banks having liquidity issues themselves, this has reduced overall available credit.

To help overcome this, treasurers are increasingly focusing on managing their own working capital and liquidity position more effectively, which has helped them manage liquidity risk. This will include counterparty risk, including bank counterparties given the issues that some financial institutions are facing. Indeed, one corporate has described "bank counterparty risk" as simply "supplier risk" as this is how it refers to its bank providers.

Of course, the working capital cycle is of paramount importance and, in conjunction with having greater visibility and management of cash position, the working capital cycle is being more closely managed. This ensures compliance with the terms of trade agreed with buyers and suppliers and also assists in stock control.

By having good control over both these important functions, treasurers are able to put in place sufficient working capital facilities to meet the corporate's day-to-day requirements at least for the next 12 months based on cashflow forecasts.

In conjunction with all of these factors, Barclays is witnessing a surge of interest in services designed to help corporate clients find alternative sources of finance, rather than traditional debt solutions. Supply chain finance is prominent amongst these, not only to ease the flow of funds between buyers and suppliers to make the supply chain more robust at a challenging time, but also as an enabler to allow buyers to negotiate improved terms while providing suppliers access to potentially cheaper funding.

The conference speakers

Gerry Bacon President, ACT
John G Bullard Global ambassador, IdenTrust
Greg Croydon Group treasurer, IMI
Julie Fabris Group treasurer, Birds Eye Iglo Group
Martin Gries Group treasury director, Reckitt Benckiser
Kim Holdsworth Group treasurer, Alpha Trains
John Holmes Group treasurer, Etex Group
Tony Kendall Group treasurer, Centrica
Ian Ladd Group treasurer, DSG international
Thomas Light Principal finance manager, Vodafone Procurement Company
Bob Lyddon Consultant and managing director, IBOS Association
Maria Malinowska Director, supply chain finance, Barclays Corporate
Richard Martin Head of payments & cash management, Barclays Corporate
Peter Matza Head of publishing, ACT
Adrian Rodgers Director, ARC Solutions
Bente Salt Group treasurer, Acergy
Chris Skinner Chairman, The Financial Services Club
John Swift Group treasury manager, The Sage Group
Julian Tasker Deputy treasurer, Johnson Matthey
Markus Unternaehrer Head of capital markets & bank relationships, Holcim

MAKING THE BEST USE OF TECHNOLOGY

Technology and systems have become vital to corporates to manage their business over the last 20 years or so. Developments in technology continue apace, with treasury management systems (TMS) and enterprise resource planning (ERP) systems under continual enhancement, with new and enhanced ancillary systems available to automate most of the manual processes within the treasury.

Any investment in technology and integration with existing systems can be substantial. However, the benefits that these bring can be substantial.

As an example, the development of bulk file solutions using standard formats such as XML can help corporates centralise the payment function while providing processing efficiency, such as straight through processing (STP), automatic reconciliation and cashflow forecasting.

In recent years, many banks have developed some very good proprietary systems, to provide corporates with bulk channel delivery, and it is natural that banks will want to protect and maximise this investment.

However, many banks, including Barclays, have recognised the growing trends towards non-proprietary channel solutions – indeed, in Barclays' view, the relationship with a corporate should not be built on the delivery channel, but around the functionality, service and overall support that the bank provides to its customers.

This is a major factor in why Barclays was among the first banks to offer a SWIFT-based corporate service as long ago as 2002 as part of its overall offering, including internet front end and host-to-host solutions.

That said, it is all about what channel fits with the strategic direction of the company. For some an internet portal may be sufficient for their needs, for others they may want to use SWIFT or simply want the ability to submit bulk files to their bank in the format produced by their own systems.

Banks must be able to respond to the individual needs of their customers, and they are continually developing their delivery channels to ensure that they can meet the needs of their customers.

WORKING CAPITAL AND THE SUPPLY CHAIN

In 2009 many companies experienced a sharp decrease in revenue and operational costs were cut resulting in reduced operational profits. Some envisage it will take five years for businesses to recover. Hence the increased focus on working capital in the supply chain that Barclays is seeing today.

In a vote conducted at the conference, 9% of the delegates indicated they were spending more time on supply chain management (see page 12). The traditional focus of trade finance has been banks helping corporates to sell. In supply chain finance (SCF), banks are turning 180 degrees to help corporates to buy and are using payment systems to increase efficiency in purchasing and procurement.

WHY LOOK AT PAYMENT SYSTEMS AT ALL?

The rapid increase in globalisation has led to more complex supply chains, extended supplier networks, extended terms, and more complex logistics – more modes of transport and more connections in the supply chain. The result is increased uncertainty leading to the holding of buffer stocks with more working capital tied up in inventory.

Using SCF as a global cash management tool, the treasurer can increase financial control, improve risk management and increase visibility. In addition, suppliers that have seen a reduction in capital, and hence an increased cost of capital, can benefit through increased liquidity and lower costs, which ultimately can translate into lower prices.

Getting it right increases competitive advantage and improves day-to-day order payment tracking and reconciliation. Increasingly banks are using supply chain systems to track the risk through the supply chain from seller to buyer and will price the risk accordingly.

The following systems are available to help supply chain management:

- electronic data interchange (EDI);
- procure to pay (P2P);
- electronic invoicing (EIPP);
- supply chain finance (SCF);
- distributor finance; and
- logistics systems (track movement of goods).

The buyer and supplier have very different perspectives. In today's economic environment, every business will focus on improving working capital. Buyers will look to pay their suppliers later, increasing days payable outstanding (DPO), will negotiate lower prices from their suppliers and at the same time, optimise lower-cost financing for their suppliers to maintain loyalty.

Suppliers will seek early payment to reduce Days Sales Outstanding (DSO) and benefit from additional liquidity. Suppliers may have a higher cost of capital than the buyer, leading to poor financial health in the supply chain. Buyer and supplier goals seem mutually exclusive.

SCF payment systems can be used to raise finance at trigger points along the supply chain:

- pre-shipment finance against the issuance or acceptance of the purchase order;
- post-shipment finance while the goods are in transit, stock or in the warehouse, by invoice discounting, SCF or buyer finance – with or without supporting insurance; and
- increased information also leads to increased certainty and reduced finance costs from their bank.

EDI is widely used by retailers and the supermarkets as part of their procurement systems. EDI uses electronic messages to place high volume orders but has limited application growth potential and is being replaced by P2P systems. P2P enables the buyer to purchase from the supplier, using electronic purchase orders, invoices, debit and credit notes. It is fast, reliable and scalable and provides order flow visibility to the buyer and their suppliers, usually via a secure web-based system.

Once the invoice has been accepted by the buyer, SCF comes into play. SCF enables the financing of the buyer's supply chain at the buyer's (usually lower) cost of funds.

SCF provides finance to the supplier by way of a discounted early settlement of the payments due to the supplier. Payments discounted to the supplier are without recourse, providing payment visibility to the buyer and their suppliers.

HOW SCF WORKS FROM THE BUYER'S PERSPECTIVE

The buyer and supplier conclude a commercial contract or framework understanding. The supplier delivers the goods and/or services and submits an invoice to the buyer.

In turn, the buyer accepts the invoice and gives irrevocable payment instructions to the bank to pay on the due date and the bank debits the buyer's account for full payment on the due date.

The payments are transaction cost-neutral when compared to existing payment methods.

WHY WOULD A CORPORATE AS A BUYER WANT SCF?

Some buyers use it to extend payment terms. It can be used to standardise payment terms, especially where buyers have grown through acquisition and production plants have different terms with the same supplier. It can also improve supplier relationships by offering a lower-cost financing option.

Most bank SCF programmes have been structured not to change the integrity of the trade payable from an accounting perspective. There are usually no fees payable by the buyer or loans to the buyer to affect important ratios adversely.

HOW SCF WORKS FROM A SUPPLIER PERSPECTIVE

The supplier and the buyer conclude a commercial contract or framework understanding. The supplier delivers the goods and/or services contracted for and then submits an invoice to the buyer. The supplier sees the invoice has been accepted and is given two choices: to wait the agreed time (for example, 45 days) for payment, or to discount the invoice for early payment.

It is dynamic discounting, which means the supplier can discount at any time up to a few days before due date. The supplier can also opt for automatic discounting and simply check on the discount rate.

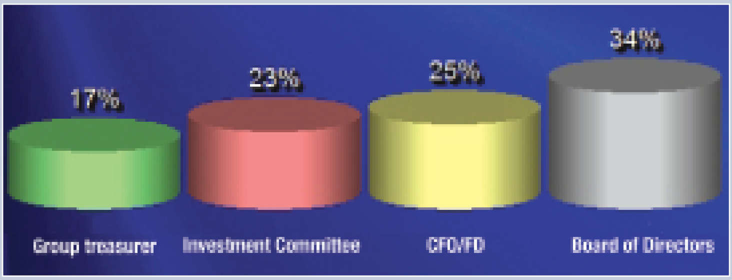
From the supplier's perspective, SCF can help to reduce finance costs, whether the terms are extended or not. The supplier pays an all-in margin at the time of discounting. The pricing to the supplier is based on the buyer credit risk pricing. Here the supplier will benefit from the rate arbitrage – that is, the difference in the investment grade buyer pricing and the non-investment grade supplier pricing.

SCF can help the supplier access early payment at better

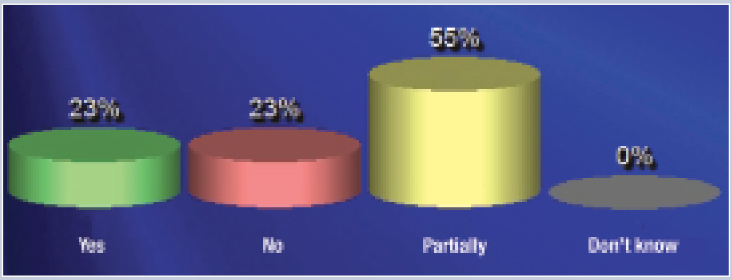
Treasurer thinking

DURING THE COURSE OF THE CONFERENCE DELEGATES WERE ASKED TO GIVE THEIR VIEWS ON VARIOUS ISSUES THROUGH A VOTING PROCESS. AMONG THE KNOWLEDGE GAINED WAS THE FOLLOWING:

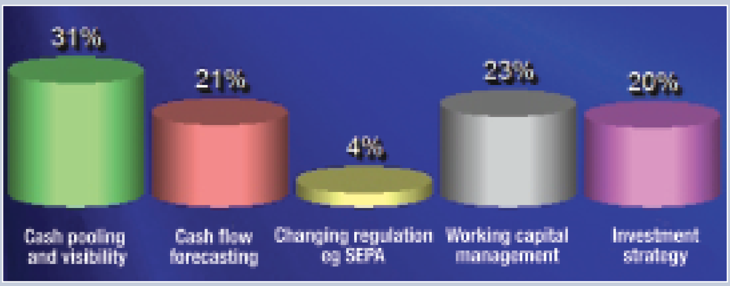
1. At what level in the organisation are investment policy decisions made?



2. Are you confident in the accuracy of your cashflow forecast?



3. And what are the specific areas of concern for cash and liquidity management?



pricing than factoring, which is typically based on the higher supplier risk pricing less a small discount for good buyers. Under SCF, the supplier receives 100% less charges at discounting and not 80%, compared to factoring.

SCF therefore offers more predictable cashflow and an unsecured, off-balance sheet financing option.

For many suppliers, SCF is an alternative source of funds – the buyer does not ask the supplier to change banks, as discounted proceeds will be paid into the supplier's nominated account. Some suppliers fear buyers will be notified of their discounting activity, but buyers are not normally given discounting visibility under SCF.

The important benefits of reduced payment queries, visibility of cashflows and process efficiencies accrue to both buyers and suppliers.

SCF is in the initial stages of development in the UK. There are some early adopters but many corporates have been busy improving their SCF knowledge. The larger SCF programmes have been delayed by the recent financial crises, in favour of smaller pilot projects of £10-20m.

Many buyers prefer a phased approach, working with selected suppliers and learning the lessons before a major roll-out. SCF solutions are attractive for retailers, producers, industrial wholesalers and manufacturers – in fact most businesses with a high annual spend with regular suppliers in the UK and worldwide.

In 2008 SCF was on the radar screen of most finance directors. In 2009 the banks saw a major increase in Requests for Information and Requests for Proposals for SCF programmes.

In 2010 Barclays expects to see SCF provide supplier liquidity and reduce supplier funding costs. The solution will also help to improve the buyer's working capital efficiency and consolidate funding capacity in a manageable SCF structure.

So what do corporates generally want from their SCF bank?

- to increase successful selection of suppliers through supplier analysis;
- to quantify the buyer's working capital benefit and the economic benefit for the suppliers;
- to focus on supplier on-boarding through existing strong corporate relationships;
- SCF flexibility as the buyer's supplier relationship management tool; and
- to provide a secure and scalable SCF system using tried and tested technology.

IT IS CLEAR THAT TREASURERS WILL DEMAND MORE FROM THEIR BANKS TO HELP THEM TO DELIVER EFFICIENCIES AND COST REDUCTIONS IN THEIR BANKING MODELS.

SCF can improve working capital for the group and improve liquidity of suppliers as businesses grow in 2010 and beyond.

HOLISTIC SOLUTIONS

Corporates need a banking provider that not only provides them with the funding they need, but is also able to provide the expertise that is capable of understanding their operational requirements and can provide holistic, workable and cost-effective solutions. Banks need to be a long term partner and adviser to corporates.

By continuously reviewing best practice, treasury departments should introduce cash management processes and controls that support the business in the good times, but which also need to be flexible enough to ensure that the business can maintain its operations through the not so good times. Banks have a part to play in this – it is up to them to have a good understanding of the business and financial flows and to suggest alternatives where these may be appropriate.

For example, it has widely been reported that there will be changes to the cheque clearing system in the UK by 2017. Any business relying heavily on cheques will have to review its business model. Barclays can suggest alternative payment types to replace cheques and to meet the needs of the business as it grows.

Technology and new payment mechanisms will continue to provide the treasurer with opportunities to reduce costs, improve security and compliance, maintain better control over cash and maximise STP.

The Faster Payment and SEPA mechanisms are examples of where the banking community has introduced new transaction services. Many organisations have already changed the way they trade with their partners as the introduction of these systems has provided opportunities to improve efficiency and reduce operational costs.

It is clear that treasurers will demand more from their banks to help them to deliver efficiencies and cost reductions in their banking models.

Many banks, including Barclays, have developed a much better understanding of their customers' needs, to deliver the banking solutions that make the efficiencies described in this article possible. In the future, corporates will be looking for this understanding to complement the range of solutions that are available.

Vivek Ramachandran is head of cash & trade at Barclays Corporate.
BarclaysCashandTrade@barclays.com
www.barclayscorporate.com