Cash management is now a major growth area in corporate finance – even to the exclusion of loans and overdrafts. Why? Because the impact of banks and corporates together focussing on the liquidity and profitability of all individual transactions – no matter where they lie on the value chain – has the potential to transform entire company or group balance-sheets. With excess working capital in the UK now standing at £76bn – according to the benchmark survey conducted by REL Consultancy Group – the benefit will extend beyond company treasuries and straight into the pockets of investors.

# Making the cash connection

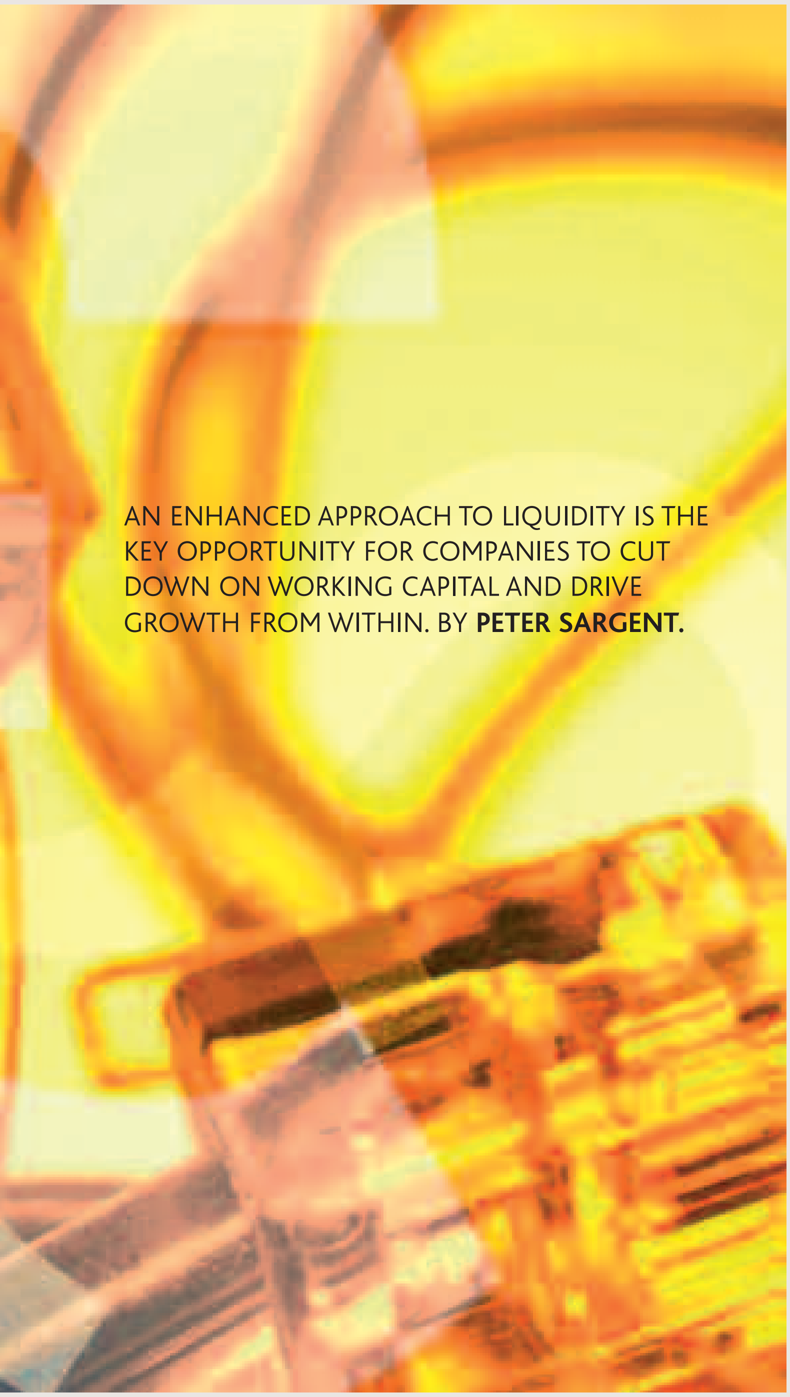
As the timeframe and error margin on cash movements becomes narrower, due to online documentation and payment mechanisms, there is a real opportunity for the micromanagement of payments and receivables to impact directly on the overall level of working capital. At the same time excess liquidity can be put to profitable use via the treasury portfolio. Online precision allows a new degree of confidence when moving cash to and from well-hedged, high-value locations created for it by treasury and risk managers. This confidence allows the procurement and commercial functions of the company to be brought together into the same cash management framework, rather than those functions making often contradictory demands at opposite ends of the value chain. Instead, the supply chain should be geared around orders, meaning the amount of time goods spend in the warehouse prior to sale should be reduced to a minimum.

By combining these goals with the cheapest available mechanisms – such as bank-provided e-commerce solutions – the value-chain itself can become a driver of growth at all levels of the business. The end results will be less lazy capital on the balance sheet, less strain on both debt and equity capital-markets funding, greater profitability from the treasury portfolio and increased transactional profitability.

**A NEW AGENDA** This is an ambitious agenda that requires a range of trade and cash bank products to be combined and applied with a new level of purpose. On the customer side there is a need for sophisticated reporting mechanisms and good realtime systems integration – linking payment and risk management systems into the treasury function. Also a key stage in realising these goals is the

## Executive summary

- Cash management is a major growth area in corporate finance as banks and corporates focus on the liquidity and profitability of individual transactions.
- Online documentation and payment mechanisms allow for micromanagement of payments.
- Cash management is no longer a question of shepherding cash flows and passively dipping into a cushion of working capital.
- The evolution in the way cash management products are applied arms treasurers with better information.



AN ENHANCED APPROACH TO LIQUIDITY IS THE KEY OPPORTUNITY FOR COMPANIES TO CUT DOWN ON WORKING CAPITAL AND DRIVE GROWTH FROM WITHIN. BY **PETER SARGENT.**

ARMED WITH THIS INFORMATION, TREASURERS CAN THEN TURN TO IMPLEMENTING THEIR WIDER PRIORITIES FOR THE FINANCIAL PROFILE OF THEIR BUSINESS.

reorganisation by banks of the way in which cash management products are presented to customers. This means products being placed at the centre of client relationships, making the broadest range available via the most accessible and familiar interface – the existing relationship manager – with the aim of creating the closest fit to the optimum liquidity profile of the company. The latest cash management offering from banks is not necessarily based upon a revolution in the products themselves. But the substantial evolution in the way these products are applied should show dividends for working capital management. *(See Figure 1)*.

The aim of such a realignment is for bank and customer to build up the best mutual understanding of the opportunities provided by the various 'cash points' that exist along a company value chain – i.e. places where liquidity is required – and how these 'cash points' fit into the overall liquidity profile of a company at any given time. In terms of accounts payable, this means pushing out payment terms towards precise future dates. And for receivables, it means piggybacking on the credit quality of counterparties to gain the fullest possible benefit from invoice discounting. Working capital is the difference between current assets and liabilities. The greater part of current assets is often made up of receivables and goods. The greater part of current liabilities is payables. It is natural that working capital reduction should focus on the interlinking of these two areas.

Armed with this information, treasurers can then turn to implementing their wider priorities for the financial profile of their business. This can range from better management information and better risk management to driving down costs and improving return on equity.

A classic way of achieving this is the matching of credit and debt positions. This can be taken cross-border, meaning banks use a customer's cash position in one country to provide comfort for the provision of a net: nil facility to amortize debt in another – especially useful if a company has raised foreign currency bank debt in response to poor credit conditions at home. Although corporates could always raise such facilities independently, they will be provided more willingly and more cheaply by banks as part of an overall framework of liquidity enhancement.

**INDIVIDUAL PRIORITIES** The strategic priorities of a treasurer cannot be divorced from the core businesses – from retailing, with the domestic currency float it requires, to international trade and the pitfalls of currency risk. Companies may find that their working capital management is affected by external factors such as seasonality of supply and demand, buy and sell side market conditions – in commodities, for instance – and fluctuations in the level of competition.

Even across a broad range of industries, there remains a distinction between moving money and managing money to enhance its value. The latter requires more sophisticated reporting routines to create the highest returns. As such, the overall solution created will tend to apply products of different sorts at these different levels.

Basic cash management products still equate to clearing and transmission services. But such basic products alone are not enough to maximise transactional profitability. This requires the application of cash accelerants to facilitate transactions and minimise company exposure via more efficient cash flows. Such products have often been developed for application to import and receivables finance. They are increasingly being applied domestically – in the case of supplier finance, for instance. Alternatively, some banks now offer the availability of working capital based solely on the comfort provided

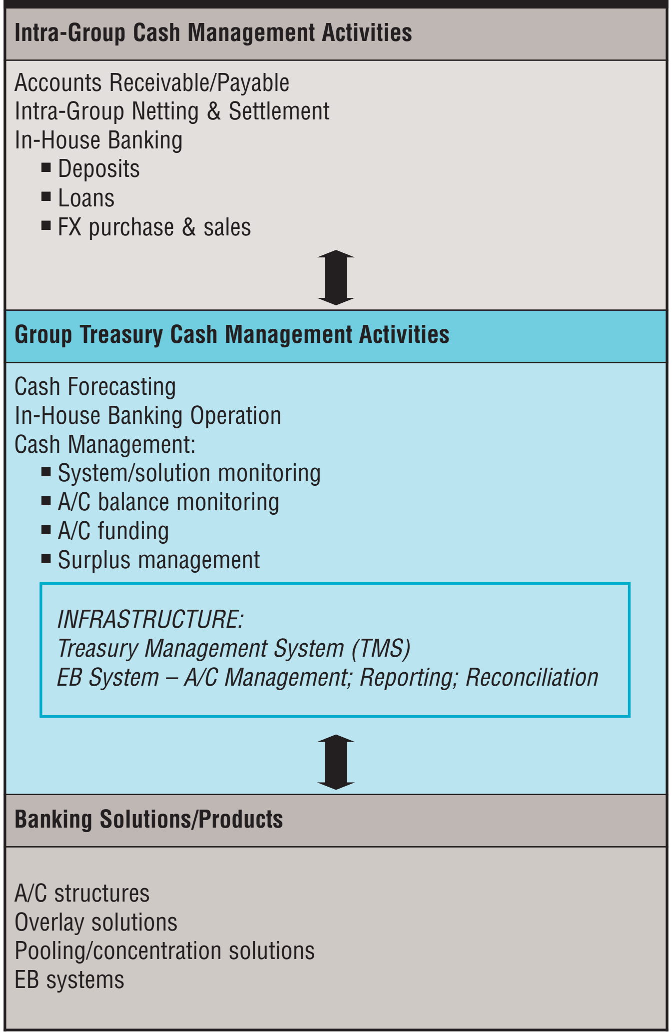



**Figure 1.** A liquidity-enhanced banking relationship

**Source:** The Lloyds TSB Corporate Guide to Treasury Best Practice and Terminology

by a company's outstanding receivables – meaning this short term debt does not have recourse to the company balance sheet.

Increased efficiency requires correspondingly greater attention to the third key area of liquidity management – risk mitigation. As any treasurer knows, actively engaging with the risks attached to an operating profit is as important as earning it in the first place – although over-hedging due to poor reporting can itself negatively impact revenue. Successful risk management may mean banks absorbing certain risks on behalf of their clients – such as country and buyer risk – in order to bring substantial reduction to companies' balance sheet exposures. Web-based systems allow for these risks to be increasingly well identified and managed.

**INTERNATIONAL WEB-ENABLEMENT** The rapid development of web-based solutions is indeed the main driver of all these opportunities. Although modem-based systems for transactional documentation have existed for some time, the new generation of provision uses a single browser portal to access a central bank-provided hub. This makes it no more expensive than web-based email. By combining automated document checking with dedicated back-offices to iron out customer queries and discrepancies, the

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result is a greatly reduced number of hold-ups in the value-chain on account of documentary error. Waiting for a Letter of Credit (L/C) to be confirmed, for instance, can have a ruinous effect on the cash management structure underpinning a value-chain – from placing orders with suppliers to booking shipping and other logistics. Given that approximately half of the documents presented under manually prepared L/Cs are currently rejected on first presentation, it is easy to see why documentary error is a primary reason for working capital excesses in the UK.

In order for the benefits of increased confidence to be shared across trading relationships, the new generation of online documentation systems allow password-protected access to be extended to counterparties. This means such counterparties – including logistics providers – can track the progress of transactions in realtime as well as share in advanced knowledge of payment dates.

It is a key feature of web-enabled trade relationships that the cash management benefits become shared between counterparties. Ultimately, this means joining up value chain cycles across several companies – linking raw materials suppliers to end-users within an overarching environment of cash-transmission and payment confidence. This is especially the case as web-based cash transmission systems continue to weaken the distinction between national and international cash flows. Aided by inter-bank co-operation and the introduction of the euro, the number of overseas banks needed by a UK company is being reduced – meaning treasurers are able to move money cross-border at the click of a mouse. With this ability they should now be free to decide how and where cash can be used to greatest strategic advantage, as well as when.

With existing debt largely refinanced to the most cost effective degree possible, treasurers are looking for further ways to maximise financial efficiency without impacting shareholder value or the workforce. A joined-up approach to liquidity is the answer. Cash management is no longer a question of shepherding cash flows and passively dipping into a cushion of working capital at unpredictable intervals when demands arise. With the opportunities that now exist for short term funding to plug the gaps on individual transactions – and the information awareness to know within the narrowest margin when actual treasury funds will be required – large amounts of 'lazy' capital on company balance sheets simply will not be a viable presence for much longer.

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