Sweeping changes

WITH SEPA ALMOST UPON US, ATTENTION IS NOW TURNING TO THE NEXT ROUND OF TREASURY EFFICIENCIES. WHERE NEXT FOR CORPORATE TREASURIES? ASKS **ANDREW REID**.

Executive summary

- Centralisation of treasury functions will let corporates achieve savings through economies of scale and avoidance of duplication.
- The centralisation of non-core business functions will facilitate automation and the end of paper processing.
- Standardisation in terms of payment formats, transaction processing and reconciliation will help treasuries benefit from the introduction of new transaction types.

Corporate treasurers are driven by two related needs. First, they are looking to achieve cost reductions from financial providers without sacrificing service quality or functionality. Second, and in parallel, they are under pressure to better manage risk – for example, through introducing more robust controls on transactions and cash handling.

Unfortunately, these two pressures can make uneasy bedfellows, although this need not be the case. A strategy based around three related themes can deliver dividends from both a cost reduction and risk management perspective. These themes can be characterised as centralisation, automation and standardisation.

CENTRALISATION A key trend in recent years has been the centralisation of treasury functions, typically as the first stage in a more comprehensive strategy. By centralising, corporates have made financial savings through the realisation of economies of scale and the avoidance of duplication of functions across different regions or sectors. The trend is reflected in the continued establishment of centralised transaction infrastructures such as payment factories or financial shared service centres (SSCs). By bundling together certain back-office services in one location, SSCs allow for task specialisation, a more efficient division of labour and the removal of non-core activities from local subsidiary businesses.

Cost savings come through specialisation and the reduction of process duplication, while the increased visibility created through concentrating functions in one location minimises the scope for human error. This increased visibility of processes allows data and decisions to be more easily auditable – aiding regulatory compliance and providing a single standardised source for measuring performance.

The adoption of a payment factory for example, typically works hand in hand with a corporate treasurer looking more strategically at banking service provision and bank account management. By removing the responsibility for and ownership of local banking from local subsidiaries, corporates can more selectively allocate transaction business to service providers. Corporates undertaking centralisation strategies can rationalise the number of transaction banking relationships they maintain, as well as streamline account structures. A number of corporates have combined the introduction of a centralised transaction processing structure with the creation of an in-house bank which provides further rationalisation opportunities. In such a scenario, payment-on-behalf-of structures have been implemented to consolidate transaction activity through a single legal entity bank account, reducing account maintenance fees and simplifying liquidity management structure and funding.

Within Europe, the opportunity for corporates to streamline accounts and reduce the complexity of transaction processing will be facilitated by the two principal pan-European transactions created by the Single Euro Payments Area (SEPA) – namely, the SEPA Credit Transfer (SCT), as of 28 January 2008 and, in a secondary stage, the SEPA Direct Debit (SDD) scheme in late 2009. While SCT can comprehensively reduce the cost and complexity of euro transaction flows, potentially through the use of a single account for the region, the secondary SDD scheme could have the bigger impact.

SDD will provide a first, truly standardised, pan-European collection instrument. Its introduction could underpin a collections factory model, similar to the payments factory approach described above, as well as a collection-on-behalf-of account model to radically restructure bank accounts and funding/liquidity models.

AUTOMATION The increased centralisation of non-core business functions facilitates automation, which further encourages enhancement through a focus on standardisation.

Corporates have attempted to dematerialise paper processing where possible, typically through the use of IT systems for payment-related documentation. Documents such as cheques and invoices seldom need to be physically produced, and electronic alternatives offer security through digital certificates and identity verification.

An associated focus has been the emphasis placed on seamless IT interfaces and data exchange. Rationalising and streamlining the number of data points and the variety of data sources, formats and communication channels can achieve significant process and cost savings. A key performance indicator of treasury automation (and effectiveness) is likely to be some form of straight-through processing (STP) ratio measurement. The ultimate objective is to eliminate manual intervention in transaction fulfilment.

STANDARDISATION The pursuit of automation and associated STP rates can be improved by a strict adherence to standardisation as a theme in itself. In terms of progress towards a single format, communication and set of standards for multiple-country banking in Europe, SEPA is a giant step forward. Further standardisation of payment formats, transaction processing and reconciliation will all benefit those corporate treasuries that understand and prepare for the introduction of new transaction types.

Several industry initiatives, such as the Transaction Workflow Innovation Standard Team (Twist) and the International Standards Team Harmonisation (ISTH) projects, aim to deliver a single, standardised, generic format for data exchange across multiple markets. Of particular recent interest is the use of XML as a single, global, generic format for corporate-to-bank data exchange. Such standardisation would take corporates another step towards the goal of high levels of STP, rationalised accounts, simplified liquidity models, increased visibility and significant cost savings.

Standardisation across jurisdictions through SEPA will also have consequences beyond the internal workings of corporate treasuries. SDD, for example, will lower barriers to entering new markets for many corporates as a relationship with a local bank to collect funds from counterparties will no longer be needed. Funds collection may be on a cross-border basis but at local transaction cost levels.

PRESSING CONCERNS FOR UK CORPORATES The focus on standardisation brings up the issue of UK corporates' general level of preparedness to embrace the changes now sweeping the industry. A number of UK corporates are still unwilling or unable to adopt treasury best practices and incapable of looking forward to the next round of challenges. Many have yet to engage sufficiently with SEPA and there remains a perception that the issue only really affects those based in the euro zone, although this is patently not the case.

SEPA should be shaping the attitudes of all UK corporates, even those that currently have minimal cross-border flows. Treasurers should fully consider the strategic and tactical choices ahead for their businesses, and benchmark their current treasury and cash management strategy against the leading corporate indicators – not just those in the UK.

The sophistication of cash management structures has greatly increased in recent years. IT platforms are being used more effectively and viable product offerings from banks have proliferated. But best practice also requires attention to the ongoing developments around SEPA if UK corporates are not to be left behind in terms of the best treasury and cash management solutions currently available.

BANKS UNDER PRESSURE Major influencers of the behaviour of UK corporates are the banks – many of which also face issues with the changes in cash management services. The biggest issue is the paradox of the increased costs entailed in sustaining direct involvement with transaction processing, coupled with a reduction, or erosion, in revenues from transaction fees. The former comes as a result of the ever widening scale of this type of business: banks need a highly efficient, robust and scalable infrastructure to continue to offer the services demanded by corporates operating across national and regional boundaries. At the same time they need a significant scale of transaction flows to amortise the high fixed costs involved in running the transaction engines. Reduced revenues from the processing of transactions will result from initiatives such as SEPA and from corporates capitalising on centralisation and standardisation to reduce the number of accounts they operate.

SEPA is a catalyst for banking change from a corporate perspective, but also a political initiative to expedite consolidation in the European banking industry. Indeed, the number of banks remaining directly engaged in processing corporate transactions will decline. As a result, corporates are advised to understand and question the longer-term strategy of their banking partners and their commitment to support transaction processing (with the associated investments in platforms/services). Only those banks with the size, scale and infrastructure will have a sustainable business model in this arena.

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