



Cash management practices: UK vs US

Ian K Watson of Bank One analyses the historical factors which have resulted in the US and UK banking systems taking such different paths.

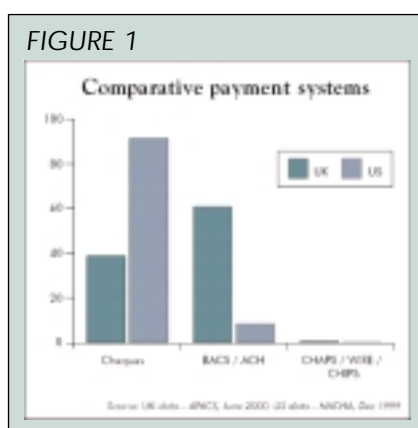
Winston Churchill once famously noted that the UK and US are "two nations separated by a common language". He could have said the same about cash management. To put the differences between the two systems into perspective, we need to look at some historical facts.

Banking structure

Arguably the most significant reason for the differences is the sheer contrast in size of the markets. This geographic scale may be at the root of the two phenomena which are principally responsible for the differences in US and UK cash management practices: the absence of national branch banking and America's "love affair with the cheque."

In any country the banking system tends to start first as a local, then as a regional, and finally as a national phenomenon. In the UK the smaller scale of the market – both geographically and in terms of population – allowed the emergence of national branch banking at an early stage. By contrast, in the US that process was inhibited by the development of a federal system, the amalgamation over time of previously autonomous states each providing their own system of government for an already large geographic area. By vesting authority for granting bank licenses and their regulation with the individual states, a national central bank (the Federal Reserve) did not come into being until 1913: this created a nation of in-state banking structures rather than a national system.

Moreover, the insistence of some states on unitary banking (allowing any bank to operate with no more than a single branch) led to a proliferation of banks. As recently as the 1990s, the US still had over 14,000 banks, and



despite more recent consolidation that number is still around 9,000.

The other major influence on product development in the US was the mail system. We in the UK can generally expect mail to be delivered within two or three days. However, in the US, with the enormous distances from east to west and north to south, mail times could be many times that. These factors have had a great impact on many aspects of the banking system.

The collection process

Because of slow mail and the extended cheque clearing times, cheques became the preferred vehicle for settling transactions. Significant effort was therefore devoted to developing products to reduce and eliminate, as far as possible, the mail and cheque collection float from the system. The result was the development of a low-cost, efficient vehicle for processing cheque receivables – the lockbox. Only now starting to be seen in the UK, the lockbox was originally developed in 1947 as a low-cost vehicle to intercept mail, reduce mail float and speed up posting of the enclosed cheque to the beneficiary's account. In contrast companies in the

UK, with their northern European movement away from cheques, allied to a relatively efficient postal system, are only now developing lockbox products, but as a vehicle to outsource receivables processing.

Electronic collection of receivables has been much slower to develop in the US than the UK. This, to a large extent, is due to the low cost of cheque processing. Collection of consumer payments by direct debit or standing instruction through the Automated Clearing House (ACH) is still at a low level compared to the percentage of payment traffic through BACS in the UK. (see Figure 1). The US ACH system does, however, have a significant amount of flexibility over BACS in the variety of message formats available and the amount of data that can accompany the payment. As with BACS, the ACH system is national and provides one or two day availability of funds.

Collections via the wire transfer system, FedWire, operate in a similar way to CHAPS transfers in the UK, with immediate availability of funds. The Fed plays a dual role of regulator and service provider through its interconnected network of 12 regional offices, each of which maintain accounts for participating banks in their respective region.

The concentration process

The lack of a comprehensive national branch banking system in the States has had a significant impact on the concentration process, where consolidation of funds in one location as opposed to balances spread across a branch network, highlights the major difference between the US and UK.

UK banks with their branch networks have been able to provide pooling

arrangements across multiple accounts for many years. These balances can be notionally pooled and the net debit or credit position either funded on an overdraft/loan or receive credit interest/investment income. Legislation in the US prohibits both overdrafts and interest-bearing current accounts and when added to the lack of a national branch banking structure, alternative netting/pooling vehicles have had to be found.

Two principal concentration options are therefore open to US-based companies, multi-bank concentration or single-bank concentration. A multi-bank system involves the periodic sweeping of funds from local bank accounts into a single concentration bank using draw down wire transfers, ACH debits or depository transfer cheques (pre-authorised cheques drawn by a company on its own account at another bank). This arrangement can be passive or active.

Data on the cash position at each bank account is collated daily and funds movement initiated to sweep balances back to a central concentration bank. Active participation involves manual intervention, passive involves sweeping balances over a pre-determined threshold. The multi-bank arrangements maintained by many companies in the US is a direct result of the lack of a national banking network.

The single bank concentration system involves the company establishing a series of zero balance accounts (see Figure 2) for each operating company and master account holder. At a pre-determined time each day, balance information on the underlying operating accounts is captured by the customer. This information can be fed into a spreadsheet or cash flow model and the end of day cash position calculated. Funds are then borrowed or invested depending on the anticipated end of day cash position. The limitation on running overdrafts and the prohibition of paying credit interest on current accounts has made zero balance structures the most common form of concentration system in the US.

The disbursement process

The disbursement processes in the UK and US have much in common, but there is one major exception, controlled disbursement. Controlled disbursement grew partly out of the Fed's desire to reduce the use of remote disbursement by companies, eg drawing cheques on banks located in remote locations

Geographic scale is the root of the two phenomena responsible for the differences in US and UK practices: the absence of national branch banking and America's love affair with the cheque

where cheque clearing times could be many days. In 1984 the Fed introduced a procedure by which cheques would only be presented to the drawee bank once per day if the total value of the cheques presented on that bank was below a pre-determined threshold.

Cash management banks then developed, in conjunction with regional banks, a mechanism to process and report daily presentations early in the day. In addition, banks also introduced a range of reconciliation products designed to make cheque issuance both more efficient and secure. A recent example being positive pay, whereby a company sends their cheque issue file to the bank who, in turn, match the file to the cheques as they are presented and obtain the customer confirmation before paying or returning any mis-matched items.

The electronic payment systems in the US also have many similarities to those available in the UK. FedWire and CHAPS are roughly comparable, with

real-time gross settlement and assurance of payment but with higher charges tends to be used for large value payments.

In addition, banks operating in the New York market may also be a member of CHIPS, an end-of-day, net settlement system, used primarily to settle the US dollar side of foreign exchange transactions.

The ACH and BACS, used more for low volume, low value, less time sensitive payments again have many similarities, the exception being, as mentioned above, the range of formatted messages available through the ACH.

The love affair is over?

The major differences between the UK and US cash management systems, stems from the differing geography and the historical lack of a national banking structure. This is further magnified by the prohibition of allowing overdrafts or paying credit interest on current accounts and the disproportionately high use of, and low cost of, processing cheques in the US.

New payment products such as the payment card (a cross between a debit and credit card), the influence of the US Government, consolidation in the banking industry and the shift to e-commerce will ultimately move the US corporate away from its love affair with the cheque. Only then will we see the products as well as the techniques in the UK and US move closer together. ■

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FIGURE 2

