A catalyst for change

SEPA IS TURNING THE ACCEPTED NORM FOR CASH MANAGEMENT ON ITS HEAD. HUGH DAVIES EXPLAINS HOW COMPANIES CAN MAKE EU PAYMENTS MORE COST-EFFECTIVELY

The crisis in the eurozone continues to rumble on, and while many would suggest grounds for optimism exist, there is seemingly no end in sight yet. Nevertheless, it's not a time for corporate treasurers to sit on their hands until the dust settles, both in terms of managing the day-to-day business and planning for the future. This is especially true for working capital optimisation in general, and payments processing in particular, given that the Single European Payments Area (SEPA) migration date of 1 February 2014 has been announced.

A survey of finance professionals commissioned earlier this year by technology company Logica and the Financial Services Club found a drop in scepticism over the future importance of the euro and the likely success of SEPA (non-believers down by 30% compared with 2011). Despite this, and the fact that the SEPA migration end date is now less than 18 months away, a surprising number of companies have yet to embark on projects to evaluate whether SEPA can potentially bring opportunity and competitive advantage, or is just another regulatory burden.

Treasurers continue to focus on funding, risk management, counterparty exposure and stability of the supply chain. So projects aimed at improving operational efficiency and eliminating, or mitigating, risk should become top priority. Creating an effective and efficient payment process is one such project. Companies that have already introduced a standardised and centralised payment process are benefiting from the improved visibility and control they have in this volatile and uncertain world.

So, where to start when considering the most cost-effective way of making payments in the EU? Don't just look at the payments process itself, as this is only one, relatively small, component of what is likely to be the optimal solution and structure. Instead, undertake a more holistic review that considers the following points and how they deliver against overarching corporate objectives:

- Current and possible future business and customer revenue models (ie trading models). Variants include legal and tax structures for supply chain, manufacturing, sales and distribution.
- Treasury models, for example, regional treasury centres, in-house bank (IHB) structures; and working capital management models covering accounts payable/accounts receivable processes in a shared services centre, payments factory or netting centre.

> Many companies have used SEPA as a catalyst to overhaul what has, for years, been the accepted norm, or best practice, in payments and cash management

Many companies have used SEPA as a catalyst to overhaul what has, for years, been the accepted norm, or best practice, in payments and cash management. They have successfully used SEPA for cross-border payments for some time and substantially reduced their transaction fees by converting payments from the traditional high-value (ie wire transfer) to low-value (ie automated clearing house) clearing systems, potentially using a single, centralised account.

The question now is whether a similar account structure can be used for domestic payments (and direct debits) within the eurozone via SEPA. Traditionally, in a multinational company, subsidiaries have maintained local accounts with local banks for the purposes of paying suppliers and collecting from customers, but the rationalisation of such structures under a SEPA review could bring about substantial cost savings through reduced transaction fees, simplified and streamlined liquidity management and greater control and visibility.

Most, if not all, regional and global banks are now fully SEPA-compliant, but their advice on the subject of account centralisation will, to some extent, depend on their capabilities. For those with limited proprietary branch capabilities in the eurozone, a centralised account structure, for example, in London, will be the 'panacea' solution anyway. A treasurer might justifiably ask a transaction banker today whether a proposed in-country account structure (and the higher fee generation associated with this) has real practical merit or is only being offered as a competitive differentiator.

But there are other important points to consider, including whether local receivables can also be centralised to the same account location or does the sales and distribution model still necessitate local accounts for specialised instruments or physical receipts such as cheques and cash? Tax and payroll can also require locally based solutions. In addition, reform of central bank reporting rules for movement of funds from non-resident to resident, and vice versa, is a factor for consideration.

When discussing centralisation strategies, treasurers should evaluate the benefits of establishing an IHB, including whether it needs to be a physical manifestation or can be operated virtually with today's available technologies. Traditionally, an IHB comprises a dedicated unit that manages the cash, FX and funding operations on behalf of various entities within a company. Each entity maintains one, or a series, of quasi 'bank accounts' with the IHB, which is in turn responsible for external bank relationships. The benefits of an IHB include better operational efficiency for the treasurer through improved visibility of liquidity and cash; greater control; funding benefits (internally rather than externally); and reduced bank fees either through eliminating transactions and flows (for example, through establishing an intercompany netting process – which can also reduce FX costs), or rationalising them.

Very often, an IHB is combined with a payments factory, which provides further benefits in terms of payment processing and streamlined bank connectivity. A payments factory leverages enterprise resource planning (ERP) technology to support functionally centralised payment processes, and has responsibility for discharging liabilities to suppliers and other third parties, internal business units or employees (payroll). Many companies have seen value in establishing a 'payment on behalf of' (POBO) model as part of this structure whereby the liabilities are discharged 'on behalf of' the underlying business units through the IHB or some other legal entity. This model can be particularly beneficial where there are large volumes of cross-border transactions to settle, but it does, of course, mean that intercompany assets and liabilities need to be managed and the supplier needs to receive adequate information with the payment to apply it to the original underlying business unit's invoice.

But, of course, the euro is not the only currency in the EU. The UK Faster Payments Scheme delivers increased efficiency through providing same-day value for low-value payments. Meanwhile, a number of global banks offer a single account solution for payments in other currencies (for example, Nordic, central and Eastern Europe, and other currencies worldwide) that leverages their global branch networks and depth of FX expertise. This can deliver substantial costs savings compared with the costs of funding, maintaining and reconciling foreign currency accounts purely for the purposes of effecting payments.

As one size will certainly not fit all when it comes to greater payment efficiency in the EU, there are plenty of considerations for treasurers looking at this alongside operational effectiveness, access to funding and risk management. Above all, in these turbulent times, availability of information and agility will be paramount.

ISO20022 XML (UNIVERSAL FINANCIAL INDUSTRY MESSAGE SCHEME)

In today's world, where concerns about counterparty exposure and operational risk through concentration are ever present, streamlined bank connectivity does not necessarily mean streamlined bank relationships.

For some companies, corporate access to SWIFT and the use of the ISO20022 XML payments standard is a single-channel way to maintain relationships with multiple banks on a regional or global basis without the burden and cost of maintaining multiple points of bank connectivity and using their proprietary formats. It also mitigates the risk of concentration and is a potential platform for enhanced contingency planning. But it is important to understand how each bank complies with the ISO format as this can vary significantly from bank to bank and market to market.

The adoption of ISO20022 XML is quite critical to the success of a POBO model in the eurozone, as it is also the standard adopted by SEPA for the 'bank-to-bank' component of the payment process. So if 'corporate-to-bank' also complies with this standard, it will reduce the risk of truncation and help to achieve the necessary flow of payment information to facilitate automated reconciliation by the supplier.

Hugh Davies is an executive consultant with Zanders Treasury and Finance Solutions (www.zanders.eu). He has more than 26 years' experience in payments and cash management within the banking sector