New cash management challenges in euro-land

Claude Barral of BNP Paribas looks at the recent changes in cash management in Europe and asks if companies can adapt to the challenge of Emu.

Over the past few years, cash management has changed considerably both in its nature and use. It has switched from being a large corporate client's means to control its global cash position, to a middle-market company's tool to manage its financial and commercial flows. The euro is a major factor that has helped cash management become a very important aspect of the bank-customer relationship.

New European cash management

The spectacular growth in commercial transactions within the European Community has created a large increase in international payments and collection operations. This new commercial environment has in turn created new demands from businesses:

- new instruments to better control their incoming and outgoing flows and to reduce their banking costs;
- new cash management tools and services from their banks;
- commercial cash management, such as improved control of payments and collections;
- more cost-effectiveness in the issuing of payments;
- more efficiency in the collection of their receivables; and
- reorganisation of treasury management and payment/collection departments, with a tendency towards centralising these functions in Shared Service Centres (SSCs).

Companies now also want to streamline their international operations and issue banking transactions to the foreign countries in which they operate, directly from their SSCs. They are changing the nature of these operations from international to domestic whenever and wherever possible. Companies want to access the various domestic payment or collection instruments through electronic banking platforms.

Most companies doing business in Europe deal with more than one bank (at least one per country), so the multi-bank compatibility of their electronic banking platform is already an issue. Customers want to use a single piece of software that can receive account reports from, as well as issue payment/collection orders to, all of their banks. This has pushed a few major banks to negotiate agreements with one another to allow customers using one bank's software to debit accounts held by other banks. This trend seems irreversible and within a few years the major bank groups will be able to deal with many other banks.

Bank-customer relations

New technology, the trend for companies to rationalise their banking relations and their other new requirements have pushed the major banks to refine their cash management services.

Today's basic customer requirements for cash management services from banks concern primarily treasury management and the various tools used in this field:

- domestic and international pooling services, whether sweeps or notional, to optimise management of cash balances on accounts and lower banking fees by offsetting debit positions by credit positions or by concentrating cash in one central location in various currencies; and
- electronic banking workstations to consolidate account reporting from the various banks worldwide and to issue treasury transfers.

Most big European banks provide this type of 'overlay' service. Companies with more advanced financial organisation require additional services which are yet to be provided widely by banks dealing with commercial flows. Electronic banking is a partial answer that has long masked the real issue.

Corporate customers face two types of banks: large global banks with extended home country networks and few branches abroad, and domestic banks with excellent local branch coverage. To offer proper commercial flow services across Europe, global banks rely on their international networks with access to local clearing systems through their main branches in the countries.

Some domestic or medium-sized banks with little or no presence abroad try to overcome the problem of increased costs by creating bank clubs, which include banks with fairly good-sized domestic networks, to carry out common cash management services. These clubs strive to cover all European countries. Three main clubs active today are: IBOS, Connector and TES. The main drawbacks for customers concern the potential difficulties that these banks may have in implementing common services from heterogeneous MIS systems or the quality of the client support from different partners.

The main issue for major banks is that they be represented all over Europe and, more specifically, in euro-land countries. Very few global banks can boast they are present everywhere and, as yet, no clubs include banks from all European countries. Some large banks use both strategies: global banking for their corporate customers and club banking for their middle-market clients.

The impact of the euro

For many companies, perhaps the majority, the birth of the euro has had little impact on their day-to-day functioning. Y2k and the three-year grace period, during which the euro and the legacy currencies will coexist, have meant that companies are preparing their switch to the new currency actively but with no haste. However, more companies are beginning to realise that the euro is going to have a serious effect on the way they manage their liquidity.

The euro has been welcomed by most involved in finance for a number of reasons. It means savings on banking fees (no more foreign exchange fees on these currencies). For companies, being able to integrate up to 11 different currencies in one euro pooling system makes the management of treasury a lot less complex than before. The convergence of interest rates to a single common rate and the disappearance of currency risk have added to the simplification of managing liquidity in euro-land. Treasury centres have the ability to better control the financial flows from their subsidiaries although some countries' legal and fiscal regulations sometimes still render pooling difficult to implement. The sweeps can be costly for the various interest tax calculations methods and many banks won't offer notional pools because of regulations that do not allow them to exclude offset positions from their balance sheets.

Furthermore, the supra-national clearing of the euro, whether through ECBs TARGET or EBA's (euro banking association) clearing system, would allow treasurers to envisage same-day value international transfers.

Barely 30 years ago, the economies of countries such as Germany, France or Italy, had very little in common with each other, and their various governments set up rules to defend their own economic and financial environments.

Since the signing of the Maastricht Treaty, enormous progress has been made in the convergence of the member countries in terms of managing their economies. Stringent rules have been softened and some, if not all, of the local monetary protectiveness has been removed. Foreign exchange control has disappeared and international financial flows do not submit to constraining conditions any more. Although not totally bright, the picture is still fairly attractive and will certainly get better.

The euro has also opened whole new possibilities in the control of commercial flows: companies can use domestic instruments to issue payments or collect receivables in the currency of the payer and be credited automatically in their own currency or in euro. This has significantly reduced costs and lightened the administrative workload of the departments, or the SSCs, in charge of payments and collections.

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The euro has indeed been a factor of simplification and of savings, but maybe not as much as the large corporations expected it to be. There are still heavy domestic constraints on treasury operations and the US-like open market is still some time away.

New requirements

New customers' requirements will lead the more dynamic banks to invest heavily in new cash management services. The technical structure of the euro clearing systems allows faster processing of operations and extended working hours, and banks will have to adapt to these new conditions and offer services that can match their performances. This means that many European banks will have to redesign some of their back-office applications to be able to deal with close to real-time clearing and quickly inform corporate clients.

Today, only about half of all large companies are informed of their intraday transactions via electronic banking workstations. This situation must evolve fairly soon; with high value operations being processed rapidly, companies will find it unacceptable not to be informed when credited with large amounts. Real-time, or 'just-in-time', information via electronic means will be extremely important when choosing a system.

It will be equally important for an electronic banking platform to provide access to the various European means of payment and, even more so, to the collections. The euro is not going to change the local peculiarities in these fields. Companies are very conservative in the ways they pay or are debited and they find it much more acceptable to pay through means that they know and understand. In France, Italy, Spain and Portugal, local collection systems are deeply anchored in the commercial habits of local companies and it makes everything much easier when providers, whether domestic or foreign, agree to be paid using these instruments.

A challenge is laid down

Once again, this is a challenge for the banks, which will have to offer electronic banking systems that cater for the various exchange possibilities encountered in euro-land. This implies that they can give access to these instruments and process the operations through their domestic and foreign branch networks or through agreements with domestic banks in euro-land countries. Whatever the chosen organisation, they will have to offer an efficient and low-cost service that has straight-through processing to guarantee speed and quality.

The advent of the euro has proved to be a great catalyst for companies and for the banks operating in Europe to re-engineer their cash management operations. Many companies are taking a close look at the structure of their organisations with an eye to optimising financial products based on a streamlined commercial flow control. Many have started with treasury management and will continue with a hard look at payments and collections.

Today's regulations and fiscal environments have not changed much and there are still plenty of government or central bank-imposed constraints. It seems inevitable that the various country regulations on currency control will merge into one general set of rules. Euro-land will progressively become a wide-open marketplace where companies will need better and more efficient ways to manage their commercial and financial flows if they are to succeed.

Banks have a challenge. They must reconstruct their cash management services, not only by offering good electronic banking workstations and multinational pooling systems, but also by being able to process as efficiently as possible, and at low cost, the issued payments and collection orders. If they want to remain in cash management, banks must offer services based on hi-tech products, quality client support, large international branch networks and efficient back-office processing. ■

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