Changes to cash management in Germany

Chris Robinson of Citibank says that the arrival of the euro means more competition between banks to offer cash management services in Germany.

Thanks to the competitive pressures of economic and monetary union (Emu), banking relationships in Germany are facing significant changes. The challenge for treasurers in future is to make the most of the opportunities that arise.

Without doubt, the arrival of Emu heralds the onset of a period of unprecedented change as European structures and institutions open themselves fully to the competition inherent in a wider domestic market. As longstanding practices give way to new, more efficient ones, the ultimate beneficiary of this dynamic upheaval will be the customer.

The advent of the euro will accelerate trends – such as the declining influence of hausbanks on corporate treasury – already evident in Germany. At the same time, it will impact local pricing subsidies and fee structures.

Competitive force

As a result there will be increased competition on both price and service for all market participants be they local or international as they try to create economies of scale in a deeper European market.

The competitive landscape in Germany, as with other European markets, will change. As a result opportunities abound for optimising cash management functions on a European scale.

Treasurers are abandoning the practice of recycling foreign exchange and instead are concentrating euro into large and liquid pools that can be quickly applied – either inside or outside 'euro-land' – for maximum return. Thus, the critical challenge for corporate users is to source services from banks that can provide this type of global network access and liquidity management capability – alongside traditional domestic payments and clearing – at a competitive price.

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Past as prologue

With 40% of the Deutschmark flows of the 11 'in' countries directed to the German clearing system, it is safe to assume that a high volume of euro flows will be directed to Frankfurt as well. So, in order to understand the ongoing changes in Germany and the opportunities arising from the completion of the single market, it is worth briefly looking both at the state of local treasury services and at the country's Emu preparations.

Chris Robinson

As a market within a market, Germany has developed its own integrated and standardised electronic banking system known locally as 'MultiCash'. The system allows customers a screen-based interface with banks and to benefit from home-grown software with the functionality to provide tailor-made cash management solutions. This software has been sold on to Austrian and Eastern European markets, making MultiCash an increasingly standardised electronic banking tool.

Standing alongside MultiCash is the two-pronged clearing and settlement system. The *Landeszentralbank* (LZB) facilitates clearing across all regions. The system in Frankfurt is known as EAF-2 and encompasses more than 60 institutions.

Meanwhile, a similar service is provided countrywide through the Deutsche Bundesbank – the German central bank – for more than 2,000 members.

EAF-2 allows the paperless exchange of Deutschmark (DM) credit transfers between participants and limits credit risk by finalising offsetting payments. Further, large commercial institutions and savings banks operate a giro system for low-value payments.

German companies still rely largely on cheques, with clearing times for major corporates of about 1-2 days. Those periods are slightly longer for smaller companies and individuals.

Germany is linked to TARGET, the European high-value clearing network, by the ELS system – the country's high-value clearing network and only true real-time gross settlement (RTGS) system.

And the fact that Germany and Austria (along with Belgium) are the only countries to transform local clearing systems from national currency denominations solely to euro is a testament both to their integrity and to Germany's commitment to Emu.

Regulatory regime

The German government has increased the pace with which it is modernising its regulatory regime. The 2% reserve requirement that banks must hold on interest-free deposit at the central bank was lifted in October, with the potential effect of adding five to six basis points to interest rates paid on corporate accounts.

Indeed, all standard European money market instruments are available locally and there are no restrictions on non-resident bank accounts – although residents holding off-shore accounts must report those balances monthly to the Bundesbank.

And while the country's high level of withholding tax is seen as a drawback, German banks have long offered zero balancing – a factor that makes Frankfurt one of the more attractive centres for euro concentration.

Hurdles and opportunities

Despite its modern infrastructure and a modernising regulatory regime, Germany's banking system remains affected by many practices befitting its heritage as a protected market.

The close relationships which banks have long enjoyed with their corporate customers has bred a system by which domestic transaction charges are kept artificially low thanks to subsidies from proportionally higher cross-border fees. Those penal charges can reach as high as DM1.50 per DM1,000, with a maximum of DM5,000 for a single high-value transaction.

The fact that most of these charges are passed on to correspondent banks or corporate counterparties has only served to strengthen these relationships. Indeed, this practice allows corporate customers that conduct only a few cross-border transactions a year to source their domestic clearing services virtually free. However, banks continue to cover those costs by paying little in the way of interest on corporate deposits.

What's more, the widespread practice of adding or subtracting one day on the delivery date of credit or debit instructions allows banks to collect significant float income that might otherwise go to their customers.

Many corporates are likely to have several core domestic service providers, preferring to maintain just one or two key relationships with international banks and using those institutions for cross-border transactions. As the single currency takes hold, it will reinforce this transition.

Frankfurt – will the euro mean a growing role for the German financial centre?

Indeed, one of Emu's primary goals is to reduce the number of banking charges and to make those charges more transparent. Thus, as some corporates renegotiate their local banking relationships amid an environment of increasing competition, traditional pricing practices will come under pressure.

The wider domestic market also allows corporates to optimise their cash management techniques through euro pooling. There are no local restrictions on concentrating the accounts of groups of companies, and German corporates are adept at concentrating their capital flows, having tended to repatriate off-shore revenues as quickly as they are earned. And it is this concentration model that potentially gives them an advantage with the introduction of the single currency.

Most German banks can offer local concentration and zero-balancing – in which an end-of-day transfer to a master account takes place. The top five banks dominating the market, including Deutsche Bank, Citibank, Commerzbank, Dresdner Bank and Bayerische Vereinsbank all offer a variation of this service.

> As cross-border impediments continue to break down, Germany's banks are under increasing pressure to change both their practices and their pricing. This, in turn, is giving corporate customers the chance to review their banking relationships with an eye to exacting even greater value

Broader market

Many banks cannot yet offer concentration in centres around Europe, thus tying their customers to prevailing local market conditions and potentially limiting their returns on pooled balances. International banks with pan-european presence will have a competitive advantage. Further, their regional networks offer customers the added bonus of lower-cost clearing and settlement services on transactions within the broader domestic market created by Emu.

As cross-border impediments continue to break down, historical banking practices will come under pressure to reform as corporates look to maximise the value they get from their banks.

Overall, the emphasis is on choice in this new competitive environment. And making the right choices is critical to maximising the benefits of the single currency. ■

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