CASH MANAGEMENT

A supplement to The Treasurer | AUTUMN 2008

Concrete and clay: European producer of building materials, Etex Group

A hidden opportunity: FX cross-currency payments

Transformation at Kofax: Financial management system overhaul

Getting it right: Reaping SEPA benefits

TREASURY, RISK AND FINANCE PROFESSIONALS
ACT

THETREASURER

The Treasurer is the official magazine of The Association of Corporate Treasurers, 51 Moorgate, London EC2R 6BH

TEL +44 (0)20 7847 2540
FAX +44 (0)20 7374 8744
EMAIL enquiries@treasurers.org

www.treasurers.org

HEAD OF PUBLISHING Peter Matza
EDITOR Peter Williams
TECHNICAL Martin O'Donovan
DESIGN Jane Denton
SUB-EDITOR Peter Kernan
BUSINESS DEVELOPMENT MANAGER, MEDIA & EXHIBITIONS Denis Murphy
SUBSCRIPTIONS Tolu Babatola

SUBSCRIPTIONS
EUROPE, INCL. UK (PER ANNUM)
1 year £190 | 2 years £285 | 3 years £380
REST OF WORLD
1 year £220 | 2 years £330 | 3 years £440
For information, telephone +44 (0)20 7213 0706 or email tbabatola@treasurers.org

PRINTED BY Broglia Press, Dorset
EDITORIAL AND PRODUCTION Bizmedia
COVER DESIGN Jane Denton

ISSN: 0264-0937

Riding high on the corporate agenda

Treasurers know cash is always important in good times as well as bad. But in these more difficult times the rest of the business stops taking cash for granted and becomes interested in liquidity.

The Treasurer, in conjunction with Deutsche Bank as founding sponsor, launched the Cash Management supplement just over a year ago. In those days few would have forecast the credit crunch, or how cash management was consequently set to rise up the corporate agenda.

Now it is hard to have a treasury-related conversation without discussing liquidity and cash management. A whole range of cash management topics are demanding the attention of treasurers as they work with colleagues, both in the rest of the finance department and elsewhere in the business.

The challenges that treasurers face are reflected in the agenda of this supplement. With features by leading banks and writers on The Treasurer, this publication discusses the major business and regulatory cash management issues facing treasurers today. Treasurers need to be aware of the rapidly changing landscape, the products and the solutions that may benefit their business, and the shifting risks that impact liquidity and cash.

Cash and liquidity are always key business drivers, but now more than ever is a time to be aware of the issues.

PETER WILLIAMS
Editor

The ACT would like to thank all sponsors and contributors to this autumn edition of Cash Management

Contents

cash management
CASE STUDY

Concrete and clay

AS A LEADING EUROPEAN PRODUCER OF BUILDING MATERIALS, ETEX GROUP'S PRODUCTS ARE HIGH VOLUME BUT LOW VALUE – WHICH RULES OUT OUTSOURCING TO LOW-WAGE COUNTRIES. GROUP TREASURER JOHN HOLMES OUTLINES ITS CASH MANAGEMENT ISSUES TO **GRAHAM BUCK**.

Executive summary

Group treasurer John Holmes explains the cash management policies of the Etex Group following the corporate activity of recent years, the central importance of the foreign exchange (FX) policy and the challenges of centralising cash and debt in a bid to use surplus cash to repay debt.

Notable events of 1893 included the World's Fair in Chicago, while Thomas Edison constructed the first motion picture studio, Rudolf Diesel secured a patent for the diesel engine and in Austria the firm of Eternit-Werke was founded by industrialist Ludwig Hatschek.

In 1905, Alphonse Emsens acquired the Belgian licence to exploit the Hatschek technology, using the name Eternit. A full century on, the Belgian Eternit has developed into Etex Group consisting of 90 affiliated companies, with a global presence in 42 countries and a workforce of more than 14,000 people.

Much of this growth has come over the past two decades. Eternit Belgium bought its German counterpart, and then bought out the minority stake in Eternit France to full ownership. Soon after the latter deal it adopted the name Etex Group, to reflect a wider range of products that now included fire protection systems, roofing materials and plastics.

Group treasurer John Holmes came on board in 1999, having served as group treasurer for UK-based building materials group Marley, which Etex acquired that year.

Post-acquisition, Holmes' first task was to arrange finance for repayment of Marley's debt and the acquisition bridging loan. Etex Group acquired 80% of the assets of UK group Glynwed in 2001, making it a worldwide leader in plastic pipe systems (the deal also saw Glynwed retain its Aga and Rayburn ovens business and relaunch as Aga Foodservice).

Not only did this purchase create high debt levels and the need to refinance, it also took place only months before already shaky economic confidence suffered a further blow from the September 11 terrorist attacks. The next couple of years were "tricky" as a result, but business disposals and its strong cashflow saw the group make the planned debt repayments.

TWO SEPARATE ENTITIES By 2003, conditions had stabilised and in June that year Etex Group's shareholders approved its demerger into two separate entities of roughly equal size; building materials and plastics for the plumbing sector. The latter was spun off under the title of Aliaxis, while Etex retained the "heavy side" – roofing, boards and fire protection businesses.

"Refinancing proved to be a fascinating exercise, as individual banks took on very different views of the two businesses," says Holmes. Some proved more supportive of Etex Group; others preferred Aliaxis – often quoting the same reason for taking an opposite view.

The group undertook a subsequent refinancing in 2005, to benefit from the then more favourable market conditions. Despite private equity firms snapping up acquisition opportunities at prices higher than the group was prepared to match, it was nonetheless able to buy into the German market for clay roof tiles through three acquisitions, of which the biggest was market-leader Creaton.

"Ideally, we would also like to further expand our presence in France," he says. "But the price being paid for deals continues to be too high. Instead we're spending heavily on organic growth across Europe, including the eastern countries."

THE GOOD YEARS Thanks to low interest rates, recent years were good for Europe's property markets and for the

construction and building materials industries. Along with consumer goods, demand for building materials is a good indicator of the state of the general economy, being highly sensitive to changes in interest rates and mortgage loan issues.

"In fact our profits have a far greater exposure to the economic effect of rate fluctuations than they do to the effect of rate fluctuations on our debt," says Holmes.

"We don't hedge this economic risk as it is impractical to do so and the resultant smoothing would work against us just as often as proving to be in our favour."

Foreign exchange (FX) exposures in Europe are partially centralised in the Belgian treasury operation, the exposure from importing fibres from the Far East in US dollars and Yen, although both are relatively small exposures in relation to the group's overall purchases.

Its main non-centralised FX exposures in Europe are in the UK – as the UK companies buy and sell in euros, treasury is working to standardise procedures for managing and reporting FX exposures and other treasury risks.

"Groups such as ours are dubbed multi-domestics – as opposed to multi-national – as we manufacture, to local specifications, from locally sourced materials selling locally, in the same currency," says Holmes. As a result Etex Group does not have major currency transaction risk.

So what maxims does the group follow to achieve effective cash management? Due to its culture of decentralisation, management of working capital is not a treasury responsibility. Holmes says that one operational point is to lessen peaks and troughs and the resulting need for more credit lines, as well as tackling the giving of excessive credit.

"In various markets, generous credit is both given and taken – for example Southern Europe – and some of the weaker secondary brands give generous credit that could be cut back.

"In Germany the tradition is to give excessive discounts for early payment and to take similar discounts offered by suppliers. This distorts perceived working capital levels and the cost of them."

OBSTACLES TO CENTRALISED CASH The decentralised nature of Etex's operations has proved an obstacle to the aims of centralising cash and debt and to using surplus cash to repay debt.

Etex took the decision in 2003 that it preferred notional pooling over zero balancing. Before then, Holmes explains, "we were too occupied with M&A activity and divestments to have enough time to devote to cash management".

The use of notional pooling has steadily expanded over the past five years, initially in the UK where the group used LloydsTSB. The notional pool in Belgium with KBC, in Luxembourg – where it has some major financial activities – with BNP and in the Netherlands with Fortis, are managed from Brussels. The pools reflect the distribution of ancillary business and there is no intention to change this. In France, the group has instead put in zero balancing pools through its main French company, using Natixis.

The French and UK companies manage their own pools with manual centralisation to/from Brussels as necessary. Similarly, other countries are centralised for major funding. Etex Group uses banks' own reporting systems as well as ISABEL for bank movements (unsorted by value-date) and daily bank balance reporting. ISABEL version 6 has been considerably delayed, but the group hopes to complete the upgrade shortly.

> ALONG WITH CONSUMER GOODS, DEMAND FOR BUILDING MATERIALS IS A GOOD INDICATOR OF THE STATE OF THE GENERAL ECONOMY, BEING HIGHLY SENSITIVE TO CHANGES IN INTEREST RATES AND MORTGAGE LOAN ISSUES

Carrying out notional pooling involves reporting and assessing the daily balance, while setting up pools requires appropriate legal documentation and raises a number of issues. Prominent among these is capital weighting charges and the means by which they can be avoided, or at least minimised. Etex Group has managed full notional cross border pooling without incurring capital waiting charges.

"Notional pooling involving a full pooling depends on the laws of the country," says Holmes. "One solution is to zero balance to a 'friendly' jurisdiction, such as the UK or Holland, and pool there.

"Another option is full notional cross-border pooling, although this depends on the bank as to whether it can be achieved, as well as in-country issues." It has been made difficult in Germany due to recent case law, while French law prevents notional pooling as interest can't be paid on a credit balance.

"Full cross-border pooling means a balance in Germany can be pooled with one in Belgium without involving any movement of funds," Holmes adds. "We intend to investigate extending it, initially to units in Poland and Hungary before adding smaller units.

"Although we have some major factories, the group isn't entirely composed of easy-to-manage large units and there is also a substantial scattering of smaller ones. So the latest cash management phase will attempt to bring some of these in, using the most efficient means possible."

Cash management would be improved by netting inter company payments and the creation of significant payment factories. The issue is treated as a divisional one – the group's three main divisions being European Building Materials, International Building Materials and Fire Protection and Insulation.

Cash pooling is run across the trio, with treasury based in the co-ordination centre, but this regime is scheduled to expire at the end of 2009 and the group is reviewing possible changes.

THE FACT THAT THE CRUNCH ISN'T HITTING ALL BANKS EQUALLY HAS SOME POSITIVE ASPECTS FOR TREASURY DEPARTMENTS THOUGH. "THERE ARE POSSIBILITIES TO EXPLOIT OPPORTUNITIES WITH BANKS THAT ARE LESS AFFECTED AND ARE STILL WILLING TO LEND".

SEPA STARTS TO HAVE AN IMPACT The introduction of the first phase of the Single Euro Payments Area (SEPA) in January means that a pan-Europe direct credit regime is now operational, although Holmes suggests that the onus is on banks to introduce the software that enables a greater take-up by clients (other than the largest clients with direct SWIFT access etc).

"Belgium's domestic banks are reasonably up to speed, but we sometimes find that payments are rejected at the other end, for example in Germany," he reports. "Same day value payments also don't work too well in countries such as Austria and Spain, due to local float being taken." Noticeably, there is no SWIFT or bank product that guarantees certainty of credit of funds on a day chosen by the sender.

He believes that the direct debit phase of SEPA will prove much more problematic, due to specific differences between European countries in areas such as their terms of recall. Businesses will not readily abandon local ACH systems for local payments and receipts and "unless further action is taken to ease their path, SEPA direct debits won't get up and running very easily". In Germany, substantial discounts are granted for early payment but the system relies greatly on direct debiting. In the UK, by contrast, direct debiting is less acceptable.

CREDIT CRUNCH TAKES ITS TOLL In the past year the credit crunch has produced a clear shift by banks and corporates alike to try to avoid commuting credit in both loans and derivatives. Some receivables programmes have seen their bank conduit and the credit enhancement under question, but overall the impact on Etex Group's financing has been modest.

"In our case, suppliers such as cement companies have high credit ratings and are not fragmented," Holmes explains. But recent market movements have persuaded the group to consider alternative sources of financing. This could involve a German or US private placement or receivables financing, although both are only tentative proposals so far.

Does he believe that the lack of liquidity has enhanced the benefits of a healthy cashflow?

"Not much if you have core borrowings, although a good cashflow may help a refinancing deal get completed more easily – assuming that a business is reducing borrowings year on year."

Holmes suggests that most companies have yet to experience the full effect of tightening economic environment. As they refinanced in 2005 or 2006, and those deals still have more than a year to expiry, the impact won't be felt until 2009 or 2010.

He describes RBS's recent closure of its leasing business as a sign of the times.

"For some banks, their lack of tax capacity means they will have to change their attitude towards leasing and some tax-structured products may disappear.

"The credit crunch could also affect bank relationships, with companies losing some banks that don't have sufficient ancillary business, or if they have over-centralised with one or two banks that bid very competitively."

"We shall be acting, where we can, to use this to push more business to the core banks that will have problems," says Holmes.

Banks are likely to continue regarding cash management as a loss leader, with further implications for relationship banking if the leading cash management bank succeeds in displacing the local banks in a relationship group.

The fact that the crunch isn't hitting all banks equally has some positive aspects for treasury departments though. "There are possibilities to exploit opportunities with banks that are less affected and are still willing to lend."

Graham Buck is a reporter on The Treasurer.
editor@treasurers.org

A hidden opportunity

FOREIGN EXCHANGE CROSS-CURRENCY PAYMENTS NEED NOT BE THE NUISANCE THEY TRADITIONALLY WERE. **TIMOTHY MERRELL** OF DEUTSCHE BANK EXPLAINS HOW.

Executive summary

Lower value cross-currency payments have traditionally been a costly nuisance for many corporates and financial institutions. But Deutsche Bank's new single platform for both foreign exchange and payments processing cuts a two stage process down to one and aims to make the whole system more straightforward and efficient.

Payments with a foreign exchange element are estimated to have a wallet of over $12bn[1] annually, with cross-border transactions representing approximately 8% of all payments[2]. Many of these payments are likely to be of a relatively low value and, traditionally, those corporates and financial institutions making large volumes of relatively low value cross-currency payments have encountered a number of difficulties. Sometimes termed "nuisance payments", cross-currency transactions are often costly in terms of both time and expense for the institution instigating the transaction.

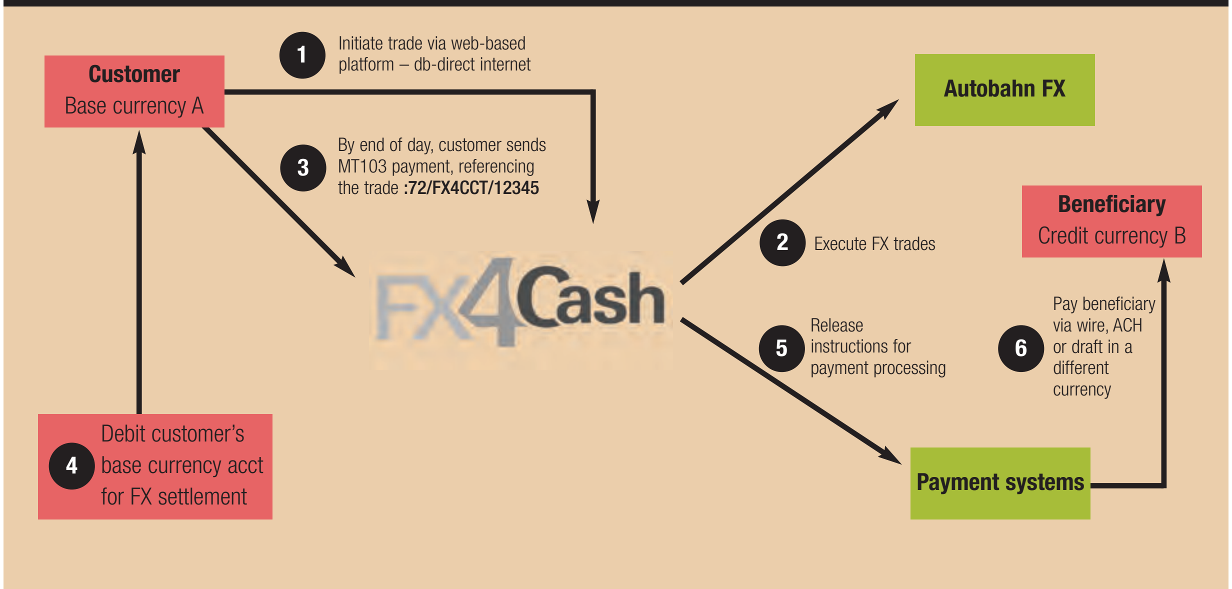
SOMETIMES TERMED 'NUISANCE PAYMENTS', CROSS-CURRENCY TRANSACTIONS ARE OFTEN COSTLY IN TERMS OF BOTH TIME AND EXPENSE FOR THE INSTITUTION INSTIGATING THE TRANSACTION

ENCOUNTERING PROBLEMS Despite the issues, there are many examples of such payments: retail banks making over-the-counter foreign exchange payments and sending worker remittances; banks acting as a paying agent for government agencies or pensions administrators; and corporates that maintain operations in several countries. All these entities will make regular, relatively small value, cross currency payments. Problems will include having to hold multiple accounts in order to pay beneficiaries in several locations and currencies, while the foreign exchange element of the transaction often lacks transparency. In addition, the practice of handling the payment and foreign exchange elements of a transaction separately increases the number of bank interactions for the instructing institution.

REPUTATIONAL RISK In some cases this may even pose a reputational risk for the institution originating the payment. For example, a paying agent for a large corporate pension scheme is likely to be making overseas payments to retirees that have emigrated or returned to their country of origin. This would typically involve the payment being made in the originating currency – say pounds sterling – with the beneficiary responsible for securing the funds in their local currency. There can be a lack of transparency here that could result in beneficiaries entitled to the same payment receiving differing amounts thanks to the application of seemingly arbitrary local bank charges. A similar situation exists for institutions making cross-currency payments for worker remittances and, in both cases, this perception of a lack of transparency and arbitrariness may lead to unhappy beneficiaries.

JOINT VENTURE SOLUTION The leading global banks have been looking at this issue, and Deutsche Bank is no exception. Developed as a joint venture between the Global Markets (GM) and Global Transaction Banking (GTB)

Figure 1: How does FX4Cash work?



divisions, Deutsche Bank has recently launched FX4Cash, a platform designed to offer end-to-end cross-currency payment solutions (see *Figure 1 above*).

It is significant that this initiative involves a partnership between the areas of the bank responsible for FX and payments processing, as Deutsche Bank has sought to address the problem of cross-currency transactions being handled in two distinct steps, with the foreign exchange element previously being considered a post-payment factor. This generally entails the foreign exchange information being provided to the client after the payment is executed. However, with growing demand – especially from corporate clients – for more efficient tools for managing their transactions and liquidity position, many need to know the foreign exchange rates before their business day starts or during the day at the point when the rates are being applied. Obviously, the leading banks are keen to fill this gap. The thinking behind the design for FX4Cash is to give clients equal access to the foreign exchange capability alongside the payments capability. The platform leverages the capability of Deutsche Bank's foreign exchange trading platform to seek the best rates in over 75 local currencies – whether traded as spot, same day, next day or forward trade.

PAYMENTS ARCHITECTURE Technology is another major issue. With much of today's payment infrastructure relying on technology that is several decades old, many institutions are encountering significant operational risk due to the danger of failing systems. And the investment required to build new infrastructure may be too great given the tough economic climate. Of course, the leading banks are all trying to respond to this issue. Deutsche Bank's approach has been to develop a new payments architecture that connects clients regardless of access channel to existing leading edge foreign exchange and payments platforms. Aside from the problem of ageing infrastructure, today's competitive payments environment has led to many financial institutions and payments providers facing the challenge of shrinking revenues due to price compression and regulatory initiatives such as the Single Euro Payments Area (SEPA). This has led to some providers seeking to offset their diminishing fee revenue with other sources of income. Partnering with one of the leading payments banks is one way of allowing them to realise new revenue streams from the foreign exchange spreads on cross-currency payments, while offering an enhanced service to their clients.

WITH MUCH OF TODAY'S PAYMENT INFRASTRUCTURE RELYING ON TECHNOLOGY THAT IS SEVERAL DECADES OLD, MANY INSTITUTIONS ARE ENCOUNTERING SIGNIFICANT OPERATIONAL RISK DUE TO THE DANGER OF FAILING SYSTEMS.

[1] *BCG Global Payments*
[2] *www.epaynews.com*

Timothy Merrell, Head of FX4Cash, Global Transaction Banking at Deutsche Bank
timothy.merrell@db.com
www.db.com/fx4cash

Proceeding with caution

RESEARCH INTO THE WAY THAT CORPORATES AND BANKS ARE RESPONDING TO THE SEPA CHALLENGE SUGGESTS THAT THERE IS STILL SOME WAY TO GO. **PETER WILLIAMS** REPORTS.

Executive summary

The Single Euro Payment Area is being taken up only slowly by corporate treasurers, due to fears over the system's perceived vulnerability to direct debit fraud. Yet despite this awareness, few businesses are enhancing their counter fraud measures. Two new pieces of research reveal the low level of response to SEPA and show that the corporates want more help from the banks to tackle the issues.

Corporate treasurers are worried about the possibility of direct debit fraud as a result of the introduction of the Single Euro Payment Area (SEPA). At the same time it has emerged that companies are only slowly adopting new processes and formats to comply with the SEPA.

Two surveys conducted among corporates have shown that much work remains to be done until SEPA is fully operational and accepted. A survey by Dresdner Kleinwort in May 2008 among companies with a turnover of over €50m found they had been very slow to adopt the new processes and formats. Only around 4% said that they had adopted SEPA and the new processes for both their incoming and outgoing payments. Most – around two-thirds – are not yet using SEPA at all.

THE SHORT AND THE LONG TERM However the bank is convinced that in the long-term SEPA will establish itself as the norm. Manfred Fleckenstein, head of global cash management at Dresdner Kleinwort, said: "Once its full functionality is in place, companies will find they can use SEPA to consolidate their payments transaction accounts in Europe, make their liquidity planning more efficient and so optimise the whole of their cash management."

But before that stage is reached, the bank survey found that the companies which are taking longer to make the transition are mostly those with a global reach or whose activities are mainly domestic, with less than 10,000 payment transactions a year or a turnover of under €100m. These businesses believe that the costs are not justified by the gains.

Fleckenstein said: "We find many clients are understandably hesitant – for them the advantages of the new process offers are not yet sufficiently clear."

He believed it was therefore not enough just to keep pushing home the message to companies that banks are able to offer SEPA at a reasonable price.

Just over 20% of businesses were considering implementing the new formats and processes within the next six months. According to the research, half planned to go over to SEPA only when it becomes a legal requirement. The research shows that many companies have found the price of SEPA transactions is not yet a strong enough reason to take on the cost of adapting their internal IT systems and treasury processes.

Many companies which collect their receivables using direct debits were also unable to make plans because the standards for the changeover to the new direct debit mandates had not yet been finalised.

LET COMPANIES DECIDE Yet despite this slow start, over two thirds of businesses recognised in principle the long-

term advantages that a single payment area offers. In the case of those actively using SEPA, that figure stood at over 85%.

Fleckenstein said: “There is no point in pressuring companies – far better to let them decide for themselves on financial grounds when the time has come for them to undertake the changeover.” He added that it was too early to set a deadline for abolition of existing processes. “Once the outstanding issues over the SEPA direct debit have been resolved, the system will soon gain momentum and widespread acceptance.”

CONCERN OVER DIRECT DEBITS It was the issue of direct debits that was the focus of the survey by Experian Payments, formerly Eiger Systems. Its research found that 98% of companies questioned do not plan to enhance payment fraud counter measures following the introduction of SEPA. However, Experian says that it is widely acknowledged within the financial services community that SEPA will bring associated security risks if the right systems and procedures are not put in place.

The survey, which questioned 43 mid-to-large size companies across the insurance, utilities and telecoms sector in the UK, also revealed that the majority – 86% – has yet to make an assessment as to whether SEPA will introduce an increased risk of payment fraud despite the first part of the framework going live earlier this year.

Of those companies which have completed an assessment, 20% of utilities and 15% of insurers believe that there is a “small” to “no risk” of payment fraud associated with SEPA. This goes against the banking community’s own conclusions.

What makes the findings more worrying, according to Experian, is the fact that direct debits and internet banking – two of the payment instruments affected by SEPA – already attracts payment fraud across the three industries, according to the research. If corporates do not have the right security procedures in place once SEPA is fully live, they could be exposing themselves to an increased risk of fraud through the SEPA instruments.

MORE HELP REQUIRED The survey also found that corporates unanimously agree that their banks could do more to help them in the fight against payment fraud. According to 91% of respondents, banks need to educate retail customers further on fraud issues, while 86% agree that banks should flag those accounts liable to be used for fraud. Furthermore, 79% think that the banks should publish levels of fraud prevailing in particular industries. The utilities sector was particularly keen on that, with 93% agreeing it was a good idea. Nearly three quarters of corporates also want the banks to offer insurance against fraud.

Jonathan Williams, Director of Communications and Product Strategy at Experian Payments, comments: “While financial institutions are now broadly aware of the security risks associated with SEPA, the survey has shown that there is a steep learning curve for the UK’s corporates. What started out as an initiative aimed primarily at consumers and corporates has become an initiative owned and driven largely by the banking community. As a result, the onus is now on the banks to educate their corporate customers on SEPA.

ONE OF THE BIGGEST PAYMENT FRAUD CHALLENGES FACED BY CORPORATES IS THE ABILITY TO LINK BANK ACCOUNTS TO INDIVIDUALS’ IDENTITY INFORMATION, WHICH WAS A PROBLEM HIGHLIGHTED BY 37% OF COMPANIES QUESTIONED

“The findings also point to the fact that banks need to work more closely with their customers to help them in the fight against payment fraud. One of the biggest payment fraud challenges faced by corporates is the ability to link bank accounts to individuals’ identity information, which was a problem highlighted by 37% of companies questioned. Banks need to share their expertise and work more closely with their corporate customers to help them overcome these challenges.”

KEEN TO LEARN It seems corporates are keen to learn more about SEPA and payment fraud. At Payment Strategies, Experian Payments’ annual payments industry event, discussions focused on the regulatory, technological and business changes taking place in the payments environment and considering how corporates can best address these challenges.

During the event, 180 corporates were asked their opinion of the SEPA framework and migration to the SEPA instruments, the challenges corporate treasurers face in the coming 12 months and their main fraud concerns.

If corporates are still questioning aspects of SEPA, so are the banks. A report examining SEPA by research and consulting firm Celent says that most European banks still strongly suspect that SEPA will negatively affect their revenue. Celent says that there is a general consensus that a real uptake to full-scale SEPA implementation will only follow after a clear definition of the migrations schedules from each of the 31 EU countries involved. The responsibility falls on the shoulders of the EU regulators and local policymakers.

On the other hand, says Celent, banks and corporations would be better off deciding on a strategy for SEPA. If they want to reap the benefits of the incumbent payment schemes introduced by the SEPA rulebooks, they need to proactively approach the market with innovative products and services.

Peter Williams is editor of The Treasurer.
editor@treasurers.org

Transformation at Kofax plc

TECHNOLOGY COMPANY KOFAX PLC HAS TRANSFORMED ITS FINANCIAL MANAGEMENT SYSTEMS. **STEFAN GAISER** OF KOFAX, AND FORTIS'S **GRAHAM BEITH** AND **MICHAEL TURNER**, REVEAL HOW THE PROCESS UNFOLDED AND EXPLAIN THE RATIONALE BEHIND THE CHANGE.

Executive summary

Over recent months, Kofax has embarked on the next phase in the evolution of its business by centralising business support functions, including financial management. In this article, we talk to Stefan Gaiser, chief financial officer, about some of the ways in which Kofax has started transforming its treasury and cash management, and to Michael Turner, head of cash management – banks & Europe, and Graham Beith, regional director – Thames Valley, both of Fortis, which was recently appointed Kofax's global partner bank.

Kofax plc (LSE: KFX) is a leading provider of intelligent capture and exchange solutions, providing application software and OEM/POS software worldwide as well as hardware distribution in Europe, the Middle East and Africa. For more than 20 years, Kofax has provided award-winning solutions that automate document-driven business processes by managing the capture, transformation and exchange of business-critical information in paper, fax and electronic formats in a more accurate, timely and cost-effective manner.

The company delivers intelligent capture and exchange solutions through a global network of more than 1,200 authorised partners, and its own sales and service organisations in more than 60 countries throughout the Americas, EMEA and Asia Pacific. Kofax now services the needs of 10,000 customers and has 1,200 employees globally.

THE NEXT STAGE
Stefan Gaiser, Kofax: Kofax is a global company which operates directly in 36 countries around the world. With our new chief executive officer, Reynolds Bish, joining Kofax in November 2007, we recognised that to move to the next stage in our company's growth, we needed to transform our business to move from a decentralised organisation, with profit and loss at individual country level, to a functionally-oriented company, creating economies of scale and functional excellence. Centralising the treasury and finance function has been a key element in this process.

Part of our transformation project has been to rationalise our financial systems to a single ERP system so that we have a single source of data internally and a global view of our financial position. In parallel with this, we reviewed our external cash management structures and decided to assess the feasibility of working with a single bank globally.

DUE DILIGENCE PROCESS We conducted a due diligence process to review the capabilities of various banks, including factors such as their geographic reach, breadth of products and services and customer service levels. On the basis of this

review, we decided to select Fortis as our global bank. There were a variety of reasons for this decision. First, Fortis had the geographic reach we required, with a local presence through business centres across Europe; and in the countries in which it did not have business centres, it had strong relationships with partner banks. Secondly, Fortis had previously been our principal partner bank in the UK, and we were very satisfied with the solutions, expertise and customer service levels which we had received.

THE WORKING RELATIONSHIP

Graham Beith, Fortis: Fortis has had a close relationship with Kofax since 2000, predominantly in the UK. When the company began its treasury centralisation project, we were able to build on our existing knowledge of Kofax in the UK, but also provide direct support to the CFO in Germany and the treasury in Switzerland.

Stefan Gaiser, Kofax: We had several objectives in working with a global bank. We aimed to pool our cash more effectively, increase our interest income and leverage group balances to reduce our overdraft costs. By achieving a global view of cash and liquidity, we saw opportunities to manage FX more strategically and measure and manage our financial risks.

Michael Turner, Fortis: One of the key elements of the solution on which Fortis is partnering Kofax is an integrated notional cross-currency, cross-border cash pooling and target balancing (cash concentration) structure. This involves the physical movement of cash from some accounts in which Kofax has larger balances into master accounts held in each major currency. This gives treasury the opportunity to manage FX risk on a consolidated basis, invest surplus funds centrally and avoid in-country borrowings. For accounts with smaller balances, these are included in a notional pooling structure, so balances are centralised for the purposes of interest calculation and credit and debit balances offset, but without physical movements of cash. This is a highly cost-effective approach and delivers the benefits of cash concentration without the cost of transferring cash or the need to set up intercompany loans, and satisfies regulatory requirements in countries which do not permit cross-border pooling. For countries in which Fortis works with partner banks, we have set up non-resident accounts for Kofax with Fortis so that the balances in these countries can also be included in the pooling structure.

We have implemented this approach gradually, starting with Kofax's larger businesses to deliver immediate benefits, but with a detailed plan to roll out to other regions. This combined solution gives Kofax the opportunity to optimise its return on the consolidated position while reducing its need to borrow.

FINANCIAL CENTRE OF EXCELLENCE

Stefan Gaiser, Kofax: A project of this type is not simply about internal efficiencies. As a market leader in information capture globally, we have relationships with 84 FT-500 companies, which are themselves global in their reach. By creating a financial centre of excellence, with better insight into our customers, we can monitor collections, identify business with each customer at a global level and therefore

WE AIMED TO POOL OUR CASH MORE EFFECTIVELY, INCREASE OUR INTEREST INCOME AND LEVERAGE GROUP BALANCES TO REDUCE OUR OVERDRAFT COSTS. BY ACHIEVING A GLOBAL VIEW OF CASH AND LIQUIDITY, WE SAW THE OPPORTUNITIES TO MANAGE FX MORE STRATEGICALLY AND MEASURE AND MANAGE OUR FINANCIAL RISKS

work more strategically with them, such as offering global payment terms to our best customers. In this way, our business transformation helps us to maintain our competitive position and do business more effectively.

Although we are still in the early stages of our transformation process, we have already seen the benefits of streamlining our treasury and cash management function. We now have a far better insight into our consolidated cash position and can therefore make informed decisions. For example, we are now in a position to take full advantage of fluctuations in FX rates while hedging our risks effectively. Looking ahead, we rely on Fortis to help us to be as agile as possible in the financial markets, and we look forward to taking advantage of its expertise as our financial activities evolve.

Graham Beith, Fortis: We look forward to working with Kofax as the company moves into the next stage of its transformation. For example, Single Euro Payments Area (SEPA) provides the opportunity for Kofax to streamline and reduce the cost of cross-border payments and will enable Kofax's pan-European customers to do business with Kofax more easily.

Fortis is an international financial services provider, with a network of over 140 business centres across Europe and Asia. Fortis has been doing business in the UK for over a century, helping companies grow locally and expand internationally. For more information on Fortis's cash management solutions, please contact Michael Turner at michael.turner@fortis.com



Stefan Gaiser, CFO, Kofax plc
Graham Beith, Regional Director – Thames Valley, Fortis
Michael Turner, Head of Cash Management – Banks & Europe, Fortis

Getting it right

MICHAEL GRAINGER EXAMINES THE INTERNATIONAL PAYMENTS LANDSCAPE FOR EURO PAYMENTS WITHIN SEPA.

Executive summary

For corporates, the most significant issue of the Single Euro Payments Area remains adherence to European formatting standards to avoid repair charges and payment delays and ensure that their payments qualify for the pricing benefits of SEPA.

SEPA is being achieved through the introduction of two new payment instruments, the SEPA Credit Transfer and the SEPA Direct Debit, which both employ the new standards as mandatory.

Banks such as HSBC are now developing automation tools to assist in the validation and generation of the new standards, which are particularly important as domestic and cross border payment standards converge.

SEPA was created to resolve the inefficiencies of today's payments market, with its lack of standardisation for multi-country clients and the existence of many different payment instruments, each with their own rules, characteristics and costs.

The international euro payments landscape has shifted considerably since 2002 – culminating with the introduction of the Single Euro Payments Area, new payment formats are now mandatory for all cross-border euro payments within the EU/EEA, aiming to harmonise the plethora of domestic and cross border clearing infrastructures throughout 31 European countries.

In terms of SEPA, for corporates the overriding issue is meeting the requirements of the Interbank Convention on Payments (ICP). Failure to meet the ICP's prescribed STP standards will result in customers experiencing additional euro payment costs or even payment rejection, being unable take advantage of SEPA.

THE INTERNATIONAL EURO PAYMENTS LANDSCAPE HAS SHIFTED CONSIDERABLY SINCE 2002

REPAIR FEES In preparation for SEPA and in order to standardise bank and bank account details, the European Payments Council (EPC) Resolution, passed in 2005, dictated that from 1 January 2006, use of the beneficiary's BIC and IBAN become mandatory on all cross border euro payments within the EU/EEA. Failure to use such standards can be subject to charges, known more generally as repair charges.

Such repair charges come into force when

1) messages do not contain a valid IBAN – International Bank Account Number (in the correct field), and

2) messages do not contain a valid BIC – Bank Identifier Code.

Repair fees have ranged around the €10 mark per payment across the whole of Europe as banks look to pass back their increased processing costs and encourage the sender to get the correct payment details from their trading customer.

For clarity, it is the sending client who gets charged by their bank as it is their responsibility to get the BIC and IBAN details from their trading partner in order to get their payment records and effect the payment.

BACKGROUND AND SCOPE Since 1 January 2007, all banks have been entitled to reject or return as a matter of course, any cross border euro payments which do not include the appropriate BIC and IBAN details, in readiness for SEPA in January 2008

Initially this affected only intra-EU payments, although European banks increasingly levy similar repair charges on any euro payments coming into the EU, regardless of origin.

As such, all corporates, wherever they are located in the world, should use the BIC and IBAN formats on their euro

payments to avoid such repair charges and improve automation.

To date, most sending and receiving banks continue to process corporate payments for their own customers without the mandatory formats, but the receiving bank will generally apply a repair fee back to the sending bank. This is either passed back to the customer or absorbed by the sending bank if the customer was charged an additional fee up front by their bank, depending on local market practice.

NEW STANDARDS FOR SEPA – BENEFITS OF PAYMENT AUTOMATION So with the introduction of SEPA in January, the use of BIC and IBAN is mandatory for the recently launched SEPA Credit Transfer instrument and enables its STP. From November next year, this will also be the standard for the SEPA Direct Debit instrument, as many of today's national payment products, with their local characteristics, are phased out over time.

Not only do BIC and IBAN protect the corporate from repair fees and avoid delays, they also enable customers to benefit from much lower processing fees (euro cents instead of several euros) by using the new formatting standards. An important aspect in the design of SEPA instruments is STP. Only the volume processing of payments on an industrial scale, without any manual intervention, keeps costs low.

The use of such standards by corporates becomes even more desirable and pressing as countries move to domestic mandatory use of IBAN. Certain European countries are already adopting IBAN as the domestic standard (Italy, Luxembourg) as they seek to remove the inefficiencies of supporting multiple clearing systems. Others already have a well defined and well supported migration plan with timetables in place between 2010 and 2012 (Belgium, France and Malta).

Extensive economies of scale for corporates within the SEPA environment will only be achieved by establishing a single set of consistent pan-European payments instruments and moving away from the patchwork of national payment practices.

Further, if the SEPA formats are used by all the parties concerned, losses of data can be avoided. Still today, different formats are used because different systems are involved. Whenever one system changes to another, the data format needs to be converted into the respective target format leading to potential loss of data. If SEPA data formats are used throughout in future, there will be no need for conversion and all necessary information will reach the beneficiary (up to 140 characters).

Finally, the amount of time allowed to settle a payment transaction has been defined in the payment schemes. In practice, whereas a cross border payment may have taken up to a week to reach the beneficiary, SEPA payments may take no longer than three days, reducing to just one day from 2012.

In this way the notion of float will all but disappear from the European payments industry. It is also identified that there may be no deductions from the amount of the money transferred. Payment commissions will in future have to be agreed by the sending bank with its customer and the beneficiary bank with its customer.

THE MESSAGE IS EVER CLEARER: CROSS BORDER AND, INCREASINGLY, EURO PAYMENTS FROM ANYWHERE IN THE WORLD MUST QUOTE THE BENEFICIARY'S BIC AND IBAN DETAILS

BANK SOLUTION FOR SEPA STANDARDS COMPLIANCE AND AUTOMATION Until now, corporates have had to go out to their suppliers/customers to source BIC and IBAN account details for cross border euro payments and make them SEPA compliant within their back office systems before submitting instructions to their bank.

HSBC can now supply its corporate customers with a software solution which will not only assist in achieving high STP levels and reduced repair fees, but also provide the tools to enable its cross border euro payments to be sent via SEPA.

This will be achieved through allowing customers to validate BIC/IBAN details before payment submission, or, if required, to derive these details from a bank name, address and BBAN (Basic Bank Account Number) details, subject to counterparty verification.

The means of delivering this information will vary according to the needs of the client, whether it be a CD based solution or online. HSBC also offers a service for the wholesale cleansing of back-office (payables or receivables) records.

As a result of SEPA, there is strong corporate demand for the latter solution where supplier bank details can be converted en masse from BBAN to IBAN, especially as European countries adopt IBAN as the domestic standard.

A CLEAR MESSAGE The message is ever clearer: cross border and, increasingly, euro payments from anywhere in the world, must quote the beneficiary's BIC and IBAN details.

It will become increasingly costly and difficult to make euro payments without BIC and IBAN.

Failure to adhere to this pan-European initiative will continue to result in higher payment processing charges or the rejection/return of customer payments, and perhaps now most importantly, such payments will be excluded from the SEPA environment. Domestic country euro standards continue to converge with cross border standards in order to fully integrate the euro payments market.

Using such tools as those available from HSBC will help corporates to embrace the cost benefits of SEPA, avoid payment delays and increase payments automation.

Michael Grainger, Senior Product Manager, Payments, Global Transaction Banking, HSBC Bank plc.
Michael.grainger@hsbc.com
www.hsbcnet.com/hsbc/solutions
AC11527

HSBC
The world's local bank

Making that selection

SELECTING A GLOBAL OR REGIONAL CASH MANAGEMENT BANK CAN BE A TRICKY BUSINESS, BUT REMAINING AWARE OF THE FACTORS TO CONSIDER CAN MAKE THIS IMPORTANT JOB EASIER

Executive summary

When selecting a primary cash management bank for global or regional needs the major areas to consider are:

- **Relationship with the group.**
- **Branch network.**
- **Payment cut-off times.**
- **Value pricing.**
- **Cash management culture.**
- **Operational quality and customer service.**
- **Bank risk.**
- **Delivery systems.**
- **Cash management products and services.**

A company's cash management needs can be complex and varied at different levels of the business. Any treasurer selecting a global or regional cash management bank needs to consider several factors.

RELATIONSHIP WITH THE GROUP It is important for the bank to have a strong relationship with the company, and a strong commitment to it. Cash management is attractive business for banks due to its relatively low risk, annuity income stream and because it does not tie up regulatory capital. Major multinational companies award this business to a bank if they believe that it will financially support the group's future activities, eg new debt issues, acquisitions, and provision of working capital facilities such as overdrafts.

BRANCH NETWORK When selecting a global/regional cash management bank, companies look for a bank with an extensive branch network that matches their footprint so that local currency accounts can be held in the currency centre for local business. Traditionally, global banks were thought to be the only banks that could offer local level services through their proprietary branches. Today, however, banks without a branch network offer alliances with strong local cash management partners. Whether through its own branches or partner banks, it is important that the network is connected through robust telecommunications. Proprietary networks have an advantage if the services offered work in the same way in every country. There is also greater accountability if anything goes awry with international money transfers. Alliance banks can try to surmount this obstacle by having good service level agreements with their partners. Most banks offer a central point of contact for the company, staffed with qualified cash management specialists who understand international and cross-border cash management. Alliances usually ensure that good local arrangements for clearing transactions are in place through partner banks who are direct members of the local clearing. It should also be noted that global banks are increasingly becoming direct members of local clearing systems.

PAYMENT CUT-OFF TIMES Whether companies decide to keep their accounts either in the currency centre or centrally in one location (ie London, Amsterdam, Brussels, Hong Kong or Singapore), cut-off times for both international payments and receipts are very important. Within a region, it should be possible for a cash manager to manage cash on a same-day basis, which means the banks must be able to move money cross-border with same-day value. Early clearing cut-off times in some countries and poor banking systems in others can make this very difficult. Companies will seek a bank with the widest possible time windows for moving money to manage cross-border liquidity more efficiently.

VALUE PRICING While most companies are price sensitive, pricing is not the main driver when selecting a bank for international cash-management services. Pricing should reflect the value received. Some banks offer a regional or global price covering all payments and receipts and other

cash management activities. Value dating may also form part of the overall price (an aspect that is particularly prevalent in Europe and South-East Asia). Any other charges, such as lifting charges, required balances or correspondent fees should be determined. Some banks charge based on turnover (this is fairly common in France). Companies also need to ensure that they obtain explicit pricing, credit interest on all credit balances and no surprises. The important point about pricing for international services is that, unlike domestic cash management services which are largely commoditised, an additional day's delay on a cross-border transfer can be considerably more costly than the amount saved on an individual transaction. A bank with operational quality can save more money and exposure than the bank with the cheapest pricing.

CASH MANAGEMENT CULTURE It is important that the bank has a cash management culture and that cash management is considered a core competency. Although many banks offer cash management services, not all invest in the required level of product development. Banks with a cash management culture understand corporate treasury, have sales staff that understand international banking and act in a consultative fashion, adding value in the sales process. The bank needs to have a track record of offering cash management services and investing in the business. Having a cash management culture is more than just having electronic banking services.

OPERATIONAL QUALITY AND CUSTOMER SERVICE Back-office quality can have a more direct impact on costs than pricing. While many banks provide front-end electronic delivery software, what is really important is what happens when the user presses the "enter" button on his PC. What actually happens in the bank's back office? How quickly does it happen? How efficiently does it happen? And to what quality standards? Back office quality has become an important issue, particularly in the more sophisticated markets of the US, Northern Europe and parts of Asia. Some banks offer value-added services such as assisting customers with payment formatting to ensure STP of payments without delay. Equally important is the quality of customer service. Mistakes happen, especially in international transactions. Companies are increasingly aware of the value of how well mistakes are handled and how quickly they are corrected. International companies are looking for a standard high-quality service worldwide and many are prepared to pay slightly more to obtain it.

BANK RISK Companies have become conscious of the credit rating of banks with which they consolidate their cash management business. It is becoming almost as important to rate a cash management bank as it is to rate the bank where investments are placed. Companies may be passing billions through their accounts on a daily basis and so they need to consider the risks attached to using such banks, even if the accounts zero out at the end of the day. Corporate credit policy can often be used as a starting point. Companies need to estimate average balances in accounts and average volumes and values of electronic funds transfers transacted through the banks concerned. Standard reporting on bank risk ratings can be useful as well. The cash management bank needs to have a good short-term credit rating. Companies should also consider country risk. Where does the ultimate country risk lie? Is it with the bank's head office or its individual branches?

It is also important to look at systemic risk. This means not only looking at the electronic banking system through which payments will be processed but also reviewing the bank's connections into the clearing systems and how they link into their correspondents (very often their weakest link). The management of the bank can be a further source of risk. Companies need to select banks with established track records with senior staff that have been in place for a number of years (although this may conflict with banks' career management practices). Ideally, companies should be looking to deal with a stable institution that has a long-term commitment to cash management.

DELIVERY SYSTEMS The bank should have a delivery capability that matches the company's needs, be it host-to-host, internet or PC-based. Preferably, the bank should provide one window, worldwide to the company's entire banking structure and products, with appropriate levels of security. This is becoming increasingly feasible with the latest developments in technology. Access to a complete range of cash management services from one electronic banking system is the prime requirement of most global cash management operations.

CASH MANAGEMENT PRODUCTS AND SERVICES
International companies now require a number of services to manage their cross-border liquidity, such as:

- Cash pooling, (notional pooling/cash concentration).
- Netting (whether proprietary software, ASP or licensed software).
- Multi-bank electronic balance and transaction reporting.
- Multi-bank electronic transaction initiation.
- Payment consolidation (using remote electronic or internet banking services).
- Auto-reconciliation of account statements.
- Foreign currency accounts.
- Money market services.
- Foreign exchange capabilities.
- Risk management advice and tools.
- Overnight investment vehicles.

Many of these services may not be available from all banks and are usually offered on a global basis only by the largest cash management banks.

Companies also seek to consolidate billing and reconciliation. Ideally, activity is tracked for the period and a single statement is presented broken down by account and by subsidiary. This streamlines the reconciliation process, particularly if an automated account reconciliation system is being used, and helps the company control bank fees. This type of billing for bank services is used in the US and is called account analysis, but it is not yet widely available on a global basis.

So tired of waiting

EVERY DOWNTURN SEES AN INCREASED FOCUS ON LIQUIDITY MANAGEMENT AND THAT MEANS THERE ARE WINNERS AND LOSERS IN THE HUNT FOR CASH.

As the credit crunch starts to bite, evidence is emerging that liquidity management is set to be a key battle ground between corporate customers and suppliers as the battle for cash hots up.

Given the gloomy economic circumstances, surprising new research from Bacs reveals that British businesses are not taking advantage of late payment legislation, with 83% of small-to-medium sized enterprises (SMEs) not exercising their rights to charge interest on late payments owed to them by other organisations. Legislation on late payments was introduced almost a decade ago.

According to Bacs, the figure highlights the battle SMEs face in collecting the £18.6bn that is collectively owed to then in outstanding payments.

Bacs, which is owned by 15 European banks and building societies, is responsible for systems behind the clearing and settlement of automated payments.

Launched on 1 November 1998, the idea behind the Late Payment of Commercial Debts (Interest) Act was to offer SMEs protection against late payments by giving them a statutory right to charge interest on overdue invoices. However, when questioned as part of an annual Bacs survey, just 15% of SMEs confirmed that they had taken advantage of their legal rights.

Michael Chambers, managing director of Bacs, said: "These figures are surprising considering the scale of late payment problems in Britain. Research conducted by Bacs by the end of 2007 showed a typical SME is now owed an average of £30,000 at any one time. Looking at this figure and other facts at hand, it's high time businesses started to tackle this problem head on. SMEs shouldn't just sit there and expect to be paid on time."

Bacs is encouraging suppliers to use its Bacs Direct Credit service where debtors pay invoices automatically. It also advises companies to "make a polite phone call in advance of invoice due dates to pre-empt payment." If, after all these steps have been followed, companies still fail to meet agreed payment conditions then SMEs should take advantage of the full legal rights they have been given and start charging interest on overdue payments."

But while SMEs are being encouraged to use the strong arm of the law, a lobby group for private companies is accusing big firms of abusing small business trust. Large companies are exploiting small businesses by delaying invoice payments and imposing new terms and settlement fees, according to the Federation of Small Businesses (FSB).

The Federation says is has evidence that big organisations are unashamedly making smaller firms wait over 100 days before getting paid, often changing terms and conditions with little notice. It dismisses the late payment legislation, saying that many businesses are reluctant to use it for fear of losing contracts with big business on which they rely to survive. It claims one company imposed payment terms of 75 days from the end of the month of invoice as well as imposing a 2.5% settlement fee.

John Wright, FSB national chairman, said, "Big companies appear to be aware that small businesses are afraid of taking them on over payment terms and are abusing their power as a result. Making businesses wait 105 days for payment and charging them for the privilege of doing so is nothing short of outrageous. At a time when small businesses are finding it difficult to deal with a slowing economy and rising costs, it is shocking that large companies think it is acceptable to use them as an unofficial source of credit."

The fear expressed by small companies of losing customers is not a new one. The Better Payment Practice Campaign, a group which aims to effect positive change in UK payment culture, found back in 2006 that 70% of companies responding to a poll were worried that they may lose an important customer to a business rival if they insisted on prompt payment. The fear was strongest among small businesses. Many companies which fail often blame "running out of money" as a primary cause. The management then blame either an unsupportive bank or slow payers as the reason for the collapse.

With large companies experiencing uncertain economic conditions just like their smaller counterparts, and with many looking to improve working capital, it seems that the dispute over payment terms and timing is set to escalate.

Peter Williams is editor of The Treasurer.
editor@treasurers.org