Suiting yourself

CORPORATES NEED TO WORK OUT HOW TO SYNCHRONISE SUPPLY CHAIN CYCLES WRITES **PETER SARGENT**.

Executive summary

- **Cash conversion cycles require closely fitting financial supply chains if they are to work at their maximum level of efficiency. With corporate treasuries evolving fast, banks can no longer add competitive value just with new products. Instead, they must build multi-product solutions unique to the client. It takes time and resources but it is the only option.**

Efficiency in cash management, payments and financial operations must be directly married to cost reduction and overall liquidity management if banks are to meet the increasingly sophisticated needs of UK corporates. This unified approach must be applied both internally – across and between all a corporate's business units – and externally when interacting with suppliers and customers.

This thinking, once the preserve of large multinationals, now applies across the widest spectrum of UK businesses. For all these companies, the traditional case-by-case approach to transactional and payment needs is now outmoded.

Companies have always thought in terms of their cash conversion cycles as a repeat process to be refined and perfected. Yet banks have caught up only relatively recently and begun to seek out efficiencies that feed into one another. Working capital management, operating costs, processing speed and proactive risk management are all links in the same chain. A failing in one is a failing in the whole – and a failing of bank as much as treasury. Building an integrated company-wide platform across these areas, however, allows financial and strategic objectives to be met head-on.

The main objective is to remain – or, indeed, become – cashflow-positive without falling back onto wholesale credit facilities, so that the value chain itself can become a driver of growth and liquidity.

This strategy requires integrated financial solutions, which have been facilitated by a 15-year corporate trend towards centralisation and outsourcing. Initially led by – but these days by no means limited to – the FTSE 100, companies have been moving beyond ad hoc money management and towards centralised management approaches for pooling, payments and working capital.

Also continuing to trickle down has been the desire to invest in shared service centres and payment factories. As a result, banks can no longer be satisfied by providing individual products to solve individual inefficiencies. They must match the evolution of supply chain management within corporates by remaining firmly focused on the sum of the parts that they are offering. And this will not be a static picture given that a development in one area may open up a range of possibilities elsewhere.

GETTING MEASURED UP The financial architecture of the company will be made up of a business-specific set of cash drivers. The bank's analysis should therefore start with these, including both 'push drivers' (money coming in) and 'pull drivers' (money going out). These drivers provide the entry and exit points for the company's internal financial supply chain, which, like the chains linking companies, relies on an asset conversion cycle, cash management and risk mitigation.

From this starting point, more specific elements of company operations can be analysed confidently and accurately. Incorporated into this analysis must be the specifics of day-to-day operations, such as the client's aims regarding open accounts versus secured terms, days sales and payable outstanding, risk management practices and the types of management information systems along the existing supply chain (such as electronic data interface penetration).

A detailed picture of management information available within the organisation should emerge, from which cost-efficient, tailored and appropriate solutions can be offered with built-in cashflow and transactional risk-management policies.

This is clearly a step up from applying a series of patches to individual problems, which has been the traditional ad hoc approach of many banks. Among other things, it spells the end of non-complementary products being applied at different points in the same framework, which generates poor client efficiencies and, most likely, additional and unnecessary costs.

By changing the way they approach corporate clients, banks are committing resources to a more embedded relationship. These ambitions will flounder in the absence of relationship managers keen to accept a high degree of ownership over their clients' interests and willing to put in the groundwork required to align their thinking with the treasurer.

Yet the cross-pollination of efficiencies should prove ample reward for both parties. For instance, better internal efficiency could open the way for a review of lending terms on a revolving credit facility, just as a credit review resulting in a larger facility could also demand some improvement in operating efficiency. The relationship manager may even do something unheard of 10 years ago: counsel against borrowing in the belief that more liquidity can be wrung from the value chain.

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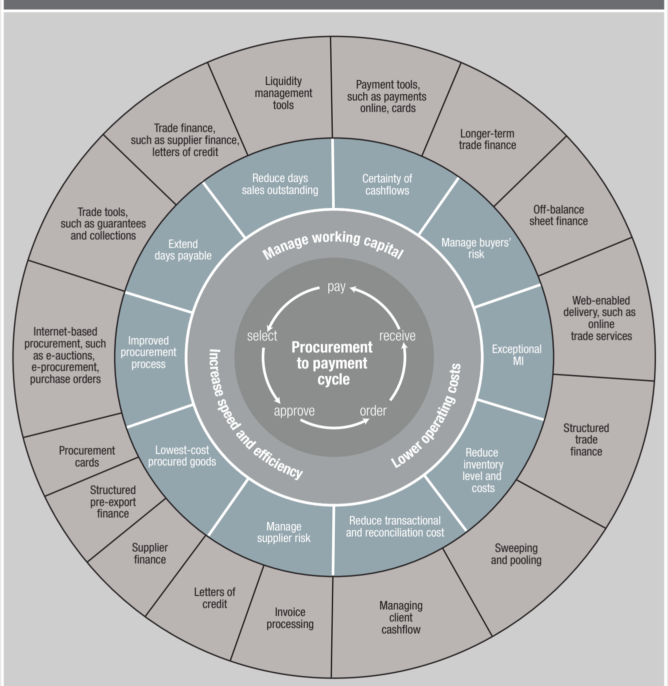
BESPOKE RESULTS Most cash-and-trade banks have a vast armoury of transactional and cash management products on offer. These include virtual reporting products, cash accelerators, foreign exchange risk and trade guarantees, as well as traditional products such as invoice discounting. But good ingredients are not enough. Where banks should really be competing to add value is in combining these products into 'bundles' that fit a client's needs more closely than any other offering.

Figure 1. Financial Supply Chain: The Big Picture



Designing a product bundle requires not just good communication between bank and client but also within the bank itself as relationship managers consult with product specialists to deliver the solution. Although swamping the client in complexity is likely to be counterproductive, relationship managers do need to be well versed in what has been made available so they are well aware of the toolkit available for use at all current and future stages of a given transaction.

In the initial stages, financial controllers will therefore be able to anticipate and prepare for the demands of a transaction's future stages, both externally, settling with counterparties, and internally, managing liquidity. This process begins with the identification of areas along the supply chain that are causing the greatest delays, in turn engendering the highest administrative costs and presenting the greatest liquidity drain on the organisation.

Technological solutions that facilitate operational and financial efficiency can kick supply chain processes into life. Technological 'enablers' such as fully web-based platforms for trade documentation not only reduce or remove error margin, they disperse better quality management information and can provide financial economies of scale. Whether arranging an e-letter of credit or installing a multi-function e-procure-to-pay server, the aim is to provide better access to the bank, precise management information, better customer experiences and lower costs for bank and client alike.

Liquidity can be broadly managed through upstream (procure to pay) and downstream (order to cash) activities. Bank solutions are tailored around these cycles and products chosen depending on business needs in an effort to harmonise the processes. Essentially, this approach seeks to link and coordinate cash coming in and cash going out of the business, creating cashflow certainty at all internal stages between.

At the buying end, this would be reflected in a system that speeds up the procurement process. A successful procure-to-pay cycle hinges on the ability of the buyer to increase the speed and efficiency of goods, services and documents as they are transferred between supplier and buyer. E-procurement solutions to streamline this

process have therefore become a major focus among banks. As well as being a conduit that enhances buyer-supplier relationships, electronic procure-to-pay systems can help fill the information deficiencies that hinder liquidity management and accentuate supplier risk. Ultimately, a good procure-to-pay system will reduce process times and improve the quality of information available to management.

On the supplier side, meanwhile, technology can prevent receivables-related liquidity constraints from arising. Banks usually offer invoice-discounting or trade guarantees as a facility to enhance downstream liquidity in the financial supply chain, but the arrival of web-enabled trade services has provided corporate clients with a portal through which these types of products can be more effectively used. This has enhanced suppliers' decision-making when it comes to regulating working capital levels, allowing them to employ appropriate risk management policies, such as foreign exchange hedging, while giving them the capability to employ credit policies that reflect the quality of counterparty information. And this will increase confidence that they will no longer be surprised by liquidity deficiencies along the financial supply chain.

A WELL-DRESSED WORLD? This big-picture view may, however, fall down when two counterparties are both looking for extended payment terms and shorter receivables. In this zero-sum situation, one counterparty simply shifts its liquidity demands onto the other while providing only short-term advantage to itself.

'Upstream' and 'downstream' technology-driven efficiencies can only stretch so far in a single supply chain. On the supply side, for example, there often exist considerable cost advantages to payment on delivery, which are lost with long payment terms.

On the sales side, individual buyers may regard the availability of credit as a key factor affecting their procurement decisions. To support such suppliers, the bank may open a credit line against its main customer base – to be drawn down on presentation of invoices. With limited recourse to the client, the facility drives sales and frees working capital for further growth. In this scenario, the bank becomes a funder of supply chain solutions that optimise the financial efficiencies along the entire chain – not just for one company.

For corporates themselves this may mean synchronising supply chain cycles with several companies, linking raw materials, suppliers and end-users within an overarching environment of cash transmission and payment confidence. As this trend deepens, corporate customers will not only have to re-evaluate the nature of their own banking relationships, they will have to contextualise their position in a value chain that passes through many more companies and many more banks.

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Figure 2. Dynamic Tensions within a Supply Chain