

TRADITIONAL BOUNDARIES BLUR

Where is the cash management industry headed?

By Hugh Davies, Amol Gupte and Eric Sepkes

Several factors will combine to shape the international cash management business in the coming year. Together with the changing role of the corporate treasurer, the shift towards centralisation and the expanding role of primary bank/overlay relationships, treasurers are likely to demand more from their banks – defying some of the traditional boundaries between cash, trade and advisory services.

This year may also be a defining one for the Single European Payments Area (SEPA) project to create a domestic payments zone across Europe by 2010. This was driven by the European Parliament's adoption in 2001 of Regulation 2560 for transactions of up to €12,500.

SEPA commits the banking industry to migrate to pan-European, rather than national, payments infrastructures and to a single set of payment and collection products (excluding cheques) by 2010. And, with the lifting of the threshold for low value payments covered by the Regulation from €12,500 to €50,000 due to take place on January 1, 2006, corporate treasurers need to put some thought into the way the operations are structured to ensure they derive maximum advantage from the new regime.

The Changing Role of the Treasurer

Now, in many of the bigger corporates, the treasury function has an operational reach to it. The treasurer is involved in the procurement process, in optimising cash within the supply chain, in change management throughout the organisation and more. Increasingly, treasury is as much about maximising operating efficiencies and improving key ratios as it is about obtaining the best overnight rate on cash.

The treasurer is expected to contribute to big strategic decisions, too. As a consequence, banks are being called upon to play more of a support and advisory role. On one level, assisting the treasurer with input on decisions over where operations may be sited – providing all the data on

tax rates, wage rates, regulatory issues and so on. On another, arming the group treasurer with the detailed information needed to fend off unwelcome propositions from local management or local banks involving manufacturing, supply or distribution issues.

The result is that the line between cash management services and trade finance services is becoming blurred.

The Shift to Centralisation

The trend towards centralisation – most apparent in the proliferation of shared service centres (SSCs) and payments factories – is set to continue. For many large corporates, the establishment of regional SSCs is early payback for implementing a unified, corporate-wide Enterprise Resource Planning (ERP) system.

However, complete centralisation may not make sense. Some corporates need to be close to their customers. Banks have to be flexible enough to support structures in which some functions are centralised while others are not. Other variations on the centralisation theme are emerging. One is the 'virtual' SSC, which captures many of the synergies of centralisation without the costs of a new site, new processes or staff transfers.

This trend begs the question whether the near future will see the emergence of global SSCs to replace regional ones. Big corporates need a multiplicity of banking relationships, something that works against the establishment of a global SSC. While, in theory, there is no reason why a well-run SSC should not be able to manage multiple bank partners efficiently, there are risk issues in putting all the corporate eggs in one basket.

However, the move towards standardisation of messaging formats and away from proprietary systems reduces the cost to a corporate of switching banks, making the appointment of a single cash management bank a more viable proposition. And that process is due to take a

major step forward in 2005 as a new standard from the Transaction Workflow Innovation Standards Team (TWIST) moves off the drawing board and into the pilot stage.

The new TWIST standard involves a core payments 'kernel' designed to deliver a single file format for mass payments globally. Banks have started to offer it to clients this year as a standard payments mechanism in HTML that can be plugged into any other standard – including those applying in the logistics and supply chain areas, for instance.

Gearing Up for Step II

The vision of a single payments system across Europe is one where there is no distinction in terms of cost or efficiency between domestic and cross-border credits or debits; and where there is no need to maintain more than one bank account in each country or currency. To that end, the first pan-European automated clearing house (PE-ACH) was set up last year by the Euro Banking Association for low-value transactions across the eurozone. Over time, each national grouping of banks is expected either to migrate its domestic (and not just cross-border) payments traffic onto an existing PE-ACH or convert its existing domestic ACH into a PE-ACH.

With the advent of the first PE-ACH, it is now possible to make so-called 'Step II' payments – those made through a pan-European clearing mechanism. Many banks already have the capability to make and receive Step II payments but have been reluctant to do so on cost grounds. To take advantage of the low-cost payments covered by Regulation 2560, all transactions in PE-ACH must indicate the customer's International Bank Account Number (IBAN) and the bank's Bank Identifier Code (BIC). That is already necessary for cross-border transactions but it will be expensive migrating domestic payments onto a PE-ACH. There is therefore in-built inertia that is slowing the migration process.

Eventually, Step II promises to change the payments landscape. Today, a corporate with operations across Europe may well have to maintain 40 or 50 different accounts across 15 countries and engage in netting and pooling strategies to gain the advantages of cash concentration. Step II has the potential to make much of this redundant, cutting costs and the changing approach treasurers take to managing their payment flows and liquidity solutions.

The key point to note is that SEPA will not be implemented by way of a 'Big Bang'. Banks and corporates alike need to think in terms of a five-year strategy. But those corporates that have positioned themselves to become early adopters of the new payments regime will also be the first to benefit from new efficiencies and reduced operating costs.

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