Cash Visibility: Uncovering Hidden Opportunities

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Among the core functions of any treasury is to manage cash and ensure internal and external payments are on time without incurring extra fees, while deploying capital effectively to maximise returns. This is ever more important in a volatile economy. It might sound simple, but it so rarely is. This article looks at the best ways to achieve cash visibility and optimise its use, to gain the best possible return in a low interest rate environment.

Cash visibility is the first step to gaining a good understanding of corporates' cash flow. This understanding puts a treasurer in a better position to access and control cash and manage risks, before finally deciding to deploy any surplus or excess cash for improved returns.

By returns on cash, most people would probably think about yield on investment. They might have to think again. Are there alternative avenues for using the cash that can generate a better return? For instance, by looking beyond the asset side of the balance sheet, can the cash be deployed to lower the cost of funding? Can the cash be deployed to improve the cash conversion cycle? How about currencies? Is the cash all in the right currency? In a low interest rate environment, coupled with a much more exacting review and introduction of stringent capital and liquidity requirements by banking regulators under the Basel III regime, corporates have to look beyond yield on investment if they want to make their cash work harder.

Let's dig deeper, to discuss the common practices and practical challenges in achieving optimal cash visibility. The following will also explore various possibilities that could help a corporate better deploy cash for enhanced overall returns.

Accuracy and Timeliness of Information

The first step towards gaining cash visibility is to ensure that the treasury function has access to accurate information on the account balances in a timely and consistent manner. This is easier said than done, as many global treasuries would attest to the challenges they face with achieving the level of cash visibility they expect. The more complex organisational structures, geographical spread and multi-banking relationships are, the more complicated it gets.

Among the reasons for this is that many corporates maintain multiple bank relationships, due to the inability of a single bank to provide a full range of services across all geographies - for example tax payments in China and up-country cheque collection - or purely to diversify bank counterparty risks. The common challenges this poses are:

- Non-standardised formats and transaction codes.
- Timeliness of information (real-time versus previous day balances).
- Unavailability of SWIFT reporting in some local banks.

Although there is no silver bullet that can achieve perfect visibility, there are various solutions available to help address these challenges. They include:

- Multi-bank reporting through electronic banking (e-banking) portals or host-to-host connections provided by the main cash management bank.
- SWIFTnet connectivity. SWIFT is developing standards with treasury management system and enterprise resource planning (TMS/ERP) providers and integration with SWIFT gateway to make it easier for corporates using these TMS/ ERP systems.
- Use of an outsourced service bureau for managing SWIFT connectivity or multi-bank balance and transaction reporting.

That said, corporates must first address some of the more fundamental aspects related to their internal processes. These may include, although not necessarily be limited to:

- Lack of treasury mandate (policy or implied) to centralise treasury and cash management functions.
- Incomplete views of currency holdings and global foreign exchange (FX) exposures at a country level.
- Inaccurate sales projections and reporting.
- Limited systems investment and integration resources.

WYSIWYG (What you see is what you get)? Think Again

While the consolidation of account and transaction information is one key enabler of cash visibility, what you see may not necessarily be what you get. There are many reasons why a corporate might not be able to readily deploy all the cash it has visibility on. These include:

- ***Regulations:*** Not all jurisdictions permit the free flow of cash cross-border, leading to trapped liquidity which cannot be accessed readily by a centralised treasury function.
- ***Tax cost:*** Corporates need to understand the after-tax cash position. Interest withholding tax, transfer pricing and thin capitalisation rules are usually applicable to cross-border transactions, and could result in high tax cost which negates any cost benefit of deploying cash for certain usage.
- ***Cash Conversion Inefficiencies:*** A key area of inefficiency, which impacts the optimisation of cash is cash application/ accounts receivable (AR) reconciliation. In many instances where payments received cannot be reconciled against AR, the cash gets 'trapped' in the cash application process, awaiting investigation, unnecessary collection calls, costly exception handling, and most inadvertently, dissatisfied customers and inability to free up credit terms for more order fulfilment by the customer. The loss of cash flow during this period is the real cost of unapplied cash. However, these inefficiencies and opportunity cost will not be apparent merely by looking at a consolidated cash balance. The true visibility of the value of the cash lies many layers beneath, and can only really be appreciated and realised by gaining true visibility of the account receivables process.
- ***FX opportunity costs:*** Corporates need to understand their total FX costs, either at a transactional level or costs of maintaining various pockets of cash in different currencies. They have a tendency to focus on larger FX transactions that are often managed at a global treasury level. However, opportunities may exist at a transactional level for lower value transactions. FX costs for the smaller value, higher volume transactions for incoming or outgoing transactions can be quite costly. Two ways to overcome this is firstly by request for more transparency for either incoming or outgoing cross-currency transactions or, secondly, by analysing the invoice currencies in various markets to ensure that FX costs are minimised.

Looking Beyond the Current Cash Position

Knowing the current cash position does not provide a treasurer with the forward-looking perspective to make decisions around best deployment of cash. Cash should be deployed not only for investments, but also considered for optimising working capital. To do so requires a more holistic visibility on bank borrowings; trade facilities; FX, cash and investments; payables due and receivables ageing; and cash flow forecast.

Corporates that invest in treasury management systems (TMS) are well placed to gain greater visibility on both their long-term and short-term net cash positions. This enables the corporate treasury functions to make informed decisions on the best use of funds. Some banks also provide dashboards on the overall relationship with their corporates, covering the full spectrum of working capital: cash, trade, investment, loans and FX. Additionally, some even provide tools for cash flow projection and forecasting. A major shortcoming of bank-provided dashboards, however, is that visibility is limited to the extent of the relationship with the bank and the extent of third party bank information which are consolidated through the bank.

Adopting a Regulatory Lens

The Basel III capital adequacy regime introduces a liquidity coverage ratio (LCR) aimed at addressing the sufficiency of high-quality assets to meet short-term liquidity outflows under specified 30-day stress scenarios. To more efficiently manage the cost of holding liquidity, banks are starting to look at cash in two broad categories - operational cash and non-operational cash. Operational cash arises from the day-to-day flows of underlying clients working capital transactions, and is valued for its stickiness. Non-operational cash on the other hand, is surplus or excess cash set aside from daily transactional flows for which corporates do not need to maintain daily liquidity.

Unless contractually tenored over >30-day period, non-operational cash is viewed to have greater flight risk in the event of a market or bank stress situation. Suffice to say, banks will factor in the regulatory cost of maintaining certain types of client deposits on their balance sheet, which will directly influence the level of interest that can be paid on those deposits. While a corporate can, theoretically, delineate its cash in such a way as to fall within the narrow definitions of operational and non-operational cash, the practicalities are far more complex than that would suggest. In many instances corporates do not - and cannot - clearly demarcate between operational cash and excess cash. There is often a buffer amount set aside for contingency purposes, which needs to be maintained in short-term liquid instruments.

Therefore a corporate able to manage its cash positions in a manner that optimises the value of that liquidity to the banks' balance sheet will be well-placed to negotiate better terms and service levels with its banks. In practical terms, this could mean that a corporate using a bank for most of its day-to-day transactional flow (for example vendor payments, collection from customers and trade settlement), treasury and liquidity flows, and longer term investments, will likely be able to utilise solutions and enablers which:

- Provides the holistic visibility of longer and short term cash and working capital flows.
- Helps to more efficiently manage the movement of cash between daily operation cash; short-term buffer/stable cash and its longer term strategic cash.
- In the process, optimise the return which banks might be willing to award on the basis of the value of liquidity brought about by the sticky relationship between the corporate and the bank.

While this might run counter to the notion of diversification of bank risk, it is the direction in which banks are steering their marketing efforts in order to adjust to the changing regulatory landscape.

Exploring Various Enablers

Minimise external funding through cash pooling: There are various cash pooling techniques provided by banks that provide both the visibility and the ability to consolidate cash positions across different accounts, entities and/or countries.

Cash concentration and notional pooling are common solutions. By consolidating cash positions across different entities/countries, corporates benefit from optimising their internal liquidity. Surplus entities can ‘lend’ to the pool and entities with shortfall can ‘borrow’ from the pool. Internal funding mechanism is automated and inter-company lending positions are tracked daily, together with the associated inter-company interest computation and reallocation.

Cash pooling therefore helps to reduce or eliminate external bank borrowings. The net interest benefit will be the differential between the interest the surplus entity would have earned from bank deposit and the interest the shortfall entity would have paid for the bank overdraft had the pooling not been in place. Effectively the corporate is eliminating the spread a bank would have earned on both sides, and this spread savings is the additional yield or return arising from the better deployment of cash. Additional benefits of cash pooling include the following:

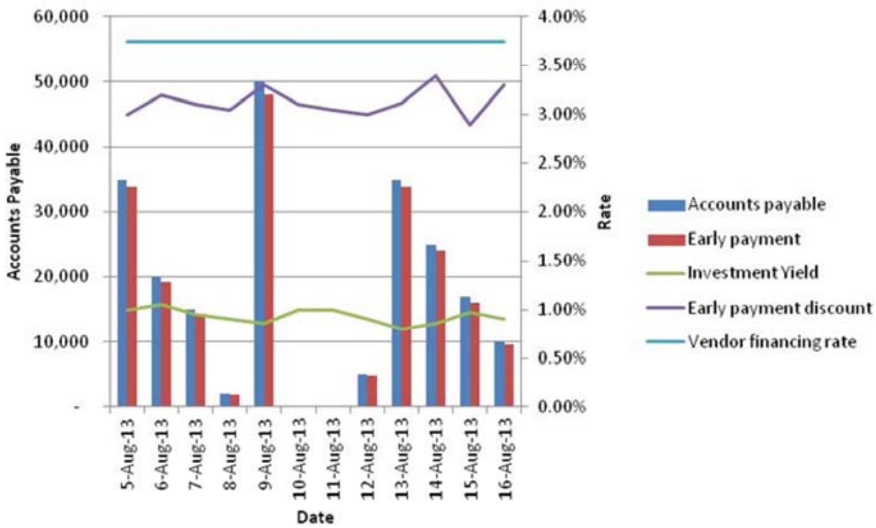
- Provides a consolidated view of cash that can be deployed and also in a preferred functional/base currency.
- Reduces the number of accounts a corporate need to actively manage.
- Bridges operational and surplus cash.
- Enables the treasurer to readily fund operational needs, while also enabling him/her to quickly deploy surplus into various investment instruments in accordance with investment policies.
- Gives the ability to establish the right inter-company behaviours, by rewarding or penalising entities based on their cash contributions to the global pool.

However, various considerations should also be factored into the deployment of cash pooling. Besides the regulatory and tax challenges discussed earlier, the legal documentation requirements necessary for the corporate to optimise its balance sheet through the use of these tools is dependent on local corporate laws, enforceability of set-offs and incorporation articles of the entities involved - and can be quite protracted in multi-country arrangements.

Investing in own supply chain: Another avenue for deploying surplus cash is in a corporate's own supply chain. For instance, corporates can elect to pay vendors in advance of the payment due date where there is an early payment discount to be taken.

This would make sense, where the early payment discount rate is higher than the bank deposit interest rate. In particular, where a corporate has a vendor financing programme in place with a bank, which offers its vendors access to financing, there will be full visibility of the vendor financing rate, and the corporate can then analyse and benchmark the investment yield (on deposits) versus. the vendor financing rate vs. the early payment discount rate - as depicted in Figure 1 below - and arrive at a decision whether to pre-pay the vendor, or enable the vendor with options to access the vendor financing programme. This not only benefits the corporate in optimising its return on cash, but also builds up a sustainable relationship with strategic vendors by enabling the latter access to cash for bridging their working capital gaps - securing its own supply chain in the process.

Figure 1: Dynamic Discounting versus Investment Yield Analysis.



Source: Standard Chartered.

Conclusion

Cash visibility will be of real value to a corporate only if it extends beyond account balance reporting. Corporates need to gain broader visibility around how much cash can be readily redeployed, and where the cash can be best utilised, in order to uncover the real hidden opportunities.

To achieve this, treasurers should:

- Factor in the cash conversion efficiency, regulatory and after-tax impacts in determining the actual cash available for redeployment.
- Improve the visibility on broader aspects of working capital and financial supply chain, including debt/ bank borrowing, accounts payable/ early payment discounts as well as opportunities to optimise FX costs.
- Utilise analytics and solutions that improve the efficiency of deploying excess cash for inter-company funding and investment in own supply chain.
- Understand the regulatory requirements which banks are now subject to, and how these influence their views on the relative value of various corporate cash deposits.

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