Treasury Information Management: Connecting the dots….

by
Bas Rebel and
Esther Kwaks

Actual and accurate information about cash flows, cash positions and financial exposures is vital for corporations. This information is the lifeblood for adequate financial management, a focus for CFO's controllers and treasurers. The increased complexity of business processes and tighter regulation regarding disclosure require more accurate information in real-time. However corporations are under pressure to reduce cost and to reconsider investments in e.g. information management technology.
Do the objectives to reduce cost and to improve the quality of information really contradict one another? New technology opens up the opportunity to recreate processes more efficiently while making transaction information available in real-time. This article is about co-ordination, integration and efficiency; connecting the dots differently.

Complex information management

Accurate information in real-time proves to be a *piece de resistance*. Traditionally financial information management is about reporting on activity in the (recent) past. The treasurer and business controller however have been leading the way to report on cash flow and exposures in the (near) future. Credible financial information about the future requires involvement from many different units within a corporation. Each of which will have its own role and responsibility and consequently a different need for information.
Information management is complex mainly because the units involved do not always speak the same business language. This Babylonic confusion is not only caused by different definition of common terms like "cash flow". It can also be attributed to differences in focus, misunderstanding of the needs of others and inconsistency in procedures or the deployment of several different systems.
As a consequence information becomes available with a time delay and additional effort for consolidation. These additional effort in terms of delays and cost, do not only impact external compliance and reporting, it also impact the quality and effectiveness of cash and risk management.

Tighter regulations on corporate governance

New regulations like IFRS and Sarbanes-Oxley make company executives and members of the board more accountable for the results and conditions of the organization. The pressure on the financial function to produce an accurate "state of the corporation" based on real-time information about expected operating results, financial positions and exposures. Furthermore due to corporate scandals like Enron's bankruptcy and "accounting irregularities" at Worldcom, shareholders, legislators and the public in general have put pressure on companies to improve their internal processes and report on these efforts externally (see e.g. Sarbanes-Oxley sections 404 and 409).
Treasury activity is subject to compliance with some special regulations like FAS133/138 (operational) or the IAS39 (soon to be operational). Compliance to these regulations on hedge accounting require an adequate and accurate understanding in the development of individual underlying exposures.

Pressure to carve cost

Profits are under pressure. The current economic climate forces companies to carve cost and postpone projects. There is a growing tendency to reduce or better eliminate non-value added activity. Within the financial function non-value added activity could be related to more than one procedure for the same processes, the maintenance of procedures, internal control and the effort to consolidate information from across the enterprise. The results of last year's survey by CFO research services under 265 US financial executives indicate the priority on

reduction in non-value added activity. Within 2 years these executives wanted to reduce the resources spent with 12 points from on average 39% of the available resources today to 27% in 2005[1].

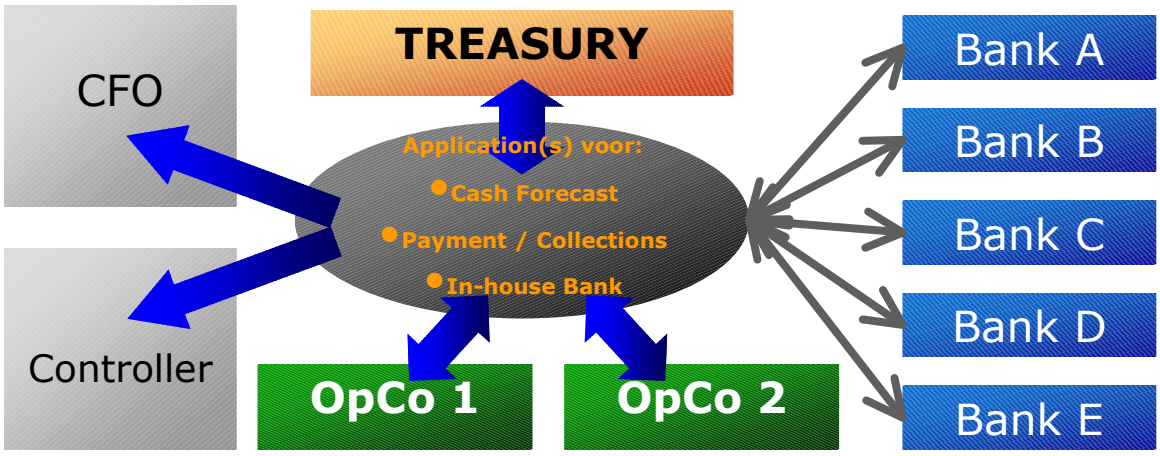
What next?

CFOs, controllers and treasurers are confronted with divergent challenges; they need to do more with less in a shorter timeframe. This bi-focused ambition is achievable only when non-value added activity within processes is made redundant by standardization, streamlining and automation of processes. Such elimination of non-value added activity needs to happen at both central and local level. Existing "dots" need to be connected differently, more efficiently.

Application of new technology allows for meeting the divergent objectives of accurate information, timely compliance and cost reduction at the same time. Browser based applications allow people in different locations to work closely together on a process. This offers a new perspective in a discussion about centralization and decentralization, because to allows centralization of process engines and *process steps* rather than a whole process. It allows for the creation of central transaction repositories from which the cash manager can tap information in real-time, without the need for local operations to report separately anymore. It also allows for centralizing critical functions as bank communication. Browser based technology opens opportunities for functions, like the treasury, to add more value to the company and be less dependent on cooperation from other locations.

Several treasury technology vendors have come up with a number of applications that support this centralized/decentralized business concepts. Depending on the company profile one could successfully implement a solution provided by some of the ERP vendors, opt for linking decidated best of breed vendors to your ERP kernels, or go for an outsourced solution[2].

The remainder of this article will explore these opportunities in more detail, using the example of a "payment factory". However because there is not a general accepted blueprint, the example will be reviewed in concept only. Similar case studies could have been worked out for the collection factory or the in-house bank.



1 CFO Resereach Services: CFOs: Driving Finance Transformation for the 21st Century p 9, 12-13.

2 See also Bas Rebel "Enterprise Liquidity Management; leveraging the investment in ERP and TMS", 19 September 2002, gtnews section cash management / liquidity.

An example: the payment factory

A payment factory is a centralized function for processing payment instructions on behalf of subsidiaries and the retrieval of bank statements for all group company bank accounts. One could say that from the perspective of the operating company, a payment factory operates as some sort of multi-bank electronic banking platform. However a payment factory is aimed at optimizing the disbursement process within a corporation. As such it might entail much more than standard EB functionality. It could also include functionality to manage invoices and dispute management with vendors. Other extensions could be in the field of transaction reconciliation and sub-ledger accounting functionality (including suspense accounting).

Depending the underlying technology, within a payment factory solution the responsibility for initiation, authorization and reconciliation of transactions could be the responsibility of the operating company, whereas the bank communication that of a central unit. As such the payment factory allows for structuring workflow across locations within a central application and database. The benefits can be real and substantial.

With transactional processing centralized, the corporate cash manager can build the (short term) cash flow forecast from accurate cash flow information in real-time without dependency on human intervention. If a transaction doesn't make the cut-off time or e.g. was taken out of a batch, the cash manager will know that immediately and does not have to wait for confirmation from the operating company. As such the payment factory eliminates the need for a separate cash reporting process while at the same time because of the increased accuracy of the forecast; the cash manager is able to manage cash balances closer to zero. This will release cash currently locked in working capital. Another positive side effect of this restructured payment process is the elimination of the major friction point between the corporate cash manager and operating companies: wrong overnight cash balances due to not reporting of last minute changes to a payment run.

The introduction of a payment factory could also reduce the direct cost of transaction processing. Most obvious one can think about the benefits of centralized purchasing of bank products. It allows corporations not only to synchronize agreements on fees, charges and hidden cost at a group and bank level. It also increases the bargain power, because with a central hub in place, rerouting transactions swiftly and cost effective is always an option.

With transactional information centralized analyzing payment flows also becomes easier. This is of course important when dealing with banks. However it is equally useful to internal advice to the operating companies regarding their payment process, their use of payment products or e.g. pre-payment discount. In summary the central repository on transactional data allows treasury to analyze payment processes and as an internal consultant demonstrably add value to operating companies.

And there are more benefits to consider more efficient payment processing within a payment factory.

As explained earlier, on the back of the transaction process the payment factory makes accurate cashflow information available to the cash manager in real-time. This combined with a centralized batching / bank communication, makes it economically viable to release payments on a group level daily rather than weekly or bi-weekly. Centralized daily execution of transactions not only reduces the overall time spend by the corporation on this non-value adding step. It also allows corporations to execute more payments on due date, instead of a couple of days prior to due date, a second mechanism to release cash currently locked in working capital.

Internal procedures can be standardized and better enforced. The central application shields the end-user from differences in the EB functionality offered by banks used within the group. This reduces the need for training and brings new employees faster up to speed.

The payment factory effectively centralizes bank communication, and as such eliminates the need of having security protocols on place in a multitude of locations, including procedures to enforce and audit these protocols.

Internal control can further benefit from the centralized registration of transactions. As indicated above the payment factory can structure the workflow for transaction processing, using built in workflow management tools. The userid could not only limit what an end-user could do to a transaction, it also will be used to log the involvement of individual users in the central database. This is a preventive measure and would also reduce the need for lengthy forensic analysis based on sometimes incomplete paper trails.

A payment factory could also simplify backup procedures in case of emergencies. This will be particularly important in cases of small operating units. Because it standardizes processes across operational units within a common application, One unit could be the back up for another. This allows for better compliance to general AO standards even in cases of minimal staffing.

Finally the introduction of a payment factory will reduce the cost for specialized IT support. At the subsidiary level because the EB applications would no longer be required, centrally because the number of bank interfaces becomes an arithmetic rather than an exponential relationship of the number of internal systems that need to be connected cash management banks.

Closing remarks

To create real and substantial benefits for the corporation, the introduction of a payment factory would not necessarily take away responsibility at the subsidiary level. Therefore it could fit well within different corporate cultures. However a corporation wide standardization of processes could be the first step towards the successful introduction of (regional) shared service centers or a prelude to outsourcing to a third party service provider.

We could have equally elaborated on the benefits of concepts like a collection factory or an in-house bank. A combination of these three concepts would create even greater synergies. It is important to emphasis that the implementation of these concepts allows CFO, Controllers and treasurers to solve the seemingly paradox of divergent objectives like improved quality of information, compliance to new regulation and cost reduction at the same time. One has to connect the dots (=operating units involved) in a different way and to leverage new technology to standardize streamline and automate corporation wide processes. Furthermore they provide treasurers more and new opportunities to add value to the corporations for which they manage the positions and financial exposures.

Bas Rebel is independent consultant treasury operations and treasury information management. He has over 12 years of experience in consulting, corporate treasury management, product management and banking. He has a broad understanding of treasury issues, especially related to transaction processing and information management within complex organizations.

Esther Kwaks is Managing Director of Orchard Finance Consultants. She has worked in corporate finance and treasury management since 1995. She started with Van Den Boom Groep as treasury management consultant and continued her career at KLM as Assistant Treasurer and Corporate Finance Manager respectively. In 2001 she returned to Van Den Boom Treasury Management, which was by then sold to NIB Capital, where she was as Head Treasury Solutions responsible for all corporate treasury consultancy and interim activities. In January 2003, Esther Kwaks disentangled her department and founded Orchard Finance Consultants."