Westpac InstitutionalBank

Merging of Transactional and Working Capital Banking Services

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Emmanuel Alfieris +612 8254 1672

ealfieris@westpac.com.au

Westpac Banking Corporation ABN 33 007 457 141

Merging of Transactional and Working Capital Banking Services

Traditionally, treasurers have viewed the cash management and working capital financing as two distinct roles for their banks. Often it has involved separate individuals within the bank, a Transactional Banking specialist and a debt specialist respectively. Going forward more of these services will be offered in a combined package.

Debits and credits to bank accounts is quickly becoming a commodity service. Banks have realised that in order to continue offering value added services to their corporate customers they need to provide services that link the debits and credits to the underlying financial transaction. For example, banks like Westpac are now offering receivable services that process invoicing, payments channels, allocations and disputes in addition to simply capturing credits. By providing services that automatically link invoicing to the eventual credits in the bank account, the banks can also offer integrated receivables financing solutions.

Similarly, the evolution of supplier finance systems being offered by many banks' Trade divisions are also solving payments for corporate. Following the implementation of a supplier finance solutions from one of our clients, a major food processing organisation, the CFO told me…."Even though I bought your solution to take advantage of supplier discounts, you've also solved my accounts payable process deficiencies and shifted the payments from my current bank by default"

The banks' role will evolve to combine a seamless delivery of banking services for debits and credits that enable straight through processing for reconciliation with automated linkages for working capital financing. Banks with processing and liquidity economies of scale will be the ideal partners for these types of combined services. They will be able companies a competitive advantage through lower cost of processing and cost effective funding.

Focusing on Unique Value Add

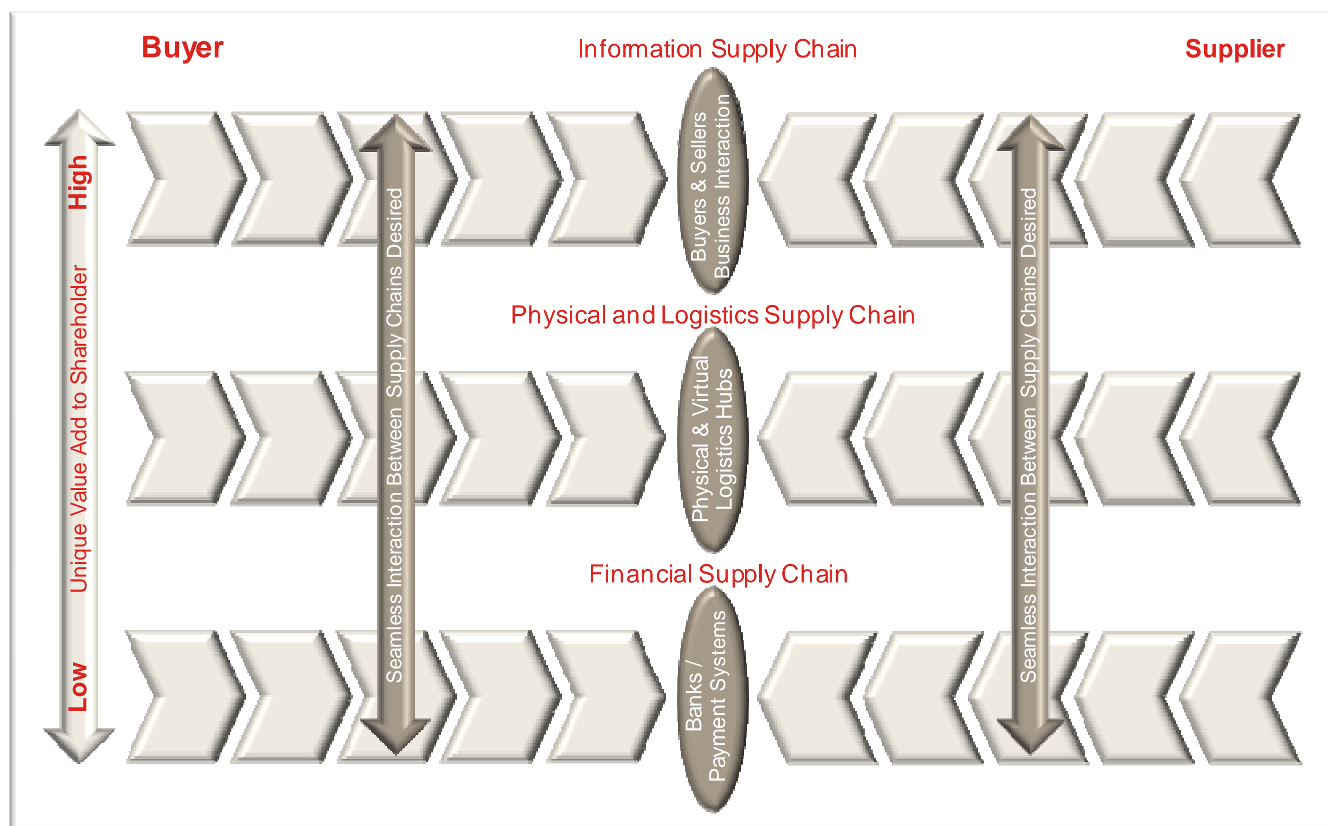
Corporations have developed and dissected numerous value chains in an effort to identify where they can differentiate themselves in their industry and add value to shareholders. Treasurers have participated in the financial management and measurement of the Value Chain but have typically not had control of any segment of the value chain. This has been the domain of their Distribution and Operations counterparts. The banking industry's relatively new investments in providing value added services for their combined transactional and working capital product suites, now enable treasurers to define and take ownership and add value for a discrete segment of the value chain.

The value chain can be dissected into a series of supply chains.

- An information supply chain between buyers and sellers that is the core of business interaction
- A physical and logistical supply chain where goods and services are produced and delivered and
- A financial supply chain from which cash flow and working capital is ultimately determined.

(Arguably there are other supply chains such as IT and Human resources etc however, these can be included as sub-segments in each of the above)

Value Chain = Series of Supply Chains



The seamless interaction between each of these supply chains will determine the efficiency of the value chain and the level of shareholder value that can be extracted.

The main unique value-add that each organisation can provide shareholders is in Information. Information arbitrage from a buying or selling perspective is ultimately what drives margin.

One of my customers, the CEO of a leading insurance company in Australia, astutely commented to me recently – "We're not in the insurance manufacture business, we're in the *life style* business". The manufacture of insurance products in itself is not necessarily a competitive advantage without deep knowledge of customers' lifestyle aspirations.

We have seen many companies outsource production and logistics elements of their business to third parties who specialise in those areas of the supply chain. For example, we at Westpac no longer print our own cheques, deposit books, statements, etc. Westpac is a financial intermediary and not a printer and have therefore outsourced this function to *best of breed* print logistics companies.

Other companies consciously remain involved in the production or logistics elements of their supply chain because they have access to information and volume that enables them to provide unique value add in those and other elements of the supply chain. Retailers globally continue to invest in warehousing and distribution capabilities because they believe that the integration with the shop front is a competitive advantage that cannot be outsourced to logistics providers.

Of course, what one company views as "Logistics" another company views as Information. Global Transport companies often view their value add in leveraging transport and storage information and logistics as a production function. Their unique value add is how well they execute the logistics with the integrated information they manage.

Leveraging the Banks' Competitive Advantage to extract Shareholder Value

Just like the transport companies of the world can release shareholder value for a company's logistics supply chain, so too can your bank do the same for elements of the financial supply chain.

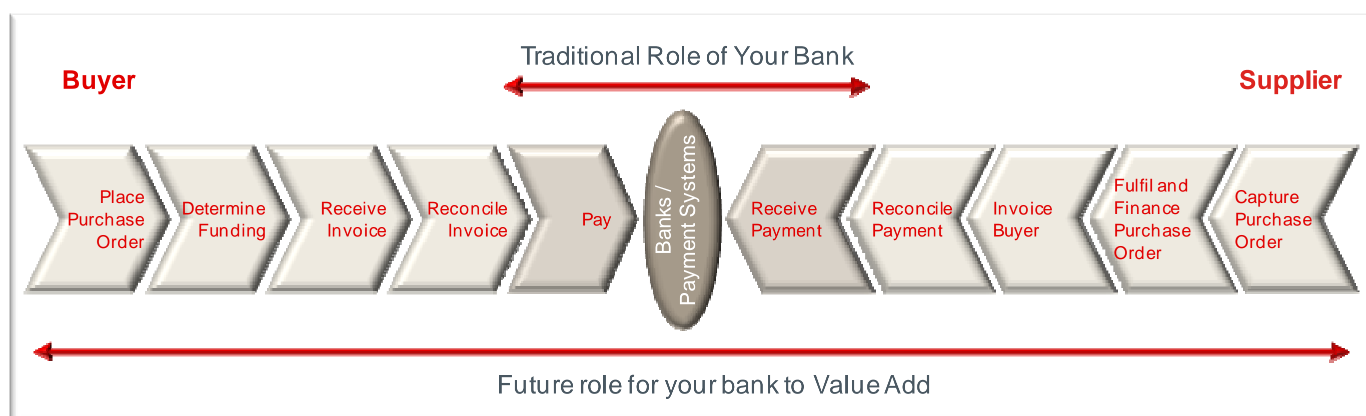
Companies can leverage their Bankers' investment and expertise in the movement and reconciliation of cash to deliver shareholder value. This will enable treasury areas to focus on where they truly do add shareholder value – Balance Sheet management.

To borrow an analogy from my insurance customer, a company that's in the lifestyle business does not typically add value to shareholders through processing accounts receivable and accounts payable.

Similarly, a CFO of one of our large regional steel manufacturing clients observed in a recent meeting – "Our competitive advantage is designing, manufacturing and selling steel products…..making and accepting trade terms and funding inventories is a finance role….Banks are good at that aren't they? Shouldn't you be managing my working capital?"

The reason why these functions have in the whole largely remained in house is that most offerings till now have meant that outsourcing these functions also meant outsourcing the interaction with customers and suppliers, a core element of the Information supply chain where companies do provide unique value add. Banks like Westpac have created solutions that enable companies to outsource the accounts payable and accounts receivable processes without imposing themselves in the company-supplier or company-customer relationship.

Beyond Just Debits and Credits



Debits, credits, reconciling those transactions and financing are core business activities for banks because they have unique access to information as a financial intermediary. Westpac's transactional banking position serves as an illustrative example.

As a market leading corporate transactional bank with 35-45% market share (depending on the survey), then 20% of all corporate payments to other corporates is a "book to book" transaction for Westpac. This provides Westpac with the opportunity to add value to its company customers and subsequently its shareholders.

In the past a Bank would simply debit the payers account and credit a receiver's account and the counterparts would communicate with each other (typically in paper form) as to the payment information.

However, banks that have invested in providing value added services can not only debit and credit

the relevant accounts but also can also facilitate the allocation process and provide funding prior to those payments being paid.

By providing robust accounts receivable and accounts payable process the banks can also provide cost effect working capital funding solutions.

For example, when a company is interested in securitising their receivables, the financier undertakes a due diligence exercise of the invoice platforms. If the financier is integrated into the invoicing process, this reduces the due diligence cost and also the risk premium associated with the degree of separation from ongoing invoice information. This will ultimately result in more innovative and cost effective working capital funding for companies.

Time to release the value

Earnings growth in an anemic economy for most large companies operating in Western Economies will been primarily cost driven as they tried to survive through the remnants of the Global Financial Crisis. This focus on cost to drive earnings will be a long term trend. Most organisations have already released the easily identifiable superfluous costs in their value chain

The creation of company- wide shared service centres including accounts payable and account receivable functions has been part of this effort. The time is ripe for companies to release even more value in the financial supply chain be leveraging the investments that their banks have made.

Emmanuel Alfieris,
Westpac Institutional Banking
ealfieris@westpac.com.au