The Real Benefits of a Latin American Cash Management Review:

Improving your company’s bottom line by eliminating hidden cash and costs

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It’s the “invisible” elements of managing cash and liquidity that can really cost a company significant money on an annual basis.

While most CFOs and Treasurers agree that their company’s cash management function is important, they frequently view it more as a routine function than one requiring specialized expertise. The result has been a downsizing of cash and treasury management staffs; with those left doing more with fewer resources.

Most CFOs and Treasurers understand daily cash settlement, funds transfers and short-term investment and borrowing. But these are only the tip of the cash management iceberg. It is the “invisible” elements of managing cash and liquidity that can really cost a company significant money on an annual basis. In high interest rate environments like Latin America the impact can be even more costly.

Taking a closer look at some of these “invisible” elements of the cash management function, reveals the significant impact they can have on a company’s bottom-line and internal efficiency when not actively managed, reviewed and measured on a regular basis. For illustration purposes the elements are grouped into two categories - *banking services and fees* and *cash flow and liquidity*.

Factors driving effective cash and liquidity management performance

“Visible”	Daily Cash Settlement	Funds Transfers	Short-term Funding/ Investments
“Invisible” or Hidden Costs	**Banking Services and Fees**		**Cash Flow and Liquidity**
	Bank Accounts		Bank Account Structure
	Collection Services		Deposit Availability
	Payment Services		Cash Concentration
	Electronic Banking Systems		Cash Forecasting
	Outsourcing Services		Idle Cash Balances
			Collection Practices
			Payment Practices

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Banking Services and Fees

Bank fees related to cash management services in Latin America will often cost a multinational company hundreds of thousands of dollars annually. For some companies, especially those with a large consumer customer base, cash management fees frequently total millions of dollars annually. These fees, whether “budgeted” or not by the company, are typically paid to the bank on a daily or monthly basis via a bank-initiated direct debit to the company’s accounts.

Alternatively, a company in Latin America may leave collected balances in its bank accounts to pay for service fees. (These balances are sometimes referred to as compensating balances.) If this is true, your company is actually paying the bank more than the stated cost of the services. In most cases, those idle collected balances can be better put to use reducing outstanding debt (or for short-term investment). Whatever method your company uses to pay for cash management services, a number of key questions need to be asked and answered.

Q: How much does your company spend annually on cash management services in Latin America?

A: It is critical to determine what your company actually spends on cash management services. Developing a complete and accurate baseline of your company’s current transaction volumes and cash management fees is a time-consuming task and requires an in-depth understanding of the banking services across the region. Because services and pricing methodologies vary greatly from country to country, it is essential to ask each of your local countries the right set of questions.

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Q: Is your company using the optimal mix of cash management services in each country to maximize cash flow and minimize bank service fees?

A: As in the United States and other parts of the world, banks in Latin America are now emphasizing measures such as risk adjusted return on capital and, consequently, seeking to increase their fee-based revenue from services such as cash management. Thus, banks in the region may have less incentive to ensure that your company is using the optimal or most cost-effective mix of services. Although the range of payment and collection services available in countries throughout the region has grown considerably during the past few years, we find many companies still not taking advantage of opportunities to lower operational costs and automate manual processes. An in-depth review, country-by-country, will identify potential areas for improvement.

Q: Is your company using local or international banks in Latin America?

A: How a company approaches the bank selection process for the region will depend on the size, locations and characteristics of the company's operations and its corporate treasury objectives and philosophy. Some companies want to use a primary cash management bank(s) for the region or its "sub-regions" e.g., Southern Cone, Andean and Central America. If this is your company's strategy, then you will need to identify and evaluate banks that can meet both your local country and regional/sub-regional needs. Alternatively, other companies are taking a country-by-country approach and identifying the "best in class" cash management bank(s) within each local country. In this case, the same bank may or may not be used in other countries in the region. Whatever your company's regional strategy, a well-developed set of criteria for selecting cash management banking partners in Latin America is important.

Q: Is your company being charged competitive bank cash management fees?

A: While your company may have obtained competitive bank fees as a result of previous direct negotiations, current providers have no incentive to offer fee reductions. A competitive request for proposal (RFP) process frequently results in existing and potential bank service providers "sharpening their pencils." However, we recommend that an RFP have much broader objectives than just reduced pricing. A comprehensive RFP should also generate improvements in internal processes, bank account structure and actual banking services used in those countries where your company operates.

Q: Is your company taking advantage of its current bank relationships and transaction volumes across the region?

A: By issuing an RFP for the overall region, companies frequently achieve better overall savings than on a country-by-country basis (or by leaving the negotiations to the individual countries). However, because cash management services and your business requirements will vary from country to country, an RFP should contain a separate, detailed section for each individual country. If your company is also evaluating or planning for "regional" electronic banking and/or payments platforms (from either a shared service center or regional treasury center), then additional sections addressing these requirements should also be included. The more accurately your company's local country (and regional) business requirements and transaction volumes are defined, the better your overall results will be.

Q: What kind of annual savings in bank service fees can a company operating in Latin America expect from this type of review?

A: Table 1 illustrates the annual bottom-line savings a multinational can achieve by reducing its cash management fees by 15% to 35%. Actual savings will vary by country and company but we have found this range is a very good benchmark.

To achieve these and other potential savings, a company must also be able to answer the following questions.

Q: How many of your company's bank accounts can be closed or consolidated?

A: Many companies operating in Latin America still maintain too many bank accounts. While this number may have been necessary in the past, it is not true today. Closing or consolidating inactive or unnecessary accounts can be a simple, but often overlooked, task. In many cases, these accounts are still accumulating service charges or holding idle balances.

Q: What is the annual cost to maintain a bank account?

A: The annual cost to maintain a bank account (including bank service charges, maintenance in the company's

Table 1
Annual Bottom-Line Savings from Cash Management Fee Reductions

Annual Bank CM Fees in Latin America	Cost Savings if Fees Reduced by 15%	Cost Savings if Fees Reduced by 25%	Cost Savings if Fees Reduced by 35%
$ 250,000	$ 37,500	$ 62,500	$ 87,500
$ 500,000	$ 75,000	$ 125,000	$ 175,000
$ 750,000	$ 112,500	$ 187,500	$ 262,500
$ 1,000,000	$ 150,000	$ 250,000	$ 350,000
$ 1,500,000	$ 225,000	$ 375,000	$ 525,000

general ledger/accounting systems and account reconciliation activities) is around $1,000 per account. We have worked with companies that were able to close between 25 to 150 "unnecessary" bank accounts across the region. At $1,000 per account, those annual savings can add up quickly.

Q: Is your company using the most cost-effective collection and disbursement methods including electronic transfers?

A: A lean treasury staff (regionally or locally) may not have the experience, focus or time to ensure the efficiency of local cash management collection and payments services. Ongoing changes in electronic payment systems and e-commerce mean that electronic payments and more automated collection methods are available in more countries today compared to just a year or two ago.

Many activities may need some adjustment, and if looked at carefully, could result in savings of hundreds of thousands of dollars every year.

Cash Flow and Liquidity

Cash Inflows and Funds Availability

Other areas that can significantly impact a company's bottom line are cash flow and the speed at which uncollected funds are converted to usable or collected cash (funds availability). Because there is no explicit line item in a company's budget labeled "funds availability" this is often an invisible and overlooked cash management function. Delays in cash inflows and funds availability result in increased borrowing costs and/or reduced investment earnings.

Another way to look at funds availability is to examine the percentage of funds deposited into your collection accounts that receive same day funds availability. If this percentage is low, there is a good chance that your company may either not be receiving optimal funds availability from your banks or not be collecting in the right geographic locations. Consequently, your company is carrying excess float and float cannot be spent for bank service fees, invested or used to reduce outstanding debt. When customer payments are received, they must be processed, deposited and converted into available cash. Understanding a bank's availability assignment and deposit cut-off times is critical. Many companies believe that funds availability is always fixed. In some Latin American countries, it can be negotiated.

Table 2

Annual Bottom-Line Savings from Accelerated Cash Flow versus Company Annual Sales

Annual Sales in Region ($ millions)	Bottom Line Savings .5 day improvement	Bottom-Line Savings 1 day improvement
$ 250	$ 37,500	$ 75,000
$ 500	$ 75,000	$ 150,000
$ 1,000	$ 150,000	$ 300,000
$ 1,500	$ 225,000	$ 450,000
$ 2,000	$ 300,000	$ 600,000

Note: Assumes 250 business days per year and an average 7.5% opportunity cost. Additional days of improvement multiply these savings even further.

How a company bills its customers, the types of collection methods used and how customer payments are processed also greatly affect cash inflows.

Q: Are your company invoices issued and delivered on a timely basis?

A: Although not typically considered part of the cash management function, invoicing practices impact cash inflows. Because mail systems in most Latin American countries are considered unreliable and thus generally not used for sending invoices, the method(s) and timeliness with which invoices are issued and delivered in each country should be reviewed as well.

Q: Does your company receive and process customer payments at company offices and/or through "cobradors" (collection agents)?

A: Customer payments received at company offices (or via cobradors) may not be deposited in a timely basis due to delays in processing the receipts, preparing the deposit and delivering the deposit to the bank. Cash inflows and funds availability can be accelerated by changing or improving the collection process associated with office receipts.

Q: If your company uses bank collection services, is it taking advantage of new developments?

A: Banks in many countries in the region now offer more flexible and efficient methods for accepting customer payments and automating the capture of invoice and remittance detail. The use of special deposit tickets, barcode technology and web-based systems are options that should be evaluated in countries where they are available. In addition to accelerating cash inflows, these types of collection services can facilitate more timely application of accounts receivables information, reduce days sales outstanding (DSO) and accelerate the sale of additional product to customers that have reached credit limits. In countries where "deferred" or "post-dated" checks are commonly used, bank check custody services should also be evaluated. (Deferred checks are sometimes discounted and used as a source of short-term funding.)

Most companies operating in Latin America can accelerate cash inflows and/or funds availability by one to four days. These improvements can be worth a substantial amount.

Table 2 illustrates the magnitude of the annual benefits to companies with subsidiary operations of various sizes. It assumes just a half-day or one-day improvement. Additional days of improvement multiply these savings even further.

When was the last time your company had an in-depth review of its Latin American cash management operations?

Cash Utilization

Despite the explicit line item "cash in banks," this is one of the most common areas companies overlook. For financial reporting purposes, companies may decrease their cash levels at month and quarter-end but that does not address the real issue. Significant pockets of idle (collected) daily cash often occur due to inefficient in-country bank account structures, too many banks and bank accounts and the absence of timely and efficient cash concentration procedures. Large (and sometimes unanticipated) electronic payments received late in the day can also cause pockets of idle daily cash.

Some important questions to be answered include:

Q: Is your company using efficient bank account structures to concentrate funds and minimize (eliminate) idle collected cash balances?

A: Banks in most Latin American countries now offer zero balance account systems. In addition, collection systems (that previously required a company to have multiple bank accounts in dispersed geographic areas of a country) are now available using a single collection/ concentration account. However, many companies are not yet taking advantage of these more efficient account structures. (Ineffective cash forecasting systems can also contribute to idle cash balances.)

Q: Does your company use an automatic investment service?

A: An overnight automatic investment service (AIS) should never substitute for effective cash management. However, for a variety of reasons, there are situations where excess cash balances may occur. In these cases, an AIS will ensure that these funds are automatically put to use. The availability of this service in the region varies by both country and bank and may include using an interest-bearing concentration account or overnight "sweep" of excess funds to a local investment account. If your company is using offshore US Dollar accounts, AIS should (almost always) be a "must."

Table 3 illustrates the significant annual bottom-line impact of maintaining idle collected cash balances. Annual savings are measured by reduced borrowing costs or increased investment earnings.

Table 3

Annual Bottom-Line Savings from Reducing Idle Collected Cash Balances

Average Daily Idle Balance Level (in millions)	**Bottom-line savings** (improved investment earnings)	**Bottom-line savings** (reduced borrowing costs)
$ 5	$ 200,000	$ 375,000
$ 10	$ 400,000	$ 750,000
$ 15	$ 600,000	$1,125,000
$ 25	$1,000,000	$1,875,000

Note: Assumes an average borrowing rate of 7.5% and an average investment rate of 4%.

Conclusion

Not many CFOs or Treasurers can emphatically state that their Latin American cash management operations are perfect. In fact, this quick review illustrates just how many activities may need some adjustment, and if looked at carefully, could result in savings of hundreds of thousands of dollars every year.

Because so many key elements of cash and liquidity management are less visible, and therefore overlooked, the true cost to a company's bottom line is often never considered or calculated. However, the magnitude of the annual savings should help CFOs or Treasurers cost-justify a comprehensive review of their Latin American cash management operations to explore potential areas for improvement.

Based on our experience, some of the most common areas for improvement are accelerated cash flow, improved cash utilization, lower funding costs, reduced bank service charges, improved internal costs and the automation of manual processes. In the end, the most important question to ask: "When was the last time your company had an in-depth review of its Latin American cash management operations?" ◆

Author's Note: For purposes of this discussion, Latin America includes Mexico, Central and South America. As noted, banking practices and cash management services vary by country. While some countries are farther along in the development of electronic payment and collection systems than others, many of our recommendations hold true for all of them.

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