

# Staying Competitive: Focus on Cash Management

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As Latin America's banking sectors and economies have recovered during the past five years, banks throughout the region have worked hard to reduce operational costs, better manage credit risk and develop more diversified and sustainable sources of revenues and profits. At the same time, increasing fee-based income has taken on greater importance.

Cash management services have long been a source of significant fee-based income and profit for major international banks. Majors such as Bank of America, Citibank and JPMorganChase report about 7%-10% of total net income as coming from transaction services - of which cash management is the dominant part - provided to corporate banking clients.

While almost all local banks in Latin America offer basic cash management services, they remain more like a support function for many banks. Few have taken advantage of organizing their fee-based corporate services as strategic lines of business. As a result, they are not taking advantage of the potential to increase their fee-based income and expand corporate deposits. Besides leaving money on the table, they risk losing existing or potential cash management business to an international bank or a more agile local bank competitor.

Latin America's domestic-owned banks can compete very successfully with international banks and other local banks in the area of domestic cash management services if they adopt the best practices and business models used by world-class cash management banks.

## The Players

Due in large part to the financial crises which hit the Latin American region hard in the second half of the 1990s and again in 2001-2002, consolidation of the banking sector has been unprecedented. Consequently, the mix of local and international banks in countries across the region has changed dramatically.

The major international banks in the region today, as measured by total assets, include ABN Amro, BBVA, Citibank, HSBC, Santander Group and Scotiabank. In some countries, international banks have such a strong local footprint and market position that they are considered to be both local and international banks in those countries. In Mexico, foreign-owned banks represent more than 80% of the country's total

banking sector assets. It is the only major economy in the region dominated by foreign-owned banks.

Globally, banks can generally be divided into three groups: (1) banks that have the reach to provide corporate products globally; (2) banks that can offer corporate products in several countries across one or more regions; and (3) banks whose corporate products are primarily geared to the domestic or local country market.

This grouping helps explain the buying behavior of companies when it comes to cash management services. Multinational companies prefer to work with international banks when those banks are capable of providing domestic and international cash management services. When an international bank does not have a local market presence or lacks an adequate branch network to provide domestic cash management services, multinational companies will look to local banks, particularly in the area of local collections.

In contrast, large and mid-sized companies with primarily domestic operations generally prefer to work with local banks that can satisfy their domestic cash management needs along with some basic international corporate services such as letters of credit, trade finance, foreign exchange or cross-border transfers. Small businesses are also served by local banks that can offer them a bundle of basic cash management services.

## Doing Business

It's important to understand some of the key factors that drive the cash management business in Latin America today. Collection services in most countries throughout the region are still heavily dependent on bank branches as many payments are still made by check or cash. Companies that receive checks in various locations around the country depend on bank branches to make their deposits. In the case of consumers, the majority of adults in Latin America still do not maintain bank accounts. They frequently make their payments in cash directly at a bank branch. To avoid congestion in bank branches and reduce costs, many banks have established special agencies or kiosks to facilitate consumer bill payments.

In the area of electronic collections, direct debits are frequently used by entities such as insurance, telephone, electric, gas and water companies, to collect from consumers that maintain bank accounts. In many countries including

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## Changing Landscape

Ownership of Top-10 banks by country\*

South America	Domestic-Owned Banks		Foreign-Owned Banks		International Banks in Top 10
	Private	Public	International	Other	
Argentina	3	3	4	0	BBVA, Citibank, HSBC, Santander
Bolivia	8	0	1	1	Citibank
Brazil	5	2	3	0	ABN Amro, HSBC, Santander
Chile	6	1	3	0	BBVA, Citibank, Santander
Colombia	6	1	3	0	BBVA, Citibank, Santander
Ecuador	8	2	0	0	None
Mexico	4	0	6	0	BBVA, Citibank, HSBC, ING, Santander, Scotiabank
Paraguay	3	1	4	2	ABN Amro, BBVA, Citibank, HSBC
Peru	6	1	3	0	BBVA, Citibank, Scotiabank
Uruguay	0	2	4	4	ABN Amro, BBVA, Citibank, Santander
Venezuela	7	0	3	0	BBVA, Citibank, Santander
Central America	Private	Public	International	Other	International Banks in Top 10**
Costa Rica	1	4	3	2	Citibank (Cuscatlán), HSBC (Banistmo), Scotiabank
El Salvador	1	2	3	4	Citibank (Cuscatlán & Uno), HSBC (Banistmo), Scotiabank
Guatemala	8	1	1	0	Cuscatlán (Citibank)
Honduras	5	0	2	3	Citibank (Uno), HSBC (Banistmo)
Nicaragua	1	0	2	4	Citibank (Uno), HSBC (Banistmo)
Panama	3	2	3	2	BBVA, Citibank (Cuscatlán), HSBC (Banistmo)

\*As measured by assets

\*\*Citibank is acquiring Grupo Cuscatlán and Grupo Financiero Uno

Source: NLRussell Associates

Brazil, Peru and Venezuela, interbank direct-debit systems are not available or operational on a nationwide basis and thus direct debits are only possible when the collecting company and consumer have an account in the same bank. In contrast, countries such as Argentina, Chile, Colombia and Mexico all have countrywide automated clearing house (ACH) systems that include interbank direct debits, making it easier for companies to collect electronically from consumers that have bank accounts across different banks.

On the payment side, checks are still widely used in business-to-business payments in most countries around the region, with the exception of Brazil. There, most business-to-business collections and payments are made electronically using a standardized collection and payment instrument called the bloquete. In countries with more developed ACH systems, such as Mexico, Chile and Colombia, more business-to-business interbank electronic payments are being made each year. When ACH systems are not available or cost-effective within a country, electronic business-to-business payments are possible only when the paying company and its supplier maintain accounts in the same bank.

### Internet Banking

Almost all banks operating in Latin America offer some kind of Internet banking system. Typically, major banks have at least two versions of Internet banking systems - one for consumers, another for corporate customers and in some cases, another version for small businesses. Most companies

use Internet banking to access daily bank statements, transmit payment instructions and/or receive collection information.

International banks have an advantage when it comes to technology and Internet banking as a result of their size, economies of scale, internal expertise and experience. The challenge international banks face globally - and Latin America is no exception - is the complex task of integrating all the various local country payment types and formats into a regional or global Internet banking platform to meet the needs of local companies as well as multinationals. These Internet banking platforms also need to be multilingual to meet the requirements of multinational or regional companies.

With global or regional Internet banking platforms, international banks have a competitive advantage when working with multinational companies that have centralized Treasury operations or regional shared service centers and that require centralized multi-country local payment capabilities. However, local banks with adequate product development and information technology (IT) resources are often more flexible and agile in responding to changing domestic market dynamics.

### Product Management

Because multinationals and large local companies are always looking for ways to make their Treasury management operations more efficient and automated, they consistently challenge their banks to develop new or enhanced cash management services. This client-driven demand can actually

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be very good for banks when the resulting new products or product enhancements can be sold profitably to a large number of other clients. Local banks in Latin America should also adopt this strategy.

For example, a few of the items high on the list of "must haves" for multinationals and many large companies today include: corporate purchasing cards, interfaces between electronic banking and companies' Enterprise Resource Planning systems and detailed remittance information to automate the application of accounts receivables. The list also includes automated processes for cross-border transfers so that incoming and outgoing transactions are not delayed due to manual processes in bank back offices, although currency control restrictions pose other delays. These types of process and product enhancements will be increasingly required by local banks in the region if they want to retain their existing large corporate clients, rather than risk losing them to an international bank that offers these capabilities.

Because of increasing competition, banks that understand, anticipate and respond to the changing needs of

### Cashing In

Cash management services fall into four broad categories - collection services, payment services, Internet banking and corporate checking account services. Because all companies need cash management services, they are one of the most important sets of products a bank can offer to its corporate, mid-sized and small-business clients.

Cash management services are attractive because the fees generated provide banks with a source of predictable and recurring revenue. They also strengthen and solidify relationships between banks and their corporate banking clients and can differentiate a bank from its competitors. Collection services are a major driver of corporate deposits.

Cash management products use minimal capital and offer very attractive returns. When organized and managed as a strategic line of business, the return on equity for a bank's cash management products is typically two to five times the bank's average return on equity when measured on a risk-adjusted basis.

To illustrate the importance of cash management services, consider that in 1988 the top 50 US banks generated an estimated total of \$4.8 billion in fees from domestic cash management services, according to data from Ernst & Young. During 2005, the most recent full-year figures available, domestic cash management fees for the top 50 US banks totaled about \$14 billion, with the top 5 banks accounting for 58% of the total. When fees from ancillary cash management products and the value of corporate deposits are included, the top US banks generated an estimated total of \$27.5 billion in cash management revenue in 2005.

their clients will be rewarded with additional cash management business. This does not mean to say that local banks need to invest millions of additional dollars to make their cash management products more competitive. Local banks already offer most basic cash management products today. What many local banks do need, however, is a strategic cash management product plan and adequate IT systems resources dedicated to maintaining and enhancing their cash management services on an ongoing basis.

### New Business Model

When looking at best practices, product management is not the only area where local banks should adopt new strategies. Any successful and profitable cash management line of business depends on the commitment of banks' executive management. Many local banks in the region do not understand how to accurately measure the profitability of their cash management businesses. As a consequence, they also need to adopt many of the financial metrics and tools used by world-class cash management banks so that banks' executives can clearly understand how cash management products contribute to the bottom line and where investments are needed to improve performance and sustain long-term growth in a competitive market. Specialized sales, product and customer service staff are also critical areas to developing a strategic business unit dedicated to growing cash management revenue.

One large local Latin American bank, for example, was a major in-country player in corporate and middle-market lending and trade finance. Cash management products existed in the bank but were not organized or managed as a line of business. With the full commitment and support of its executive management, the bank organized its cash management products as a separate strategic business unit, expanded its staff with specialists, and developed financial measures and tools from which to monitor and manage results. In less than two years, the bank began to experience double-digit annual growth rates in its cash management services and is a recognized cash management leader in its country.

To better compete in the area of cash management services, local banks in Latin America need to take advantage of their unique local strengths and networks. However, experience shows that when a bank organizes its cash management products as a strategic line of business and adopts the practices used by best-in-class cash management banks, it can achieve competitive advantages that lead to stronger corporate banking relationships and an increase in the bank's overall income and profitability. ■

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