

The Real Cost of Undervaluing the Cash Management Function

A Cash Management Operations Review: What have you got to lose?

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It is the “invisible” cash management activities 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 overnight investment or borrowing. But these are only the tip of the cash management iceberg. It is the “invisible” cash management activities that can really cost a company significant money on an annual basis.

Cash Management Function Responsibilities			
Visible	Daily Cash Process	Funds Transfers	Investments/Borrowings
Invisible	Bank Fees	Cash Flows	Controls
	Bank Services	Account Structure	Check Fund Control
	Overdraft Costs	Deposit Availability	User IDs
	Electronic Banking Systems	Cash Forecasting	Account Signatories
	Bank Conversions	Treasury Automation	Procedure Manuals
		Invoicing Practices	Data Security

Source: NLRussell Associates

When we take a look at some of these “invisible” aspects of the cash management function, you see 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. These functions are grouped into three categories – bank fees, cash flow and funds availability, and controls.

Bank Fees

Bank fees related to cash management services will typically cost a company tens if not hundreds of thousands of dollars annually. These fees may be “budgeted” by the company and paid to the bank on a monthly or quarterly basis via a bank-initiated direct debit to the company’s account, check or electronic transfer.

Alternatively, a company may leave “idle” collected balances in its bank accounts to pay for service fees. In this case, the company is actually paying the bank more than the stated cost of the services because the “earnings credit” calculated by the bank on these balances is often 200 basis points below a company’s actual cost of bor-

rowing. If a company is in an investment mode, the earnings credit is often 100 basis points below what can be obtained if the funds were invested overnight or on a short-term basis. (The earnings credit is utilized to compensate companies that maintain collected balances because banks are prohibited by law from paying interest on corporate checking accounts).

Whatever method your company uses to pay for cash management services, it is critical to determine the cash management service charges. Once these costs are known, a number of key questions need to be asked – and answered.

Q: Should my company write a check to pay for cash management services or should it use collected balances to pay for these services?

A: A company which uses collected balances to pay for cash management services is not maximizing the use of the company’s available cash. This is true whether the company is in a borrowing or investment mode.

Cash flow and funds availability are often among the most invisible and overlooked cash management functions.

Q: Is my company using the optimal mix of cash management services?

A: As banks put more emphasis on increasing their fee-based revenue from services such as cash management, they have less interest or incentive to ensure your company is using the optimal or most cost-effective mix of services. Frequently, a company is paying for services that are not necessary or it is not taking advantage of lower cost methods for funds transfers.

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 a request for proposal process or through direct negotiation, many things can degrade the accuracy or competitiveness of your bank charges. It is not uncommon for a company's service fees to creep up over time or as a result of a bank merger.

Table 1 illustrates a simple calculation of a company's estimated annual cash management service fees using a company's annual revenue and its customer base profile (consumer to business or business to business). It demonstrates how quickly these service fees can become a significant cost to a company. If cash management service fees are paid using collected balances, the actual cost to the company is even greater than shown.

**Table 1
Annual Bank Cash Management Fees by Company Type**

(1) Assumes average consumer transaction of \$100 per sale and average bank collection costs of \$0.15 (approximate cost of retail lockbox and check clearing services).

(2) Assumes average wholesale transaction of \$5,000 per sale and average bank collection costs of \$0.80 (approximate cost of wholesale lockbox with check clearing services).

Annual Sales (\$ millions)	Company with Consumer to Business Customer Base (1)		Company with Business to Business Customer Base (2)	
	Transactions	Bank CM Fees	Transactions	Bank CM Fees
\$ 100	1,000,000	\$ 150,000	20,000	\$ 16,000
\$ 250	2,500,000	\$ 375,000	50,000	\$ 40,000
\$ 500	5,000,000	\$ 750,000	100,000	\$ 80,000
\$1,000	10,000,000	\$1,500,000	200,000	\$160,000
\$2,000	20,000,000	\$3,000,000	400,000	\$320,000

**Table 2
Annual Bottom-Line Savings from Cash Management Fee Reductions**

Bank CM Fees	Cost Savings if Fees Reduced by 15%	Cost Savings if Fees Reduced by 25%
\$150,000	\$22,500	\$37,500
\$375,000	\$56,250	\$93,750
\$750,000	\$112,500	\$187,500
\$1,500,000	\$225,000	\$375,000
\$3,000,000	\$450,000	\$750,000

Using the results from Table 1, Table 2 shows the potential annual bottom-line savings a company with a consumer to business customer base can achieve by reducing its cash management fees by 15% to 25%.

A medium to large consumer company can generate six figure annual bottom-line savings with a comprehensive review of its bank cash management services and fees. However, to realize these potential savings, a company must be able to answer questions such as these.

Q: How many bank accounts are inactive or should be closed or consolidated?

A: Closing inactive accounts can be a simple yet often overlooked task. In addition, companies with multiple subsidiaries or field locations may find they have numerous bank accounts no longer needed, but still accumulating fees or holding idle balances. These accounts can frequently be consolidated or closed.

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

A: A lean Treasury staff may not have the experience or focus to ensure the effectiveness of cash management collection and disbursing services. For example, on-going changes in electronic payment systems and e-commerce make electronic collection and payment methods even more cost-effective today than they were just a few years ago.

The potential cost from failure of proper controls can exceed hundreds of thousands of dollars.

Cash Flow 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 are no explicit line items in a company's budget called "cash flow" or "funds availability" these two areas are often among the most invisible and overlooked cash management functions. Delays in cash inflows and funds availability can result in significant 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 not be receiving optimal funds availability from your bank or perhaps you are not collecting in the right geographic location. 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. Even when a company uses a bank lockbox service, it can receive less than optimal funds availability when bank processing or the timing of daily deposits is delayed. Most banks use different funds availability schedules for different types of companies. And, the company not using a lockbox service is subject to more delays in maximizing its available cash.

In addition to accelerating funds availability, there are many factors that can greatly influence the timing of a company's cash inflows. Some important questions to answer include:

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

A: Whenever sales terms are based upon the invoice date, any delays in issuing the invoice can result in customer payment delays. A typical company can accelerate its cash inflows by at least two to three days by addressing these invoice-timing factors.

Q: Are your customers paying beyond the invoice due date?

A: Chronic late paying customers can significantly impact a company's cash inflows when there are no (enforceable) penalties for late payments. If your Treasury department maintains a cash forecast, it is important to understand what portion of your customer base can delay cash inflows due to late payment behavior.

Q: Does your company receive and process customer payments at company offices?

A: Funds collected through most company offices may not be deposited on a timely basis due to delays in processing the receipts, preparing the deposit and delivering the deposit to the bank. By changing or improving the collection process associated with its office receipts, a company can improve cash inflows and funds availability by one to three days.

Most company's can accelerate cash inflows and/or funds availability by one to five days.

Improvements can be worth a substantial amount. Table 3 illustrates the magnitude of the annual cost savings to companies of various sizes assuming just a one-day improvement.

**Table 3
Annual Bottom-Line Savings
versus Company Annual Sales**

Annual Sales (\$ millions)	Bottom-Line Savings
\$100	\$30,000
\$250	\$75,000
\$500	\$150,000
\$1,000	\$300,000
\$2,000	\$600,000

Note: Table 3 assumes 250 business days per year and a 7.5% opportunity cost. Thus, for a \$1 billion company, a one-day improvement in funds availability equals \$300,000 in annual savings $[(\$1B/250 \text{ days}) \times 7.5\% = \$300,000]$. A one-day improvement at a mid-sized company with annual sales of \$500 million can be worth \$150,000 annually. Additional days of improvement multiply these savings even further.

Because funds availability and cash inflows are frequently invisible, and therefore overlooked, the true cost to a company's bottom line is never considered or calculated. However, the magnitude of the annual savings should help any CFO or Treasurer cost-justify a comprehensive review to explore potential areas for improvement.

Controls

A company's Treasury staff cannot operate effectively without good controls. Most Treasury departments operate as cost centers with limited budgets, personnel and systems support. Consequently, controls are not always fully established or kept current. For example, a company with numerous bank accounts may find that its list of authorized signers contains a significant number of people who are either no longer involved with the treasury function or have left the company.

One of the more difficult tasks a CFO or Treasurer faces in insuring that their controls for treasury functions are current, is understanding the opportunity cost associated with missing or out-of-date policies and procedures. The best way to accomplish this is to evaluate the financial cost to a company if a control does not exist or fails. Table 4 highlights these costs across five categories of controls.

When was the last time your company had an independent review of its cash and treasury operations?

**Table 4
Opportunity Cost of Ineffective Controls**

Control	Associated Risk(s)	Potential Loss
Check Fraud a) daily verification of all checks presented for payment b) timely reconciliation of all bank accounts	Fraudulent check is paid. The company is held liable, under more recent interpretations of UCC 3 and 4, since it did not demonstrate proper due diligence through the use of readily available positive pay and account reconciliation bank services.	Amount of check
User IDs and Passwords a) kept current b) kept properly secured c) at least two operators for every cash management function	a) fraudulent funds transfers by previous employees who still have access b) failure to fund disbursement needs because critical employee absent and remaining staff does not have proper access codes	a) amount of fraudulent funds transfer b) overdraft and non-sufficient funds charges from missed account fundings or late payment penalties from missed critical payment deadlines
Account signatories kept current	a) fraudulent funds transfers by previous employees who still have access b) failure to fund disbursement needs because none of the authorized signers are any longer with the company	a) amount of fraudulent funds transfer b) overdraft and non-sufficient funds charges from missed account fundings or late payment penalties from missed critical payment deadlines
Procedures manual: current and complete	A missing, incomplete or out-of-date manual can lead to inaccurate training of new staff and inadequate support for back up staff when key employees are absent	Overdrafts or non-sufficient funds charges from unfunded obligations; late payment penalties from missed critical payment deadlines
Data security a) regularly backed up b) disaster recovery plan in place and tested on a regular basis	a) Lose key data if suffer a system crash b) Unable to execute key cash management functions in a disaster situation	Overdrafts or non-sufficient funds charges from unfunded obligations; late payment penalties from missed critical payment deadlines

Clearly, a company can lose substantial amounts when a control fails. Table 5 demonstrates the order of magnitude of potential losses a company may typically face.

Potential Loss	\$100s	\$1,000s	\$10,000s	\$100,000s	\$millions
Fraudulent check		X	X	X	
Fraudulent wire			X	X	X
Overdraft / NSF fees	X	X			
Late payment penalties	X	X	X	X	

From even this brief analysis, it is evident that a CFO or Treasurer must concentrate skilled resources on managing controls. When you take a closer look at the potential losses to your company detailed in Tables 4 and 5, the potential cost from failure of any of the controls listed can exceed hundreds of thousands of dollars. Thus, the only effective solution is to guarantee that all treasury function controls are current, complete and regularly examined.

Conclusion

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

Some of the most common areas of improvement are accelerated cash flow, lower funding costs, reduced bank service charges, improved internal costs, reduced operational and/or financial risk and the automation of manual processes. When was the last time your company had an independent review of its cash and treasury operations?

NLRussell Associates is a Boston-based cash and treasury management consulting firm that specializes in working with mid-sized and large corporations. NLR offers a wide range of consulting services including cash and treasury management operations reviews. To discuss your company's needs and learn more about how NLR can help your company's treasury department achieve results, contact us.

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