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Treasury 3.0 from a Practitioner's Perspective: Opportunities and Challenges

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This article sets forth some potential opportunities and challenges to the treasury practitioner and their organisations as the world evolves from a 2.0 to 3.0 era. The emphasis here is on the word 'potential' - none of us knows exactly how things will evolve.

When your company's treasury group showed up for work today, they likely set out to accomplish a number of tasks using several different tools.

These activities are for the most part traditional - cash concentration (taking into account today's funding requirements and receipts), short-term borrowing and investing, inter-company transfers, foreign exchange (FX) and risk management transactions.

Many technology products will be used for these activities such as: treasury workstations, enterprise resource planning (ERP) or accounting systems, customer relationship management systems (CRM) for reciepts, purchasing systems, foreign exchange (FX) systems, and risk management systems.

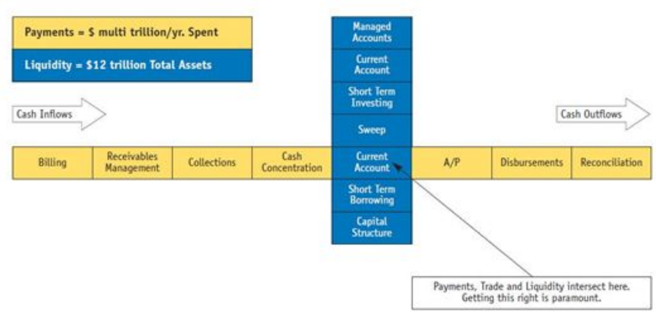
All of these activities - which are vital for the business to operate - have been executed consistently and repeatedly for years. While we may have tweaked and modified them as the opportunity arose, continuously on the lookout to improve effectiveness, efficiency and performance, we have a general idea of how this world operates and do not typically need to engage in philosophical contemplation or deep reflection upon them - we simply get the work done in the best manner we can.

But according to Treasury Strategies, all of our activities and tools are part of the 2.0 era - at a time when we are moving to a Treasury 3.0 world.

What Does Treasury 3.0 Bring?

Treasury Strategies, in "Treasury 3.0 Services: Challenges and Solutions", believes that the 3.0 environment will be characterised by "payment and liquidity solutions offered by banks, as opposed to specific product sets put together by companies." We can understand this better if we look at Figure 1 from the article.

Figure 1: Payment and Liquidity Solutions Offered to Banks in the Treasury 3.0 Environment

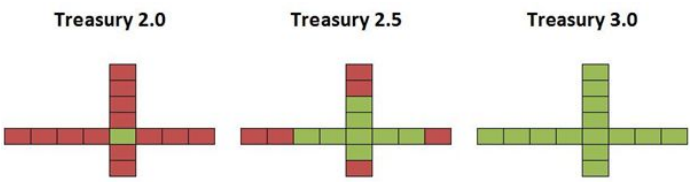


Source: Treasury Strategies

Figure 1 depicts two axes. The horizontal segment contains the generic cash flow processes of any business - order-to-cash (O2C) and procure-to-pay (P2P). The vertical segment contains asset and liability management activities. In 2.0, the bank stands at the intersection of these with the bank account.

We can visualise the bank-centric solution concept as a progressive expansion from the operating-account core along both axes (banks in green).

Figure 2: Bank-centric Solutions in Treasury 3.0



Source: Treasury Strategies

How is this going to change our world?

Opportunities and Challenges for Organisations

The move to Treasury 3.0 heralds both opportunities and challenges to the corporate practitioner.

Credit capacity increases

For a bank to agree to provide credit to an organisation, it assesses the likelihood that it will be able to generate ancillary business from the relationship. Credit is the foot in the door from which this process begins.

Treasury Strategies states that companies spend approximately US$1 trillion on working capital activities, of which US$100bn currently goes to banks, with the remainder going to internal costs, technology and other outsource providers.

With the advent of bank-centric comprehensive solutions, more of these funds will go to the banks and less to the others, which then should allow organisations to increase the amount of bank line of credit available to them.

A quick example can illustrate this point. Let's assume we currently pay to our various banks US$1m in fees, and when the banks feed this information into their various RAROC and regulatory models they determine they can extend US$50m in credit lines. At this 50:1 ratio, if we increase our bank fee outlay to US$5m, then we can now access US$250m in credit.

Access to credit is riskier

Organisations spend a fair amount of time thinking about how to distribute their 'fee wallet' appropriately. This is a far more achievable task in the largely disaggregated Treasury 2.0 environment, primarily because we can mix up the counterparty structure in many different ways.

For example, Bank 1 can provide credit card services on the purchasing side, while Bank 2 can do so on the receivables side. Or Bank 1 can be a depository institution, while Bank 2 can be the disbursement institution. Or Bank number 1 can be business unit A's bank, while bank number 2 is business unit B's.

Given a solution-oriented setting, which by its nature will span a large portion of the horizontal axis we examined in our previous graphs, we will end up with less flexibility in allocating fee-business with many institutions, since much of the activity will now be concentrated in fewer institutions.

How then can other banks be 'fed'?

The likely result is that credit capacity will be concentrated in fewer banks than before, which is at odds with a risk management strategy that relies on diversification to succeed.

Enjoying the benefits of broader scope

In the Treasury 2.0 era, firms are required to spend time and resources integrating their various software products and systems. The treasury workstation must be able to play well with the ERP system, the FX system, the bank systems, etc.

Getting this software to 'play well together' requires IT support. This fact unfortunately serves as a limitation to Treasury's flexibility, since we often run into a something I have previously called "The 1,000 man-year problem".

This phrase is a euphemism for a chain of events following a technology project request by treasury. These events include, after a widening of the eyes and involuntary hand motions on the part of the IT folks, a dark reference to the fact that our proposal will likely require '1,000 man years' to accomplish, and consequently it needs to be included in the multi-year IT plan, so that it can be performed at a time when nothing else big is going on and sufficient resources can be devoted. Because of this, our project will need to wait two or three years.

Comprehensive end-to-end solutions provided by the banks shift more of the interface programming requirements from our organisation to those within the banks.

The bank enjoys much larger economies of scale than any one of its customers, so even if the project actually does require 1,000 man-years the bank has that amount of resources fully available now.

Second, given the bank will serve many different customers, it is more likely that any request we may make is already getting attention from the bank, as others have already brought it to their attention.

Finally, our organisation is a customer of the bank, and we therefore have the advantage of 'always being right', a status that never seems to occur within a traditional corporate IT department.

At a higher cost

Since Treasury 3.0 contemplates a migration from product-centered activities to bank-centered solutions, Treasury Strategies notes that fewer banks will be able to provide the comprehensive solutions contemplated. This will create cost pressures on the firm for two reasons.

First, one of the five forces in Michael Porter's competitive strategy framework is supplier power. Given that we are moving from a scenario where many banks provide a service to one where fewer are able to provide the end-to-end solution, this shifts leverage from the firm to the supplier. Translation - increased cost.

Second, treasury activities are 'sticky'. They do not 'plug and play' very well. One does not just up and change a bank on any given day or at any given time - it involves a project management effort requiring multiple entities within the organisation - IT, treasury, customer relations, accounting and audit, among others. In the strategy vernacular, there are high 'switching costs'. This stickiness also lowers the organisation's negotiating leverage.

Organisational co-ordination and focus increases

A banking paradigm where comprehensive end-to-end solutions are the norm provides an opportunity for the organisation to manage these processes from a fresh perspective.

The 2.0 era, which focused on product solutions put together by companies, allows a certain level of 'siloism' to exist within the company. For example, purchasing card activities are often the province of supply chain. Card processing for receipts might be handled somewhere in accounting, treasury or customer relations.

These units might contract with counterparties without consulting the rest of the organisation, or in a way that aligns with the interested party's goals and objectives even though this alignment may be sub-optimal from the perspective of the whole.

By shifting to an end-to-end, comprehensive solution provided by a common counterparty, internal groups within the firm will need to co-ordinate the management of the bank's service relationship and its service contract. The bank will insist on a clear contract management hierarchy in order to avoid being pulled in many directions simultaneously.

This then provides an opportunity - supply chain needs a, b, and c in the card platform, while customer relations requires d, e and f. In the past supply chain would go hire Vendor 1 as the best solution to its needs, while customer relations hired Vendor 2.

In the Treasury 3.0 world, these two groups will need to get together and decide collaboratively about the desirability and prioritisation of a, b, c, d, e and f. This process should be more transparent from the organisation-as-a-whole perspective, ultimately benefiting the company.

Higher operating risk and loss of control

Supply chain groups within an organisation generally source from more than one vendor in order to manage the loss of critical process inputs. This is done in order to ensure that these critical inputs will be available when needed.

However, this diversification of operating risk will be less achievable in the 3.0 era. Creating redundant end-to-end solutions will be costly to implement. Companies will need to decide who to do business with, fully aware that there can be no turning back. To some extent this can become a broader social issue. If there is only a relatively small handful of institutions able to deliver the end-to-end solution, isn't this just another manifestation of 'too big to fail'?

Another facet of operating risk involves organisation control over processes. As part of the end-to-end bank solution, we will essentially be outsourcing large parts of this to our provider. If we view these activities as core, or a source of competitive advantage, we face a conflict with the 3.0 trend. Think about a firm like Zappo's, with their legendary customer service. Would they ever achieve the same effect if they outsourced their call centre operations?

Conclusion

This article sets forth some potential opportunities and challenges to the treasury practitioner and their organisations as the world evolves from a 2.0 to 3.0 era. The emphasis here is on the word 'potential, none of us knows exactly how things will evolve.

What steps can we perform in order to better prepare for this transition?

Ask questions and learn

The treasurers of your primary banks are a great source of information about what is happening in the industry. Use them. Take advantage of their knowledge. Ask what your peers are thinking and doing within your industry and the finance and treasury profession. As is the case in all times of change, nobody knows it all.

Evaluate your alternatives

Ultimately, if the costs and challenges are too steep, you can always refuse to participate in Treasury 3.0, much like some folks will always pay by paper cheque or cash. Determine the points where Treasury 3.0 becomes a 'fatal flaw' for your organisation.

Get creative

It is often the case (though not always) that an acceptable mitigant can be found for the more objectionable challenges. Can a market be developed to trade in the operational risk of a bank counterparty? Can insurance be purchased for this event? There are many perspectives we might be able to use to address our concerns.

Have fun

According to Treasury Strategies, the 2.0 era started around 40 years ago - so these era shifts don't happen very often. Let's enjoy the ride while it occurs.