

Cash Flow Financing

Finding its Natural Place in Transaction Services

This month East & Partners released its inaugural Working Capital & Receivables Funding Report in response to bank clients increasingly targeting the cash flow financing needs of SMEs and middle market customers. Commercial banks are finding themselves under threat from smaller financial companies offering innovative, non asset based financing solutions as well as the explosive growth taking place in broker activity generated by businesses wanting more flexible collateral conditions for short term borrowings.

As a result, banks have moved to strengthen their propositions to this market, wrapping refreshed cash flow financing product offerings into their wider transaction services models. But service providers have taken different approaches regarding the most effective way of strategically achieving their aims with as many different models as players in operation.

Cash flow financing has become increasingly viewed as a natural bedfellow to transaction banking; the day to day management of a customer's working capital needs. Indeed, Bank of America deployed a "working capital services" model for its commercial and corporate markets fully fifteen years ago. Results from East's report, however, indicate this penny has not dropped with the majority of commercial banks active in the Australian markets. In fact, based on this new market analysis, it can be argued that there remains a working capital finance mentality and a separate transaction banking mentality on the part of service providers.

For example, these new analytics show that a service provider, although successfully growing its share of transaction banking business, can slip behind in receivables financing, lease financing, invoice discounting, inventory financing and other cash flow financing products. High transaction service market share can be accompanied by poor liquidity funding wallet share. Interestingly, this seems especially prevalent in situations where the bank holds a dominant share of the customer's payments business, on the face of it an absolutely natural sister to receivables financing, yet a situation which is often not capitalised upon. This can be attributed to a non-integrated business and delivery structure but also a lack of importance and mental "shelf space" given to cash flow lending by a primarily transaction banking oriented relationship manager, sales team, and divisional management. Certain products can fall by the wayside, particularly in a model where sales and product are housed separately – a structural separation which makes it even more difficult to execute a responsive, customer centric approach to the market.

At the other end of the spectrum, some banks have their cash flow financing product functions located across a number of business units representing different market segments. Trade and invoice discounting might sit in one business division with transaction banking sitting in

another and leasing in yet another. The danger with this type of non-integrated model is that a clear view of the end customer can be lost, not to mention the lack of accountability caused by a clumsy structure maintaining a product centric view of customer interaction.

A more coherent model might be one where product and sales are contained within a standalone working capital financing business division centred on a specific product line. While this type of silo based approach to market might avoid some of the pitfalls of the previous one, the customer could find themselves the subject of a series of uncoordinated sales pitches from product specialists. The days of this approach achieving a decent level of cross sale for a bank have gone as customers want to be relationship managed by a banker who understands their business and therefore their working capital requirements.

Clearly, successfully integrating cash flow financing into transaction banking under a structurally sound working capital services model remains a work in progress for most commercial banks in Australia.

Figure 1

Total Borrowings Segmentation

	Average Percent of Total Borrowings per Customer
Overdraft Facilities	5.4
Factoring	0.9
Invoice Discounting	4.6
Leases	7.1
Payables Financing	2.0
Inventory Financing	1.7
Secured Term Lending	78.3

Source: Working Capital & Receivables Funding Report—September 2005

Figure 2

Total Market Product Importance

	Average Rating Reported 1 — 2 — 3 — 4 — 5 (important) (unimportant)
Overdraft Facilities	1.66
Factoring & Discounting Facilities	1.88
Lease Finance	1.92
Payables Financing	2.02
Inventory Financing	1.72

Source: Working Capital & Receivables Funding Report—September 2005