# Topic 7 Corporate banking

## Learning objectives

In this topic we shall cover:

* why corporates use banks;
* what banking services they use;
* how these services facilitate efficient cash management and working capital management;
* the difference between cash management and working capital management;
* the long-term funding options available to them.

## 7.1 Corporate bank use

Corporate banking covers the provision of financial products and services to small and middle-sized businesses as well as larger companies. We have already covered the retail and private banking sectors, which serve individual customers, in topics 5 and 6 respectively.

Corporates need banks for the same purposes as individuals. Banks provide corporates with current accounts, loans and investment products that facilitate their day-to-day financial operations. The volume of business and transaction size for a corporate, however, is substantially greater than that of the average individual.

Banks offer a wide array of financial products and services to corporates to support their business activities. These are designed to facilitate a corporate’s cash management and working capital management and include:

account services;

long-term lending;

foreign exchange;

trade finance;

supply chain finance.

## Key terms

**Cash management**

Cash management, also known as treasury management, is a broad term that refers to the collection, concentration and disbursement of cash.

**Working capital management**

A business strategy whereby a company aims to operate with maximum efficiency by monitoring and using its current assets and liabilities optimally, using various forms of financing offered by banks.

**Technology: a game changer**

The explosive growth in digital technology over the past two decades has allowed corporates to operate more efficiently. Corporates can now:

connect at speed with their banks, suppliers and customers to make and receive payments in real time;

obtain a quote and exchange currencies instantly;

conclude a trade transaction more quickly;

* access bank services via multiple channels, including online banking, mobile banking apps, host-to-host connectivity (an automated one-to-one solution for data transfer between a bank and its corporate client), and SWIFT (an automated solution for payments and messaging between a corporate and many banks);

automate processes such as account reconciliation.

You will learn more about digital solutions for corporates in section 7.9.

Although technology is constantly changing the way that corporates do business, most have basic needs that they want banks to fulfil. Corporates also want to work with a bank that understands their business and caters to their unique needs; banks will often assign a relationship manager to provide tailored solutions to corporate clients. Relationship managers generally work with the corporate’s cash manager, assistant treasurer, treasurer, chief financial officer and a variety of other stakeholders, from accounts payable and receivable managers to procurement teams.

Corporates also require banks to provide:

good customer service;

consistent credit support;

market knowledge;

fair pricing.

**FACTFIND**

What do corporate customers really want? Find out more:

The Financial Brand: [5 things business owners expect from their bank](https://thefinancialbrand.com/30633/business-banking-expectations/)

The Global Treasurer: [What corporates really think about their banks…](https://www.theglobaltreasurer.com/2017/03/02/what-corporates-really-think-about-their-banks/)

Some things can be improved:

The Global Treasurer: [Cash management is king: choosing the ideal cash management software solution](https://www.theglobaltreasurer.com/2018/02/13/cash-management-is-king-choosing-the-ideal-cash-management-software-solution/)

Euromoney: [Coronavirus: what corporate treasurers need from their banks](https://www.euromoney.com/article/b1kzxyfhxjy8q6/coronavirus-what-corporate-treasurers-need-from-their-banks)

## 7.2 Account services

Account services used by corporates include payments, collections and information reporting. Just like individual banking customers, corporates must settle amounts due and collect income for services or goods provided (known as ‘payments and collections’ or ‘payables and receivables’). Corporates may also use online banking or a mobile app to transact and receive information reporting.

However, unlike individuals, corporates also need access to sophisticated tools to help them efficiently manage their payables and receivables. Banks and other companies, such as fintechs, provide these services to corporates to help them manage their cash and liquidity. You will learn more about cash management in section 7.4.

## Key terms

**Liquidity**

Having adequate assets that are easily convertible into cash to meet short-term financial obligations.

**Liquidity management**

The practice of managing cash, including assets that can easily be converted to cash.

The tools offered by banks include:

* collection tools, such as virtual accounts or lockbox services (a service where customer payments are directed to a post office box, from which they are retrieved, processed and deposited by the bank into the company's account);
* visibility of cash in multiple accounts (sometimes in different countries);
* more sophisticated channel management, including host-to-host, use of application programming interfaces (APIs) and SWIFT for corporates;
* different types of cash concentration or notional pooling schemes.

Account services become more complex when managing accounts overseas as corporates must then manage different regulatory environments, multiple time zones and potential language barriers. There are benefits, however, to holding an account in a foreign country (ie a ‘local’ account).

**Local accounts**

If a company has a business based in another country or does substantial, ongoing business with a single foreign country it may want to open an account with a bank in that country’s currency. A local bank account can allow a corporate to make payments and collect receipts more efficiently, giving it access to a country’s local payment system. Generally, making a payment in the country’s own currency is less expensive and faster than making a cross-border payment from the payer in one country to the recipient in another, which may involve multiple banks (correspondent banks), often located in different time zones.

## Key terms

**Correspondent bank**

Correspondent banks assist other banks in carrying out international transactions.

With regards to cost in particular, entities making payments to corporates would much rather make a local payment, in-country, than have to effect a cross-border payment.

Additionally, if a company has both receivables and payables in that currency, then running a bank account will reduce foreign exchange costs on selling and buying currency, as well as reducing currency risk.

## Key terms

**Currency risk**

The potential loss that could occur from a change in foreign exchange rates. For example, if a supplier invoices in its own currency, the buyer must exchange its currency for the buyer’s currency.

### 7.2.1 How banks earn revenue from account services

Banks may charge corporate customers fees for account services. These may be monthly maintenance fees, transaction-based fees or both. An example would be a US$50 monthly fee to maintain an account that charges a US$10 fee to make a cross-border payment and a US$1 fee to make a local payment.

## 7.3 Foreign exchange

Companies will need to receive and pay amounts in foreign currencies for running a business in, exporting to or purchasing from companies in other countries. They can use their banks for these currency exchange services.

**Buying and selling foreign currency**

If a company receives an invoice in a foreign currency, eg in Japanese yen (JPY), and it accounts in US dollars (US$) then the company will need to sell US$ and buy JPY, instructing the bank to pay the JPY to its creditor. This is referred to as spot foreign exchange and it happens instantly at the current exchange rate.

Banks undertaking this service for their customers can make a profit on the exchange rate and generally charge a transaction fee.

**Currency risk**

If a company knows that it will need to make a payment on an invoice in 60 days’ time, in foreign currency, it can take out a forward contract with the bank. The bank would then buy the foreign currency ‘forward’ so that in 60 days’ time the bank will pay the creditor and charge the customer. The advantage of this to the customer is that they know how much the payment will cost them. If they wait for 60 days and undertake a spot transaction then the markets may have moved and the same payment may cost more in local currency.

## Key terms

**Forward contract**

A contract between two parties to buy or sell an agreed currency at a specified price on a future date.

**Spot rate**

The price quoted for immediate settlement. It is the current market value of an asset (eg foreign currency), available for immediate delivery at the moment of the quote given.

**Bank rates**

A bank will take the market spot rate and add a margin for the bank to ensure that it makes money on both buying and selling foreign exchange with customers.

**Example**

In this example, a corporate needs to sell US$ and buy JPY140m. Referring to the key terms box in this section, study the three different scenarios and note the differences in the cost to the bank and to the customer, as well as the foreign exchange (FX) gains the bank can make on each version of the transaction.

|  |  |
| --- | --- |
| **Scenario 1: the customer undertakes a spot transaction with the bank to buy JPY and sell US$ for immediate settlement** | |
| Market spot rate: 110.76  Bank buy rate: 109.12  Bank sell rate: 112.40 | |
| Bank sells US$ to buy JPY for customer at market spot rate. This costs the bank: | JPY140,000,000 / 110.76 = US$1,263,994.22 |
| The customer sells the bank US$ and buys the JPY at bank buy rate. This costs the customer: | JPY140,000,000 / 109.12 = US$1,282,991.20 |
| Profit for bank on transaction is the difference between the two transaction costs: | US$1,282,991.20 - US$1,263,994.22 = US$18,996.98 |

|  |  |
| --- | --- |
| **Scenario 2: the customer takes out a forward contract with the bank to buy JPY in 60 days’ time but with the exchange rates fixed today** | |
| Market forward rate: 109.79  Bank forward buy rate: 108.09  Bank forward sell rate: 111.49 | |
| Bank sells US$ to buy JPY for customer at market forward rate. This costs the bank: | JPY140,000,000 / 109.79 = US$1,275,161.67 |
| The customer sells the bank US$ and buys the JPY at bank forward buy rate. This costs the customer: | JPY140,000,000 / 108.09 = US$1,295,216.95 |
| Profit for bank on transaction is the difference between the two transaction costs: | US$1,295,216.95 - US$1,275,161.67 = US$20,055.28 |

|  |  |
| --- | --- |
| **Scenario 3: the customer waits 60 days and then undertakes a spot transaction with the bank to buy JPY and sell US$ for immediate settlement** | |
| Market spot rate in 60 days’ time: 100.43  Bank buy rate in 60 days’ time: 99.06  Bank sell rate in 60 days’ time: 101.80 | |
| Bank sells US$ to buy JPY for customer at market spot rate. This costs the bank: | JPY140,000,000 / 100.43 = US$1,394,005.78 |
| The customer sells the bank US$ and buys the JPY at bank buy rate. This costs the customer: | JPY140,000,000 / 99.06 = US$1,413,284.88 |
| Profit for bank on transaction is the difference between the two transaction costs: | US$1,413,284.88 - US$1,394,005.78 = US$19,279.10 |

As you can see from the calculations above, the cost to the company of waiting to buy the JPY for 60 days is higher than the cost of the forward transaction as the market has moved against them.

**Activity**

A corporate that banks in US$ needs to pay an invoice for CAD50,000 for a one-off purchase. The invoice needs to be paid straight away. The corporate does not have a CAD bank account. Using the market spot rate, bank buy rate and bank sell rate below, calculate the cost of the transaction to the corporate and to the bank, as well as any gain made by the bank on the transaction.

|  |  |
| --- | --- |
| **The customer undertakes a spot transaction with the bank to buy CAD and sell US$ for immediate settlement** | |
| Market spot rate: 1.27  Bank buy rate: 1.25  Bank sell rate: 1.29 | |
| Bank sells US$ to buy CAD for customer at market spot rate. This costs the bank: |  |
| The customer sells the bank US$ and buys the CAD at bank buy rate. This costs the customer: |  |
| Profit for bank on transaction is the difference between the two transaction costs: |  |

**Earning revenue from foreign exchange**

Banks earn revenue from foreign exchange by charging service fees and for the ‘spread’ on a transaction. Additionally, the bank may not actually buy the foreign currency to deliver to the customer or pay on behalf of the customer, but it will have offsetting transactions in that foreign currency, allowing for the bank to meet the customer demand at a lower cost, ie if the bank had a customer buying JPY and selling US$, and a second customer buying US$ and selling JPY, then the bank could offset the two transactions, so it does not have to transact in the market at all.

## Key terms

**Spread**

The difference between the currency rate that the bank receives and the currency rate that it charges its customers.

## 7.4 Cash management

As we learned earlier in this topic, cash management refers to the collection, concentration and payment of cash; in other words, the managing of cash flows. The goal of cash management is to maximise the availability of cash not otherwise invested to avoid insolvency, which makes it a key component of liquidity management. Account services (discussed in section 7.2) form the foundation of good cash and liquidity management.

## Key terms

**Cash flow**

The net amount of cash being transferred into and out of the business.

**Cash concentration**

The aggregation of cash in multiple bank accounts into a single account to manage a cash position more effectively.

The requirements corporates have of banks can be broken down into three parts:

* The **operating** part of cash activities, which is based heavily on the [net working capital](https://corporatefinanceinstitute.com/resources/knowledge/finance/what-is-net-working-capital/) element of the balance sheet and funds the day-to-day operations of the company. Working capital was discussed in section 2.1.
* Cash inflows and outflows connected to **investing** (eg investments in real estate or buying new equipment and machinery), which will need funding.
* **Financing** activities, which include borrowing money to invest and grow the business, or paying out dividends.

Banks earn interest on the products they offer to manage these activities and can also earn valuable fee income for the provision of services.

## 7.5 Financing

Corporates need financing for a variety of reasons, such as to meet short-term funding requirements, expand a business, purchase assets or restructure existing debt.

There are many products available to corporates that require financing, some shorter term in nature, others longer term. While most forms of financing may be bilateral in nature, involving one lender and one borrower, some financing may involve more than one lender and may even combine different types of financing, such as a syndicated or club loan. Some loans may be held by the lender and other loans may be eventually sold to other investors. Other loans may be collateralised by the borrower.

## Key terms

**Collateralisation**

The use of a valuable asset to secure a loan. If the borrower defaults on the loan, the lender may seize the collateral.

Financing is often provided by banks; however, it can sometimes be provided by other types of investors. You will learn more about this later in the next section.

### 7.5.1 Loans

Bank loans are one of the most common forms of finance for corporates. They are generally a quick, straightforward way to secure funding, and are usually provided over a fixed period of time.

For businesses seeking to purchase business premises, commercial mortgages are widely available and will generally offer flexible terms.

**Loan types**

* **Term loans** – loans where funds are provided for a set period (as outlined under a drawdown schedule). The principal is drawn down in tranches over set periods to tie in with the borrowing needs of the customer and amounts paid back cannot be redrawn. The interest rate on a term loan can be fixed or variable.
* **Revolving credit facilities (RCF)** – these provide a borrower with greater flexibility up to a pre-agreed limit on drawing down and repaying funds. Key features of an RCF include:
  + multiple withdrawals can be made up to the pre-agreed limit;
  + drawings can be repaid at any time and as many times as required;
  + interest is received only on the amount that has been borrowed in the period, although other fees are normally charged, including utilisation fees (the fee charged for the credit that is used) and commitment fees (the fee charged by a lender for future or unused credit);
  + the RCF is only in place while the borrower meets the terms of the facility.

**Syndicated loans**

A group of lenders, known as a syndicate, may work together to provide financing to a corporate under a single loan agreement. This often occurs when a corporate wants to borrow a significant amount of money, usually more than any single lender is willing to provide. This type of loan spreads the risk among the lenders in case of borrower default. Syndicated loans often include both a term loan and an RCF facility. They may also include other facilities such as a letter of credit or guarantee facility. A lender may sell its participation in a syndicated loan to other investors.

A club loan is a type of syndicated loan where the lenders do not intend to remain in the syndicate until the loan matures. Club loans are generally smaller in amount than syndicated loans.

### 7.5.2 Debt and equity financing

Companies can raise money by issuing debt or by raising equity, such as by issuing shares. There are significant differences between debt and equity financing, specifically borrowing money versus selling equity, but both provide stability through long-term investment.

**Debt financing**

Companies can raise funds by issuing bonds to investors, whereby the principal must be paid back to investors in the future. Selling corporate bonds allows companies to raise funds for expanding business, financing mergers, or for supplementing or replacing bank funding. Raising funds in this way offers benefits such as stability via long-term investment and protection of the value of the business's shares.

Two options are available to companies to issue debt:

* **Public offering** – large companies with credit ratings can issue bonds on the capital markets using a bank to underwrite the bond.
* **Private placement** – smaller companies can use a private placement, or non-public offering, to offer bonds to a limited selection of private investors.

**Equity financing**

As you learned in Topic 2, equity represents the ownership of the value in a business. Companies can raise funds by issuing shares, giving investors a stake in the business.

The first time a company raises equity is usually to become a public company and when launching an initial public offering (IPO) to raise cash to fuel expansion. After that, companies can choose to raise further equity from existing investors through a rights issue or an open offer, or look to attract new investors by conducting a placing.

## Key terms

**Rights issue**

When a company sells new shares in the business to existing shareholders.

**Open offer**

When a company sells new shares in the business to both existing shareholders and new investors.

**Placing**

When the company sells new shares in the business to new investors.

A private company that doesn’t want to list its shares, possibly due to its size, the additional scrutiny of going public, or the stage of its development, may find it problematic to sell shares. In these instances, a private company may turn to private equity or venture capital. Private equity managers or venture capitalists work alongside the company’s management team to enhance the running of the business. That way, they’re involved in the company’s strategic (and sometimes operational) decisions and can play an active role in helping it become successful.

## Key terms

**Private equity**

Capital invested in a company that is often stable but not publicly listed.

**Venture capital**

A form of private equity provided to companies, often in the start-up phase, which exhibit significant growth potential.

The disadvantage of equity financing is that the owners of the company have to give away a portion of that ownership, and the future profits and IPO benefits that that might bring them, at an early stage when they might not get the best possible price for the shares. However, the expertise of a good equity partner should more than compensate for the loss of ownership.

**Check your understanding**

What are the longer-term financing options available to corporates through banks?

## 7.6 Trade finance

The term ‘trade finance’ refers to intermediation by banks through the control of documents relating to the shipment of underlying goods. Although trade finance is commonly associated with international trade, it can also be used domestically.

The benefits of trade finance to the client include:

* **credit risk mitigation** using trade instruments (eg methods of settlement) such as letters of credit, collections and guarantees;
* **finance** using trade instruments as a basis for its provision;
* **settlement**, with the trade instruments themselves often incorporating the settlement process;
* **liquidity and enhanced qualitative balance sheet metrics** such as days payables outstanding (DPO) and days sales outstanding (DSO).

## Key terms

**Days payables outstanding**

The average number of days it takes a company to pay its accounts payable.

**Days sales outstanding**

The average number of days it takes a company to receive payment for a sale.

**Days inventory outstanding**

The average number of days that a company holds inventory for before turning it into sales.

You will learn more about DPO and DSO in section 7.8.

**Methods of settlement**

The four basic methods of settlement used in trade finance each carry a different level of risk for the buyer and seller and are as follows:

* **Payment in advance** – the buyer pays for the goods or services in advance.
* **Documentary credit** – an undertaking provided by the buyer’s bank stating that if the seller complies with its terms and conditions, the bank will arrange settlement in the manner described therein.
* **Documentary collection** – after the seller despatches its goods, instead of sending the documents direct to the buyer, it will send them via the banking system to hold pending payment or acceptance by the buyer.
* **Open account** – a seller will despatch its goods to a buyer and send an invoice (and any other customary or required documents) asking for payment or agreement to pay on a specified date.

The chosen method of settlement selected will depend on a number of factors, including the:

* relationship between the buyer and seller;
* availability of facilities and working capital to the buyer and seller;
* countries involved in the transaction.

It should also be noted that open account transactions are well-suited to supply chain finance solutions. You will learn more about supply chain finance in section 7.7.

### 7.6.1 The risk ladder

At the outset of negotiations, the buyer and seller must agree on the terms of how they are to trade. The risk ladder (Figure 7.1) is a popular concept that demonstrates that the most secure method of settlement for a seller is the least secure for a buyer.

**Figure 7.1 The risk ladder**

Diagram

Description automatically generated

### 7.6.2 How banks earn revenue from trade finance

Trade finance can generate income for a bank in the following ways:

* The bank acts as an intermediary between the importer and exporter in a trade transaction and can therefore generate significant **fee and commission revenues**.
* The bank provides short-term working capital finance within the context of a trade finance transaction, which generates **interest income**.
* The bank can **cross-sell other services**, such as foreign exchange and correspondent banking.

## 7.7 Supply chain finance

A supply chain is the series of companies that buy and sell items that are incorporated into a final product. For example, a series of suppliers might make parts for an engine, which are later incorporated into a final product: a car. As all of these suppliers are necessary to complete the final product, the car company is very interested in its supply chain, as failure of one link means that the final product cannot be completed.

There has been a lack of consistency among practitioners in the use of the term ‘supply chain finance’. Some have adopted a very narrow, single-product definition that refers to the financing of approved payables. Others refer to a much wider family of solutions that facilitate domestic and international supply chains.

In this qualification, standard market definitions for supply chain finance techniques and practices are used, as published by the Global Supply Chain Finance Forum (GSCFF) in 2016.

Supply chain finance [SCF] is defined as the use of financing and risk mitigation practices and techniques to optimise the management of the working capital and liquidity invested in supply chain processes and transactions. SCF is typically applied to open account trade and is triggered by supply chain events. Visibility of underlying trade flows by the finance provider(s) is a necessary component of such financing arrangements which can be enabled by a technology platform.

(GSCFF, 2016)

**FACTFIND**

**Standard definitions for techniques in supply chain finance**

You can explore the GSCFF’s [standard definitions](http://supplychainfinanceforum.org/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf) on their website.

Explore the [Global Supply Chain Finance Forum](http://supplychainfinanceforum.org/) website.

Supply chain finance techniques are based on receivables purchase agreements or loans and advances and can occur at different stages of the supply chain. These are:

* the purchase order stage (pre-shipment);
* the inventory stage;
* the invoice stage (post-shipment).

## Key terms

**Receivables purchase**

An agreement whereby a seller of goods can obtain financing by selling all or a part of their receivables (the amount owed for supply of goods or services) to a bank or other finance provider.

The stages at which individual supply chain finance solutions may be used to meet client needs are illustrated in Figure 7.2.

**Figure 7.2 Techniques relative to the supply chain**

A screenshot of a computer

Description automatically generated with medium confidence

*Source*: Bugeja and Taylor (2018)

### 7.7.1 Receivables purchase techniques

As we learned in section 7.7, receivables purchase is an arrangement whereby a seller can obtain financing by selling all or a part of their receivables to a bank or other finance provider. In other words, a company sells its as yet unpaid receivables, generally an invoice issued. Here, the finance provider is buying an asset rather than making a loan.

Supply chain finance techniques based on receivables purchase include:

* **Receivables discounting** – sellers of goods and services sell individual or multiple receivables (represented by outstanding invoices) to a finance provider at a discount.
* **Forfaiting** – the purchase of future payment obligations (which are normally in negotiable or transferable form without recourse). The purchase is carried out either at a discount or at face value in return for a financing charge.
* **Factoring** – sellers of goods and services sell their receivables (represented by outstanding invoices) at a discount to a finance provider (commonly known as the ‘factor’). The finance provider becomes responsible for managing the debtor portfolio and collecting the payment of the underlying receivables.
* **Payables finance** – a buyer-led programme within which sellers in the buyer’s supply chain are able to access finance by means of receivables purchase. The technique provides a seller of goods or services with the option of receiving the discounted value of receivables (represented by outstanding invoices) prior to their actual due date and typically at a financing cost aligned with the credit risk of the buyer. The payable continues to be due by the buyer until its due date.

(Adapted from GSCFF, 2016)

### 7.7.2 Loan or advance-based techniques

The following are supply chain finance techniques based on loans or advances:

* **Loan or advance against receivables** – financing made available to a party involved in a supply chain on the expectation of repayment from funds generated from current or future trade receivables. Usually made against the security of such receivables, but may be unsecured.
* **Distributor finance** – financing for a distributor or large manufacturer to cover the holding of goods for re-sale and to bridge the liquidity gap until the receipt of funds from receivables following the sale of goods.
* **Loan or advance against inventory** – financing provided to a buyer or seller for the holding or warehousing of goods.
* **Pre-shipment finance** – a facility made available to a seller of goods and/or services for the sourcing, manufacture or conversion of raw materials or semi-finished goods.

(Adapted from GSCFF, 2016)

## 7.8 Working capital management

In Topic 2, you learned about assets and liabilities. Earlier in this topic, you learned about financing and supply chain finance products and techniques. Working capital management is a business strategy whereby a company aims to operate with maximum efficiency by monitoring and using its current assets and liabilities optimally, using various forms of financing offered by banks.

To better understand working capital management, it is important to know a few key terms.

## Key terms

**Working capital**

The net sum of a company’s current assets less current liabilities. In essence, the amount of available capital that a company can use to pay short-term expenses.

**Current assets**

Accounts receivable, or money a company is due to receive within a year, and inventory in all stages of the product process.

**Current liabilities**

Accounts payable, or money a company is due to pay within a year.

Accounts receivable, inventory and accounts payable are not cash. However, they are expected to convert to cash within a year and impact cash flow. This is known as the cash conversion cycle.

**Cash conversion cycle**

The cash conversion cycle is a metric that expresses the time it takes for a company to convert its resources, such as inventory and accounts receivable, into cash and the time it takes for a company to pay its bills (accounts payable).

The cash conversion cycle consists of three stages, which can be quantified by calculating ratios from information contained in the corporate’s financial statement. These include:

* days inventory outstanding (DIO);
* days sales outstanding (DSO);
* days payables outstanding (DPO).

**Formula**

Cash conversion cycle = DIO + DSO – DPO

**FACTFIND**

Learn more about the ratios used to calculate the cash conversion cycle:

Corporate Finance Institute: [Cash conversion cycle](https://corporatefinanceinstitute.com/resources/knowledge/accounting/cash-conversion-cycle/)

Understanding the cash conversion cycle and its components is one way that a relationship manager can better gauge a corporate’s financial health and offer appropriate financing and supply chain finance techniques. When viewed together and over time, the ratios provide information such as:

* how fast accounts receivable are converted to cash;
* whether too much inventory is held;
* whether a corporate pays its bills slowly;
* changing financial trends within a company.

However, it is important to note that cash conversion cycles may not be applicable to all types of corporates. Cash conversion cycles work best in helping relationship managers understand the needs of corporates related to inventory.

**Working capital management tools**

Understanding a corporate’s business model and financial position, including the cash conversion cycle, is key to being able to make suitable suggestions as to which working capital tools may best meet a customer’s needs to help them operate most efficiently. Leveraging effective working capital management processes can ensure that a corporate maximises cash flow, increases profit and reduces risk.

A sound working capital strategy for most corporates can include a revolving line of credit for short-term needs, debt or equity financing for long-term funding requirements, or supply chain finance products based on receivables purchase or loans and advances, particularly if a company has inventory and raises invoices.

**Working capital financing**

* **Overdrafts** – these are repayable on demand and interest is charged only on the amount overdrawn. You learned about overdrafts in Topic 5.
* **Money market lines** – bilateral facilities made to prospective borrowers who may or may not have a bank account with that bank, at rates related to wholesale money market rates.
* **Other facilities** – these are not directly from lending and include trade finance facilities such as documentary credits and guarantees. You learned about documentary credits and other trade finance products in section 7.6.

**Cash management and working capital management**

Cash management (discussed in section 7.4) and working capital management work together to ensure a corporate is operating efficiently and is financially stable. In fact, many consider cash management to be an essential activity in any sound working capital management strategy, and both offer significant insight into a corporate’s financial stability.

**Figure 7.3 How cash management and working capital management inform on financial health**

## 7.9 Digitalisation for corporates

In sections 5.7 and 6.9 you learned about how digitalisation has transformed banking and investing for retail and high-net-worth customers respectively. In this section, we will look at a few specific examples of how digitalisation has created efficiencies in the banking experience for corporates.

**Account services**

In most countries, payments are now processed in real time through instant payment schemes available 24/7, 365 days a year. Infrastructural development of payment systems and collaborative efforts in many countries have also improved interoperability and efficiency for corporates.

**Connectivity options**

Corporates now have an assortment of digital connectivity options, many of which are integrated across borders and are available through cloud computing, facilitating faster, more transparent processes. Digital connectivity solutions for corporates include:

* **Enterprise Resource Planning (ERP) systems**, which transmit information across an organisation – between sales and treasury teams or from procurement to treasury ­teams, for example – to facilitate the management of the business.
* **Treasury management systems**, which house data on receivables, payables, cash positions, interest rates, foreign exchange rates and counterparty credit limits. Besides driving cost efficiencies, they also improve cash visibility and forecasting, governance and security, and liquidity management.
* **Host-to-host connectivity**, which enables corporates and banks to transmit files to and from each other.

## Key term

**Cloud computing**

Use of remote servers hosted on the internet to store and process data, as opposed to a personal computer or a local server.

**Cross-border transparency**

To improve the speed, transparency and tracking of cross-border payments, SWIFT developed the global payments innovation standard, commonly referred to as SWIFT gpi. Large corporations with treasury departments that require better visibility into their payment processes benefit considerably from SWIFT gpi.

|  |
| --- |
| **FACTFIND**  **SWIFT gpi**  Find out more about the benefits of SWIFT gpi for [corporates](https://www.swift.com/our-solutions/swift-gpi/swift-gpi-corporates) and for [banks](https://www.swift.com/our-solutions/swift-gpi/swift-gpi-banks).  Watch the following [video](https://www.swift.com/our-solutions/swift-gpi/about-swift-gpi). |

### 7.9.1 DLT in trade finance

As you learned in section 6.9, blockchain is only one of more than 100 instances of distributed ledger technology (DLT). Corporates and banks use DLT in trade finance to save on costs and time by eliminating the need to process, validate and authenticate the same information repeatedly.

Other benefits include:

* reduced operational risk through increased transparency;
* improved management of the cash conversion cycle (from the corporate perspective);
* better use of limited amounts of regulatory capital (from the bank perspective);
* clarity around the legal liability of all parties involved (‘permissioned’ DLT with smart contracts, see section 7.9.2);
* guaranteed authenticity (‘permissioned’ DLT with smart contracts, see section 7.9.2);
* easily trackable data, as nothing can be altered, and the ledger is present across multiple nodes.

**Digital trade finance consortia**

Several consortia are already using applications based on DLT; Marco Polo and we.trade are two prominent examples. As these initiatives evolve, the lines between trade finance and supply chain finance are becoming increasingly blurred.

## Key terms

**Consortium**

A group of businesses or banks that have joined together for a shared purpose. A trade finance consortium will aim to maximise cost and time efficiencies through the creative and innovative use of DLT.

**FACTFIND**

**DLT in action**

Explore the following examples of trade finance consortia:

* [Marco Polo](https://www.marcopolonetwork.com/)
* [we.trade](https://we-trade.com/)
* [Contour](https://contour.network/)

Read about how DLT is transforming trade finance:

Flow: [Trade and the blockchain – where are we now?](https://flow.db.com/trade-finance/trade-and-the-blockchain-where-are-we-now?kid=nl2020)

Hyperledger: [Dubai’s digital Silk Road modernizes trade with Hyperledger Fabric](https://www.hyperledger.org/learn/publications/avanza-case-study)

### 7.9.2 Smart contracts

Smart contracts are another useful application of DLT. They enable an asset to be transferred into a program that automatically executes a set of pre‑encoded instructions. At a certain point in the transaction life cycle, the program will automatically validate a condition and determine whether ownership of the asset should pass to one person or another. The DLT also stores and replicates the underlying data to provide security and immutability.

### Key terms

**Smart contracts**

Smart contracts contain computer code that can be stored or replicated on a distributed ledger platform and executed by a network of computers. Smart contracts reduce operational risk via automation of workflow.

The benefits of smart contracts include:

* **Speed**: smart contracts use code to automate workflow, reducing processing time.
* **Accuracy**: automation reduces the risk of error generally associated with manual processing.
* **Trust**: data encrypted on a shared ledger is considered immutable.
* **Cost**: the removal of intermediaries reduces cost and enhances efficiency.

Smart contracts are designed to guarantee a specific set of outcomes, therefore eliminating the risk of uncertainty or confusion.

**Benefits of smart contracts in trade finance**

Smart contracts provide benefits to parties in a trade finance transaction by reducing the use and transmission of paper across the globe, creating cost and time efficiencies.

**FACTFIND**

“Smart contracts could secure trust among parties in open account trading, enhance transparency in trade transactions, guarantee data reliability, reduce the risk of errors or fraud, and facilitate the exchange of payments” (Elsaid, 2020).

Trade Finance Global: [The application of blockchain in trade finance: opportunities and challenges](https://www.tradefinanceglobal.com/posts/the-application-of-blockchain-in-trade-finance-opportunities-and-challenges/)

## Test your knowledge

1. Which of the following would be considered a local account?
   1. A Singaporean bank account held by a British firm in Singapore.
   2. A bank account based in Dubai that is held by an Australian surf brand in Egypt.
   3. A UK bank account held by a British company in the UK.
   4. A bank account based in Sri Lanka and held by the Pakistani cricket team in India.
2. A syndicated loan may:
   1. include a term loan but never a revolving credit facility.
   2. involve only one lender.
   3. allow a lender to transfer participation to another investor.
   4. not include trade finance facilities such as a letter of credit.
3. The requirements corporates have of banks can be broken down into three parts:
   1. operating, accounting and financing.
   2. payments, foreign exchange and treasury management.
   3. operating, investing and financing.
   4. liquidity management, financing and foreign exchange.
4. A bank is allowed to appropriate its client’s fleet of Teslas under which of the following circumstances:
   1. syndication.
   2. liquidity management.
   3. collateralisation.
   4. receivables purchase.
5. Payables finance:
   1. is led by the seller.
   2. is a form of finance involving receivables purchase.
   3. occurs during the purchase order stage.
   4. involves a loan or advance against inventory.

## References

Bugeja, J. and Taylor, L. (2018) *Certificate in Supply Chain Finance*. The London Institute of Banking & Finance.

Elsaid, H. (2020) *The application of blockchain in trade finance: opportunities and challenges* [online]. Available at: <https://www.tradefinanceglobal.com/posts/the-application-of-blockchain-in-trade-finance-opportunities-and-challenges/>

GSCFF (2016) *Standard definitions for techniques of supply chain finance* [pdf]. Available at: <https://cdn.iccwbo.org/content/uploads/sites/3/2017/01/ICC-Standard-Definitions-for-Techniques-of-Supply-Chain-Finance-Global-SCF-Forum-2016.pdf>