

# Size matters in SEPA

*How will the advent of the Single Euro Payments Area impact on liquidity management for companies doing business in Europe? There's no simple, 'one size fits all' solution, but one thing's for sure: this is no time for finance directors to be hiding their heads in the sand.*

Europe's financial system is about to embark on a change that ECB President Jean-Claude Trichet recently described as no less challenging than the launch of the euro, and no less important: the rollout of the Single Euro Payments Area (SEPA). The aim is to make sure that individuals and companies are able to make euro payments all over Europe as easily as in their home countries, dissolving the current distinction between national and cross-border transactions. This is seen as an essential step in strengthening the internal market, enhancing competition, improving efficiency and contributing to economic prosperity. SEPA payment instruments will start to be introduced from 1 January 2008, with national card and electronic payments (credit transfers and direct debits) gradually migrating to SEPA compliant systems over the following two years. The European Payments Council expects a "critical mass" of payments to be switched over by 2010 (though it has not defined precisely what it means by this).

However, with the EU and national governments still to agree on the details of the Payment Service Directive (PSD) that will establish the legal framework for SEPA, and the banking industry still discussing the standards on which the technical infrastructure will be based, some uncertainty still clouds the final shape of this brave new world of payments without borders. Addressing a gathering of all the main SEPA players in November 2006, European Internal Markets Commissioner Charlie McCreevy expressed a degree of frustration with the slowness of progress, urging industry leaders to "take the bull by the horns and migrate to SEPA as soon as possible".

## Moving target

In this context, it's perhaps understandable that some corporate finance directors have yet to factor the impact of SEPA fully into their forward planning. Faced with a moving target, many – particularly at smaller and mid-market companies – are cautious about rushing headlong into major new investments in SEPA-compliant systems. Yet there's no doubt that many such companies involved in cross-border business in Europe do indeed have much to gain from the transition, not least in the area of liquidity management – and much to lose if they fail to plan effectively and in time for the changes ahead. Moreover, there is a distinct possibility that the migration to SEPA may not in fact take place in the gradual way that is envisaged. If progress is slower than expected, the European authorities may force a more rapid transition by means of regulation - and for companies that haven't made adequate preparations, this could become a major problem. Even those that opt for a wait-and-see approach need to be ready to act in a rapid and properly informed way as and when the need arises.

## Liquidity impacts will vary

In terms of liquidity management, SEPA's impacts are going to vary substantially depending on the type of company and the scope of its operations. Size, of course, is an important factor, but by no means the only one. It may be useful here to distinguish four main categories of corporate that will be affected to greater or lesser degrees.

The first consists of small and medium-sized enterprises that are mainly or entirely active in a single national market. For this group, SEPA is unlikely to offer much in the way of either immediate benefits or potential pitfalls. Basically, these companies will probably remain happy with the payment and liquidity management arrangements that they're using at present.

Then there are the really big cross-border players – the multinationals. Many of these already have large central payments and collections centres for their European operations, and are already managing consolidated euro balances on a daily basis. Aided by new technology, many have already gained greater global control over their liquidity by including all the currencies (including non-European currencies) from their various operations in an integrated liquidity pool by means of a combination of target balancing and cross-border, cross-currency notional pooling.

That said, SEPA will bring opportunities for large cross-border players to further rationalise their liquidity management structure by using pan-European formats. These companies would be wise to follow the rollout of SEPA closely and be ready to review their liquidity management in the light of new circumstances.

The third category consists of locally focused companies involved in import and export. For them, it may well make sense to discontinue separate local accounts in the various European countries where they make and collect payments, taking advantage of opportunities to streamline cash-flow processes and reduce costs by consolidating onto one bank account for the whole of Europe.

Finally, there is perhaps the most diverse group, the “multilocals”. Typically these are mid-market companies with a presence in more than one country and activities that go beyond simple import-export. Many of these also stand to gain from SEPA, especially if their bank offers a pan-European electronic banking platform that can effectively streamline their payments and collections services. Here too, an increasing number are already taking advantage of specialist cashmanagement solutions such as target balancing, interest cost / interest earnings offsetting and cross-border pooling, offered by banks with their own integrated network of offices in the required locations. It might be thought that such companies will be encouraged by SEPA to consolidate their liquidity management onto a single centralised account. But it would be a mistake to assume that there is a ‘one size fits all’ solution.

### Cultural and logistical factors

In particular, there is an important distinction to be drawn between centrally led corporates and companies where the financial management is decentralised. For centrally focused companies, SEPA will clearly make it easier to collect money centrally at holding level. But for companies that have grown by acquisition and where local management is still very much in charge of country operations, it may be more difficult to make a convincing case for radically changing their financial business model.

For one thing, local managers often appreciate being able to have direct contact with locally based banking advisers, and the importance of personal relationships should not be underestimated. At the same time, these companies may wish – or indeed need – to continue using widely accepted local payment methods that simply cannot be handled remotely from another country. In other words, there’s a need to take “cultural” factors into account as well as the purely logistical issues.

Among the factors that may favour the continued use of local, SEPA-enabled accounts alongside centralised cash-pooling arrangements is the continuing use of physical cash. Despite the so-called ‘war on cash’, cash usage is actually still growing, even in Western Europe, and quite large numbers of companies – particularly retailers – will need to have cash services from a local bank account, at least for the foreseeable future. Such services are very hard to organise at a pan-European level, not least because movements of cash are often handled by security firms that are subject to national legislation and that, for the moment at least, don’t usually cross borders (moving large amounts of cash across long distances is also costly).

### Time to take action

So what steps should treasury and finance officers be taking now? Firstly, every company involved in cross-border business needs to take stock of how its liquidity management is likely to be affected. In consultation with their banking partners, they should consider what new opportunities will be opened up and exactly how SEPA may impact on their working capital management and payment value chain. Having assessed these opportunities and procedural impacts, it’s important to work out when they should be taking any necessary action and making investments to meet the new challenges. In drawing up a SEPA action plan, multinational and multi-local companies will need to ask themselves whether decisions should be taken on an individual country basis or for the group as a whole. They should also establish a budget for any investments in new technology and training, and set a date by which the company actively plans to switch to SEPA-compliant systems.

### Work closely with your banking partners

For some companies, this kind of evaluation process can reveal that there are real advantages to be gained by overhauling their liquidity management arrangements alongside their cross-border payment systems. Others may conclude that taking hasty action is unlikely either to save money or make their administration any easier. Given the complex and fast-changing environment and the fact that every company will need to address its own particular situation, this sort of 'SEPA audit' is best carried out with the help of a bank with in-depth knowledge of the wider regulatory context, local trading practices and the company's own strategic and operational priorities. A genuine partner bank of this sort will prove an invaluable travelling companion on your company's journey towards SEPA.

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