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The Hidden Catalyst for Accelerating Financial Performance: *Liquidity Cash Concentration*

In today's credit-constrained marketplace, corporate Treasury is under increasing pressure to find ways to support business growth objectives. Savvy companies are tapping into a hidden catalyst to accelerate their financial performance: cash concentration. This paper analyzes Citi data on the use of cash concentration liquidity solutions, along with publicly available company financial data. The findings reveal that a positive correlation exists between companies that maximize cash concentration - allowing them to redeploy cash - with those that maximize returns.

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High-Performing Treasuries May Have Cracked the Code When it Comes to Financial Performance

Everyone loves a winning strategy. Treasury is no exception. It comes as no surprise that top performing companies have top performing Treasuries. These professionals may have cracked the code when it comes to maximizing financial performance. To gain a better understanding of those potential winning strategies, we turned to the Citi Treasury Diagnostics[1] (CTD) benchmarking tool, that measures Treasury performance relative to industry peers. In this instance, 330 companies were categorized into three performance buckets: Top 25%, Middle 50%, and Bottom 25%.[2]

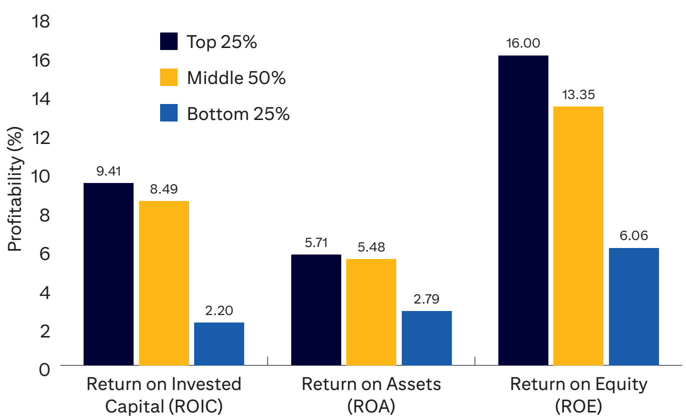
[1] Citi Treasury Diagnostics: Benchmarking Tool for Corporate Treasury Leadership

[2] Unlocking Success: Treasury Leadership and Shareholder Value, May '24

The top 25% companies consistently performed better across Return on Invested Capital (ROIC), Return on Assets (ROA), and Return on Equity (ROE). Figure 1 illustrates that treasury performance has a positive correlation with company performance.

Figure 1: Financial performance by ROIC, ROA, & ROE segmented by CTD performance

Profitability



Source: Citi Treasury and Trade Solutions, Citi Global Data Insights, Factset

The Citi Global Perspectives & Solutions (GPS) report, TREASURY LEADERSHIP: Does it Matter?,[3] demonstrates that high-performing treasuries effectively manage working capital, proactively identify and mitigate financial risks, and efficiently deploy liquidity to fund growth. Effective liquidity management, discussed further in this article, is characterized by centralizing cash, enhancing efficiency, and mitigating financial risks.

Cash Concentration: The Underutilized Key to Liquidity Management Optimization

When it comes to liquidity management optimization, one of the most effective strategies is one of the least used. Cash centralization and concentration can be viewed as best practice and an industry norm. However, almost one-quarter (22%) of companies surveyed don't concentrate their cash (Figure 2).

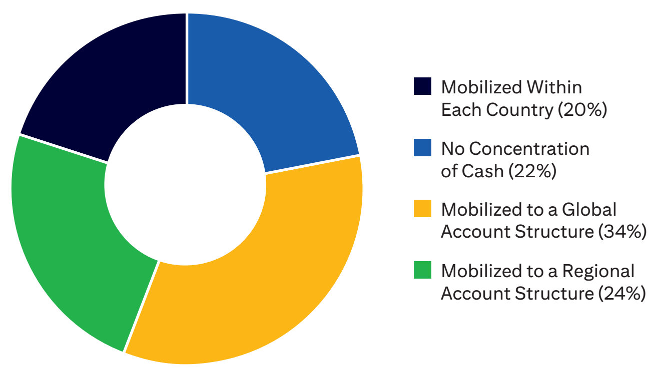
The foundation of effective liquidity management entails centralizing cash daily across legal entities, currencies, and banks into a global cash pool via automated concentration processes. With a more streamlined, centralized cash management process, funds can be readily deployed when necessary to meet strategic objectives of the business.

It is noteworthy that larger companies have a greater propensity for embracing cash concentration as evidenced by CTD data, which shows that as companies grow their revenue, they are more likely to concentrate cash. In our survey, we found 83% percent of larger companies concentrate their cash at either the global or regional level (Figure 3). This is almost double the share of smaller companies (42%). The contrast between larger and smaller companies could not be more pronounced.

Even for those companies that are concentrating cash, our survey data reveals opportunities for improvement. Of those concentrating cash, 59% concentrate 75% or more of the allowable participation (Figure 4). The majority (66%) of those surveyed have some level of manual concentration of cash (Figure 5). Clearly, replacing manual concentration with automation offers the prospect of greater efficiency and improved liquidity optimization. With only 40% of companies with annual sales greater than $2 billion per year enjoying fully automated cash concentration, the need for wider deployment of such best practice is obvious.

Cash Concentration Attributes through Treasury Benchmarking

Figure 2: Overall Concentration of Cash



[3] GPS Report: TREASURY LEADERSHIP: Does It Matter? (citi.com). Nov '23

Figure 3: Cash Concentration Level

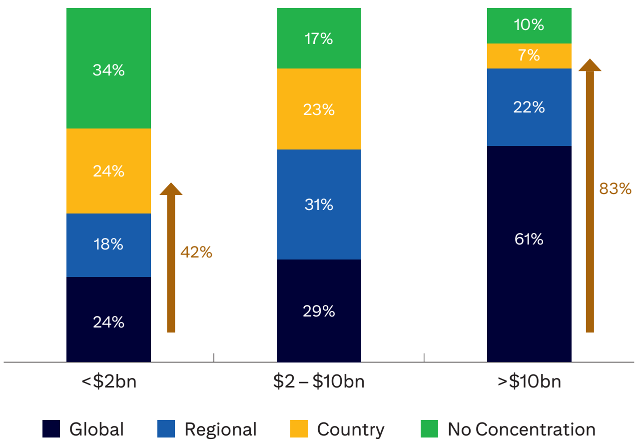


Figure 4: Flows Participation

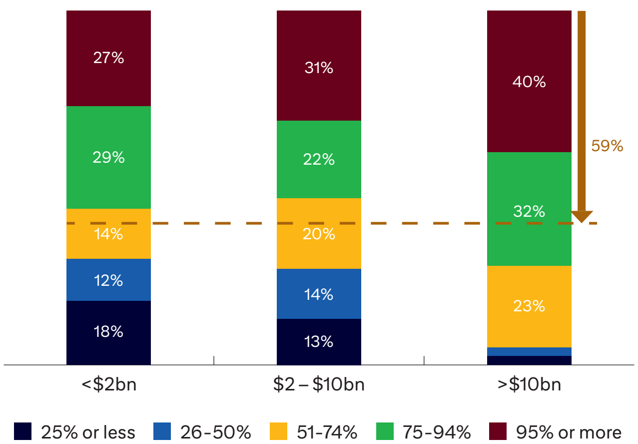
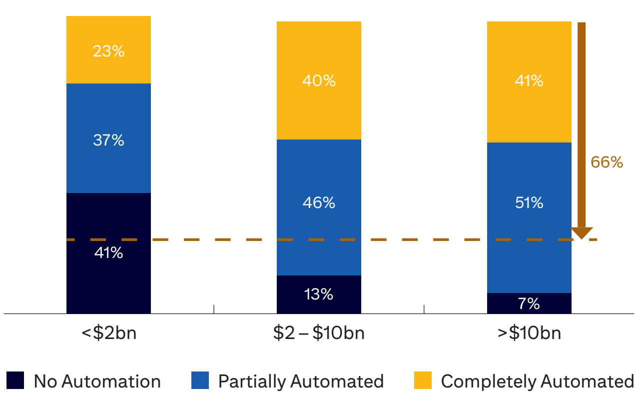


Figure 5: Automation Level



With only 40% of companies with annual sales greater than $2 billion per year enjoying fully automated cash concentration, *the need for wider deployment of such best practice is obvious.*

As mentioned earlier, the centralization of cash to the highest level allowable and mitigation of risk - through bank account structures to a single-entity header account - is accepted as best practice, and the first step towards an in-house bank. Techniques, such as physical pooling, notional pooling, and the use of virtual accounts, are readily available:

- **Physical pooling** concentrates cash held across multiple company subsidiaries through a layered account structure and can be cross-entity, cross-currency, and across banking relationships, requiring the management of intercompany loans. As seen in Figure 3, such concentration of cash can be to a global, regional, or country level.
- **Notional pooling** involves offsetting balances for interest optimization on a set of accounts without the physical movement or commingling of funds.
- **Virtual accounts** simulate the effects of physical or notional pooling and offers the real-time physical concentration of cash where only the header account is real.

For further detail on these solutions and suitability for your situation, please contact your Citi representative.

Profitability & Cash Efficiency Boosted by Citi Liquidity Management Services

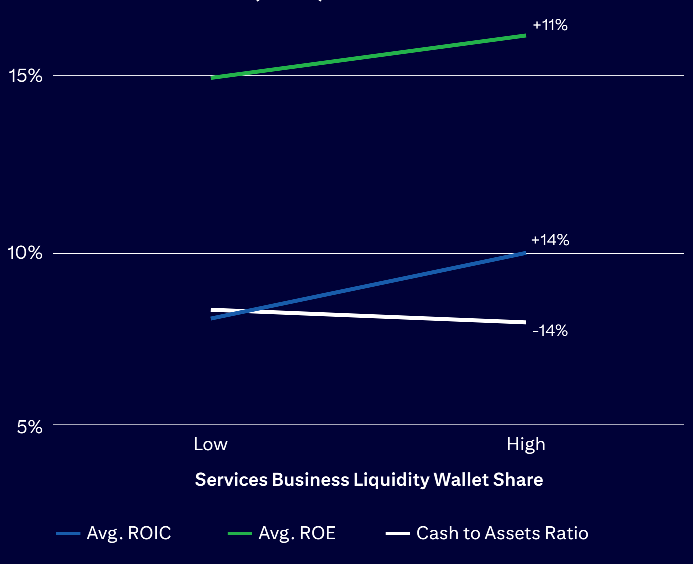
For many successful companies, their ability to boost profitability and cash efficiency is directly linked to the use of advanced liquidity management tools. Our analysis verifies that company financial performance can be correlated with the strength of clients' relationship with Citi Liquidity Management Services as measured by Citi's Liquidity Wallet, which is calculated by applying liquidity spread to minimum operating balance.

We drew this conclusion based on public record financials sourced from FactSet as of FY22.[4] When examining profitability and cash efficiency measures, we looked at Return on Invested Capital (ROIC), Return on Equity (ROE), and Cash to Assets Ratio. As clients increase their utilization of Citi Liquidity Management Services, we found lower ratios indicating greater company efficiency in managing cash with less cash idle, trapped or locked up in working capital and more cash deployed to assets for greater yield.

Digging a little deeper, we saw an increase in returns (ROIC & ROE) and reduction in Cash to Assets Ratio. More specifically, as indicated in Figure 6, the average ROIC and ROE increased by 11% and 14%, while the Cash to Assets Ratio fell by 14% as liquidity wallet share with Citi went from an average low of 4% to an average high of 28%. The total population average liquidity wallet share across the 1,695 companies reviewed was 12.5%.

Profitability & Cash Management Efficiency by Liquidity Wallet Share

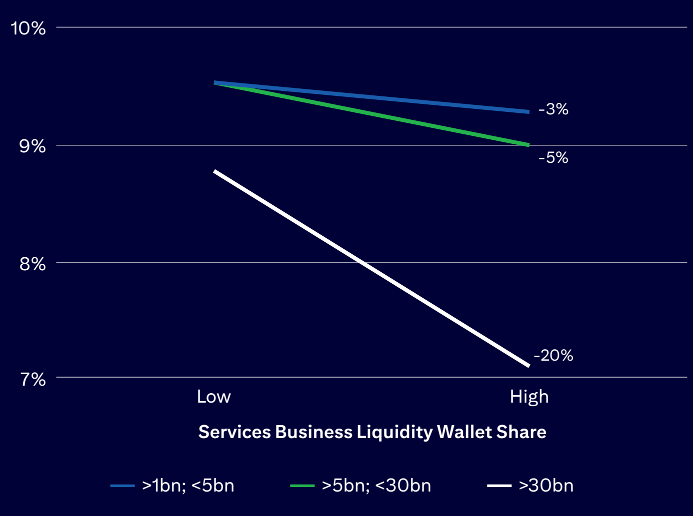
Figure 6: Company Returns & Cash/Assets Ratio vs. Liquidity Wallet Share with Citi (FY22)



Not surprisingly, lower Cash to Assets Ratios correlate with improved sales. We found that larger companies show increased efficiency and effectiveness as measured by their reduced Cash to Assets Ratio. Companies with Annual Sales > $30bn with High utilization of Citi Liquidity Management Services show a 20% drop in their Cash to Assets Ratio vs. similar sized companies with Low utilization of Citi Liquidity Management Services. The ratio dropped from 8.9% to 7.1% between the two service participation levels.

Cash Management Efficiency by Company Annual Sales

Figure 7: Cash to Assets Ratio by Company Annual Sales vs. Liquidity Wallet Share with Citi (FY22)



[4] Company performance analysis prepared with ICG Client Analytics, April '24. 1,695 companies analysed. Wallet and share are as of FY22, public financials sourced from FactSet as of FY22. Avg. Liquidity Wallet Share across total population = 12.5%. Avg. "low" = 4% share, 753 companies; Avg. "high" = 28% share, 459 companies; zero wallet share for 483 companies.

High Utilization of Citi Liquidity Management Services is strongly correlated with high ROIC and ROE. Our research found that companies with Annual Sales > $30bn with high utilization of Citi Liquidity Management Services have 16% higher ROIC and 6% higher ROE on average than those companies with low utilization of Citi Liquidity Management Services. The differences become even more impressive as the size of the company reduces. We found that companies in the $1bn - $5bn range of annual sales enjoyed a 23% higher in ROIC and 27% higher in ROE. However, it should be noted that these smaller companies were working off of a lower basis.

Figure 8: Return on Invested Capital by Company Annual Sales vs. Liquidity Wallet Share with Citi (FY22)

Return on Invested Capital

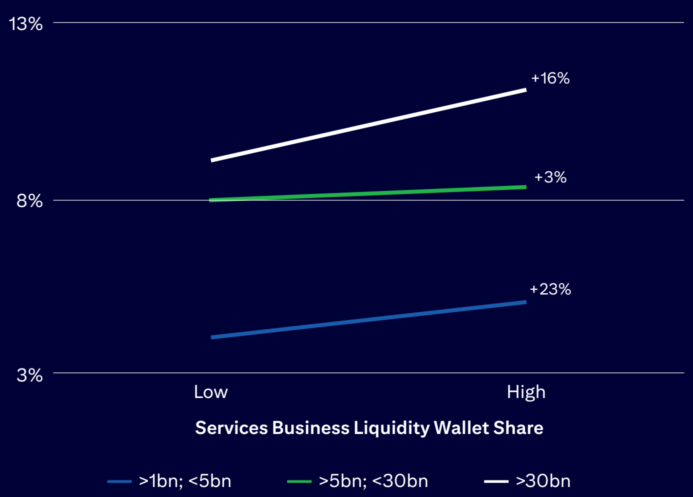
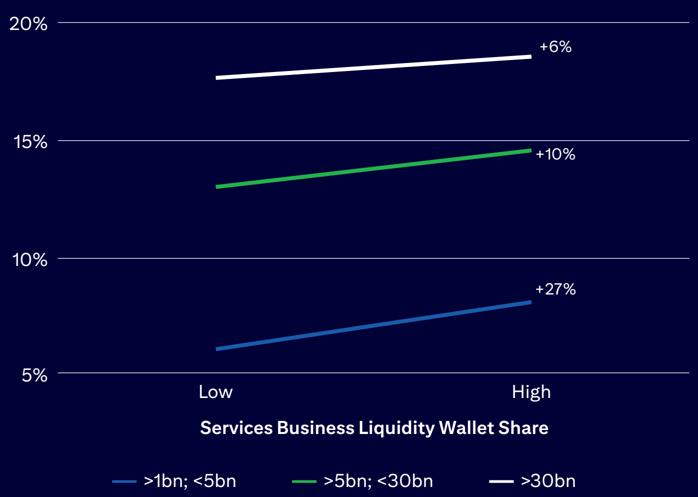


Figure 9: Return on Equity by Company Annual Sales vs. Liquidity Wallet Share with Citi (FY22)

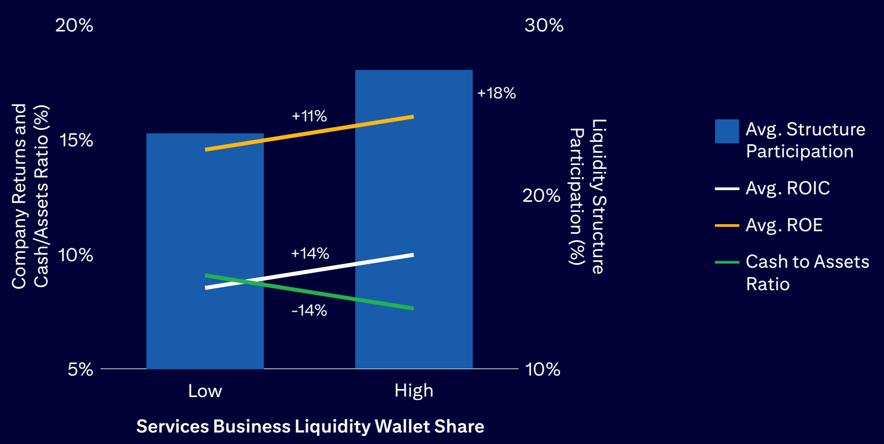
Return on Equity



Rise in Returns and Drop in Ratios Tied to Citi Liquidity Structure Participation

Lastly, to further validate our previous findings, we analyzed the actual utilization of cash concentration services at Citi at the service processor level. We examined Liquidity Structure Participation, which is expressed as the ratio of bank accounts participating, where allowable, in a cash concentration structure utilizing Citi global cash concentration engines over the total number of bank accounts held at Citi branches for study participants. The results were illuminating. In Figure 10, we chart an 18% increase in actual Liquidity Structure Participation as companies increase their liquidity wallet from an average 4% (Low) to an average 28% share (High) across the 1,695 companies analyzed. The uplift in Liquidity Structure Participation reinforces the positive correlation seen throughout this article for company returns and reduction in Cash to Assets Ratio.

Figure 10: Liquidity Structure Participation, Company Returns & Cash/Assets Ratio vs. Liquidity Wallet Share with Citi (FY22)



Summary

Our analysis shows that companies that maximize the concentration of cash, where allowable, tend to enjoy better financial performance. These Treasury organizations are successfully tapping into their own company's hidden catalyst to help accelerate the business. Some of the best practices outlined here highlight the importance of achieving higher profitability through Returns on Invested Capital and Assets, and reduced Cash to Assets Ratio, which indicates enhanced levels of cash efficiency. The lesson learned is that high-performing companies are deploying effective liquidity management techniques through centralization of cash. Treasury professionals would be well served to closely examine these successes to look for ways to achieve similar success in their own organizations.

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Citi Client Advisory Group is a treasury practitioner-led team advising on treasury, payments, working capital management and innovation. Insights and opinion are based on the team's independent analysis and engagement with clients.

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