Cash management made easy the Laporte way

Relationships and simplicity are key to setting up a successful global cash management system, says Mike Nicholson of Laporte plc.

There are two basic concepts underlying the Laporte approach to cash management: simplicity and relationships. Here, we will explain how we put in place an efficient global cash management system that met both criteria.

Laporte has always been relationship-focussed and has sought to develop links with a major bank in each of the key territories in which it operates, namely the UK, US, Germany, Italy, France, Canada and The Netherlands. Initially, these links took the form of bilateral borrowing facilities. However, recognising that the margins payable on our loans were hardly likely to enthral a bank's credit committee, we adopted a policy of placing all of our treasury business, including retail banking, with those banks.

This meant that we adopted a 'one bank per country' policy which, in some places, necessitated a radical restructuring of our banking operations. For example, before the exercise, we had relationships with more than 30 institutions in Italy, while in Germany our retail banking was carried out by five different banks, which did not include the bank that lent us money.

Taking the first step

Having decided on the bank line up, the next issue to resolve was what form of cash management system to adopt. Our approach was, first, to develop an efficient system in each of the aforementioned territories that met both the needs of treasury and those of our subsidiaries. This meant we wanted systems that minimised the interest costs of the group, yet provided our subsidiaries with the same degree of information they were used to receiving without increasing their workload.

As far as the subsidiaries were concerned, it was essential they knew what their bank account balances were before the operation of any cash management system, hence our preference to introduce cash pooling systems, whereby debit and credit balances could simply be offset for interest calculation purposes.

While this is common in the UK, where Laporte has operated a pooling system with Barclays for more than 25 years, in many countries such arrangements are not possible. Therefore, Laporte had to adapt the systems available to meet its needs.

In the US (our biggest market accounting for about 40% of sales and profits), before 1995 Laporte operated a UK-style pooling system with Barclays. Following the decision by Barclays to pull out of US retail banking, the company was faced with no alternative but to use a traditional US-style zero balancing system whereby the balances on subsidiary bank accounts are automatically upstreamed into a holding company concentration account.

To ensure our subsidiaries' needs were met, a key requirement built into the request for proposal sent to the leading US cash management banks was for the bank to be able to provide us with a nominal balance report which showed what the balance would have been on the subsidiaries' accounts had there been no zero balancing. The successful bank, Chase Manhattan, was able to provide us with a custom-built report available through its electronic banking platform, Insight.

Mike Nicholson

Founded in 1988, Laporte is a leading UK-based speciality chemical manufacturer with operations in 16 countries. In 1999, turnover was £930 million of which 43% was derived from North America, 31% from the UK, 23% from Continental Europe and 3% from the rest of the world. ■

Chase handles all domestic payments made by Laporte companies in the US. To enable treasury to more accurately establish the group's cash position (see *Figure 1*), each subsidiary has a controlled disbursement account (CDA) which is zero balanced from the unit's operating account. Every morning the subsidiary receives notification of the cheque presentment value that will be charged to the CDA that same day, thereby taking the guesswork out of daily funding.

Historically, Laporte has used a variety of lockbox banks to receive payments from customers. In keeping with its policy of using only lending banks for retail banking, the company invited those of its relationship banks with a US presence to quote for all of its lockbox requirements. As we wanted to spread our business among as many relationship banks as possible, and did not want to be dependent on only one institution for all of our US banking needs, (see *Figure 3*) Chase was excluded from this study and the business was awarded to Bank One.

FIGURE 1

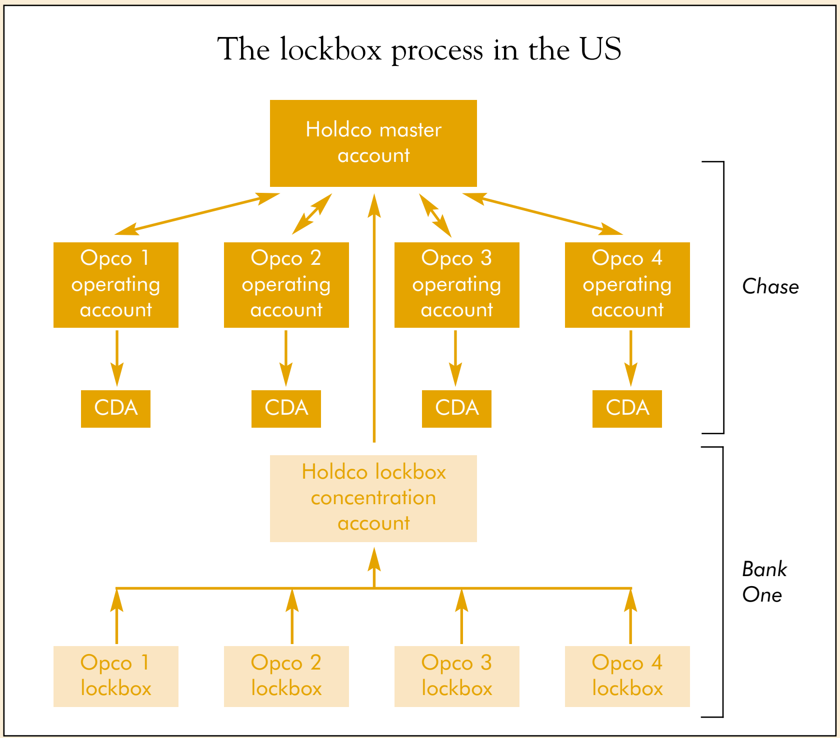
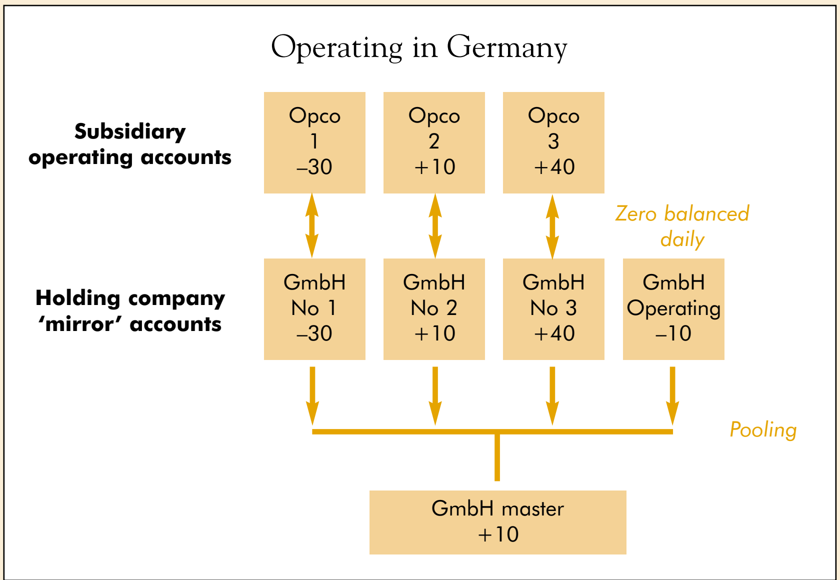


FIGURE 2



In Germany, as notional pooling is not possible if units do not belong to the same legal entity, we had to tailor the zero balancing approach to meet our needs. As you can see in *Figure 2*, we did this by opening sub-accounts in the name of our German holding company, Laporte Holding GmbH (LHG), at the Munich branch of Commerzbank, which 'mirror' the subsidiaries operating accounts.

Therefore, entries on a subsidiary's account held at its local Commerzbank branch are automatically transferred to its holding company mirror account. The holding company sub-accounts are then pooled for purposes of interest calculation. For management accounting purposes the mirror accounts are deemed to be owned by the subsidiaries.

In Italy, we had a similar position made more complicated by the fact that we had both resident and non-resident accounts. Again, we have adapted the conventional zero balancing system to ensure our subsidiaries know what their balances would have been had there been no zero balance account (ZBA).

The approach we adopted was to ask Banca Commerciale Italiana (BCI) to operate a reverse sweep system of cash management. In effect, at 23.59pm each day the bank sweeps the balances of our subsidiaries into the account of our holding company and at 00.01am the following day reinstates the balances.

In France and Canada, we operate cash pooling systems with Banque de Neuflize, Schlumberger, Mallet, Demachy (owned by ABN AMRO) and Toronto Dominion, whereby two accounts are opened for each participant within the cash pool. There is a current account that records all of the daily transactions and a mirror account which shows the opposite values to those of the current account. The mirror accounts are then zero balanced to a Laporte master account.

Handling foreign currency

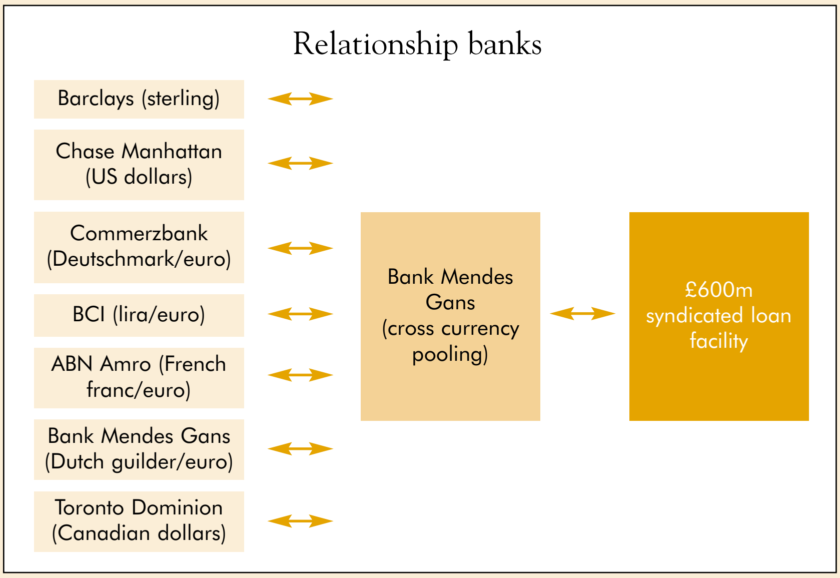
Having set up national cash management systems, the next challenge was to find a more effective way of handling foreign currency payables and receivables. Historically, Laporte subsidiaries held their foreign currency accounts with the same bank that provided their domestic banking business. For example, UK firms held their currency accounts at Barclays, while German companies used Commerzbank.

In addition, each subsidiary was responsible for arranging its own foreign exchange hedging. This was clearly inefficient in that, although the company operated a pooling system on a currency-by-currency basis in the UK (its most important exporting territory), it could not offset the credit balances on, for example, its dollar pool against the debit balance on its Deutschmark or French franc pools. Furthermore, the credit balance on its dollar pool at Barclays in the UK obviously could not be offset against a debit balance on the dollar accounts held with Commerzbank in Germany.

A change of tactics

In 1997, the decision was made to introduce a global multilateral netting system in respect of the company's foreign currency intercompany and third party supplier payments.

FIGURE 3



Originally, we intended the system to run along conventional lines, whereby on a pre-arranged settlement date each subsidiary paid or received only one net amount in its local currency from or to its local bank. During the implementation phase it became clear that it would be better to change the system to incorporate third party receivables. We therefore decided to move all of the group's currency accounts from our subsidiaries local banks to the bank providing the netting service, Bank Mendes Gans (BMG) based in Amsterdam. This simplified the netting process in that all payments could be settled in their original currency.

Of greater importance, however, was BMG's ability to provide a cross currency cash pooling system whereby not only would the debit and credit balances on accounts within a specific currency pool be offset for interest calculation purposes, but the net currency positions would also be offset. Therefore, a net credit balance of $3m within the dollar pool would offset a net debit of £2m within the sterling pool.

Outsourcing

Relocation of all of the company's foreign currency accounts to one bank also enabled treasury to achieve a further goal, namely the introduction of a centralised transaction exposure hedging programme whereby only the net group exposures are covered. The introduction of such a system avoided the situation where one subsidiary may have been buying dollars and selling sterling at the same time as another subsidiary may have been doing the opposite. It also reduced the workload at subsidiary level and improved control in that the group could be confident that exposures had been covered.

As treasury did not have the resources to operate such a system, responsibility was outsourced to BMG. The system requires each subsidiary to submit, on a monthly basis, a forecast of all cross border currency flows for the ensuing 12 months analysed between sales and purchases.

BMG then assimilates this information and provides treasury with a report detailing the group's net sterling exposure against each traded currency. These exposures are then hedged in accordance with group policy. Treasury also acts as an in-house bank and enters into forward foreign exchange contracts with each subsidiary to hedge its identified exposures. The mechanics of this operation are outsourced to the bank, with control being maintained by Laporte.

Bringing everything together

Having established national pools and a cross currency pool, the next stage was to bring everything together. One obvious way would have been to use a single bank, but this would have run counter to our policy of spreading business among as many relationship banks as possible. Instead, we used BMG as the pivot for our worldwide cash management activities. Therefore, if there is surplus lira in Italy and a dollar overdraft in the US, we will move lira from BCI to BMG and transfer the equivalent amount of dollars from BMG to Chase.

In some cases this is done electronically using the domestic bank's software, for example, Barclays' Business Master International or Chase's Insight, while in other cases, for example, Commerzbank and BCI, we use the Multibank capabilities of the BMG MegaWorkstation to move funds from our accounts in Germany and Italy to our accounts in Amsterdam. If there is a net surplus within the seven cash management systems we operate, cash is used to repay borrowings.

Keep it simple

Laporte believes in keeping things simple (which is essential in a small department of only three people). We believe this approach achieves this, not least because by locating all of our currency accounts at BMG and opening an account in a subsidiary's indigenous currency with the bank we are able to move funds from one country to another without the complexities of intercompany loans and the associated legal and tax issues that may arise. For example, if we have surplus sterling in the UK and are short of euros in Germany we will move sterling from the account of Laporte plc at Barclays to its account at BMG and move euro from the account of Laporte Holding GmbH (LHG) at BMG to the LHG account at Commerzbank.

On a conservative basis, we estimate we have saved £250,000 a year through the implementation of the netting and cross currency pooling systems as a result of lower transaction costs and reduced float times.

These savings are probably outweighed, however, by the intangible savings. For example, if we embark on a corporate restructuring and need to move money from Company A in Country X to Company B in Country Y, and then to Company C in Country Z, we can do it on the same day through the same bank, rather than have to move money from bank to bank and country to country, which is costly and time consuming. ■

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