CREATING A VIRTUAL TREASURY

BY CENTRALISING ITS TREASURY SYSTEMS WORLDWIDE, BP GROUP HAS INCREASED ITS EFFICIENCY AND OPTIMISED PERFORMANCE. **NICK BAMFIELD** AND **DAVID BRIGHT** OF BP GROUP EXPLAIN HOW THEY PULLED IT OFF.

BP is one of the world's largest petroleum and petrochemicals groups, with a turnover of about $180bn. Its main activities are exploration and production of crude oil and natural gas, refining and marketing of crude oil and petroleum products and manufacturing and marketing of petrochemicals. We have a growing activity in gas and power and in solar power generation. BP operates in more than 100 countries in Europe, North and South America, Asia, Australasia and Africa.

THE CHALLENGES. The BP of today is very different from the BP of five years ago. It changed fundamentally in 1998/99 when the group started the process of consolidation which swept the oil industry with the merger of heritage BP and Amoco. This was quickly followed by the acquisitions of Arco, Burmah Castrol, Vastar, Veba and others.

Since the early 1990s it has been BP's philosophy to centralise core treasury activities. BP Finance was developed as the group's in-house bank, providing daily global cash management based on an integrated treasury system serving back office, middle office and its own finance dealers. In the period up to 1998, while we regularly updated the technology and expanded the model, progress was evolutionary. BP's world changed with the merger and subsequent major acquisitions. The group grew to twice the size, with around half its cashflow arising in the US and its treasury activity supported by multiple sets of completely separate legacy treasury systems and processes.

The immediate challenge was to integrate these treasury activities as quickly as possible. At the same time we recognised that not only was it easier to integrate treasury activities into the in-house bank model, but it also provided us with the ideal platform to increase our operational efficiency, rationalise our global banking architecture, and optimise our tax-efficient funding of the group. We could extend our use of our central treasury system, taking advantage of advancements in technology and run our model across two integrated, but geographically distinct, treasury centres in the UK and the US.

The BP Group today does not have the advantage of operating one standard enterprise resource planning (ERP) platform across its worldwide business units. SAP, Oracle, JD Edwards and others are employed (although the movement is towards reducing this number). We have outsourced accounting shared service centres in the US and Europe, which, together with a small number of part-time, in-country members of the extended treasury teams manage the domestic cash pools for their countries and handle their domestic, low value, high volume settlements and receivables activities. Cash is pooled daily into currency header accounts with our global overlay bank which are managed centrally by the treasury team. The net liquidity and foreign exchange positions are then covered in the market by BP Finance's own dealing room. We also manage centrally all large, time sensitive or foreign currency settlements.

So, BP Finance acts as the BP Group's internal bank. The centralised in-house bank model operated by the Global Treasury Services team, in BP Finance, utilising the Wall Street Treasury Management System, provides the following:

- the ability to net the group's daily borrowing, lending and currency positions;
- the scale to disintermediate banks and access global financial markets directly;
- the ability to settle inter-group transactions in-house, avoiding fees and value dating losses; and
- the flexibility to optimise tax efficiency of the group funding structure.

Figure 1 provides a high level overview of the centralised model. The challenges of integrating the treasury activities of these merged heritage companies into the new BP are what gave impetus to the BP Virtual Treasury project.

THE BP VIRTUAL TREASURY PROJECT. There were two main drivers behind the project. First, we needed to integrate five different heritage companies, with their incompatible banking platforms and different treasury processes, into one unit. Second, this redesign gave us the chance to optimise our central treasury systems and processes, and create a new global team around a new vision. There were three key elements to the project: **>>**

FIGURE 1
FINANCE: BP'S INTERNAL BANK.

The scale of the new BP has significantly increased the prize from a highly efficient centralised Group cash management model.

- Daily Group-wide pooling and netting: individual borrowings, lendings and FX to avoid margin, transaction costs and credit risk
- Finance dealers place net positions directly into the financial markets: use the Group's scale to dis-intermediate banks and achieving better pricing
- Settle intra-group transactions in house, avoid bank fees and float time
- Optimise tax efficiency of the Group funding structure
- Reduce need for local treasury expertise outside the center

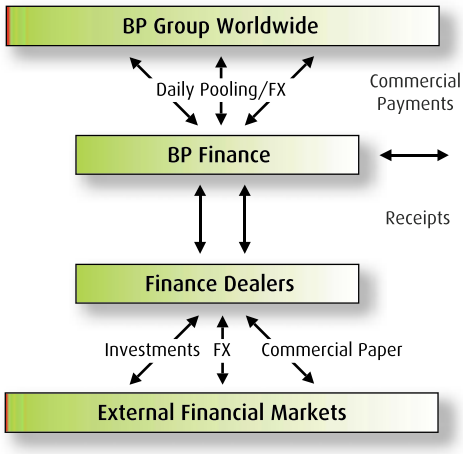
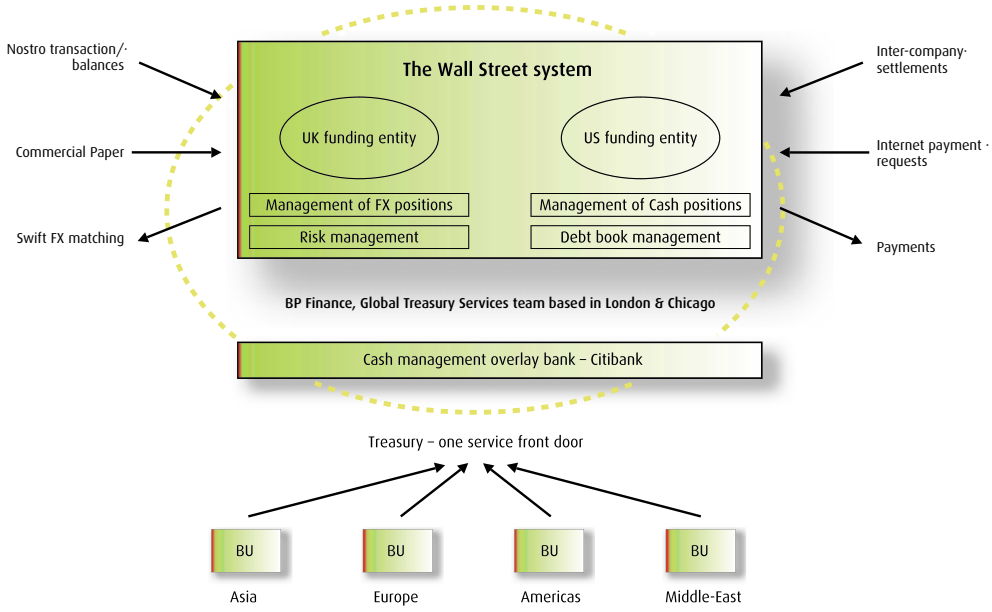


FIGURE 2
AUTOMATED INTERFACES.



'WITH RIGOROUS UP-FRONT PLANNING CONDUCTED TOGETHER WITH OUR THIRD PARTY PROVIDERS, THE PROJECT WAS CAREFULLY MANAGED AND DELIVERED ON TIME AND WITHIN BUDGET'

<< ▪ First, for operational efficiency, we wanted to create a common systems platform and common treasury processes across our treasury centres, as we wanted to run our central treasury from two locations (London and Chicago). This was seen as the ultimate way to maximise the benefits of global scale, while at the same time preserving the best regional practices and providing a local face to our BP business unit customers.

- Second, it was important that we maintained flexibility and tax efficiency globally. In the old BP we had used the in-house bank approach where we had run internal bank accounts for our business entities out of the UK. It became clear that the most efficient approach from a tax/funding perspective would be to create an in-house bank in the US to mirror the existing structure in the UK, both using the same integrated treasury system platform. This had a number of advantages. It eliminated potential tax inefficiencies: the US in-house bank could act as a settlement agent for inter-company trading in the US (as the UK one does for the rest of the world), avoiding the cost of intra-group commercial transactions settling through the external banking system.
- The third strand concerned our banking structure. We had inherited five sets of heritage banking relationships. In the US alone we had about 800 different bank accounts and 60 different banking suppliers. This had to be worked down to an optimum number, enabling cost savings and efficiencies for us, and more business and more profitable relationships for the banks.

By the end of 2000 we had worked up a project plan, which included 12 detailed sub-projects, each with individual project leaders. A full-time project manager was appointed to manage the inter-dependencies between the sub-projects. The critical path for project delivery was identified and a formal project review process was conducted through the project life cycle (with detailed weekly sub-project review meetings, monthly formal management review meetings, and quarterly full team challenge meetings). With rigorous up-front planning conducted together with our third party providers, the project was carefully managed and delivered on time and within budget. The implementation took place throughout 2001, with the final elements being completed in 2002.

In retrospect, one of the best decisions we made was to have one of the Wall Street System analysts based with us in Chicago for most of 2001 as part of the team. We put a lot of emphasis into planning the project in detail upfront, but like all good plans we hit several unexpected problems along the way. Each of these required us to rework the plan and modify the timeline.

THE CASH MANAGEMENT MODEL. In most parts of the world, our model is to use one transactional bank per country with a global overlay bank (Citibank). The choice of the in-country bank is based on our local needs. For instance, in Europe, where we have a large retail business, we select a local bank to provide the branch coverage that a retail business needs. So, in France, for example, BNP is the local transactional bank.

In the US, the model is slightly different because of the size of the market and the range of banking activities. We want, where possible, to get to a pan-US solution for any particular activity, using the market leader for that type of business. For example, we have recently rolled out a new cash collection process from our service stations in the US. Previously, we used a variety of different methods and a range of regional banks to collect cash around the US. Having tendered the business we are now rolling out a project called Virtual Vault, with Bank of America. Under this project we are standardising across the whole of the US the cash collection process using armoured cars and centralising the data collection process into a 'virtual vault'. This will enable us to simplify the business, improve data quality and reduce business costs. To date, we have tendered five of the seven distinct banking activities we have identified in the US. When we complete the process this year, we anticipate that we shall end up potentially with three strategic US transactional banking partners.

Our overriding cash management objective is to achieve global pooling of our cash and foreign exchange positions on a daily basis. This is the activity that adds the most value, allowing us to net down the balances and then pass the residual positions to our dealing room to trade out directly into the financial markets There are some parts of the world where exchange controls or tax regimes make this hard to achieve – China is currently the most material gap in our pooling structure – but, wherever we can, we put our global pooling model in place. We also manage centrally all foreign currency, large or time-sensitive commercial payments and receipts for the group. We do this either by file transfer for bulk repetitive payments or individually for one-off payments.

UTILISATION OF TECHNOLOGY. The economic case for running a centralised global treasury model for a group of our size was compelling. So we then needed to decide whether to extend the use of the Wall Street System to replace the various platforms and systems that had been inherited from other companies. The trade-off was that it would mean redesigning all the treasury processes in the US. However, we were convinced that this short-term obstacle would be more than offset in the long term by the benefits of running with one common platform and one set of processes.

The Wall Street system was an obvious choice from our experience from running it in London. We particularly valued the full integration it provides between the back, middle and front office functions which enables us to make the most of BP's dealing capability. The back office functionality, the cash management, FX and risk management, credit and the debt book are all in one place, avoiding the risks and costs of data reconciliations.

There was a lot of cash management functionality in the Wall Street System which we hadn't used before. We carried out a number of reference visits before taking our final decision. A visit to AIG to see this functionality was very useful and reassured the members of the team that it was robust. To get the cash management functionality we wanted, we had to introduce a different technology platform on which to run Wall Street. We upgraded to a graphical user interface (GUI) browser front-end running on a Citrix platform.

'USING THE LATEST TECHNOLOGY IN INNOVATIVCE WAYS, OR BEING AT THE LEADING EDGE, WILL NEVER BE WITHOUT PAIN BECAUSE THERE ARE FEW PREVIOUS LEARNINGS TO GUIDE YOU'

Another key issue was the choice of global overlay bank to use, which is critical to any global cash management solution. As it happened, BP and Amoco both used Citibank as their global cash management bank. Given the investment in the relationship from both sides, it was the obvious choice to make.

We have tried to build as many automated interfaces as makes sense (see *Figure 2*) into the system. In *Figure 2*, 'BU' represents our business units around the world. A key principle behind Virtual Treasury is that wherever our businesses are interfacing with treasury, they should have a common experience and level of service. The systems and processes are the same, so when staff move around the world they have the same experience from treasury. The service front door through which they enter treasury is the same, whether they are coming into London or Chicago.

Figure 2 highlights the interfaces into Wall Street. From the bottom right, we make commercial payments electronically through Citibank, using its proprietary software over a leased line. We have electronic interfaces to our businesses, where we make payments on their behalf. These include an electronic data interchange interface running on our internal wide area network for repetitive payments using beneficiary templates held within Wall Street. Using this interface our BU customers achieve full straight-through processing (STP) from their ERP systems. To complement this we have built an internet payment delivery system to remove the need for paper instructions, allowing BP Finance to add value to the settlement process by routing high value and cross-border payments to avoid bank repairs.

We act as the settlement vehicle for inter-company transactions. From our internal internet invoice presentment and payment system, inter-group invoices can be settled automatically through the internal bank accounts held with the in-house bank. We bring in our balance and transaction information from the banks into Wall Street electronically for nostro reconciliation, using a combination of Swift messages and BAI message formats in the US. We have an automated interface with the issuing and paying agent that we use for our commercial paper (CP) programme, and we use Swift access for automated matching of FX deals to settlement. Our aim has been to build a series of interfaces to Wall Street to try to standardise, simplify and automate wherever it is cost/value justified. In general, the higher the level of transaction volumes, the greater are the benefits available from automation. But where volumes are low, there is often little point in automating because the benefits do not justify the costs.

BENEFITS ACHIEVED. Extending the Wall Street system's functionality and upgrading the technology base to incorporate the use of the US cash management module allowed us to streamline cash management processes, automated and eliminated 90% of individual daily US operational tasks and delivered a 17% increase in overall productivity in our Chicago-based treasury team.

Our STP capabilities were further enhanced with the introduction of our internet disbursements solution (e-PD), and the elimination of paper flows and their associated manual processes has made significant unquantified efficiency savings in our business units as well, while significantly increasing security around the process.

With the in-house banking model of internal multi-currency bank accounts extended to the US, creating a new US-based central funding entity, the need for five separate US heritage cashflow streams was eliminated. Inter-company settlement processes world-wide were simplified, with an automated interface to the in-house bank for settlement. Together this enabled delivery of significant value through tax-efficient funding, renegotiated bank contracts, a reduction of more than 200 bank accounts and elimination of inter-company external cash movements, and provided resource/productivity optimisation.

By consolidating BP's short-term credit or overdraft position, BP Finance is able to obtain better rates of interest and avoid the higher costs associated with borrowing smaller sums from local banks. In addition, by dealing directly as counterparties in the FX and money markets, BP is able to obtain a more even-handed price than if the trading was done on its behalf by a third party. With Virtual Treasury, we have maximised the scale and reach of our daily global cash pooling, degree of automation and STP, and the value we generate through access to the financial markets via our dealing room.

LESSONS LEARNT. You cannot complete a project of this magnitude without learning many, sometimes painful, lessons. Some key ones for us were:

- It helps to break down a large project into manageable sub-projects. However, it is vital to recognise the interdependencies and to ensure clear and regular communication between them;
- using the latest technology in innovative ways, or being at the leading edge, will never be without pain because there are few previous learnings to guide you;
- it is vital to ensure the correct technical skill set is employed and useful to involve key third-party suppliers in your project planning and execution teams; and
- be clear that the complexities of getting layered products such as bank software, communications and public key infrastructure (PKI) software to work together in a robust manner can be time-consuming unless you can use a combination that has been tried and tested in practice elsewhere.

Finally, in retrospect, a project like this was a fantastic way to create a new team. Through developing together a shared vision of where we wanted to get to and then going through the highs and lows of delivering it, the project really did fuse together a group of individuals from different heritage companies into one new organisation – one virtual treasury.

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