

SHARED SERVICES STRUCTURES

JOHN MOWBRAY AND GRANT SLINGER OF DIAGEO
BUSINESS SERVICES DESCRIBE HOW DIAGEO SUCCESSFULLY INTEGRATED ITS TREASURY OPERATIONS WITH THE BACK OFFICE PROCESSES OF ITS IN-MARKET FIRMS ROUND THE WORLD.

■ Background

Diageo is the world's leading drinks business. It produces and markets an unrivalled range of brands including Smirnoff, Johnnie Walker and Guinness. It has in-market companies in most countries. These are wholly owned subsidiaries or joint ventures which can own trademarks, manufacture product or sell to third party customers within a defined geographic territory.

Diageo has had a devolved culture in which in-market companies have always enjoyed a high degree of autonomy over their marketing and operational choices, using disparate systems. Yet, like other multinationals, it has also recognised the benefits that can be derived from centralising back office processing to gain economies of scale and standardised business practices.

In 2001, Diageo started to design and build an integrated infrastructure and set up a shared services centre in Budapest, Hungary, called Diageo Business Services. Business units in 14 European countries will eventually be supported from this centre. In parallel, a second centre has been established along similar lines in Stamford, Connecticut to support US and Canadian business units.

The shared services centres carry out processes within the following areas: order to cash, purchase to pay, record to report, master data. In addition, they perform back office processing of cash management and treasury settlement activities for the group treasury.

The building blocks to the Diageo treasury integration process were shared services facilities in Hungary and the US, a pan-European banking structure developed with Bank of America, and an in-house bank structure held on the Corporate Financial Management (CFM) module of SAP's enterprise resource planning system.

The result: a single treasury interface to the business. This facilitates outsourcing and automation of treasury and inter-company accounting, centralisation of cash, optimisation of foreign and inter-group payments, and enhanced treasury control and visibility of group working capital.

The benefits: significant bottom-line reductions in processing costs.

THE OPPORTUNITY FOR TREASURY. For the group treasury in London, the challenge is to continuously improve control over and enhance visibility of working capital across the group – and to do it as cost effectively as possible. When Diageo Business Services was set up, treasury took a 'clean sheet' approach to the opportunity this presented. In the event, though, it was by building on and extending earlier work that treasury was able to gain real advantage from the new arrangements.

IN-HOUSE BANK AND THE PAN-EUROPEAN BANKING INITIATIVE. In 1998, Diageo instigated a pan-European banking programme to take advantage of the euro, and to support previous shared services initiatives. The solution, which was developed with Bank of America, delivered the following:

- standardisation of data interfaces between Diageo and the bank;
- standard, automated payment and reconciliation processes;
- local, electronic payments replaced crossborder payments wherever possible; and
- centralisation of cash through daily zero balancing to an in-house bank.

The pan-European banking system is saving Diageo about £3m a year as a result of headcount savings and reduction in bank charges and interest.

So far so good, except that, since Diageo still had disparate enterprise resource planning (ERP) systems, this initiative was unable to fully integrate the treasury accounting and settlement activities of the in-house bank with its business units. Also, it did not provide treasury with visibility of its working capital and currency exposure forecasts.

TREASURY/BUSINESS INTEGRATION. This important next step – integrating the treasury activities of Diageo's in-house bank and business units – has now been realised using the CFM module (CFM) of SAP within the following structure.

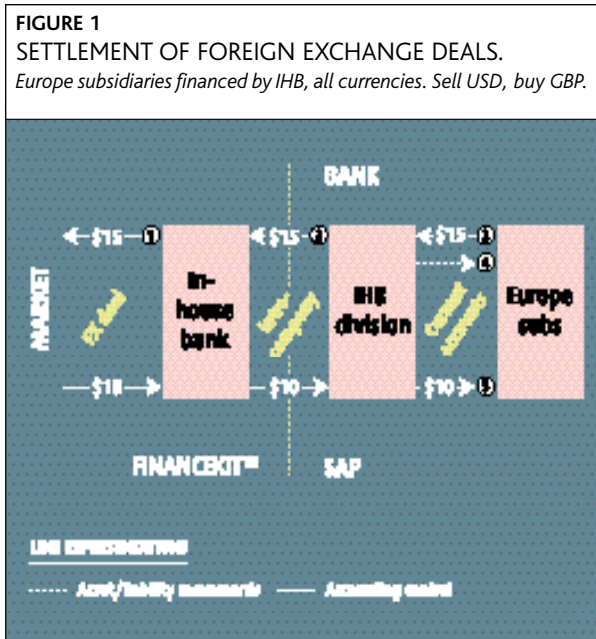
In-house banks for Europe and the US manage all working capital for the Diageo group. Each business unit has an interest-bearing current account with its in-house bank for all currencies in which it trades.

This structure allows for transactions originated by the various business units to be standardised and treated in the same way, creating a common interface for the treasury and a single way of working for the shared

services centres. Above all, it eliminates manual processing and automates reconciliation for each in-house bank/business unit legal entity relationship. It also offers a scaleable model which enables new subsidiaries migrating to SAP to plug into the new structure with relative ease.

Significant time-savings are the result. Previously, each business unit would have had one or two people managing treasury back office processes. Now a team of three covers all countries. This new structure handles four different transaction types:

- Daily zero balancing of business units' bank accounts to the respective bank account of the in-house bank.
- Crossborder third-party payments. Within SAP, these are routed from the business unit to the in-house bank, which has non-resident accounts in all required currencies. The in-house bank issues payment instructions to the bank, using local country settlement.
- FX settlements. Deals are executed by treasury in the markets (using the in-house central treasury system, FinanceKit™). A back-to-back deal is recorded between treasury and the in-house bank, with the subsidiary as counterparty (see Figure 1). This is interfaced



to SAP to record contracts between the in-house bank and treasury, and between the in-house bank and the business unit. All settlements are automated monthly on the inter-company settlement date.

- Intercompany settlements. Within Diageo, there is a significant volume of inter-group trading, as products are sold by supply business units to in-market demand companies round the world. When two business unit legal entities have an outstanding trading balance, settlement takes place using the functionality of the in-house banks on a monthly inter-company settlement date. The vendor invoice is tagged to the customer account, enabling book-entry settlement to be processed through the in-house bank. This avoids manual work and the need to move cash. Interest accruing

on the current accounts between the in-house bank and the business unit is automatically calculated and applied to both groups.

IMPROVED CASH AND CURRENCY FORECASTING. An important advantage of this close integration between treasury and Diageo Business Services is that cash forecasting information is consolidated. The SAP systems provide real-time forecasts, based upon actual transactions awaiting settlement or clearing. This increases treasury control of cash management and FX transaction hedging, and provides an early warning system which often allows treasury to act to put funding in place or take investment opportunities that would otherwise be missed.

REAPING THE BENEFITS. Integrating treasury operations within Diageo Business Services has brought considerable benefits to both treasury and the business units:

- By creating a suite of integrated treasury services within SAP, treasury is now able to serve the shared service centres through a single interface to CFM, on a one-to-many basis. This new-found scalability and flexibility enables rapid migration of business units on a plug-in-and-go basis, and means automated, and therefore less costly, services can be delivered by treasury. This, in turn, allows treasury to spend more time on the strategic management of the group's working capital.
- Treasury accounting and settlement tasks have effectively been outsourced and reconciliation has been automated. It now takes a small team in the shared services centres a few hours at the end of each month to reconcile and agree balances, compared with multiple teams taking a few days previously.
- The new structure ensures that cash is at the centre all the time, and since cash forecasting has been improved, better use can be made of available funds.
- Overall, treasury control and visibility of working capital, and of any potential problems or shortfalls, has been enhanced.
- Bottom-line savings in the region of £5m to £10m a year are expected from the new arrangements.

We believe this project illustrates how, once the right building blocks are in place, treasury can drive incremental process improvements in the wider business, as well as leverage shared services structures to increase treasury control and visibility of working capital.

In Diageo's case, treasury operations are now an integral part of the total business solution which is delivering a global process and shared services strategy.

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