Stitched together

CARLO NAZARENO LOOKS AT HOW SETTING UP AN INTERCOMPANY MULTILATERAL NETTING STRUCTURE WILL ADD VALUE TO SOPHISTICATED GLOBAL AND REGIONAL CASH MANAGERS.

Executive summary

- The perpetual challenge for global and regional cash managers is to find the optimum way of managing their cashflow. How can I continue to stretch my payment terms? How do I reduce my accounts receivables? How will I make better use of my idle cash? What forecasting methods would be best to predict my cashflow forecasting? These questions continue to push cash managers to look for creative solutions to meet and remain competitive in a financial world that is continually evolving due to the globalisation.

In the past, the rules of the business game were focused on increasing revenues. However most companies are now looking more at reducing expenses through process efficiencies leading to a healthier bottom-line. This way of thinking has infiltrated the treasury space as corporate treasurers and cash managers are beginning to look into improving internal processes and practices that affect cashflows. One such area often reviewed and talked about is intercompany obligations and settlements. If in the past, most companies just relied on management and financial accounting to handle these settlements, they now realise the requirement for a more efficient way to transfer and settle cash between subsidiaries, to improve their in-country cash cycles and reduce local short-term loans to manage their operations by leveraging the corporations' global cash pool. It is during these times that cash managers start looking at the concept of intercompany multilateral netting and the benefits that the company can gain from putting such a structure in place.

THE FUTURE OF MULTILATERAL NETTING Multilateral netting has been around for more than three decades and most companies still have not taken advantage of its benefits. As global and regional treasurers of small and medium-sized enterprises (SMEs) join the global competitive environment, they will be required to think of additional functionalities and creative processes to challenge their larger competitors. Multilateral netting will be one of the foundations to strengthen their cash management processes. Banks and software houses will be looking at this market and will offer value-added services to meet the demands of these up and coming organisations. Multinational banks will continue to position themselves as one stop financial services shops, offering netting with an entire suite of cash management products, which their software competitors cannot match. Software houses will continue to differentiate themselves by creating bespoke functionality in shorter time-to-market timeframes as well as offering specialised outsourcing functions at competitive rates to add value to these companies. New revolutionary services will emerge and it will be the global and regional treasurer who will be the victor in the end.

BENEFITS A multilateral netting structure allows a company to develop a discipline in settling their intercompany obligations through transparency. A netting centre acts as the central control point to ensure that all participating subsidiaries follow the agreed process, and if need be, penalise subsidiaries who do not settle accordingly. Regional and global treasurers play a more active role in managing intercompany cashflows, as well as gaining a better understanding of requirements centrally. The netting calendar improves forecasting cashflows at the country level. Since the calendar is pre-agreed at least a year in advance, each domestic cash manager can optimise the use of their funds and plan their requirements in accordance with their incoming or outgoing flows. This also reduces administrative time spent in managing payments.

Financially, since the netting centre manages all flows to and from participants, the entire corporation benefits from the preferential FX spreads for the cross currency FX requirements, as well as from lesser account maintenance and funds transfer fees. Participants do not need to worry about FX rates, as settlements will be primarily completed in their local currency. Unnecessary FX and funds transfer transactions are eliminated completely. Finally, the corporation is able to reduce intercompany credit and FX risk exposure. The discipline reduces unnecessary exposure as well as reduces dependencies on local funding.

OVERCOMING CHALLENGES IN IMPLEMENTING A MULTILATERAL NETTING STRUCTURE Initiating change on a global or even regional level will definitely not occur easily. To determine whether such a structural change would be acceptable to all stakeholders in a corporation, one must always determine whether multilateral netting is in sync with the corporation's overall financial strategy and goals. Although the benefits are definitely quite substantial, implementation of a change of this magnitude in the company will require senior management buy-in as well as their leadership to ensure that the change will be achievable and practical. A

Offsetting inflows and outflows

Netting is a process that involves cash inflows offset with cash outflows. Netting can either be bilateral, where two counterparties agree to net their obligations with each other, or multilateral, where more than two parties, through an exchange or a central entity, agree on a single process and netting calendar to settle their obligations. Multilateral netting, more often than not, allows settlement to be completed either in a single currency or in multiple currencies depending on the participants' local regulatory requirements for settlement. Ideally, and in most instances, netting settlement is limited to a single transaction (either inward if in a net receiving position, or outward if the net position is a net payables position) completed through the local currency of the participating subsidiary. There are two types of multilateral netting structures. It can either be payables driven, where the payer initiates the settlement of the obligation, or receivable driven, where the payee initiates the settlement based on the invoices that are due to them.

corporate champion who is well respected by the subsidiaries would be a major advantage during such a transition, as 'influence management' will be essential for the change. After obtaining senior management support as well as aligning to corporate objectives, the next step would be to determine where to get started. Will a big bang approach work or will a phased roll-out be more prudent? During this phase, domestic regulatory restrictions need to be taken into consideration. Some countries will have special requirements or restrictions for participating subsidiaries within the country and approvals may need to be sought before a subsidiary can participate. Local central bank reporting should also be considered to ensure that all processes will be completed within the legal means while, in other circumstances, payments must be completed on a gross basis and not on a net basis. The last process that needs to be in place would be a dispute management process. Whether it be a payables driven or a receivables driven netting (but more probably a receivables driven netting), disputes will need to be closed and agreed upon to make payments and settlement smoother.

CREATIVE SOLUTIONS A multilateral netting structure is a powerful tool in increasing control and reducing costs. Any corporation that is looking at setting up such a structure has a number of options available within the market. Solutions range from simple stand alone database spreadsheets to highly sophisticated internet-based systems created by specialised software companies and large multinational banks. All systems will supply the most basic requirements for calculation and reporting. Other companies try to differentiate themselves by adding functionalities such as in-house banking, FX hedging, backward and forward enterprise resource planning (ERP) integrations, electronic invoicing and dispute management, ad-hoc management information systems (MIS) report generation, and sophisticated forecasting tools. Other companies and banks also offer specialised outsourcing of the management processes of the netting centre. What is important is to make sure that the system you choose meets the company's operational requirements as well as its short and long-term goals. Purchasing off-the-shelf software may be cheaper and easier to install in the short term but may be more expensive due to upgrades, licences and after sales support. Banks may have state of the art systems that automatically handle settlements, but at times may be restrictive in additional bespoke functionality that may be required. Therefore, ensure that the corporation's short-term and long-term goals are addressed by the software or service provider or bank that is chosen.

IMPROVING PROCESSES The benefits of setting up an intercompany multilateral netting structure will add value to sophisticated global and regional cash managers by improving their intercompany settlement processes and reducing costs. In today's world where the survivors will be the companies who remain resilient and creative in their expense and operational processes, netting will be one of the cornerstones in ensuring that these companies will continue to retain their competitive edge.

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