Box of tricks

KELLOGG EUROPEAN TREASURY MANAGER FRANCES CAVANAGH OUTLINES TO **GRAHAM BUCK** THE CEREAL GIANT'S CASH MANAGEMENT STRATEGY AND MIGRATION TO A NEW TREASURY SYSTEM.

Originally incorporated as the Battle Creek Toasted Corn Flakes Company in February 1906, Kellogg is today a multinational that manufactures in 19 different countries and markets its products in more than 180. Its position in the cereals market internationally is challenged only by General Mills and Nestlé.

Kellogg annual sales approach $13bn and its total global workforce is 31,000. It opened its first UK factory in Manchester in the late 1930s and added a second plant at Wrexham 40 years later. Since 2005 its European headquarters have been in Dublin. According to Kellogg, there were several reasons for this transfer, including Ireland's attractive rate of corporation tax, the availability of skilled workers and its appeal as a place to do business.

Not surprisingly for a business that originated in Michigan in the US, North America is the group's biggest market, followed by Europe. However, as Frances Cavanagh, the group's European treasury manager confirms, Kellogg is developing its sales in India, thanks to the country's fast-growing middle class. It also has interests in China and Latin America.

Kellogg treasury operations consist of corporate treasury, based at the US head office in Battle Creek, Michigan, and regional treasury, with Dublin the centre for the group's European operations. Russia has its own local treasury representation. For markets outside North America and Europe, the group allocates treasury responsibility to a designated individual, who also carries out other duties.

COMMODITY HEDGING The price of a number of the group's raw materials, such as wheat, corn and sugar, has been volatile in recent years although less so than some other commodities. Kellogg confirms it carries out some hedging of commodity risk in the US, although not in Europe, but prefers not to reveal details of what policy it follows.

"There isn't a specific treasury policy relating to commodity hedging, but we utilise the risk management policy very much as a generic tool for areas such as currency, interest rates and commodities," says Cavanagh. "Kellogg reports in US dollars, but has currency exposures that it hedges, with Dublin responsible for the European exposures and the Michigan office hedging for the rest of the world."

The central plank of the group's cash management policies is leveraging its substantial global purchasing power through its network of credit facility banks.

"Michigan handles our credit bank relationships and also negotiates our credit facilities as and when they fall due for renewal," says Cavanagh. "The Dublin regional hub deals with local business units in Europe and some local banks that may not be in the credit facility."

Kellogg also aims to limit its total number of bank accounts, to ensure that its cash management structure is as efficient as possible. "We've maintained this policy despite the banking crisis two years ago," she adds. "We believe that reducing the number of accounts remains a valid policy as our risk continues to be sufficiently spread. The main aim is to have as much visibility of our funds as possible.

"In certain markets some credit facility banks may lack the functionality that we require and we may select one that is, for example, more cost-efficient – this might be a bank in Spain with a certain payment method, or in Italy with a particular receivables method. However, many of these relationships with local banks are long-standing."

SECURITY AND LIQUIDITY Dublin and other business units keep Michigan's head office corporate treasury regularly updated on information such as cash balances and investments. Cavanagh says that treasury policy is to attach greater importance to security and liquidity over yield. "We're a conservative company and this is a policy we have always adhered to," she says. "Michigan also doesn't really get involved in managing the day-to-day cash management relationships, so Dublin carries out this role for all of Europe and ensures that funds are in the right place at the right time."

The centralisation model for Europe dates from the late 1990s, when the group transferred from its individual country model and based its regional hub in Manchester before transferring to Dublin five years ago. Manchester now confines its activities to managing the group's UK business as well as housing the European financial services centre..

Cavanagh says that the group has good visibility of its cash and last December signed up to a global multicurrency cash pool with BMG (Bank Mendes Gans), part of the ING group, which it manages from Dublin. BMG has a reputation as a niche player in providing liquidity management and information management services for multinationals and has traditionally promoted cash management as its core activity.

"We initially used this new facility for our European business and, more recently, have added some of our international business to it – a policy which we will steadily extend even further," Cavanagh says. "It is already proving to be a useful tool and BMG is also proving to be a good counterparty."

She describes the group's cash forecasting, although split into different tranches, as "from a European perspective still a relatively simplistic calculation. While on a daily basis we have good visibility of our bank balances, payables, etc, it's obviously difficult to predict incoming receivables and we therefore ignore an element of our receivables as a result."

Cash forecasting is carried out by the regional centres on a quarterly basis and completed at the end of each quarter and submitted to corporate treasury in Michigan. Dublin is working to fine-tune the process, having recently added a feed from its SAP system to its Wall Street treasury system.

"We provide the data and our task now lies in making it more meaningful. On another level and specifically for budgeting purposes, one of my colleagues has built a model, using Hyperion HFM, to forecast the figures for our cash in the bank."

When Kellogg's European treasury moved from an in-country model to a centralised one at the end of the 1990s, the group selected Citibank as its pan-European banking partner for the new structure and retained a notional euro pool in London.

"At that time, the new structure was regarded as cutting edge and it has remained stable over more than 10 years, being grown organically as we have added new accounts and identified new banking needs," says Cavanagh. "Over that period we have worked to rationalise the structure as much as possible. We're keen to ensure that the cash pool structure we have with BMG is fit for purpose, so operational structure is linked to liquidity structure."

The process is scheduled for completion by the end of the first quarter of 2011 and, says Cavanagh, will radically change the way cash is managed on a day-to-day basis. "Key to this aim is to partner with Citi and our other banks, using them as our trusted advisers. We're now ready and willing to leverage their capabilities to a greater extent than perhaps we have done in the past, as we regard them more as a true partner than a service provider."

In July this year Kellogg North American and European treasury operations went live with a new workstation, transferring from Richmond's Millennium system (later acquired by Wall Street) to Wall Street's ASP.

"We can leverage a great deal of additional functionality from this new workstation, which releases a lot of extra capability for mapping a range of different transactions," explains Cavanagh. "We can also use ASP more to enhance matching rates.

"Looking to the future, there is a lot going on, so we will continue to re-engineer our current structure. Our aim is to create a best-in-class treasury organisation, and with the introduction of BMG and the other treasury workstation, we are putting the building blocks in place to achieve this.

"In terms of what's next, we are interested in SWIFT payments and XML to ensure that the processes are straight-through. And that will be my own personal challenge for 2011."

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Box: Kellogg cash management policy

- Leverage global purchasing power and company-wide relationships, by working with credit facility partner banks whenever possible
- Increase visibility and controls of cash by reducing the number of accounts and increasing the efficiency of the account structure
- Continue to partner with local banks when credit facility partner banks are not able to provide needed services in an effective or cost-efficient manner
- Prior to opening or significantly changing a bank account, business units must obtain approval from corporate treasury
- Prize security and liquidity over yield
- The policy also sets out the minimum permissible counterparty credit ratings, as well as reporting requirements, etc.

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