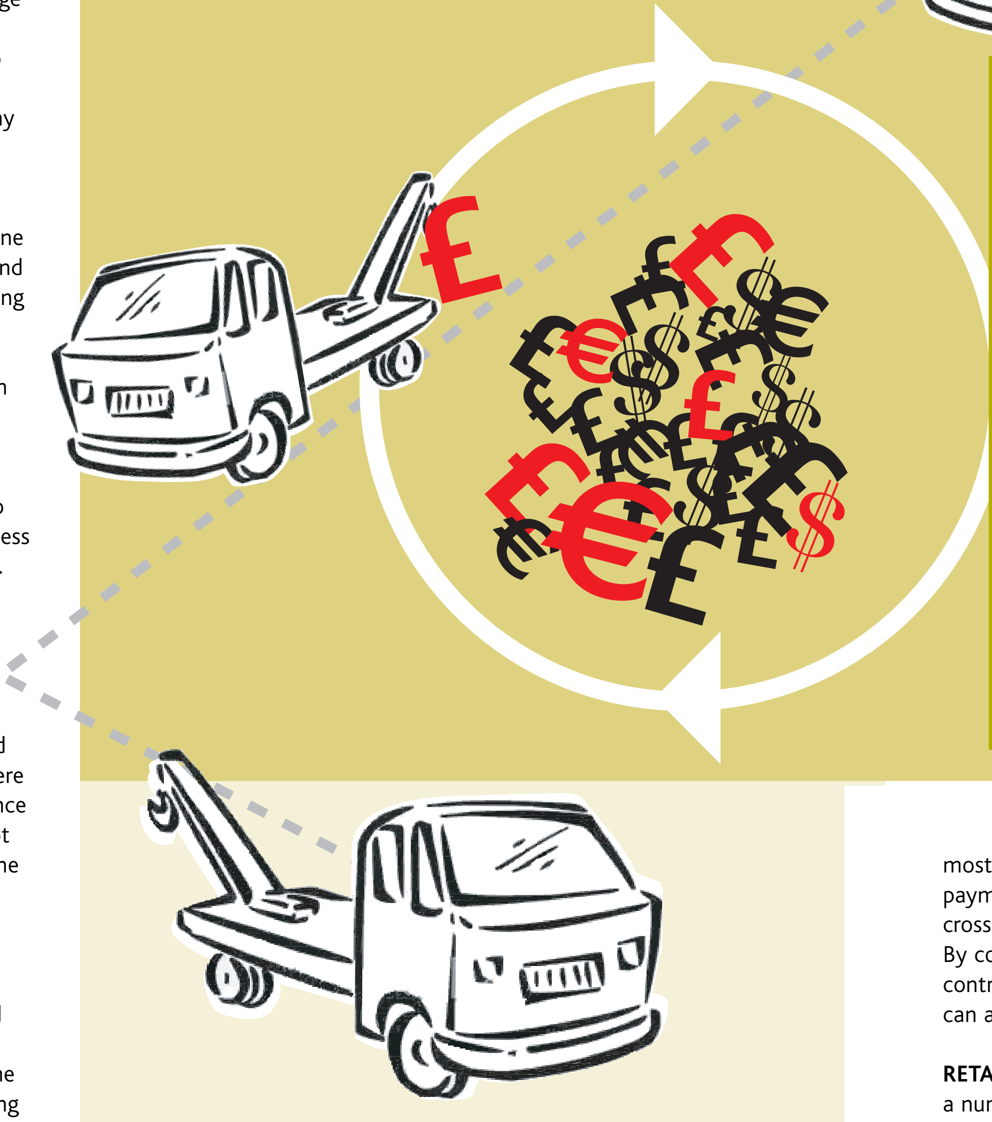
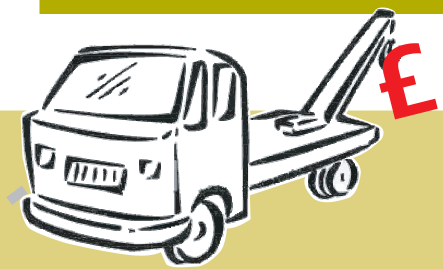
A CENTRAL COLLECTION

AS CORPORATES FOCUS ON CENTRALISING THEIR CASH MANAGEMENT IN THE WAKE OF NEW LEGISLATION SUCH AS SARBANES-OXLEY AND IAS 39, THE KEY DRIVERS OF COST REDUCTION AND INCREASED CONTROL REMAIN. **JAMES MITCHELL** REPORTS.





More and more corporates are making moves to centralise their cash management functions. Despite the high levels of attention given to IAS 39 and Sarbanes-Oxley (see *No shelter from the storm*, page 16), cost and risk reduction are driving this development. The ability to streamline processes, enabling a corporate treasury to reduce overheads and regain control over disparate operations, makes centralised cash management an obvious choice for many corporates.

THE FIRST STEP AND BEYOND. The first step many treasuries take when moving towards a centralised operation is to streamline the number of external banking relationships they have. Many find that the 80/20 rule still applies, with 20% of the banks accounting for 80% of the business. By centralising cash management, treasurers are able to dramatically reduce the number of banks they deal with. Rather than maintaining several bank accounts in every country in which their organisations are active, they can form strategic relationships with key global banks that offer coverage in all required locations. This not only considerably reduces costs in terms of fees, but also offers better rates due to increased volumes, whilst minimising operational overheads, as less bank workstations and corresponding infrastructure are required.

In the same vein, by opting for a single, enterprise-wide cash management solution that is adopted by all its subsidiaries, a corporate is also able to make dramatic cost savings. Multi-national organisations operate a myriad of disparate systems, acquired over time with the company's growth. The cost of maintaining such a diversity of legacy systems, all of which need to interface with one another, is astronomical. Operationally, there are high overheads associated with staffing costs and maintenance contracts. Often the systems are difficult to integrate and do not deliver the level of straight-through processing (STP) required. The issues that must be faced include dealing in many different banking formats, creating bespoke interfacing between systems and coping with a never-ending series of upgrades.

Naturally, this myriad of disparate systems and standards not only generates costs but also has a major impact on control and risk. For example, in a decentralised operation, cashflow forecasting, which is a core function for any treasury, can become pure guesswork. Forecasts are submitted in differing formats using incompatible standards, resulting in limited correlation of financial data, and highly inaccurate figures. The impact of this can be frightening as on a broader scale, the CFO or treasurer cannot always be confident of the financial figures they are quoting.

CENTRALISATION: THE 360° VIEW. A centralised approach is the best way to combat these issues. By ensuring that all subsidiaries are operating from a single database, using a common system and procedures, central treasury is able to not only rationalise processes and reduce costs, but also take control. By ensuring that all financial data is held in a relational format, central treasury can have complete visibility and feel confident that the data it is working from is clean and dependable.

To really reap the full benefits of centralised cash management, simply rationalising the number of bank accounts is not enough. Many corporates put in place a payment factory and in-house bank solution. This allows financial payments and payables and receivables to be consolidated and managed centrally.

An in-house bank can manage all payments on behalf of subsidiaries, with the ultimate goal of operating accounts in the most streamlined and/or cost-effective manner. By managing all payments centrally, the in-house bank is able to convert expensive cross-border payments into domestic ones, reducing banking costs. By coping this with an automated payment factory, which controls and tracks all internal and external accounts, a corporate can also control and track where cash is in real-time.

RETAINING CONTROL. Centralised cash management can work in a number of different ways. If there is a political battle for control of cash, not all subsidiaries need to relinquish their powers. It is still perfectly feasible for them to retain control over local operations and maintain local bank relationships if required. However, central treasury can still have complete visibility over all activity and can decide exactly how much control each subsidiary is allowed. Web-based technology enables the subsidiaries to enter, approve and monitor their own payments, view in-house account statements and integrate local accounts payable systems with the central treasury quickly and cost-effectively.

CLEAR ADVANTAGES AND CLEAR SAVINGS. Although centralised cash management can deliver compelling cost reductions, one of the largest benefits is the increased visibility it affords. By using a single system and a common database across the entire organisation, central treasury is able to take control and ultimately increase free cash turnover within a company. Transparency across all accounts means that cash can be pooled each day to ensure it is working as effectively as possible – either paying off debts or being invested in the market – making idle cash a thing of the past.

Executive summary

- Centralisation of the cash management function offers cost savings and control benefits.
- By forming strategic relationships with global banks, corporates can eliminate the need for bank accounts in every country in which they are active, and reduce fees.
- Payment factories and in-house banks allow the consolidation of financial payments and payables and receivables. An in-house bank can convert expensive cross-border transactions into cheaper, domestic ones.
- While maintaining visibility over all treasury activity, a centralised treasury can also allocate levels of control to subsidiaries.
- It can also deliver clean, dependable data, enabling treasurers to analyse reports and drill down for information. This audit trail is a big step towards higher standards of corporate governance.

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An often overlooked, but very measurable corporate benefit of uniform systems and processes delivering clean and dependable data, is the award of a better rating from credit agencies. By consistently demonstrating that it has a firm handle on its finances, an organisation can display a determined response to recent financial corporate scandals. In many organisations forecasting has been said to be as accurate as a game of Chinese whispers, especially once each region or subsidiary submits a cash forecast and the results are pooled together. The various ways of recording information means that each forecast does not correlate with the next, leading the results to be doctored, and thus giving a perceived view of reality. If the cash management function is centralised and common processes and procedures adopted, then the data is far more easily correlated, giving an accurate picture of liquidity and risk.

With this type of approach, overall decision-making becomes more informed as the CFO and treasurer can be confident that the forecasts they receive are based on accurate data and standardised processes. Risk is better managed and exposures can be hedged and unnecessary losses reduced. A dashboard view into the underlying data means the CFO or treasurer can view and analyse reports from his/her desktops and gather any further information required. This audit trail of all activity is extremely important in the light of scandals such as Barings, Worldcom, Enron and Parmalat and the ensuing focus on corporate governance.

NO SMALL TASK. Centralising cash management is no small task and corporations often face opposition and barriers from within the organisation. Investing in technology is also only 40% of the battle towards efficiency. The remaining 60% involves on internal support, education and combating internal politics. In order for an organisation to realise all of the benefits inherent in centralised cash management, the entire company needs to work in unison. Time needs to be spent prior to implementation, aligning procedures and devising common processes – providing a framework on which the system is built. Once the system is installed, training is imperative. The key factor is that the right people are involved in the project from the beginning and that it is implemented with the support of each and every relevant department within the organisation.

Although legislation and regulation, such as Sarbanes-Oxley, are not prime drivers for centralisation, they do become easier to manage when using a centralised approach. Sarbanes-Oxley is all about control and if an organisation does not know where its risk lies, how can it control its processes? The data integrity and enhanced Management Information System reporting offered under a centralised model ensures that board members can feel confident in the reports they sign off.

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PHILIPS CONNECTS ITS CASH SYSTEMS

Dutch electronics giant, Philips, recently moved its cash management from a decentralised to centralised structure, establishing an in-house bank and payment factory. It now benefits from reduced cashflows, improved visibility and control and lower costs.

Having faced tough times, the company was under pressure to cut costs. It took the decision to centralise its cash operations in 1997 with the objective of gaining greater control, increasing efficiencies and reducing costs while freeing up working capital.

In order to centralise its cash management effectively it needed a scaleable, best-of-breed cash management solution, capable of connecting all 1,100 subsidiaries via the internet. After a stringent evaluation process, it selected the Alterna solution (now the Cash Management Module (CMM) owned by Trema).

In deploying the cash management solution, the organisation wanted to more improve its management of cashflows across subsidiaries while gaining visibility and control enterprise-wide. This was to be be achieved by introducing not only an in-house bank, but also a payment factory to process all of the company's payments.

THE SITUATION TODAY. The centralised cash management operation is situated at the firm's main office in the Netherlands, with satellite offices in Asia, Latin America and the US. A payment factory has been built which manages 1.5 million payments from 650 subsidiaries worldwide each year. By managing all payments centrally, expensive international payments can now be converted into domestic ones. Additionally, by reducing the amount of external activity, the company has been able to cut back the number of external banks used on the payments side from around 100 to just two, enabling it to benefit from reduced fees and reduced overheads.

Alongside the payment factory, in-house banking has also been introduced, which manage all inter-company payments, removing the need for costly external payments and third party netting services. This further reduces the required number of external banking relationships. Through the introduction of the payment factory and in-house bank, Philips has been able to eradicate more than 400 interfaces previously maintained between the organisation and its banks.

By reducing the amount of cash in circulation, the company is able to increase the turnover of cash. Through the use of an overlay bank, it can zero-balance almost all of its cash into various currency centres every day. While both the payment factory and in-house bank have allowed the organisation to group all of its global cash resources and manage the cash belonging to each division more efficiently, use of web-based technology has meant that the subsidiaries have retained autonomy where required. Subsidiaries are able to enter, approve and monitor their own payments, view in-house account statements and integrate local accounts payable systems with the central treasury via the web and Electronic Data Interchange (EDI) interfaces.

Although a reduction in costs was a key driver for the project, a key benefit of centralisation is improved risk management. One of the prime functions of Philip's central treasury is to mitigate any financial risk that exists inside the organisation on a daily basis by covering any exposures. Prior to installing CMM, this was impossible due to a lack of visibility. A common system and single database means that it can now easily identify the company's foreign exchange exposures and hedge them.

THE NEXT STEP. Philips is now focused on increasing country connectivity, especially in Asia Pacific countries that still need to be incorporated into the new structure. Upgrading to the latest version of CMM will be instrumental in achieving this.

A further priority is to increase the number of subsidiaries using the payment factory, although all subsidiaries enquiring into company payments will do so via the CMM web browser. The company is committed to getting subsidiaries in more countries such as Japan, Thailand, the Philippines, Mexico and Malaysia submitting payments.

Moreover, it has considered trying to repeat the success it has had with the payment factory and in-house bank on the collections side, with the creation of a collections factory, so that it can standardise and streamline receivables.