6.3.2 Exercise in Cash Management

Unit: Unit 2 – Treasury Applications

Module: Module 6 – Managing the corporate structure

Date: 1 September 2016

Summary: An exercise in cash management in a multinational.

Keywords: parent, holding company, operating subsidiaries, royalties, license, multi-lateral netting, foreign exchange, intercompany loan, cash management, pool, control account, local currency, MT103, Sarbanes-Oxley, syndicate, ancillary business, overlay, SWIFT, double tax treaty, withholding tax

Background

Situation report

Our company is a major IT company with a UK headquarters, its shares being listed in the FTSE and on Nasdaq. It has grown by acquisition in Europe, and has large subsidiaries in Netherlands, France, and Denmark (which is the basis of a business in all of the Nordics and Baltics). Its main customer in these countries is government, hence the need for a locally-incorporated subsidiary to credentialise itself, and to act as a base for marketing, contracting and servicing. From that base it has built out into relationships with financial institutions, oil&gas, mobile and other industry verticals.

It has a wide service range:

- bespoke building of IT systems
- package application selection and installation
- systems integration

In practice the range is not as diverse as it might appear, because few bespoke systems are now built from the ground up: they include packages and components that are integrated. In terms of the design and coding of a new system, this is done in their coding centres in India and Malaysia. In terms of deployment this can be done at the company's outsourcing centre in Poland, or on client site.

So what is the problem?

These markets are not growing, and local costs are high. The presence in the USA is underweight considering the market potential there. The company owns the Intellectual Property rights to a large number of software products that it has developed as part of its ongoing work: these are both applications relevant to running a business in an industry vertical, and to background systems integration, and also systems for monitoring and controlling other systems.

The company has decided to develop its business in three new marketplaces:

- Central & Eastern Europe beyond the Baltics (and the Polish outsourcing centre is not serving clients in Poland as such);
- Latin America
- Asia-Pacific

What has the company done?
It has acquired a US-headquartered IT services company (the target) that has built up a business in acting as reseller, installer and servicing agent for:

- Multiple software companies, mainly US-headquartered, across all types of software
- In countries where those software companies do not see the scale or opportunity to directly service the market themselves

In the process the target has acquitted a number of interesting licences, rights and contracts which, our company believes, could be better exploited within its existing network and within our network.

Our company views the target's subsidiaries as acting in future like our existing ones particularly in the Nordics and Baltic region: they create credentialisation for our company and its services, and act a base into that market for sales, contracting and servicing, without building up a large cost base there. In particular all subsidiaries globally should be marketing and selling the large number of software products that our company developed as part of its ongoing work pre-acquisition, and which the target is bringing to the party.

Not only that, they should be selling our coding capabilities in India and Malaysia, and the competencies of our outsourcing environment in Poland.

The company has paid Net Assets plus 7 times the previous year's Profit Before Tax to acquire the US group, which is toppish but is thought justifiable to obtain so many existing presences in just one transaction. Depreciation plays very little role in the US group's figures because they are not an owner of hardware or other depreciable assets, so PBT is more or less the same as Free Cashflow. Intellectual property was not being amortised as long as there were demonstrable sales.

GROUP FIGURES PRE-ACQUISITION

ALL EXPRESSED IN USD MILLIONS

Balance Sheet of the Group pre-acquisition

Cash	10,236	S/t loans	18,957
Receivables	45,879	Creditors	62,690
WIP	89,634	Tax	8,871
Intellectual Property	17,580	M/t loans	50,488
Equipment	15,784	P&L	36,590
Land&Buildings	12,483	Capital	14,000
	191,596		191,596

Where these positions exist

Country	Cash	Receivbs	WIP	S/t loans	Creditors
UK	45	13,532	23,451	3,832	17,704
Netherlands	8,751	0	0	12,265	0
France	76	11,870	26,801	35	16,225
Denmark	25	3,528	6,751	21	4,865
Sweden	65	4,502	8,548	17	6,105
Finland	52	3,924	7,730	23	5,397
Estonia	31	2,621	5,127	8	3,671
Latvia	46	751	1,435	6	984
USA	897	5,151	9,791	2,682	5,922
Poland/Outsourcing *	95	0	0	14	153
India/Coding *	76	0	0	22	891
Malaysia/Coding *	77	0	0	32	773
Total	10,236	45,879	89,634	18,957	62,690
Totals from above	10,236	45,879	89,634	18,957	62,690
Difference	0	0	0	0	0

* Receivables are all intra-group charge-outs to sister companies on customer jobs
Billed just before month-end to the sister company with the customer contract
Settled in the mutlilateral netting at month-end so no Receivables or WIP

THE TARGET

Acquisition statistics

(in millions)	GBP	FX Rate	USD
Acquisition price	11,200	1.62	18,144
Net Assets	6,650	1.62	10,773
PBT element of the price	4,550	1.62	7,371
PBT multiple paid	7		7
PBT of the acquired group	650		1,053

ALL EXPRESSED IN USD MILLIONS

Balance Sheet of Acquired Group

Cash	3,280	S/t loans	2,860
Receivables	12,620	Creditors	22,690
WIP	19,190	Tax	1,767
Intellectual Property	5,720	M/t loans	5,730
Equipment	2,160	P&L	8,773
Land&Buildings	850	Capital	2,000
	43,820		43,820

Where these positions exist

Country	Cash	Receivbs	WIP	S/t loans	Creditors
USA	521	1,985	3,011	628	3,591
Netherlands	996	0	0	624	0
Brazil	1,120	3,421	4,851	603	5,634
Chile	65	548	952	85	1,241
Mexico	41	486	721	75	863
Uruguay	51	351	534	66	622
Poland	20	89	127	112	148
Czech Republic	41	165	222	98	234
Slovakia	6	78	98	46	107
Hungary	21	92	149	45	175
Romania	8	47	95	25	111
Bulgaria	5	97	156	37	167
Singapore	45	632	1,182	6	1,377
Hong Kong	62	494	850	4	997
Thailand	95	1,068	1,612	115	1,756
Malaysia	67	873	1,352	93	1,635
Australia	55	1,174	1,750	86	2,094
New Zealand	32	898	1,333	92	1,698
Vietnam	17	67	112	12	134
Cambodia	12	55	83	8	106
Total	3,280	12,620	19,190	2,860	22,690
Totals from above	3,280	12,620	19,190	2,860	22,690
Difference	0	0	0	0	0

© Association of Corporate Treasurers

What is the new legal structure of the company?

The UK company remains the parent. UK subsidiaries are directly owned by it. It owned the existing foreign subsidiaries through a Dutch Holding company, and the US group's shares were purchased by the same Dutch Holding company. This initially created a five-level structure because the US group's operating subsidiaries were also owned in the same way: now the two Dutch Holding companies have been merged into one, and the remaining one directly owns:

- the pre-existing foreign subsidiaries
- the acquired US company
- the new foreign subsidiaries

Ownership of the entire group's software products is likewise vested in the Dutch Holding company, and royalty revenues for usage of those products should be an increasing revenue stream:

- royalties paid by each subsidiary for the right to market and sell the palette of products;
- royalties paid on each sub-licence, received either direct from the licensee or through the subsidiary in the country where the end-user contracted for the product.

The purchase price for the acquisition was GBP11.2 billion equivalent in USD. It was met in its entirety with the proceeds of a loan under the parent's guarantee taken by a Dutch Capital BV and onlent to the Dutch Holding company.

The Dutch Capital BV handles all international fundraising over 1 year. There is also a Dutch Finance BV that handles:

- all international fundraising below 1 year
- multilateral netting
- FX
- Intercompany loans and deposits
- Cash management

Global Treasury operated the Dutch Capital BV and the Dutch Finance BV from its UK base. Pre-acquisition the company had succeeded in getting 75-80% of all cashflow to go through its main bank in each country. There was and is a pool in each of those banks and the Dutch Finance BV holds the control account. That enables the Dutch Finance BV to insert a daily deficit in the pool, or extract a daily surplus. Every month, on the day of the netting settlement, the Global Treasury agrees the adjustment of the balance of the intercompany loan/deposit account it holds for each subsidiary, until the next month. The adjustment consists of:

- current balances
- plus/minus the netting result for that subsidiary
- plus/minus projected cash needs/surplus until the next time
- The adjustment, if positive, is paid out to the subsidiary's account in a pool from the Dutch Finance BV's account in the same pool, or else the reverse, a negative adjustment is debited to the subsidiary's account in the pool

All of these pools run in local currency. Global Treasury has online access to the accounts in the pool using the browser-based ebanking tool of the bank concerned. Danske is able to show all the pools in Nordics+Baltic through their system. The Dutch Finance BV – like the Capital BV and the Holding BV – has its accounts with ING in the Netherlands, and Global Treasury has negotiated with ING and with Danske, Barclays, BofA (New York) and SocGen that all MT103 messages between these four banks and between a nominated list of accounts will be handled as follows:

- They are initiated in the respective Remitting Bank's ebanking.
- That bank will send the MT103 payment under SHA charging (each bank levies its own fee, no deductions from proceeds, no pass-backs of fees).
- Field 23E of the MT103 will be populated with the instruction code INTC to ensure it is recognised as intercompany by the Beneficiary Bank.
- The Beneficiary Bank credits the whole amount immediately to the available balance and charges their fee separately at the end of the month.

Monies at Lloyds are centralised into Barclays, and not direct to ING. Managing 5 ebanking systems is regarded as onerous but not impossible. However it is recognised that expanding this method further would be most problematical.

Global Treasury runs the multilateral netting itself, on a programme originally franchised from Omnicom.

What is the challenge in cash management?

The company has to show Sarbanes-Oxley compliance before, during and after the acquisition. In other words, the processes behind all the numbers rolling up into balance sheet positions at a group level and reports such as the 10K for the US SEC have to be robust and well-controlled.

That includes having visibility of all cash.

The Dutch Holding Company needs to have access to as much of the group's free cash as possible in order to meet loan payments.

Both groups had ERP systems before the acquisition and these will be consolidated in due course, but for now the picture of "cash" available from internal systems is fragmented, such that bank-derived information must play a bigger role than it might do in a company with fully-centralised ERP.

Which banks have to be kept happy?

The banks that have put up the acquisition money are the main banks to the group and to its subsidiaries pre-acquisition. While the syndicate has three tiers in it, the important banks for allocating ancillary business are in the two top tiers, and they are:

Top Tier

Barclays/UK	ING/Netherlands	SocGen/France

Second Tier

Danske/Nordics+Baltic	Lloyds	ANZ	BofA

The tiering correlates directly to the size and importance of the subsidiaries that the banks service. Lloyds services a number of UK subsidiaries. The pre-existing North American subsidiary in USA needed a bank connection too, and ANZ-Grindlays services the coding centre in India. The bank that services the coding centre in Malaysia (Malayan Banking Berhad) does not do this kind of lending.

Nordics+Baltic for the company means:

- Denmark
- Sweden
- Finland
- Estonia
- Latvia
- Poland (for the day-to-day needs of the outsourcing company

Task 1:
These banks should be allocated the ancillary business deriving from the acquisition, so the unwritten understanding is that the first option would be to replace the target's banks with our banks in each country.

Go to the websites of these banks. Match off their international presences with the locations of the subsidiaries of the US company that you have now acquired.

Insert ✓ or ✗

Country	**Barclays**	**ING**	**SocGen**	**Danske**	**Lloyds**	**TorDom**	**BofA**
Brazil							
Chile							
Mexico							
Uruguay							
Poland							
Czech Republic							
Slovakia							
Hungary							
Romania							
Bulgaria							
Singapore							
Hong Kong							
Thailand							
Malaysia							
Australia							
New Zealand							
Vietnam							
Cambodia							

© Association of Corporate Treasurers

Current banks being used by the acquisition target:
Here are the current banks being used by the US group, including in the USA.

Country	Banks
USA	Citibank, Silicon Valley Bank, SunTrust
Brazil	Citibank, Banco Real (Santander Group)
Chile	Banco de Chile (Citibank), Santander
Mexico	Banco Nacional (Citibank), Santander, Bancomer (BBVA)
Uruguay	Citibank
Poland	Citibank, PKO Bank, Bank Zachodny (Santander)
Czech Republic	Citibank, CSOB
Slovakia	Citibank, CSOB
Hungary	Citibank, K+H Bank
Romania	Citibank, UniCredit Tiriac Bank
Bulgaria	Citibank, CIBank
Singapore	Citibank, United Overseas Bank
Hong Kong	Citibank, Dah Sing Bank, Bank of East Asia
Thailand	Citibank, Bangkok Bank, Siam Commercial Bank
Malaysia	Citibank, Malayan Banking Berhad, RHB Bank
Australia	Citibank, National Australia Bank, Westpac
New Zealand	Citibank, ANZ, Bank of New Zealand
Vietnam	Citibank, Vietnam Bank for Industry and Trade
Cambodia	ANZ Royal Bank, Phnom Penh Commercial Bank

The company has tried to use Citibank for local needs as much as possible, which in some countries cannot be very much: Citibank is used as an Overlay and the source of electronic balance reporting into the US parent. The ‘marching orders’ to local finance managers are to use Citibank to house surplus funds, and to use Citibank for all foreign transfers, incoming and outgoing. Then the CFO in the USA can see the position through the Citibank ebanking service, and can order transfers:

- Between accounts held in the Citibank network, subject to exchange controls when these are cross-border
- Into the local banks that the subsidiaries use from the Citibank branch in the same country
- In some instances where the other bank is prepared to act on an MT101 Request for Transfer, transfers in the other direction: out of the local bank and into the Citibank branch in the same country.

Task 2

Our company's sense is that we will probably need SWIFT-based reporting set up with all of our banks, even if we currently take the pool reports on the pre-acquisition banks through each bank's ebanking.

We're not sure yet whether to take this reporting through an aggregator bank like Barclays, or directly via SWIFT Corporate Access, or through another form of aggregator (is that a SWIFT Service Bureau??).

Go the SWIFT Corporate Access Bank Readiness page and record which banks may be able to help you in the countries where your group now has a presence:

http://corporates.swift.com/en/certification/country

Note the level the bank has to reach to qualify for the certificate. Does this mean it is inaccessible via SWIFT?

Insert the names of the banks who certified as "SWIFT-Ready", eliminating the ones you would not be prepared to deal with.

Country	Banks
Brazil	
Chile	
Mexico	
Uruguay	
Poland	
Czech Republic	
Slovakia	
Hungary	
Romania	
Bulgaria	
Singapore	
Hong Kong	
Thailand	
Malaysia	
Australia	
New Zealand	
Vietnam	
Cambodia	

© Association of Corporate Treasurers

Totality of the group now

A snapshot of the financials of the different companies in the group is found in the accompanying exercise spreadsheet. For reference purposes the group now consists of:

Country	**Presence**
UK	Group parent, multiple domestic subs of pre-existing group
Netherlands	Multiple domestic subs of pre-existing group, Holding Company BV, Capital BV, Finance BV
France	Multiple domestic subs of pre-existing group
Denmark	Subsidiary of the pre-existing group
Sweden	Subsidiary of the pre-existing group
Finland	Subsidiary of the pre-existing group
Estonia	Subsidiary of the pre-existing group
Latvia	Subsidiary of the pre-existing group
USA	Subsidiary of the pre-existing group, HQ of the acquired group, domestic subs of acquired group
Brazil	Subsidiary of the acquired group
Chile	Subsidiary of the acquired group
Mexico	Subsidiary of the acquired group
Uruguay	Subsidiary of the acquired group
Poland	Outsourcing centre and subsidiary of the acquired group
Czech Republic	Subsidiary of the acquired group
Slovakia	Subsidiary of the acquired group
Hungary	Subsidiary of the acquired group
Romania	Subsidiary of the acquired group
Bulgaria	Subsidiary of the acquired group
India	Coding centre
Singapore	Subsidiary of the acquired group
Hong Kong	Subsidiary of the acquired group
Thailand	Subsidiary of the acquired group
Malaysia	Coding centre and subsidiary of the acquired group
Australia	Subsidiary of the acquired group
New Zealand	Subsidiary of the acquired group
Vietnam	Subsidiary of the acquired group
Cambodia	Subsidiary of the acquired group

The following page shows key barriers, if any, to Cash Management pertaining to that country, as well as the corporation tax rate in the country, whether there is a Double-Tax Treaty with the Netherlands and what are the withholding tax rates on different types of transfers of money.

Key facts per country [the rates are not meant to be factual][1]

CTR means the local rate of Corporation Tax in %

DTA means "is there a Double-Tax Treaty with the Netherlands?"

RTY means the withholding tax deduction rate in % on Royalties stated in the DTA if there is a one, or the domestically-fixed rate if there is no DTA

BINT means the withholding tax deduction rate in % on Bank Interest stated in the DTA if there is a one, or the domestically-fixed rate if there is no DTA

IINT means the withholding tax deduction rate in % on Intercompany Interest stated in the DTA if there is a one, or the domestically-fixed rate if there is no DTA

Country	CTR	DTA	RTY	BINT	IINT	Other issues
UK	32	✓	0	0	0	
Netherlands	25	N/A	N/A	N/A	N/A	
France	40	✓	0	0	0	
Denmark	35	✓	0	0	0	Thin Cap 2:1
Sweden	36	✓	0	0	0	Thin Cap 2:1
Finland	33	✓	0	0	0	Thin Cap 2:1
Estonia	28	✓	0	0	0	Thin Cap 3:1
Latvia	26	✓	0	0	0	Thin Cap 3:1
USA	35	✓	0	0	0	
Brazil	25	✗	15	20	25	Strict exchange control
Chile	24	✗	12	18	24	No non-resident accounts
Mexico	26	✗	14	20	26	
Uruguay	27	✓	10	15	20	Multi-currency; liberal
Poland	28	✓	0	0	0	Stamp Duty on capital transfers
Czech Republic	29	✓	0	0	0	
Slovakia	27	✓	0	0	0	
Hungary	26	✓	0	0	0	
Romania	25	✓	0	0	0	
Bulgaria	29	✓	0	0	0	
India	22	✗	10	15	20	Exchange control queue for foreign currency
Singapore	15	✓	5	10	15	
Hong Kong	17	✓	5	10	15	
Thailand	21	✗	10	15	20	
Malaysia	18	✗	8	12	16	Residents cannot hold accounts abroad
Australia	32	✓	0	0	0	
New Zealand	30	✓	5	10	15	
Vietnam	17	✗	8	12	16	Exchange control queue for foreign currency
Cambodia	16	✗	8	12	16	Exchange control queue for foreign currency

[1] This table is not refreshed for the latest rates and issues and may be out of date.

Now it's time to come up with some answers:

Your objectives are:

- visibility of all cash
- Sarbanes-Oxley compliance
- increase cash held in the Finance BV for making available to the Holding BV to meet its debt payments to the Capital BV ~ and so on to the banks
- reward the banks that put up the debt with the ancillary business

Question 1
What would you do to increase cashflow?

Question 2
How would you view the usage of:

- SWIFT Corporate Access
- An Overlay Bank?
- Your own pre-existing banks?
- The acquired group's local banks?

Question 3
What is your structure for International Cash Management going forward and why? What will be the residual problems?

Question 4
What might you have to ask other departments in your company to do to help?