Guest Editorial

'The centre holds': From the decentralised treasury towards fully centralised cash and treasury management

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INTRODUCTION

In many multinational corporations, treasury managers are facing huge challenges in managing transactions across multiple locations and time-zones while working with many outside banks. The greater the geographic reach of a company, the more difficult it is to access and track accurate and timely cash-flow information. At the same time, medium-sized companies that are growing in market value and size must decide how to implement the right solution for managing an increasing volume of transactions. Centralisation of treasury activities offers corporations the ability to achieve higher efficiency, greater transparency and access to real-time information across a broad geographical area and many entities.

The first shared service centres (SSCs) were developed by US corporations at the end of the 1980s, their objective being to maximise the return on investments in enterprise resource planning solutions. Today, multinational companies, especially those based in Europe and North America, are increasingly recognising the benefits they can gain from centralising their treasury and liquidity management. As an SSC combines multiple tasks, processes and IT infrastructures in one central location, a key advantage of the centralised treasury is the ability to deliver measurable, automated, unified, transparent and efficient processes. Moreover, a centralised treasury pools highly-qualified people, their skills and knowledge into a single centre that allows management to monitor and expand treasury operations swiftly and efficiently.

CASH AND LIQUIDITY MANAGEMENT

Within the treasury function, cash management is an activity that clearly benefits from economies of scale and process reengineering. By centralising its cash management operations, a corporation can achieve better management of internal cash-flows, reduce its float and transaction fees, and, of course, pare its operating costs. By standardising liquidity management processes, significant improvements can also be obtained in terms of control and security of cash.

INCREASING AWARENESS OF THE IMPORTANCE OF FINANCIAL RISK MANAGEMENT

In addition to the measurable financial advantages of the centralisation, such as 'cost savings', the centralisation, standardisation and automation inherent in SSCs offer an opportunity to streamline control and management processes in treasury, increase visibility over all company cash-flows, reengineer processes, and build in desired efficiencies and controls. In most cases, firms must rearchitect their technology platforms to realise the level of integration and automation necessary to achieve the benefits of centralisation.

Corporations are increasingly aware of the financial risks they face, particularly in the areas of foreign exchange exposure and interest rates — both on the investing and funding sides. Their awareness results from new regulatory pressures, such as Sarbanes-Oxley, other regulatory requirements, and a new emphasis on corporate governance. The improved transparency and control that result from centralisation support improved risk management, both in terms of financial and compliance risk. Exposures can be hedged and unnecessary losses reduced; at the same time, stop signs can be raised about transactions that may put the company at risk of Sarbanes-Oxley violations.

Technological advances and the solutions of banks and third-party providers make centralised cash management and the operation of an 'in-house bank' a reality for any multinational company. An in-house bank provides the most aggressive level of cash centralisation, as a centralised treasury unit maintains control and oversight of the internal accounts of individual companies and performs investing, borrowing, hedging and other treasury operations on behalf of the internal accounts of these companies. An internal settlement is usually processed on a bilateral net settlement basis. The in-house bank generally includes one or more primary concentration accounts for external settlement. However, larger corporations do not want to depend on a single bank and try to optimise their banking costs by managing external bank accounts as efficiently as possible. At the subsidiary level, it makes no difference if one or more external accounts are maintained by the central treasury as the subsidiary can manage its banking activities at a level of autonomy determined by the treasury — eg for collections and local disbursements — and is provided short-term investment and borrowing through its interaction with the in-house bank.

This structure naturally minimises costs for the administration of current accounts and payment orders by netting internal risk exposures and funding/investing requirements, consolidating investable balances for greatest yield, and, potentially, by consolidating payment execution. Of course, the centralised pooling structure is balanced with the efficiencies and needs of local banking systems. Relevant accounts exist for each currency and are situated in their home countries to achieve the best conditions for domestic payment relations and the storage of excess or drawing loans. All in-house banking accounts are placed with a single worldwide financial institution so that the fastest possible international coverage of financial needs is possible. Multiple accounts may be used for some currencies if establishment of these accounts reduces costs. As only the in-house bank can transact with external banks, it necessarily requires the whole group to aggregate its requirements internally, and derive maximum economies of scale for external transactions.

IMPACT OF A GLOBALISATION

As more companies expand operations across international borders, the erratic behaviour of the international financial market necessitates standardisation of international payments, as the simplification of fund movements becomes the extended challenge for corporate treasury. Corporate treasury is required to be more aware of the volatility of the international financial market and conversant with the current payment standards practised by other corporate treasuries, in order to keep up with international trends. For example, the recent implementation of the Single Euro Payments Area (SEPA) has resulted in the SEPA credit transfer replacing myriad payment instruments across the EU countries. The SEPA credit transfer was introduced in January 2008, and the SEPA direct debit in November 2009.

These challenges influence corporate treasury in determining the scope and coordination of centralised functions and the practicality of various organisational models. Although some corporations have experimented with a single global treasury centre, most have thus far preferred to consolidate to regional treasury centres, mostly because of language barriers and time-zone issues.

LOCATION CRITERIA FOR ESTABLISHING TREASURY CENTRES

As most multinational companies have already centralised their treasury and cash management activities, one of the most important questions concerns where best to locate treasury operations.

There are many factors to consider when researching where to locate a regional treasury centre. Such criteria include, *inter alia*, tax, educational and banking system reforms, political and economic stability, comprehensive legislation, skilled workforce, strong regulatory and supervisory frameworks, central bank reporting requirements, and low costs for business operations (see, for example, the work by Polak and Roslan[1,2]).

Beyond these criteria, there are still further variables to consider, and these can be difficult to measure. Such variables include city/country infrastructure (including availability, quality and cost of office space, access to transport links such as international airports, and the quality and cost of telecommunication networks), language barriers, availability of expertise, availability of outsourcing options, access to key financial markets and banking centres, the stability of communication networks, time-zone location, notional pooling considerations, cash concentration constraints and many more.

Unfortunately, in practice most existing SSCs exploit ‘only’ the cost savings. The reasons for this include:

- excessive focus on cost savings, to the point of ignoring other strategic benefits such as improved quality and scope of work;
- multicultural and other barriers — ‘custom and practice’ is a very significant factor in many countries;
- excessive ‘rationalisation’, making it difficult to attract key specialists to the SSCs and motivate them appropriately.

CORPORATE TREASURY OUTSOURCING

Another phase of centralisation is to remove the process out of the company entirely. Many firms, especially medium-sized companies, opt to outsource some part or the majority of their treasury operation. The main reasons for this include:

- avoiding expensive systems and IT investment;
- acquiring a skills set that is not available in the in-house treasury;
- allowing the company to concentrate on its core business, instead of treasury;
- establishing a full treasury capability where one does not exist.

Personally, I would prefer direct management and control of cash-flows through the company, especially in the present economic climate.

NEARSHORING

To cite Eric Mueller from Deutsche Bank, many corporations are now taking an approach that has become known as ‘nearshoring’ (as opposed to ‘offshoring’ to low-cost countries such as India). For European-based companies, the term generally refers to the establishment of SSCs in Central European countries (mostly Hungary and the Czech Republic, which are both free from legal restrictions as regards cash concentration and/or notional pooling) where 'skills are high, cultural and language barriers are less pronounced, and costs are still relatively low'.[3] Furthermore, for many corporations locating SSCs in these countries, there is the added benefit of closer proximity to existing manufacturing facilities.

CONCLUSION

Centralisation of treasury activities offers companies the ability to achieve higher efficiencies, greater transparency and access to real-time information across a broad geographic area, multiple time-zones and many entities. There are different phases in the centralisation of treasury management, from the decentralised treasury to fully centralised cash and treasury management. Many firms start with the centralisation of foreign exchange and interest-rate risk management as the first step towards centralisation of treasury activities, and then proceed through cash and liquidity management up to fully centralised treasury.

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