Taking a flexible approach to centralisation

Centralisation has long been a key objective for corporate treasurers. But advances in technology and an evolving regulatory landscape mean companies today can take their centralisation projects further than ever before. And while centralising a treasury is seldom a smooth or swift undertaking, the prospective efficiency and risk management benefits make the end result worth the effort.

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Centralisation is far from being a new concept in the world of treasury management. Yet it is one that remains a key focus as treasurers of companies operating across multiple locations covet even greater efficiency, transparency and access to real-time information.

Although there is no one-size-fits all model for centralising treasury activities, establishing an in-house bank (IHB) has long been viewed as a fundamental first step. With industry research showing that treasuries across both developed and emerging markets are increasingly looking to centralise their operations, interest in IHB structures has naturally increased. "For many centralised treasury structures, an IHB is a prerequisite," says Jan Dirk van Beusekom, Executive Director, Client Advisory, BNP Paribas. "Since more companies are now busy centralising their treasury activities, appetite for in-house banks is growing."

The trend may also be a reflection of the treasury community's evolving priorities. A survey of corporate treasurers conducted in 2015 by BNP Paribas and The Boston Consulting Group, for instance, found that the top three treasury priorities for that year were managing risks effectively, improving process efficiency and improving cash visibility. Perhaps the IHB is becoming an ever more popular model because of a growing realisation in the treasury community that a centralisation project can be a catalyst for improvement in all three of these areas.

Top priorities

The international chemical and advanced materials company Solvay, headquartered in Belgium, attests to this fact. Several decades have passed since the company first implemented an IHB structure in the 1980s, and a lot changed during that time. Like many companies that implement an IHB structure, Solvay opted for a staggered approach: centralising as and when technological and regulatory change opened up new opportunities to do so. Each incremental improvement meant better control over those three areas – risk management, process efficiency and cash visibility – that treasurers say they care most about. It is an approach other companies looking to establish centralised treasury models could learn a lot from.

"Back when we first implemented the IHB there was no Single Euro Payment Area (SEPA), no euros and no internet," Jean-Francois Caillol, Solvay Cash and Forex Manager, notes. "But we wanted to centralise intercompany flows as far as possible. Over the subsequent years we saw the arrival of the internet, the invention of the modern ERP, the birth of the euro and finally SEPA. And because of those developments we were able to realise a number of technical improvements."

The treasury structure Solvay have in place today is based around an IHB that operates as a centralised treasury unit, maintaining control and oversight of the internal accounts of the individual business units across the 53 countries the company is present in. Each business unit has an internal bank account in the books of the IHB and all payment and collection processing are managed by the IHB via SWIFTNet on either an on-behalf-of basis or, where that is not possible, on an in-the-name-of basis. Transactional exchange risk hedging and internal financing are also centralised through the IHB. For payments, treasury decided it was important to utilise SEPA from the overlay account wherever possible.

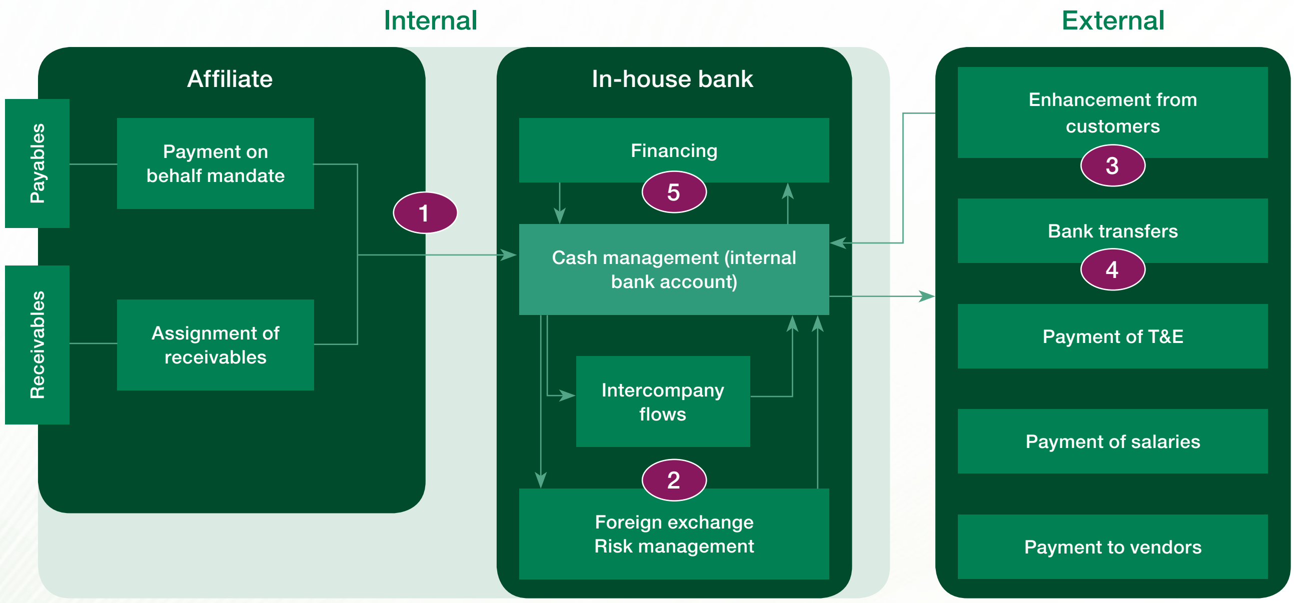
Assignment of both payables and receivables to the IHB was crucial since assigning only one would be "like trying to walk on one leg" Caillol opines. To do so would generate an imbalance in external and internal bank accounts and leave the company more exposed to FX risk. "We wanted customers to make their payments to the in-house bank and not to the individual companies; and we want suppliers to receive payments from the in-house bank and not from the individual companies."

Centralising cash, foreign exchange and inter-company financing together meant Solvay's exposures could be more easily identified, measured and managed and unnecessary losses reduced. "It's much easier to monitor counterparty risk," says Caillol, "when your cash is not spread across different accounts all around the world." Through having a centralised view on commercial FX exposures by monitoring Accounts Payable (A/P) and Accounts Receivable (A/R) assignments by business units, Solvay's treasury has also attained greater visibility and control. "If you improve your processes on payments and collections, you will also be able to improve your days payable outstanding (DPO) and days sales outstanding (DSO) and hence improve working capital management," says BNPP's van Beusekom.

Overcoming challenges

Seeing the improved transparency and control centralisation supports at Solvay, there is a growing appetite to establish more centralised treasury structures. But treasurers should be under no illusions: challenges inevitably arise in the transition from basic cash and risk management processes to more sophisticated models. Solvay's treasury knows this from hard experience.

Chart 1: Integration of AP AR the the way it works



Source: BNP Paribas Cash Management University

"Regulation remains one of the biggest obstacles to centralisation," says Caillol. "Our model works very efficiently in open economies like those of European countries, for example, and the US and Canada. But when it comes to countries like Brazil or South Korea that have currencies that are non-convertible or more tightly regulated, it becomes much more difficult."

Van Beusekom agrees that it is the specific regulations encountered in some of these more challenging markets that makes centralisation difficult for companies. He advises companies seek to adopt a more flexible approach. That indeed was one of the things that van Beusekom views as most impressive about the approach taken by Solvay. "Not all payments can be on-behalf-of," he says. "For that reason, being flexible is so important. For some entities you will be able to have payments on-behalf-of (POBO) and in others it will need to be payments in-the-name-of. Treasury would still be centrally organised, but it would mean using the accounts of local entities when that is required. It should be about integrating the flows as much as possible into the centralised model, but accepting the limitations."

Having a flexible, adaptable model is obviously beneficial in the sense that when regulations change in certain markets, it is relatively straightforward for treasury to respond and take advantage. It was this adaptability that allowed Solvay to increase centralisation after the introduction of the euro and SEPA. Caillol believes it will continue to be of benefit as the different regulatory environments Solvay operate in continue to evolve in the years ahead. "While there are restrictions in certain countries, the picture is constantly evolving. Take the FX reforms we've seen recently in China, for example. We know when countries open their economies we are ready to implement our system there."

Systems and processes must also be ready to adapt to changes within the company, as well as changes in regulatory environment. In the case of M&A, for example, Caillol says there is sometimes a need to use transitory services and develop alternative solutions as treasury carves out existing companies and migrates new entities to a compatible ERP. Such flexibility helped minimise disruption after Solvay completed its acquisition of US based materials technology and speciality chemicals company, Cytec Industries, in 2015. "Today we have a model that has not only demonstrated its effectiveness but also its ability to evolve with both internal and external changes."

A helping hand

Before embarking on a centralisation project of their own, Caillol and van Beusekom would encourage treasurers to consider very carefully what they want to accomplish and what model fits best for their particular company and then bring in the technology and banking expertise to help them reach that goal.

Technology was certainly a critical piece in the puzzle for Solvay. Before the arrival of the modern ERP system, there was a limit to how far the company could take their centralisation initiative. Indeed, the structure the company have in place today would not be possible, Caillol insists, without a very powerful SAP system, SWIFT connectivity and an intranet platform enabling clients to access their statements and perform transactions. "An IT system that is well designed and maintained is an absolute necessity," he says. "For us it is vital to support the complexity of our volumes."

Solvay's story also highlights how successful centralisation rests on true cooperation between banks and their corporate clients. For companies looking to centralise like Solvay, BNP Paribas offers a dedicated implementation project manager who maintains a dialogue with the clients' cash management team throughout the life of the project. On a more general level, the bank additionally provides educational opportunities for clients to learn about different approaches to centralisation and discuss these with the bank and their peers. Van Beusekom says: "We organise regular workshops and Q&A sessions and other events like our Cash Management University where treasurers can meet and discuss projects and share frameworks with corporates thinking about adopting these types of structures."

From the perspective of Solvay's treasury, these services are an invaluable resource for any company endeavouring to centralise.