Creating Value for Multinational Customers through Cash Management

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GLOBAL account management becomes more and more important due to an increasing internationalisation of customer business and the banking industry. Multinational customers (MNCs) wish their banks to support their internationally structured business and especially to manage their cash along international credit lines. European banks on the other hand are today already competing with each other in the whole European, if not the international market. There have been enormous improvements in banking IT systems in the past few years. However, the IT infrastructure in most banks is far from uniform, either on the international or on the domestic level. This is a serious obstacle for using products in global account management. One such product is cash management, which enables the bank to better service the MNC by tailoring its offers towards the organisational structure of the MNC.

Global account management

The primary aim of any organisation is to maintain liquidity, profitability and flexibility – aims on which banking connections have a direct influence. Liquidity is first ensured by cash and then by existing credit lines, flexibility can be achieved by extending credit lines[1].

In the 1980s there was a development away from primary banking connections towards transaction banking as the market for banking services became more and more transparent. Already in the beginning of the 1990s, MNCs have tried to reduce the number of their banking connections and have agreed on special conditions like negotiated fees or value dating of bookings with their primary banks[2]. Today MNCs value both a close relationship with their bank as well as trying to obtain the best bargain at a particular moment, i.e. the bank needs to look at both their transaction (price and quality) and relationship (flexibility and stability) orientated propositions. As all the standard banking products are nowadays delivered by all banks at an acceptable quality level, banks need to differentiate themselves and compete on the relationship level. New concepts need to be of a rather strategic nature and deliver additional value, which in turn will also be noticed by the MNC. A prominent example is global account management which can be defined as an organisational form and process by which the worldwide activities serving a given MNC are coordinated centrally by one person – the global account manager (GAM) – within the bank. MNCs make a substantial commitment towards setting up these concepts in cooperation with their chosen primary bank[3]. This includes an acknowledged perception of mutual dependence between the MNC and the bank.

The concept is simple, and from a MNC's perspective, it is also meant to be simple because it provides the possibility for a single point of contact with the primary bank. However, from the bank's perspective its implementation is frequently problematic. In most cases, global account management is established alongside an existing countrybased organisation[4]. For the country account managers (CAMs) this is often perceived as a threat to their autonomy; these struggles involve more than territorial pride, since clear customer ownership is the principle underlying the control and reward system of the performance of accounts.

Within the framework of global account management new products need to be introduced or existing ones need to be enriched in functionality. This paper is going to concentrate on cash management services – it is first going to explore various forms of cash management services. It then provides a new global product development, which will add additional value to existing cash management services by transferring the country view to a more globally oriented approach of relationship banking.

Cash management services

Balances in different locations are an expensive use of corporate funds and bringing those balances together has historically been a considerable amount of manual work demanding scarce time of account managers[5]. Hence, information on account balances are also the basis for automated cash management services. Interest results can be optimised by off-setting credit and debit balances. This avoids overdraft charges, interest payments and costly short-term borrowing thus

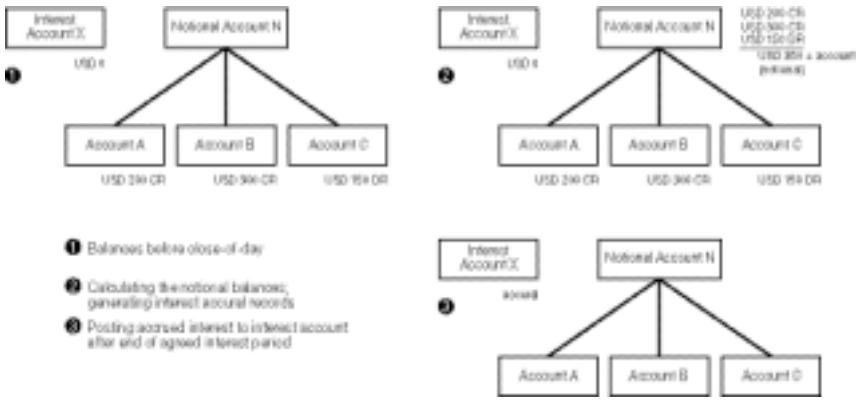
strengthening the company's balance sheet. A reduced borrowing level also improves a number of key financial ratios, making the company more attractive in the capital markets. Also, withholding tax on credit interest can be minimised. Due to a fierce market however, the loss of interest earning for banks by cash management services cannot be compensated for by higher fees. Rationalisation potential as an effect of cash management can help to save costs. More important, cash management services will be major criteria for enterprises while selecting their banking partners[6]. The appointment of a single global bank or a few principal banks in different countries with one as the leading bank[7] can even simplify the process for setting-up cash management services.

Liquidity management techniques

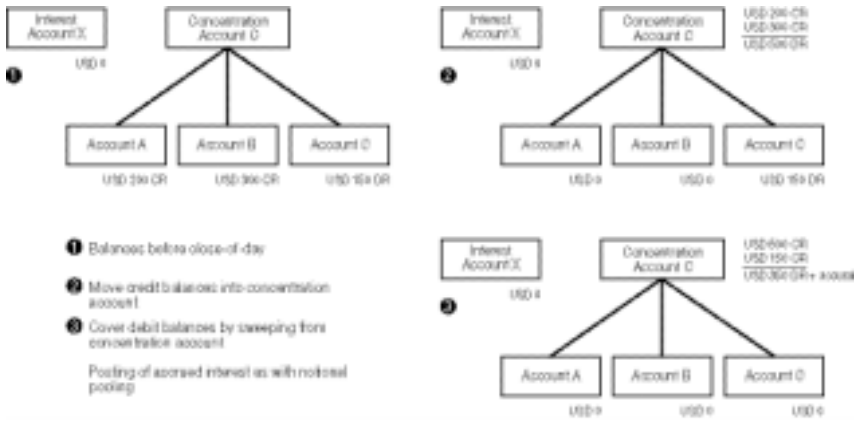
Liquidity management techniques aim at bringing together simultaneous long and short positions. There are two alternative approaches: notional pooling and cash concentration. With notional pooling the actual funds do not move but the bank will combine balances of several accounts and pay/charge interest on the combined balance only. Cash concentration is where the funds are physically moved into a single combined account (concentration account). Zero balancing and flexible balancing are the two most commonly known implementations of cash concentration[8].

Notional pooling: The close of day balances across all accounts of a client are notionally netted. This can be technically implemented by establishing a parent-child relationship with the parent account being a dummy account that caters for the notional balance entries. Figure 1 shows an example – accounts A, B and C are to be notionally pooled to target account N which is only created to hold the notional balance entries. By creating these entries, accounts A, B and C remain unaffected. The accrued interest can either be posted

1 – Notional pooling example[9]



2 – Zero balancing example[10]



to one of the accounts A, B or C at the end of the interest period or a separate interest account X is created.

Cash concentration: Funds are physically moved from accounts of the cash-pooling group to a single concentration target account by means of account entry transfer. Zero balancing, as the most traditional method of cash concentration, sweeps all credit balances of the source accounts to the concentration account. Debit balances will be covered by a vice-versa sweep from the concentration account. Figure 2 provides an example of zero balancing and denotes the differences to notional pooling. Flexible balancing is an extension of zero balancing with the possibility to apply target balances (cap and/or floor) to each account in the cash-pooling group. The caps and floors are used to keep group liquidity within a certain level without manually transferring entries back from the concentration account as would be necessary with zero balancing.

The customer typically pools his funds in each country under the respective national pooling or concentration arrangements to a target account. On a supra-national level, these national target accounts will in turn be treated as source accounts and be pooled or concentrated. Thus a concept of multi-level cash pooling or concentration can be implemented by defining one account as target account on one level and as source account at the next higher level.

While cash management systems manage the daily monetary position of the group, the supervision of credit utilisation is part of the daily treasury work for the customer and its bank. A global limit system will ease the control of local and global credit lines.

Business concept for global credit lines

The current situation is that MNCs have higher credit lines on a worldwide basis than actually required by them as a group. A buffer credit line needs to be added to each limit so that all counterparts can operate.

Advantages of a global limit system for the bank constitute:

- A better return on capital at risk by eliminating local buffer credit lines
- In cases of regional economical crisis – such as the Asian or Argentine crisis – consolidated and reliable information about the bank's exposure can be extracted from the global limit system online; the same holds of course true for an inquiry on the bank's exposure to one specific MNC
- The amount of written and verbal communication to other branches of the bank can be reduced as the limit utilisation is centrally controlled

An efficient handling of global limits requires the worldwide presence of the respective bank. Overlay banks can be used in countries where the primary bank is not present. However, overlay banks usually exchange data (transactions and limit utilisation) only once a day and this limits the possibility of a real-time utilisation overview.

While setting up a liquidity management contract, the bank will pay attention to the fact that the customer and each of the customer affiliates will jointly and severally assume liability for the payment of all amounts due in connection with the agreements for each participating account. This is often required by central banks and also important in case an affiliate should go bankrupt[11].

In addition to such a pooling agreement, the bank may grant the customer an overdraft facility for managing the balances on the participating accounts. In case this global overdraft facility is supplemented by various country facilities, a facility hierarchy is set-up, which should reflect the legal structure between the customer and his affiliates in a corporate group. Then credit risk exposure can be monitored against individual counterparts and groups of related counterparts.

In this structure the following terminology is used (Figure 3 depicts an example for a model MNC named Nuts Holding Plc.):

Group Parent is the head of the 'credit family' which comprises a customer credit hierarchy. Overall credit exposure and global limits are monitored at this level and hence its details need to be maintained in a global limit system even though the bank might not do credit business with the group parent as such. The group parent may have its own branches or subsidiaries, i.e. may also be a sub-group parent.

Sub-group Parent comprises a number of counterparts that share the same credit limit within a customer hierarchy. A sub-group parent is a legal entity with its branches and its fully guaranteed subsidiaries; it can also be a group parent or a subsidiary, but not a branch.

A *Subsidiary* is a legal entity of the counterpart. It is either a child of a group parent or of another subsidiary or it can be a sub-group parent. But where it is guaranteed by another sub-group, it becomes a member of the credit family of the guarantor. In the example, Walnut Ltd. is fully guaranteed by Almond Ltd. and is therefore part of the credit family of Almond Ltd.

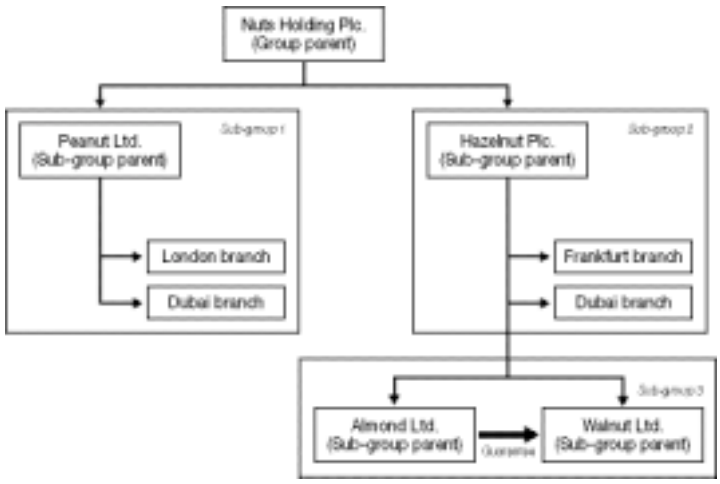
A *Branch* does not have credit limits assigned directly to itself, and not being a legal entity in its own right it shares its sub-group parent's limit. However, this share can be restricted to a certain percentage of the parent's limit.

In order to furnish such a MNC with a global limit to be utilised at its different branches, subsidiaries and sub-groups, the MNC will advise the bank of the maximum that each entity of the credit family will draw. At every one point of time and after authorisation of this credit line, a so-called Umbrella Facility or Global Allocation Limit (GAL) is established. It is reported as a joint and several liability.

Together with the amounts, the scope of business to be monitored under the facility needs to be defined:

- Only accounts already integrated in global cash management – on

3 – Customer counterpart hierarchy (example)[12]



average, this will lead to a maximum of about 20 limit checks per account per day
- All customer accounts – this could potentially lead to a non-manageable number of transactions, see below discussion on IT infrastructure
- Any other kinds of business like guarantees, loan, foreign exchange deals, etc.

Without an automated global limit system, excesses of the local credit line have to be approved by the local account manager. In case the credit excess exceeds the local responsibility, the global account manager (GAM) needs to be contacted.

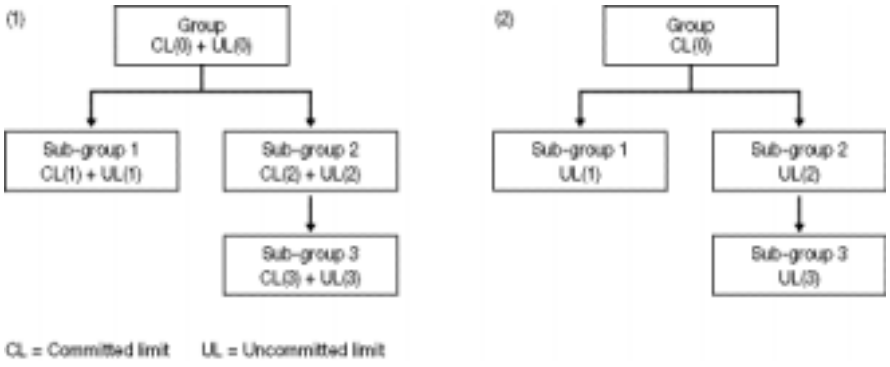
The main aim in setting up a global limit structure is to get as close to the internal sub-group structure of the customer as possible. The group parent is assigned a global limit; all sub-groups are assigned a sub-group limit. A limit check is first done on the lowest hierarchical level and then automatically passed on to the next higher level. On the lowest level, accounts are connected to limits.

There are two different business scenarios (see Figure 4):

1. The global limit and all sub-group limits are committed[13] ones – the committed limit at the next higher level must always be greater than or equal to the sum of the committed limits on the lower level. The opposite would result in legal problems; for instance, although the group has already utilised its global limit, the sub-group might still have some availability and would have a legal right to make a drawing.
2. The global limit is committed and all sub-group limits are uncommitted – the only legally binding limit is the global limit and all sub-group limits are allocated by the global account manager according to risk aspects for controlling the credit utilisation of the global limit through the whole credit family.

There can be several more scenarios that are a mix of the two main

4 – Scenarios for global limit structure



cases described: in addition to a committed limit, there can always be an uncommitted limit, which can serve the account manager as an allocation limit, i.e. in order to approve short-term limit excess.

The limit check is to be done in ascending tree order. Let us assume that a transaction on an account with Walnut Ltd. is to be limit checked and that the limit hierarchy is set-up according to Figure 4, part (1). Walnut Ltd. belongs to Sub-group 3 and so the transaction is checked against CL(3) first and then this limit check is passed up the tree to CL(2) and finally to CL(0). In case of a limit excess, the local account manager can use UL(3) or UL(2) respectively to pass the transaction through. Then the utilisation of all ULs in ascending tree order is updated. In case credit authority of a local account manager is exceeded, he might also request the global account manager to allocate part of UL(0) to this transaction. If UL(0) is used to pass through this transaction, the utilisation of the other ULs is updated in descending tree order.

Let us now assume that the limit hierarchy is set-up according to Figure 4, part (2). In case UL(3) is exceeded, the global account manager is automatically contacted since the local account manager does not have credit authority via UL(3) and hence cannot pass through this transaction. The global account manager could:

- adjust the uncommitted limits by reducing a – possibly – not yet fully utilised UL(1) and increasing UL(2)/UL(3)
- add UL(0) on the global level and allow for a temporary global limit excess.

Of course, at any level a transaction request can also be rejected.

IT realisation

The challenge for an IT implementation of the above described scenarios lies in the fact that various entities of the credit family can be in different countries and that different IT infrastructure may be used in all these countries.

Not only the IT infrastructure is different, but terminology and data provided may differ. A prominent example is the use of balances. There does not appear to be one uniform definition of value, booked and collected balance and in each location a different balance may be used for limit checking. All computer systems will – because of technical limitations or business requirements – incorporate different business into the balances displayed, some will update the utilisation real-time, others only after the last end-of-day processing. Customer, account and credit line identifiers differ from system to

system and from country to country. Also the whole philosophy of facilities can be fundamentally different. In some systems, a facility is set-up first and accounts as well as other credit business (guarantees, cash loan, etc.) are attached to it, in others a facility helps to club several accounts together.

In principle, there are two different approaches to this problem: select one existing local limit control system as the leading global system or design a new and independent global limit system. A basic architecture for a new and independent global system is depicted in Figure 5. All local limit systems communicate with the central global limit system via an interface layer. Typically, this interface layer will consist of a messaging and queuing middleware functionality.

The performance of the middleware and the global limit core system can be critical if transactions not only on cash management accounts but on all customer accounts are to be included.

It should always be emphasised that the local limit systems – in case of reconciliation differences with the global limit system – are to be considered as the leading systems since they are responsible for initiating the actual bookings.

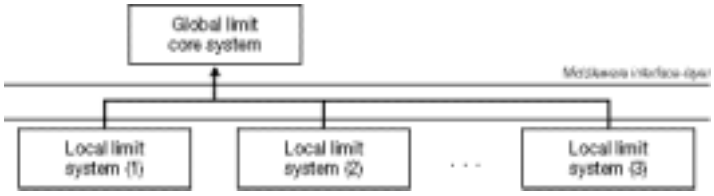
Conclusions

While there is a strong business and market need for the bank to offer cash management services together with global credit lines, the IT realisation will be a great challenge as most banks currently do not have a uniform IT infrastructure worldwide. This will not be an ad-hoc project, which can be handled by a small team, but together with the IT development a careful analysis of existing and current workflows in this fairly new international field needs to be done.

But the benefits for the bank and customer are clear and a bank that will have successfully implemented this concept full-scope, definitively has a unique selling proposition amongst its competitors by creating additional value for the MNC.

Because of an increasing technical and organisational complexity within banks, the flow of information and data available on both products and customers needs to be carefully monitored. Existing credit norms emphasise short-term and local profitability[14] and thus tend to underestimate the value of a global customer. Supported by a global limit system, the GAM can act as a true central point of contact[15] and conflicting advice by different CAMs due to a lack of overall data is avoided. The implementation of cash pooling techniques together with a global limit system can be a significant step towards customer relationship management (CRM) within global account management. ◆

5 – System architecture



For a full list of abbreviations and references, please see following page.

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Footnotes

1 Meinhold 1991, p509
2 Meinhold 1991, p508
3 Bukh *et al*, 1998, p113
4 Birkinshaw *et al*, p232
5 Raymont 1998, sec 1
6 Messner 2001
7 Thunmann 1992, p12
8 Raymont 1998, sec 2, Messner 2001
9 Messner 2001
10 Messner 2001
11 Webb 2001
12 Messner 2000
13 A committed limit (CL) is a customer advised limit, it is legally binding for both parties. An uncommitted limit (UL) is an internal credit line in addition to the committed limit; in most cases it is not communicated to the customer (unadvised)
14 Perrien *et al*, 1992, p28
15 Moriarty *et al*, 1983, p12-13

Abbreviations

CAM – Country Account Manager
CL – Committed Limit
CRM – Customer Relationship Management
GAL – Global Allocation Limit
GAM – Global Account Manager
IT – Information Technology
MNC – Multi National Customer
UL – Uncommittel Limit

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