MAKING CASH A CORPORATE RESOURCE

by Bas Rebel, European Cash and FX Manager, Perkin-Elmer

IN BRIEF

After comparing cash management with logistics management in the areas of organisation of core business, treasury business activity and available IT infrastructure, the article provides a detailed examination of the approach to cash management of Perkin-Elmer. The author describes the company's IT solutions and the functions of its European Treasury Center, which has the objectives of improving both cost structure and information flow, thus enhancing the effectiveness of the corporate hedging programme.

The chosen in-house banking structure is examined and the performance of the Auros In-house Bank software is described. By analysing cash management issues as logistic issues, Perkin-Elmer is now confident that it is on the track of the Holy Grail of cash management – making cash a corporate resource.

The Perkin-Elmer Corporation is a leading supplier of systems for life science research and related applications. The company develops, manufactures, and markets life science systems and analytical instruments used in markets such as pharmaceuticals, biotechnology, forensics, environmental testing, food, agriculture, and chemical manufacturing. Analytical Instruments Division products analyse substances at the molecular and elemental level in basic and applied research, new product development, and quality control. Perkin-Elmer had revenues of approximately $1.5 billion in fiscal year 1998 and employs more than 7,000 people worldwide.

Year end	1998	1997	1996
	US$ 000	US$ 000	US$ 000
Turnover	1,531.2	1,373.3	1,249.0
Total debt	45.8	89.1	89.8
Liquid assets	84.1	217.2	121.1

IT is a challenge, if not a quest, for a group cash manager to make liquidity available at any time and in those currencies and locations where group entities require it for their disbursements. Since the cash manager is constantly confronted with allocation and information issues similar to those facing logistic managers, it is interesting to compare cash management with logistic operations. This might help to improve the treasury activity.

- An efficient inter company handling of cash can reduce the working capital requirement as much as a more efficient production cycle. In this respect, company management could monitor the effectiveness of the cash manager using the 'cash turnover' ratio (which could be defined as the average short-term cash, divided by annual sales, times 365 days) compared with the inventory turnover ratio.
- Questions like "where to locate my warehouse?" and "which logistic service provider will we use for transport to the customer?" are familiar to the cash manager. One only needs to replace 'warehouse' with 'bank account' and 'logistic service provider' with 'bank' and 'product to' with 'cash from', and we are then dealing with cash management issues.
- In order to make the day to day operations effective, the cash manager has a similar need for information on forecasted cash flows to that of the logistic manager on forecasted orders and deliveries.

Key factors

Following the assumption that cash management is comparable with logistics, key factors driving a cost-effective logistic and cash management infrastructure should be similar too.

- ***Organisation of core business.*** The nature of the business and the chosen management strategies drive the logistic operation. They also drive the legal structure of a group. In its turn the legal structure determines the required (inter company) cash flow and is thus shaping the required cash management infrastructure.
- ***Organisation of the treasury/logistic activity.*** Answers to such questions as "is the logistic operation or treasury operation a cost or profit centre?" and "is it an independent or a shared service operation?" drive the position of both the logistic manager and the cash manager. Furthermore in both fields the necessary information flow is driven by the level of centralisation (or decentralisation) of activities.
- ***Available IT infrastructure.*** The IT environment available to support the required flow of information concerning order handling or liquidity

handling (availability of, request for and approval to release products/funds) set limits to the solutions that can be implemented.

Notwithstanding the similarities, the cash manager has two major advantages over the logistics manager – he can take away discrepancies between supply and demand by simply exchanging 'available inventory' (= available liquidity) for 'required product' (= required currency) at almost any moment. Furthermore, cash is the final stage in the business cycle, so the cash manager has more sources available from which to calculate the forecasted liquidity position.

Each group of companies is organised in a particular way. Therefore no such thing as a general solution to group cash management exists. One needs to study the particular business case before a customised solution can be implemented.

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The Perkin-Elmer business case

The European business of Perkin-Elmer is predominantly a sales and service operation. Perkin-Elmer runs a centralised logistic operation servicing local, resident sales and service entities. As a consequence, the inter company cash flow that must be accounted for is at least as large as the external cash flow exchanged with customers and vendors. As a result of the chosen business model the larger part of our inter company cash flow is highly time-sensitive and cannot be subject to leading and lagging. Since some cash changes hands within the Perkin-Elmer group several times before being disbursed to vendors, the risk of having a large amount of cash at banks is substantial.

The treasury activity at Perkin-Elmer is a shared service cost centre. Almost two years ago, a European Treasury Center was created to assist central treasury in the US monitoring the European cash flow. The mission was to reduce the level of cash at banks and to improve the information flow on currency risks. However not all cash management related activity is centralised in the two treasury centres. The chosen business model requires decentralised control over cash at local banks and a decentralised handling of account-receivables (mainly cash application/management of DSO). Therefore, the role of the European Treasury Centre was always that of coordinating European cash and risk management.

The shared service IT group operates a state of the art global WAN infrastructure. The ITgroup is also able to support regional and worldwide applications and interfaces from a limited number of computer centres.

Cash management solution

In order to support the business model the following objectives were formulated at the start of the European Treasury Center. In many ways these objectives resemble those of the logistic operation.

- Improve the information about (forecasted) available cash (linking cash to the currency hedges like linking the available inventory to the sales orders);
- Implement a cost efficient cash management infrastructure supporting the business model with a limited number of external bank accounts at a limited group of banks. The selected bank account infrastructure should anticipate the arrival of the euro (optimising the structure and location of our currency 'warehouses');
- Reduce the level of cash at banks in Europe to the minimum by de-linking the external operational cash flow and the internal cash flow (lower the level of inventory by centralising the 'warehouse' management); and
- Avoid the conversion of currency outside the corporate hedging programme (forestalling purchases outside the purchase frame agreements).

These objectives were not formulated just to improve the cost structure, but also to improve information on cash flow and thus to enhance the effectiveness of the corporate hedging policy. After a preliminary study we determined that an in-house bank infrastructure would accomplish the objectives. This in-house bank is a combination of:

- A separate treasury entity acting as the vehicle out of which the European Treasury Center offers services to Perkin-Elmer group companies. This entity will maintain current accounts with all (European) group entities;
- Zero balance cash pools with local banks in each national clearing centre will be used to transfer cash from the external bank accounts into the internal current account structure. The treasury entity is the pool master in each cash pool. The local entities will account for the end of the day zero balance into the in-house bank as a cash

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transfer between two bank accounts;

- The treasury entity handles all cash transfers for other group entities with which it maintains a current account relationship. The following payment routing rules are applicable:
  - Transfers between group entities are effected on the internal (in-house bank) current accounts directly;
  - External payments out of a cash pool where the entity holds an external account are released from that account. At the end of the day the zero balancing updates the balance on the internal account automatically; and
  - All other external payments are released from the pool master account in the cash pool on behalf of the submitting entity. An internal transaction updates the balance on the internal (in-house bank) current account of the submitting entity.

By implementing such an in-house bank structure, Perkin-Elmer will be able to cut the number of external bank accounts by more than half. More important however is that since all liquidity is held by treasury, liquidity management can be based on a consolidated cash flow. The cash manager needs not be concerned about which entity owns the cash. And last but not least, the in-house bank promises a substantial reduction of the level of cash at banks to the minimum required for paying out vendors, salaries and taxes only. Inter company payments are no longer a factor. The in-house bank redefines the role of its external bankers to that of corresponding bankers (the pool master account operates as a kind of nostro account) and makes cash a true corporate resource.

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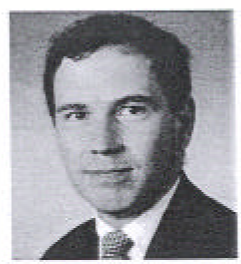
In order to implement the in-house bank structure without expanding the treasury staff, we needed sophisticated software that could automate the routing of transactions. Even more important, the treasury software needed to be accessible from remote locations for file down loads, entering and authorising payments. In short, we required a central treasury database that could be accessed over the WAN.

The Auros In-house Bank Software, provided by the Canadian company Alterna Technologies Group, helps us to standardise and optimise many treasury-related activities requiring input from the local entities:

- The record layout for external and inter company payments files is identical and can be extracted out of general ledger systems directly;
- Approval of payments is given in the software. The required four-eye authorisation principle can be respected more easily, since the empowered management can access the system at all Perkin-Elmer's locations;
- The European Treasury Center is able to calculate a detailed cash forecast based on downloaded A/P and A/R files using algorithms developed on a statistical analysis of historical payment behaviour. The software matches effected payments and receipts to the open items and updates the cash flow forecast instantly;
- The software is able to generate G/L postings for both the treasury entity and the participating entities based on predefined mapping rules;
- The Internet/intranet technology, on which the software is developed, is such that hardly any specialist IT support is required at the local entity level. Besides the network support and the maintenance of flat file interfaces with the local G/L software, only IT support at the central level is required; and
- The staff at the European Treasury Center has been expanded by one person only, who as well as being the front-office trader is highly involved with the implementation of the in-house bank at local entities and is training local staff on how to use the software.

By analysing cash management issues as logistic issues, we were able to formulate specific objectives that would make cash a corporate resource. Modern technology incorporated in the In-house Bank software confirms to us that we are on the track of this Holy Grail of cash management. □



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