Actualizing Success: How Multilateral Netting Streamlined Diversey's Cash Flows

Mark Layton: Compared with the physical cash transactions that missed month-end cut off so much easier, and we have a bit more discipline now around people reviewing the preliminary report.

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Kerry Wekelo: Thank you for joining us today for the fourth episode of actualizing success podcast. This week we have a member of our Treasury practice and an actualize consulting client to discuss how multilateral netting, streamline diversities. intercompany cash flows. Our guest stars on the podcast today are manager Craig Chapman and Diversity Global Treasury manager Mark Layton. Craig and Mark, thanks so much for being on the show. Thanks for having us. So, before we get started, first, I wanted to make sure our listeners have a good understanding of what multilateral netting is. Craig, could you give us an overview?

Craig Chapman: Yeah, absolutely Kerry. So multilateral netting is a process where companies establish a netting center, and that becomes the Central Party to all intercompany transactions with other participants, thus eliminating the need for multiple bilateral transactions. The approved participants in this process are typically internal, but in some cases, the netting program can be extended to external parties, for example, third party suppliers. So, one of the things to point out as we're going to call the subsidiaries participants, and what that means is they've been approved to participate in the netting process. So usually, you're going to set up a netting cycle. So, during the month or another agreed upon netting cycle duration, sometimes it can be quarterly, most of times its monthly. The multilateral payments between participants are consolidated offset, and they're reduced to a single transaction for each participant and that's either a two or a from the netting center. And those are via accounts that we set up at the netting center. And that could be linked to either physical accounts or internal accounts for settlement. The netting cycles, settings will control when invoices can be entered. And when the cycle closes, and then ultimately settles either internally or physically. netting is usually process of either payables based and that's where the payer inputs purchase invoices, or it could be receivables base, where the receiver inputs the sales invoices. For each participant, it will be required to decide on settling either internally or externally, or whether the participant can be part of the program at all, and so on. In some cases, there are legal restrictions regarding you know. In summary, netting will reduce the cost of making payments and bring structure and discipline to the intercompany process. And we'll highlight a few more of those benefits as we go forward in the podcast.

Kerry Wekelo: Thanks, Craig. That was definitely very helpful. And I know multilateral netting has been really increasing with our client base as well. Do you have any success stories from our clients?

Craig Chapman: Yeah, absolutely. So, for many companies, netting has been able to provide better visibility to the intercompany FX exposures and the cash balances. In some cases, clients have reduced their invoice volume from handling 90,000 down to a single transaction per participant, which really increases the effectiveness of your reconciliation. It also lowers their transaction costs by reducing the number of external payments. A lot of times another side benefit was clients were able to reduce the number of funding requests and manual wires that were requested. And at the same time, it was minimizing all the cross-border transfers, which significantly reduces the payment risk. So, clients that also utilize the in house back also saw a significant reduction of physical intercompany settlements by optimizing an in-house bank structure within the netting program. And that allowed them to settle internally instead of sending out a physical payment for each participant. So, it was a great benefit.

Kerry Wekelo: Great, thanks so much. What types of organizations would benefit from implementing multilateral netting?

Craig Chapman: It's not always the case. But in general, they're large multinationals with complex legal structures within the intercompany balances across a lot of countries and currencies. So, they're intercompany activity is high churn high volume complex currencies, but that doesn't. That doesn't say if you only have a couple currencies that this process wouldn't benefit, but that's the general MO for a net and client. So, they have significant number of subsidiaries, a lot of banking relationships, a lot of foreign exchange activity where participants are going out to the bank to get foreign currency instead of going to the central networks. And then they also could keep a high volume of cash at the local subsidiary banks.

Kerry Wekelo: So, Mark, thanks again for being on the on the show and going through the netting process with us. What were some of the challenges you experienced before you implemented netting to help your organization?

Mark Layton: Thanks Kerry, great to be here. We had some very high payment volumes and numbers of transactions going through the system. As Craig mentioned, we have up to 90,000 transactions per month by netting cycle and trying to translate those outside of netting results in very high bank fees. As well as the rest of them something goes wrong when you're making physical transmission of cash. And this, feeds through to inefficient use of resources, particularly on the cash application side when you're trying to clear off the AP and AR ledges. And there's more, there's more errors when you're making large numbers of transactions. Another area, which can lead to issues, depending on the country is concerned is legal compliance and potential tax liabilities that can come about through incorrectly applied invoices, and FX. transactional costs are significant. One of the major benefits we've been able to achieve using settlement on the enhanced bank is we don't actually need to do FX transactions at all to do those and it is as a separate process for our multi-currency notional pool.

Kerry Wekelo: You just recently implementing multilateral netting, can you share some of your experiences with us? Certainly,

Mark Layton: Certainly. It is very important before you embark on a process like this, that you involve all the important participants in the process. And that just doesn't just mean the entities that are going to have their transaction settled within the nursing. It also means the associated support sectors of the business, such as accounting, tax and legal to make sure their input is considered before you proceed. that's especially important when it comes to thinking about countries where netting may need to be in compliance with local laws and regulations all kind of expose you to tax issues if it's not done properly. As with any project, it's important to make sure that the timeline is clearly set out, that the roles are assigned to the correct people. Everyone knows what they're supposed to do that there's a clear roadmap, you know how long it's going to take and make sure you have a strong project manager so, you stick to the deadlines, and the due dates when implementation is going to take place. Insofar as possible, every entity should be following the same process, we have a little bit of diversity within diversity and that results from different DRP systems being used. But within that constraint of how much consistency you can apply across the whole company, we have a process that is essentially the same for every entity. Integration with your MRP system is important because you want to minimize the number of manual processes. So, on a on a payables-based system, that typically means making sure you have a good AR reconciliation cash application tool so, you can clear off the receivables from your ledger. One of the one of the nice things about this netting system is you don't have to implement it for everyone at the same time. You can start with a core group of however many entities you want, and add new entities ask them when they're ready to do it. Netting generates a lot of savings to the group overall and the subsidiaries participating. It's also recommended but I would recommend that you're involved for professional consultancy to help you set up the netting system that will all pay itself back many times over surely time savings and efficient implementation.

Kerry Wekelo: Yeah, always good to have a third party, especially when you're busy doing your day-to-day job, that's for sure. How did you make some of the key decisions when you were starting out such as whether to do payables or receivables-based netting and how did you pick your netting center location?

Mark Layton: These are very important considerations that you need to decide on before you start implementing payables based versus receivables basis particularly important consideration, for we had initially considered implementing receivables base, because that enables you to clear more of your intercompany invoices during any given cycle. But from a practical consideration, payables base is a was simpler in our case to implement. Most netting centers are run on a payable basis. It's so simple and effective way of reducing the cost of making XML payments, the payer typically has the option of blocking invoices, they don't want to pay. And this can lead to some aging of the intercompany ledger. But with internal discipline, you can still resolve most of those issues within the netting system. With respect to the choice of location for the netting center, we have a long-established in-house bank in the Netherlands, which is also managing the cash pool. And this made it the natural and logical choice for the netting center. So, this wasn't something we needed to take a lot of time on. Other companies might want to consider the particularly the tax and legal issues that may result from having the netting center in a particular location. But I would say if you already had an in-house bank, or a currency pool, then is likely you'll put the netting center in the same entity.

Kerry Wekelo: That makes sense. Mark, what were some of the benefits that we'll realize is result of implementing netting?

Mark Layton: We have two very significant benefits. One of them Craig mentioned earlier in his comments. And that's the ability to reduce a vast number of transactions down to one per entity. So, this is not just the settlement itself, it's the settlement on the netting is always one payment or one receipt or entity. This is the transactions themselves. In diversity, we have several entities who make 1000s of payments to the same entity. So, the NCAA paying 5000 invoices to STP. And that's an ideal candidate for consolidation, and just entering salary level transactions in the netting. Craig made this a very nice macro to simplify and make very easy that process of loading of consolidating all those entries into one and loading it simply into the netting system. Another benefit, which is very, very important to us, was a great reduction in fees compared with our prior process. So, we're saving around $15,000 from using the Caribbean netting process.

Kerry Wekelo: That's significant. Now with your netting, it can be settled either internally or require on an external payment, were you able to settle all your entities on an internal basis?

Mark Layton: Oh, almost all of them, we have around 55 participants in our netting system. And 51 of them, in fact, are able to settle on the in-house bank. So that leaves just 4 and we're having to make physical payments. Those countries Mexico, Taiwan, Singapore, and China, which for various reasons, are unable to just settle directly on the in-house bank. But Kyriba also supports the creation of the payment or receipt resulting from the netting, which is also a very nice synergy that you don't need to take the result of the netting and then put it into a separate system. It's all seamlessly integrated within the same process. We are reviewing the non-participating entities to see if we can increase the number of countries that participate very often there's countries like Turkey, for example, or Russia, where we determined several years ago that they weren't able to be included within the netting process. But legislation changes and quite often countries can participate. And this type of implementation is also an excellent opportunity to revisit that and determine whether the countries can be included.

Kerry Wekelo: Yeah, absolutely. I mean, a good reason to reach back out with them. So hopefully you can get it all streamlined so you have everything going through one process for sure. Craig, I'm curious, what would be key decisions that you would need to be looking at if you were going to start a multilateral netting program?

Craig Chapman: Yeah, sure, if a company is interested in establishing a netting program, you should initially focus on four important areas, and as Mark mentioned, involve the right resources up front. So those four areas would be tax and legal technology, the overall structure of the netting enter, and then operational decisions. So, from a tax and legal perspective, you will want to involve the tax and legal teams into the project early in the process, because they need to evaluate whether certain countries can participate based on their level of knowledge of each local area. They'll also be a guiding decision maker in terms of whether a participant can settle internally or externally. And they, tax, will definitely drive the location of the netting center based on advantageous tax rules of that location. And then the final decision from a tax and legal standpoint, and this will be likely driven by the location of the genetic Center, where you need to determine a functional currency of the center. And that currency will be the driving force for all your settlements. And then from a technology standpoint, technology is definitely an enabler to the netting process, you need the right piece of software to pull off running a netting center. So, if you don't have that technology in house today, you must gather your business requirements, evaluate potential netting system vendors. And then finally, based on your analysis and requirements, you would perform a final vendor selection, and then an implementation partner to move forward with that, that new structure. And then the other two concerns would be structural and operational. So, from a structural standpoint, I need to decide on the netting driver. So, what that means is whether it's going to be a payable based or receivables-based system, I also need to decide whether I'm going to allow third parties to participate or if it's strictly going to be my internal participants. And then finally, I want to wrap up the final decisions on participants location, and functional currency for all the participants must be determined as well. And then operationally, you just want to focus on what's the net encounter, am I going to run a monthly program? What are some of my cutoff dates, I need to establish settlement accounts, whether those are physical accounts or internal, I need to decide if there's any restricted currencies. Another key decision is whether disputes will be managed in the netting software or externally. So most netting packages have a license fee per user so this decision whether disputes are managed internally or externally from the software is a big one because if you decide to manage internally, each one of those users would have to have a set license with that provider. So those are the four key areas once you once you're first starting.

Kerry Wekelo: And that's very helpful. And Craig, I know you've implemented netting, and with many of our clients across the board, Mark mentioned some of the benefits of implementing a netting program. What would you say overall, what you've seen from our clients would be the benefits of implementing netting?

Craig Chapman: Yeah, so the top ones would fall into, again, four categories. But for many treasures, the efficiency gains alone are significant and can justify implementing a netting program alone. But there's other key benefits which are netting is going to provide a robust audible tool. So, I'm going to go back and see what happened each month I'll have it on record I'll have how significant tax treatment risk can be audited external audit compliance risk, and it improves accounting's ability to clearly reconcile and clear intercompany balances a lot quicker when nettings implemented. Then, and Mark mentioned this, but there is an aspect whereby reducing those physical intercompany payments, in turn, it's going to lower your bank fees. And if you're routing these intercompany net settlements through a single legal entity, the impact is much greater than the current situation where you're sending out all these physical payments. And then finally, you're going to reduce FX transaction volumes because the netting center is going to handle all the FX requirements. And we've mentioned this a few times, but the physical settlements are greatly reduced. And it really becomes enhanced if you integrate an in-house bank structure within your netting program because then it's going to extend to your existing LHB structure our in-house bank structure.

Kerry Wekelo: Those are excellent benefits of it if you are considering implementing netting in your organization. Craig and Mark, thank you for all your insights that you've provided today. I think we have a really good overview of netting. And I think that's all we have time for. Thanks again for being on the show. We really appreciate it.

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