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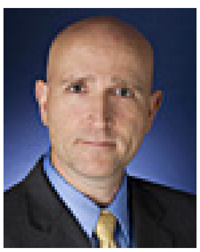
In-house Banks: A Smart Way to Create Efficiencies



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As the world's top corporates look to create shareholder value and achieve a higher level of operational efficiency, the desire to better manage cash flows and treasury functions has really come to the fore.

Globalization has been the catalyst for more complex cash flows, in multiple currencies from multiple locations and multiple legal entities. It has created structures that are disparate, multi-locational and complex. This has led some corporates to review their structures and key performance indicators and implement new structures that enable them to manage a host of disciplines, including funding, risk management, investment, liquidity management, payments and collections, and management information systems. In short, they set up what's known as an "in-house bank" (IHB).

At Deutsche Bank, we are having more discussions with our clients around such structures, which are not exactly banks in the true sense of the word but offer the type of services and adopt the characteristics of a cash management bank.

An IHB at Bombardier

One of our clients, Bombardier, was an early advocate of the concept and has been realizing the benefits. Debra Hinds, Director, Global Cash Management, at Bombardier, explains: "We were looking to consolidate a new treasury workstation model, moving the center of competence from Brussels to Zurich. The overriding theme was to seek out efficiencies and, quite simply, to better manage and provide greater transparency around our cash."

In most cases, an IHB enables a company like Bombardier to take the place of third-party banks. The company's subsidiaries open accounts with the IHB, either in a single functional currency or multiple currency accounts. Subsidiaries can be granted credit lines and borrow and invest with the IHB.

Implementing an IHB can enable corporates to streamline and consolidate cash flows, enhance working capital management, achieve greater control, and improve risk management and reporting.

"We have been able to achieve a much better level of cash utilization, as well as rationalize FX transactions executed locally and regionally," Hinds says of the company's IHB. "And we have certainly been able to make better use of cash on account, lending money in the pool to our entities. We are satisfied that we have attained a far better way of managing our cash."

An Evolutionary Process

While an IHB offers many advantages, it is not easy to implement. "There are many considerations and many people to align in the process, so expectations have to be tempered around timelines. You are looking at many jurisdictions and with that comes tax, legal and regulatory issues that will vary across the regions," Hinds says.

Indeed, setting up an IHB has many requirements, including getting buy-in across the organization and senior management's endorsement. An IHB is not something that can be taken out of a box, plugged in and off you go. The scope of the project must be determined, and the corporate must secure the optimal technology and cross-organizational cooperation and service level agreements.

Cautions Hinds: "This is an evolutionary — not a revolutionary — process. It's very much one step at a time. In our case, it was 190 different accounts into the structure and therefore not something that could be done in one step."

Furthermore, implementation has to balance global, regional and local requirements as well as the locations where the IHB will operate. Wherever that may be, the support infrastructure has to be in place along with communications and the appropriate skill-sets to support the project.

Bombardier ensured that the best possible structure and practices were put in place. "We made certain we did not just incorporate the old way of doing things," Hinds says. "It was not a question of bringing legacy structures into the IHB — this was a chance to do something new and that's what I would advise people to do if they are taking this route."

Not for Everyone

IHBs may not suit everyone. There are drawbacks in setting them up; they are complex and processes are concentrated. In other words, those things that may deliver benefits to some companies, may create challenges for others.

Also, there are alternatives that can deliver many of the same benefits of an IHB: greater standardization of policies and systems; rationalization of banks and accounts; and pooling and netting solutions that can help create treasury efficiencies.

The companies that will benefit most from an IHB are complex, global and largely decentralized; use diverse systems; and have variable funding requirements. The evaluation of such a project should involve all stakeholders and, from day one, engage external tax and legal advisors, as well as bank providers. You also want to adopt a multi-year phased approach to implementation.

“It’s important to define your objectives, as an IHB is more sophisticated than it may first appear,” Hinds says. “And you need a system that can handle this well — you will not be able to function on spreadsheets.”

Ultimately, IHBs can deliver enormous benefits for large global corporates. “Preparation is key,” Hinds says. “If you ensure your treasury operation has the right building blocks for an IHB, the entire process will go that much smoother.”