Deutsche Bank
Global Transaction Banking

The Road to European Payment/ Collection Factories

Passion to Perform

Over the past few years, Deutsche Bank has implemented many integrated payment and collection solutions for corporate clients around the world.

With this experience, Deutsche Bank has developed best practices that can assist corporates looking for integration efficiencies within their global cash management structures.

So what are the steps to be taken when centralizing payments and collections?

Definitions and Benefits

Shared-Service Centers (SSCs), In-House Banks and Payment/Collection Factories are distinct organizational vehicles, but the borders between them can be blurred. Companies may have different definitions/interpretations of what exactly they are. The reason is that all three are cost centers that focus on supplying standardized, recurring services to the business units more efficiently and more effectively. All three provide:

Lower Costs

- External economies of scale leading to lower bank fees and fewer bank accounts
- Internal economies of scale leading to lower IT, headcount, or overhead costs

Centralized Processes

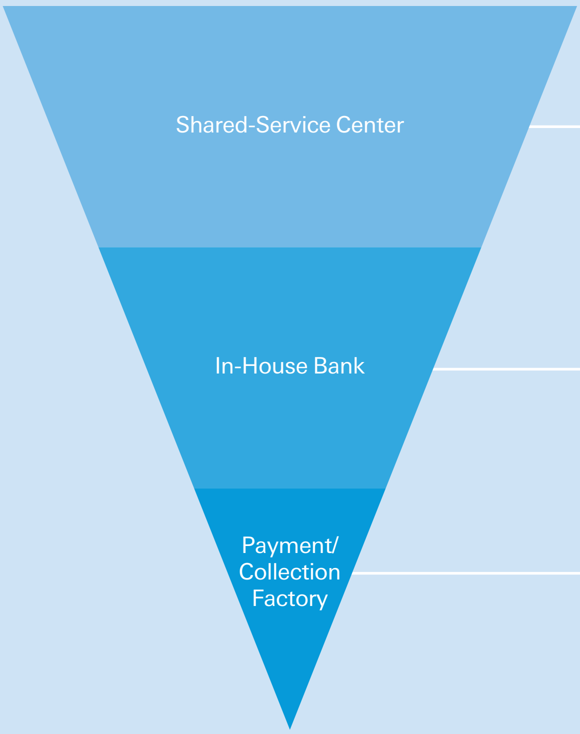
- Better liquidity management and simpler, more visible cash positions
- Improved processing quality and speed
- Harmonized payment/collection processes and procedures
- Streamlined account reconciliation
- Fewer IT interfaces and file formats

Reduced Risks

- Stronger internal controls
- Increased IT security

The idea is to "industrialize" labor-intense, repetitive processes and replace them with more capital-intense, centralized ones. However, while the goals between all three are similar, an SSC has the broadest scope, while a Payment Factory has the narrowest.

Chart 1: Definitions of Shared-Service Center, In-House Bank and Payment/Collection Factory



A Shared-Service Center is an accountable entity within a multi-unit organization tasked with supplying the business divisions with specialized services. The range of services can vary and include accounting, human resources, IT, security, liquidity management, or accounts payable and accounts receivables. The basis for the provision of services is a Service-Level Agreement (SLA) between the participating entities with cost allocation on the basis of transfer pricing agreed.

An In-House Bank is often part of a broader SSC and has the purpose of supplying various financial services to the business units. These services can include the provision of FX, interest-rate, liquidity, intercompany-liability or funding management. For example, to facilitate the efficient processing of transactions between internal entities, an In-House Bank can provide the business units with internal virtual accounts. Combined with netting of these internal flows, this can substantially reduce external bank fees.

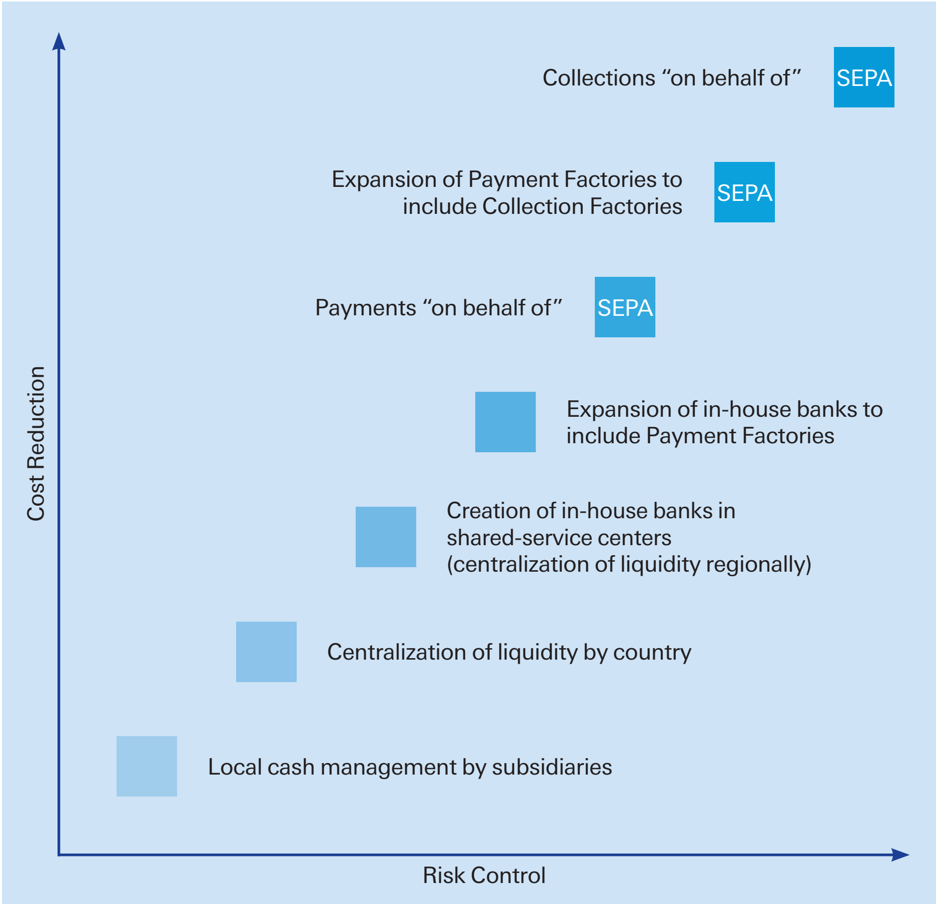
Payment Factories are by nature SSCs that are focused on the accounts-payable function. Often, they are part of an In-House Bank. The goal is to simplify and automate accounts payable. Accounts payable is an ideal candidate for centralization because invoice receipt and processing are often paper-based and labor-intense processes. Likewise, Collection Factories are centralized collections-processing centers that are focused on the accounts-receivable function.

As illustrated in chart 2, the normal starting point for most corporates is not a Payment/Collection Factory, but a decentralized structure with decentralized handling of payables and collections, whereby local interfaces to local banks are set up.

Research by gtnews showed that two-thirds of companies' payments are initiated by units outside central treasury, while 33% of central treasuries have sole control over payments initiation. Companies that allow other business units to initiate payments have on average 9.5 units outside central treasury initiating payments. In Europe, a greater number of business units (12) are able to initiate payments, perhaps reflecting the geographical diversity and the number of national payment systems in Europe. [1]

On the road towards centralization, a phased approach usually makes sense, whereby more and more formerly decentralized tasks are migrated to an SSC in a step-by-step manner. Often, the first step is to sweep liquidity from local bank accounts into a central account per country or region to improve control, visibility and investment options for excess cash. This can be followed by establishing an In-House Bank, which can facilitate inter-company netting to reduce the number of external payments and thus complexity. After that, as a third step, payments and (potentially later) collections can be centralized by establishing a Payment/Collection Factory within the SSC.

Chart 2: The Evolution of Payment/Collection Factories



Drivers

This final step, the creation of Payment/Collection Factories, is currently experiencing renewed momentum for many reasons:

- SEPA (through the creation of pan-European payment and collection instruments and the use of a harmonized format)
- Increased payments complexity (as a result of the growth in international trade):
  - To various countries
  - Through multiple banks
  - With distinct connections
  - Using different formats
- Regulatory changes (e.g. Payment Services Directive)
- New technologies (e.g. web-based platforms)
- Evolving standards (e.g. XML)
- Increase in convertible currencies
- Geographic expansion of corporates

Project Management

The idea of a payment/collection factory is to "industrialize" labor-intense, repetitive processes and replace them with more capital-intense, centralized ones. This means that centralizing accounts-payable and accounts-receivable processing is a rather complex task requiring a substantial investment and a significant change in internal processes and organizational structure. As a result, senior management buy-in is essential. Also, strong project-management discipline is required because of the inherent complexity. Such a project could have the following components:

- Data collection
  Current countries, legal entities, ERP systems, bank relationships, costs and cost components, processing steps, inventory of transaction types used today
- Data analysis
  Pros and cons of current set-up (quantitative and qualitative, e.g. is now a good time to stop using paper checks?)
- Definition of strategic goals and requirements for the new structure
- Definition and analysis of tactical steps/considerations for the new structure
  - Decision on exact structure, degree of centralization, location, processes
  - Pros and cons of new/proposed set-up (quantitative and qualitative)
- Senior management buy-in
- Implementation
- Setting and monitoring of key performance indicators (KPIs)

[1] gtnews Payments Survey info from 2010

Data Collection and Analysis

As part of the project plan there are many aspects that will influence the exact structure, degree of centralization, location and processes of the Payment/Collection Factory.

Chart 3: Strategic and Tactical Questions to ask when planning a Payment/Collection Factory (Part 1)

Scope	– Should only AP, only AR, or both be centralized?
	– How strong is the balance sheet and how important is internal funding?
	– Could a collection factory help reduce DSO?
	– How much can working capital be improved by centralizing payments?
	  – Where are suppliers and where are the corporate’s own production units located?
	  – What are the entities’ terms of payments?
	  – How fast are current payment processes – are they sufficiently fast to take advantage of discounts?
	– How much can working capital be improved by centralizing collections?
	  – Where are the customers located?
	  – What are customers’ terms of payments?
	  – How fast are current collection processes?
	  – Are the customers consumers or businesses?
	    – If they are consumers, direct debits could be centralized, but cross-border credit-transfer receipts may be more difficult
	– Which entities/subs should be included?
	– How can common goals between different parts of the organization be ensured?
	– Should any of the current tasks remain with the local entities?
	– Which payments/collections should be included?
	– How can the existing relevant bank relationships, accounts, payments/collections, bank interfaces, formats, and local regulations best be identified?
	– What do the internal and external cash flows look like?

Banks	– How many banks should be used? – What are the pros and cons of fewer vs. more bank relationships?

Account Structure	– What account option(s) makes the most sense? Options can include:
	  – Payment/Collection Factory (PF/CF) owns central accounts (including currency accounts) and makes payments/collections (incl. cross-border) on behalf of the legal entities
	  – PF/CF owns local in-country accounts and makes local payments/collections on behalf of the legal entities
	  – Legal Entity (LE) owns the account, PF/CF generates payments/collections, LE only authorizes them
	  – LE owns the account, PF/CF generates payments/collections, PF/CF authorizes them (power of attorney)
	  – Hybrid structure, e.g. payments on-behalf-of (but collections remaining with) local entity, which could later be migrated towards on-behalf-of collections

Legal & Tax	– What is the legal structure of the entities in scope? – What is the legal status of “on-behalf-of payments” in the relevant countries? – What are the central-bank-reporting obligations (for the payment factory, the group entity, the beneficiary)? – How would they change? – What are the tax implications?

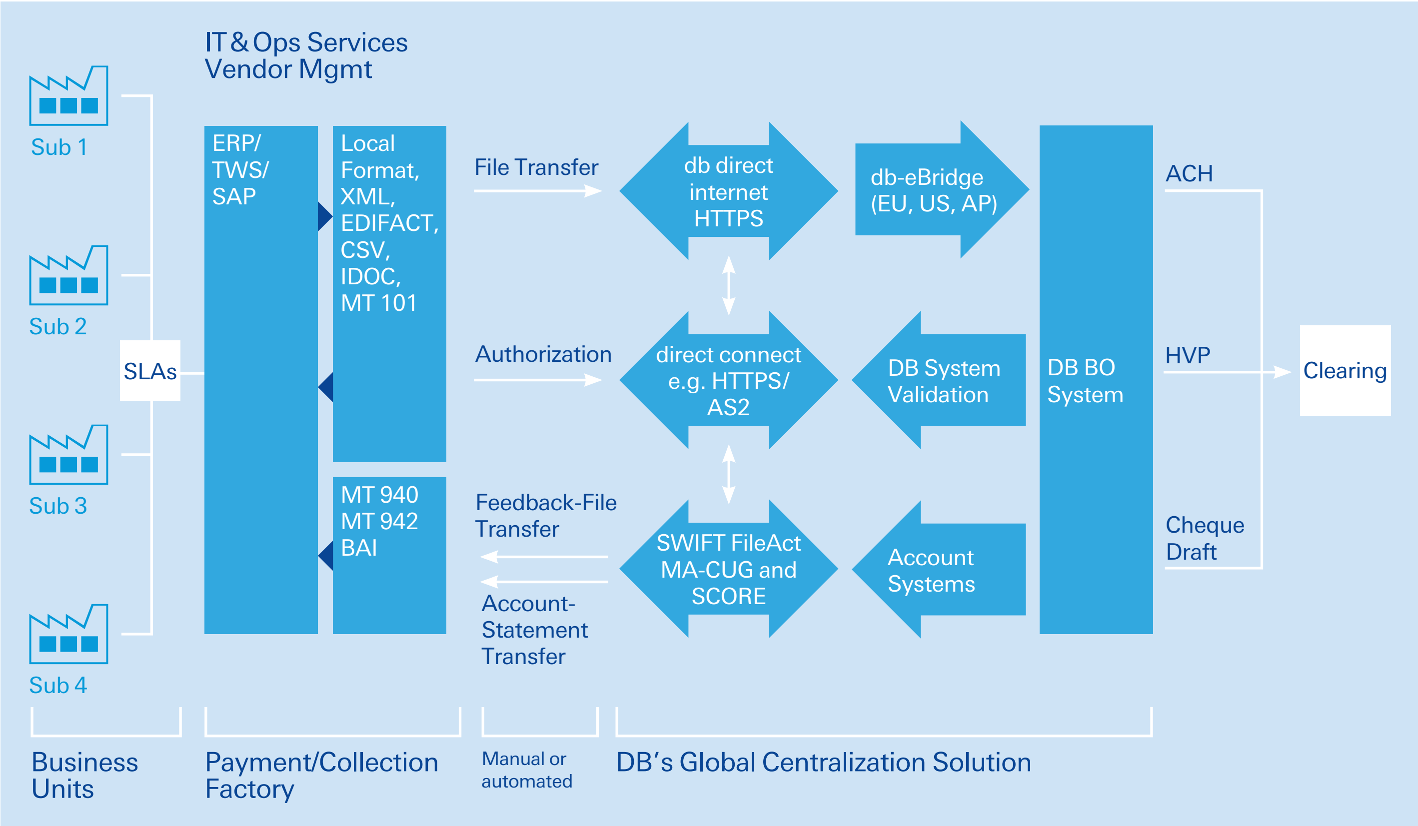
Location	– Where should the PF/CF be located? – HR costs and quality, language, travel costs, real-estate costs, time zones, tax – Do the exisiting AML requirements change (which could potentially lead to delayed payments/ receipts)? – Should a regional or a global PF/CF be used?

Commercial Model	– What should be covered by Service-Level Agreements (SLAs)?
	– What are the agreements regarding:
	  – Internal compensation for repair items?
	  – Intercompany loans?
	  – Transfer pricing?
	– How can the success of the PF/CF be measured (definition of KPIs)?
	– What are the transactional costs?

Operating Model	– What should the new processes for making/receiving payments/collections, account reconciliation, and liquidity management look like?
	  – What instruments should be used for payments/collections?
	  – SEPA vs. local ones?
	– What is the level of inter-company trade?
	– What are potential effects on cash forecasting?
	  – Will payment advices be available as timely as before?
	– What should the back-up processes look like (continuity-of-business plans)?
	– Which characteristics influence the choice of IT infrastructure?
	  – PF/CF must handle various sources of information from subsidiaries?
	  – What kind of file formats are received from subs?
	  – What file format is sent to bank(s)?
	  – What treasury/ERP systems are in place?
	    – Is it a global system or a fragmented structure?

Bank Connectivity	– Which connectivity option makes most sense?
	  – Electronic Banking, host-to-host, SWIFTNet or others?
	  – Phased approach: start with electronic banking and move to host-to-host later?

Chart 4: The Flow of Payments/Collections in a Payment-/Collection-Factory Structure



Senior Management Buy-in

Having senior management buy-in is crucial when starting a major centralization initiative. Quantifying the value of centralizing the corporates payments/collections is therefore very important. It is important to ask how the business case compares to other projects for which funding has been asked.

To strengthen the value of the project, it is extremely important that qualitative factors such as risk-management, compliance benefits, or harmonized processes and procedures are also listed. These benefits will very often be more important than costs saved from reduced bank fees or IT expenses.

Therefore, probably the most important questions to ask are about the business case (See chart 5):

Chart 5: Strategic and Tactical Questions to ask when planning a Payment/Collection Factory (Part 2)

Business Case	– What are the qualitative and quantitative benefits? – By how much can bank fees be reduced? – By how much can working capital performance be improved? – How large are the processing-quality and processing efficiency improvements? – By how much can IT-maintenance costs be reduced? – By how much will the visibility of liquidity be improved? – By how much can risks be reduced? – What are the compliance benefits?

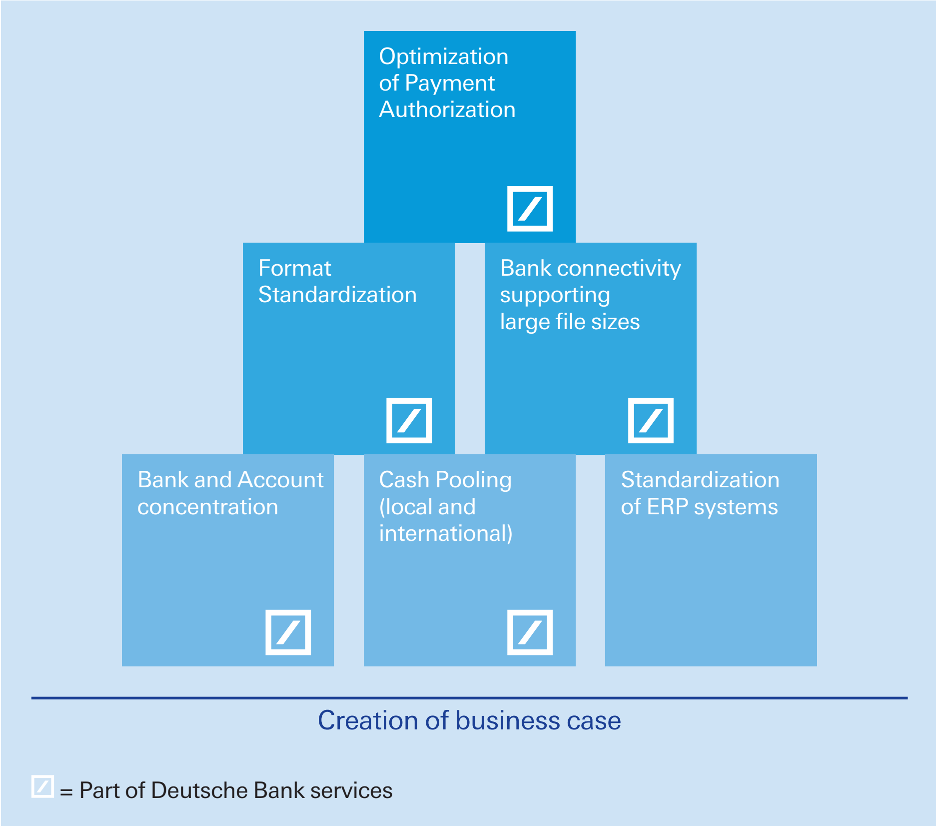
While there will be frequent surprises along the way, answering most or all of the questions listed will give a corporate a good starting point for quantifying and qualifying the required business case and creating the detailed project plan.

How Deutsche Bank can help

The creation of a Payment/Collection Factory requires strong senior management commitment. With this pre-condition in place, a detailed project plan needs to be developed, taking into consideration the analysis and complex decisions required.

Deutsche Bank will share best practices, experience, and lessons learned and will guide corporates through its solutions that facilitate centralization. Examples include access-channel, file-format-conversion, reporting, FX-conversion, cross-border-ACH and multi-currency-account solutions that are geared to the specific needs of Payment/Collection Factories and will have a significant impact on the corporate's business case.

Chart 6: Deutsche Bank's Solutions for Payment/Collection Factories



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