A winning approach

ELECTROCOMPONENTS' TREASURER, GRAEME HANCOCK, EXPLAINS HOW THE GROUP TACKLED MULTI-CURRENCY CASH POOLING

The treasury of Electrocomponents is highly centralised and it aims to have as comprehensive a control of the group's worldwide cash as possible. Until recently, the company's objective was for subsidiaries to have their local and foreign currency bank accounts, where physically feasible, in single-currency cash pools. These pools were either 'notional' (where businesses retained their own bank accounts within the pool) or 'zero-balancing' (where accounts were swept to an Electrocomponents account).

In both cases, the group only paid interest to the bank on the net pool position and treasury managed that net position daily. For example, for Singaporean dollars (SGD) we had an SGD notional cash pool in Singapore. This comprised the main account for our Singaporean subsidiary, RS Singapore; SGD accounts for the RS companies in Hong Kong, Australia and the Philippines (trading partners of RS Singapore); and two accounts for Electrocomponents (one for foreign currency deals, the other for managing the net pool balance). Using single-currency pools started to cause problems, however:

- With group expansion, the number of pools expanded in tandem until we had pools in 10 currencies, using four banking systems. Even then, cash in some of our newer businesses (for example, China) or smaller ones (for example, Poland, the Czech Republic, Hungary, Switzerland and New Zealand) was only getting limited management;
- Some pools were small and achieving suboptimal rates on money market deposits and borrowings; and
- Increasingly, there were credit and debit balances on different pools. When material, the group could undertake cross-currency swaps, but often this was not feasible.

ABOUT ELECTROCOMPONENTS

◆ Electrocomponents is a publicly listed company with a turnover of £1.3bn for the financial year ending 31 March 2012. Through its brands RS Components and Allied Electronics, it is the world's leading high-service distributor of electronic and maintenance products. It sells in excess of 550,000 products to more than one million customers in 32 countries, typically with dispatch to the customer on the same day as the order.

Multi-currency cash pooling

The problems with single-currency pools became acute in Asia-Pacific. Here, treasury had four small pools – Hong Kong dollars (HKD), SGD, Australian dollars (AUD) and Japanese yen (JPY). Two years ago, we therefore started to investigate multi-currency cash pooling.

We wanted the different currency positions – HKD, SGD, AUD, JPY and New Zealand dollars (NZD) – netted together on a daily basis (at competitive and auditable market rates) and to then manage the net position with deposits and borrowings of marketable sizes in British sterling (GBP) or US dollars (USD).

We approached a number of potential counterparties who confirmed this was broadly achievable. The favoured structure was a notional pool. (Although it was possible to have a zero-balancing structure that created a series of intercompany loans between our businesses and Electrocomponents, it was felt this would be too onerous in terms of ongoing administration and more likely to lead to withholding tax issues.)

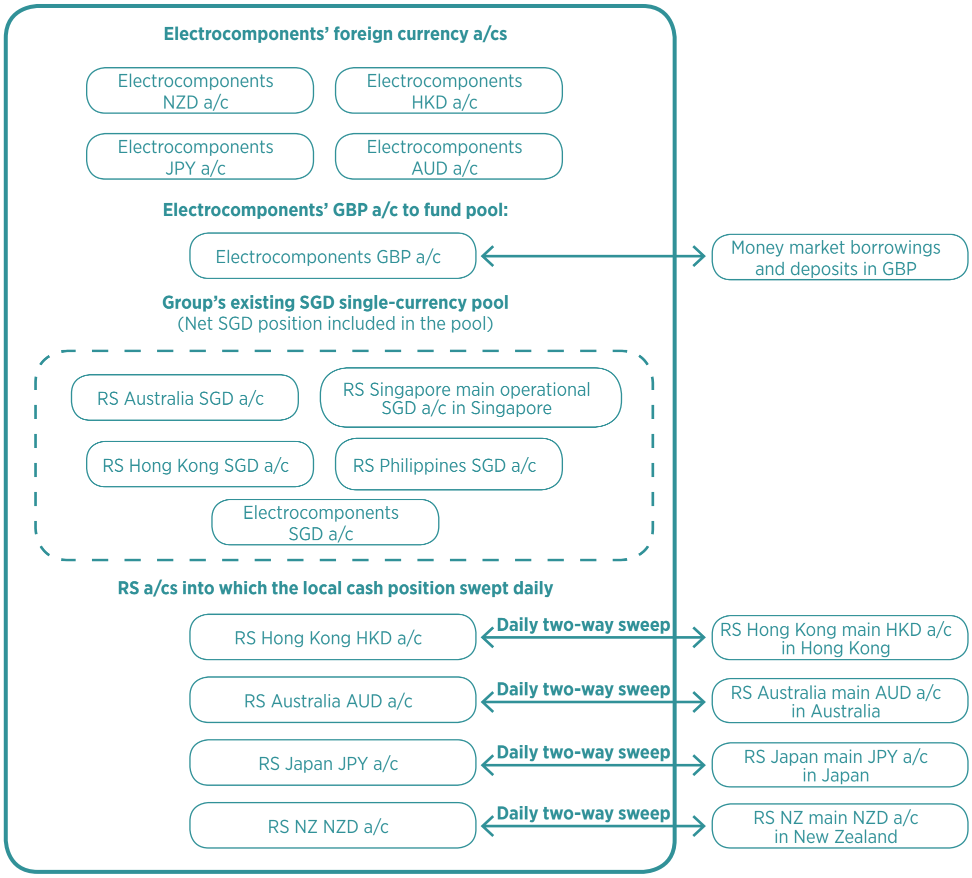
The next question was, where should we locate this pool?

This answer depended on how benign the withholding tax regime was between the location chosen and the jurisdictions of the various pooled companies (Australia, Hong Kong, New Zealand, the Philippines, Singapore and the UK). Ultimately, we chose Singapore, although the tax implications of this location still needed to be carefully considered.

With the required structure and location determined, the next stage was a tender with our relationship banks. Tender criteria were:

- **Effectiveness in ensuring all daily liquidity in Australia, Hong Kong, Japan, New Zealand and Singapore could be swept into the pool.** (For us, one bank was our 'on-the-ground' banker in most of these markets. We could thus achieve two-way sweeping with this bank for virtually all our local balances.)
- **Competence in implementation.** Multi-currency pooling is complicated. There is a lot of documentation and both sides need to be flexible. It also requires considerable planning and both sides need to commit time and resource. We found that agreeing documentation took much longer than we had hoped, so, in hindsight, a degree of legal review pre-appointment might have been worthwhile.
- **Interest offset arrangement.** The bank that we selected converted all debit and credit balances to GBP and then determined what percentage of debit balances were matched by credit balances. For matched debit balances, the interest applied was the relevant currency Libor

ASIA-PACIFIC MULTI-CURRENCY POOL
(All bank accounts notionally converted into GBP. Net pool position managed with GBP deposits and borrowings)



rate. For unmatched debit balances, the interest applied was the Libor rate plus an agreed overdraft margin. All credit balances received the relevant currency Libid rate.

- **Auditable and competitive exchange and interest rates.**
- **Ongoing service.**
- **Pricing and size of the overdraft facility over the pool.**
- **Pricing of product.**

Benefits of pooling

Overall, our experience of multi-currency cash pooling has been positive. Although implementation was drawn out due to the time it took to review the documentation, once the pooling was operational, we had a structure that brought the following benefits:

- Savings in costs, interest and departmental time;
- Improved intercompany settlement efficiency as settlement could take place across the pool;
- Reduced external gross debt and cash balances since we reported the net pool position; and
- More of the group's cash was brought under central control. Also, since implementation we have reduced balances in other more restricted Asia-Pacific markets (with judicious management of intercompany flows between those markets and companies in the pool) and have started to investigate bringing further currencies into the structure, such as Chinese renminbi.

Next steps

Fresh from our success and armed with the knowledge that we gleaned from cash pooling in Asia-Pacific, we have recently gone out to tender for our European and US cash management activities. Again, the ultimate aim is a multi-currency notional pool with one bank to replace our existing Scandinavian, euro and USD single-currency pools (currently with three banks). We also want to include, for the first time, the group's Polish, Hungarian, Czech and Swiss positions. Once more, we will use two-way daily sweeping to bring as much of the group's liquidity from local businesses into the pool as possible.

This pool will have a notional conversion into USD and treasury will manage the net position through transfers to and from an Electrocomponents USD account. As with Asia-Pacific, the aim is to save on costs, interest payments and departmental time and improve intercompany settlement while bringing even more of the group's cash under central control.

Graeme Hancock is group treasurer of Electrocomponents