Cash is king
Establishing effective cash concentration structures

May 2017

Does your company hold a large number of bank accounts...

...spread in different jurisdictions
...with various banking partners
...in a number of different currencies
...resulting in limited visibility over cash
...increased administrative burden
...and increased interest expense?

Then cash pooling is for you...

Cash pooling is a banking structure which will help your company achieve the following main benefits:

- Interest optimisation;
- Cash concentration and increased visibility and control;
- Identification of the group’s net FX exposures;
- Efficient liquidity management; and
- Utilisation of surplus funds.
Cash is king: The need

Organizations change constantly and their growth strategy and the way they conduct business reshapes and evolves continuously in response to an increasingly volatile and disruptive environment. This often leads to multi-jurisdiction presence and multi-currency operations, which subsequently lead to a geographical spread of cash. Limited visibility and control over this cash, increased administrative burden, as well as cash trapped within countries with capital controls, are key challenges faced by Treasurers today in their effort to manage the group’s cash effectively.

To overcome these challenges, multinationals consider the need to establish smart cash concentration structures in order to achieve alignment of their cash management strategy with their growth plans. A sophisticated cash concentration structure is reflected in the organization’s financial results, whilst it can also contribute in meeting other objectives on the Treasurer’s agenda, such as optimization of the interest expense, foreign exchange risk management and reduction of external borrowing.

Common objectives on the Treasurers’ agenda

- Reduce interest costs and external borrowing
- Enhance the way the group manages liquidity (i.e. centralisation)
- Improve financial results
- Optimize the way the group manages foreign exchange risk
- Holding of a number of bank accounts in a number of operating currencies with various banking partners across the globe
- Operations in multiple jurisdictions
- Increased administrative burden
- Trapped cash in countries due to currency restrictions
- Limited visibility and control over the group’s cash

...but in meeting the above objectives, Treasurers face the following challenges:
**Cash pooling at a glance**

Cash pooling is a liquidity management technique whereby funds are physically concentrated or notionally consolidated into a single cash position. In other words, it is a structure which allows the balances in a number of separate bank accounts, countries and currencies to be aggregated and managed collectively.

Optimization of the amount of interest a company pays and receives tops the list of the value added benefits. With a cash pool structure in place, the cash pool provider (typically a bank) will consider the pooled balance when applying interest, as opposed to applying such interest to each bank account individually, in the absence of a cash pool.

Further benefits can be realized too. To name a few, the use of a cash pool will help a company achieve increased visibility and control over its cash, improve liquidity management and optimize the use of surplus funds, which may further result in the reduction of external borrowing. In addition, a multicurrency cash pool mechanism may help a company identify its net FX exposures accurately, and hence enable their effective management.

When setting up a cash pool, certain considerations apply depending on the type of the cash pool, which, amongst others, may include legal, tax and accounting implications, initial and ongoing costs, as well as in some cases the creation of intercompany loans. In addition, country restrictions and capital controls may not allow cross border concentration, in which case local pooling options will have to be examined.

**Types of cash pooling**

There are two types of cash pooling: the physical pooling structure (also known as zero or target balance) and the notional pooling structure. More details on the mechanics of each are outlined below.

**Physical cash pooling (zero or target balance)**

*In practice:* All cash balances in the pool are physically transferred on a frequent basis to or from a single account (the cash pool header account), depending on whether there is an excess or a shortfall of cash in the participating bank accounts. In this way, interest applied on the cash balance is optimized, as it is applied on the balance of the header account (i.e. the net balance of the pool).

The above example illustrates the mechanics of a zero balance structure. In the absence of such a structure, the cash balances of Entities 1, 2 and 3 in Austria, Germany and France, respectively, remain in their local bank accounts and interest is applied on each of them individually. With a zero balance pooling in place, the entire balances of Entities 1, 2 and 3 sweep automatically to or from the cash pool header account, with the end balance in the local accounts becoming zero. Interest is then applied on the balance of the pool header account.

The same principle applies in a target balance structure, with the only difference being that the end balance in the local bank accounts is not zero. Instead, it is a specified balance of the company's choice, depending on the nature and the purpose of the local account, as well as on each entity's needs.
**Notional cash pooling**

*In practice:* In the case of a notional pool structure, there is no physical movement of funds between accounts. The individual cash balances are instead virtually netted off against each other, and interest is applied on the net balance of the pool. Therefore, interest optimization may be equally achieved.

The above example illustrates the mechanics of notional pooling. In the absence of a notional pooling structure, interest is applied on each of the individual balances of Entities 1, 2 and 3 in the UK. With a notional pooling structure in place, interest is applied on the net balance of the three accounts (and paid in one of the accounts of the company’s choice), without the physical transfer of funds within the pool.

**Key features**

The table below provides an overview of the typical features for each of the two pooling structures presented above. In practice, for some of the below features, there is space for manual intervention in order to achieve customized solutions tailored to an organization’s needs and objectives.

<table>
<thead>
<tr>
<th>Zero or target balance structure</th>
<th>Notional structure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Physical transfer of funds</td>
<td>✓</td>
</tr>
<tr>
<td>Bank accounts in different currencies</td>
<td>✗</td>
</tr>
<tr>
<td>Bank accounts in multiple banks</td>
<td>✓</td>
</tr>
<tr>
<td>Bank accounts in multiple countries</td>
<td>✓</td>
</tr>
</tbody>
</table>
A hybrid solution – illustrative example of a common structure adopted by multinationals

In reality, multinationals tend to adopt a combination of the two available types of cash pooling. Instead of concentrating cash from every single account a company operates (local and cross border), often the cash is first concentrated in each country and then on a cross border basis. As regards the selection between a notional or physical structure locally, this is often driven by cost and other considerations. In general, a physical structure is more expensive than a notional structure due to the physical movement of cash. The following diagram illustrates a realistic form of a cash pool for a multinational company.

**Key benefits of cash pooling**

- **Optimised interest return**
  Interest is applied on the pool net cash balance as opposed to gross cash balances

- **Reduction of administrative burden**
  The group's cash is automatically centralised and readily available to Management

- **Efficient Management of FX exposures**
  Net FX exposures are identified and monitored, enabling improvement of the group's FX management policy

- **Balance Sheet improvement**
  A cash pool will help a company identify areas for improvement in the working capital space

- **Increased visibility at group level**
  Cash visibility is greater, both domestically and across currencies and borders

- **Efficient liquidity management**
  Shortfall and surplus cash positions can be netted against each other within the pool, without the need of manual transfers between the two

- **Opportunities to invest surplus cash**
  Centralized cash, if surplus, can be invested externally with further optimization of the interest result for the group

- **Central control of cash**
  Cash is controlled centrally, improving Corporate Governance and the decision making process
How PwC can help

PwC Cyprus has a dedicated, multi-disciplined team of experts who can assist you in establishing a comprehensive and effective cash concentration structure. In particular, we can help you:

- **Select the appropriate cash pooling structure**
  We can assist you in selecting the appropriate solution for your group, tailored to your needs and based on a number of pre-defined criteria, as agreed with you beforehand.

- **Design a customised solution**
  Following the selection of the preferred solution, we will design the cash pool mechanics, taking into consideration a number of different factors such as local operations, existing banking partners and operating currencies, as well as country restrictions.

- **Implement the selected solution**
  We will drive implementation step by step, from planning the different work streams to making the cash pool a reality. In addition, we may also advise on the various legal, tax and accounting implications that will arise during implementation.

- **During the “Go-live” period**
  Once the cash pool is live and fully operational, we will oversee the cash pooling operation and ensure that it is running smoothly. In addition, we will draft the company's cash management policy and the procedures for operating the cash pool, and train your cash management team in order to enable you to operate the cash pool without the need for an external advisor.

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