

International Cash Management

- **Optimizing the movement of corporate funds**
 - **Minimizing the cash tied up within the company**
- **Ensuring that the firm's financial flows are managed in an optimal fashion**

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International Cash Management: *The Processes*

- **Ensuring that funds are available *when & where* needed**
- **Sourcing funds in an optimal manner**
- ***Investing* excess funds optimally**

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Optimizing the Movement of Funds

- **Minimal movement of funds**
- **Movement at lowest possible cost**
- **To extent possible, minimizing tariffs & other taxes**

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Optimization (1)

■ **Having the funds:**

- In right *place*
- At the right *time*
- In the right *amount*
- In the right *currency*

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Optimization (2)

■ **Goals**

- Minimal costs
- Maximum income
- Maximum flexibility
- Maximum control of affiliates

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Obstacles to Optimization

■ **Corporate resources**

■ **Environmental constraints**

- Economic
- Political

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Obstacles: *Corporate Resources*

- **Managerial sophistication**
 - **Requires a good *cash budget***
 - **A schedule detailing the time and size of future cash inflows and outflows**
- **Corporate liquidity needs**

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Obstacles: *Economy*

- **Inflation**
- **Interest rates**
- **Availability of funds**
- **Transactions costs**
- **FX-market conditions**

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Obstacles: *Political Environment*

- ***Trade controls***
- ***Exchange controls***
- ***Money & capital controls***
- **Government bureaucracy**
- **Legal system**

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Need for Funds

- Transactions need
- Precautionary need
- Investment need

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Transactions Need

- Scheduling of payment & receipts
- Method
 - Savings
 - Line of credit
 - Standard
 - *Revolving*

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Precautionary Need

- Safety balances in excess of transaction balances
- Method
 - Separate balances in each unit
 - *Pooling*

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Investment Need

- Accumulation of funds in excess of precautionary balances
- In anticipation of specific or unspecified opportunities

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Pooling (1)

- Pooling transfers the control of intra-corporate funds
- The funds do not necessarily need to be transferred to the control center

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Pooling (2)

- Transfers the control—generally, the funds do not actually flow to the control point

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Pooling (3)

- Each affiliate retains minimal cash balances—transaction balances

- Extra funds are shifted to the centralized control
 - Precautionary balances

 - Excess balances

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Decentralized Cash Depository

	(a) Transactions Needs	(b) Standard Deviation	(a) + 3(b)
U. K.	10,000	1,000	13,000
France	6,000	2,000	12,000
Italy	<u>12,000</u>	<u>3,000</u>	<u>21,000</u>
Totals	28,000	6,000	46,000*

* Total decentralized cash needs: 46,000

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Centralized Cash Depository

- The standard deviation of a set of standard deviations is the square root of the sum of the squares of the individual standard deviations.

- In this example: 3,742

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**Centralized Cash Depository:
Pooling**

	(a) Transactions Needs	(b) Standard Deviation	(a) + 3(b)
U. K.	10,000		
France	6,000		
Italy	<u>12,000</u>		
Totals	28,000	<u>3,742</u>	<u>39,226*</u>

* Total centralized cash needs: 39,226
--a savings of 6,774(000)

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Pooling: Advantages (1)

- Increased financial control of affiliates
- More efficient use of intra-company resources
- Minimizes cash needs
- Centralizes FXX mgt

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Pooling: Advantages (2)

- Economies of scale
 - Greater investment expertise
 - Better knowledge of markets
 - Lower costs of investment
 - Higher rates of return on investments

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Pooled Funds

- The “pooled” funds do *not* need to be moved to the financial center of the company.

- Funds can be used either
 - Within the firm (or)

 - Outside the company

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Optimal Borrowing Terms

- Low *interest rate*

- Desired *format*: fixed vs. floating

- Favorable *payment schedule*

- Greatest flexibility
 - Restrictive *covenants*

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Payment Schedule

- Full *amortization*

- Partial amortization
 - *Interest only*

 - *Balloon loan*

 - *Bullet loan*

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Other Borrowing Terms

- **Security**
 - Unsecured
 - *Collateralized*
 - Tangible or intangible assets
 - Guarantee or insurance
- **Covenants (financial ratios)**

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Satisfying Financial Obligations

- **Transactions & precautionary balances**
- *Lines of credit*
 - Standard
 - *Revolving*

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Netting

- **Process of subtracting intra-company payables from intra-company receivables**
 - Only the *net* difference is paid received

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Netting (2)

■ Advantages:

- Lower transaction costs
- Lower FXX and hedging costs
- Lower risk of government interference
- Reduced *float*

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Netting: Example (1)

Receiver	Payer (000)			Total Receipts
	U.K.	France	Italy	
U.K.	--	4000	3000	7000
France	2000	--	7000	9000
Italy	5000	8000	--	13000
Total Pmts				29000*
	(7000)	(12000)	(10000)	(29000)

* Total payments = \$29000 ²⁹

Netting: Example (2)

Receiver:	Payer			Total	Net
	U.K.	France	Italy		
U.K.	--	3000	4000	7000	(15000) (8000)*
France	7000	--	2000	9000	(8000) 1000
Italy	8000	5000	--	13000	(6000) 7000
Total Pmts				29000	0
	(15000)	(8000)	(6000)	(29000)	

* Total payments = \$8000 ³⁰

Netting: Example (3)

- With netting, the total amount of the payments has been reduced from \$29,000,000 to \$8,000,000.

- At a cost of 0.10%, the savings is:

$$[\$29,000,000 - \$8,000,000] * 0.001 =$$

$$= \$21,000$$

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Blocked Funds

- Financial assets which cannot be freely transferred out of the country because of government controls

- Exchange controls
- Money & capital controls

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Blocked Funds: Examples (1)

- Inconvertibility
- Multiple exchange rates
- Taxes
- Quotas

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Blocked Funds: Examples (2)

- **Mandatory repatriation**
- **Mandatory conversion**
- **Deposit period**
- **Licensing**

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Blocked Funds: Examples (3)

- **Queues**
- **Central-bank approval**
- **Advanced deposit**

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Blocked Funds: Response (1)

- **Transfer Pricing**
- **Unbundling**
- **Swaps**
- **Unrelated exports**
- **Local investments**
- **Countertrade**

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Blocked Funds: Response (2)

- **Fronting loans**
- **Back-to-back loans**
 - = Parallel loan
- **Maximize**
 - Local funding
 - Local sourcing

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Blocked Funds: Response (3)

- **Fund with loans rather than equity**
- **Sell blocked funds at discount**
- ***Countertrade***

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Unbundling

- **The separation of intra-company payments / receipts into separate parts, instead of "bundling" them together**

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Unbundling (2)

- Interest and dividends
- Royalties and licensing fees
- Shared expenses
 - R & D
 - Administrative overhead
 - Advertising & public relations

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Transfer Pricing

- An intra-company price charged from one affiliate to another
- Since the entire transaction is intra-company, it is often possible to set the price to maximize the company's benefits

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Transfer Pricing: *Motivation*

- To evade blocked funds
- To shift profits to low-tax country
- To shift profits away from high-duty countries

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Transfer Pricing: *Effects* (1)

- Reducing taxes
- Reducing tariffs
- Avoiding exchange controls
- Shifting locus of profitability

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Transfer Pricing: *Effects* (2)

- Bolstering credit rating of affiliate
- Disguising affiliate's true profitability
- Reducing XR risks

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**Transfer Pricing:
*Government Controls***

- Comparable uncontrolled price requirement—"arm's-length"
- Resale price (backward)
- Cost plus (forward)

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Reinvoicing Center

- **The problem: Our Singaporean subsidiary manufactures components for our Mexican sub.**
- **Singapore wants to be paid in S\$, while Mexico wants to pay in M\$. One or the other will have FXX.**

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Reinvoicing Center (2)

- **FXX, anywhere in the company, can potentially be very damaging for the whole company.**
- **The management of FXX is complicated--& most managers aren't competent to do it.**

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Reinvoicing Center (3)

- **The solution: Shifting all intra-company FX risk to a special finance office**
- **Using a single account to concentrate all intra-company FC-denominated billings**

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Reinvoicing Center (4)

- Singapore bills the R/C in S\$.
- The R/C bills Mexico in M\$.
- Both the importer and exporter have only local-currency exposure on intra-company transactions.
 - Neither has any FXX to worry about.

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Reinvoicing Center (5)

- The reinvoicing center bears all of the FXX—an M\$ receivable & S\$ payable.
- However, it has the expertise to manage that exposure.
 - Off-setting intra-company FXX (or)
 - Hedging

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Reinvoicing Center: *Advantages*

- Specialization—in all parts of the company
- Simplifying the tasks of managers
- Centralization of control
- Managing FXX

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Funds Transfer

- **The movement of funds, or claims on funds, between countries**
 - **Relatively little currency actually moves**
 - **Less than 1%**

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Funds Transfer: *Methods (1)*

- **Traditional ways**
 - **Mail transfer**
 - **Cable (or wire) transfer**
 - **For example, Western Union**

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Funds Transfer: *Methods (2)*

- **Electronic transfer**
 - **CHIPS: Clearinghouse Interbank Payments System**
 - **SWIFT: System of Worldwide Interbank Financial Telecommunications**

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Mail Transfers

■ Advantages

- Cheap
- Familiar

■ Disadvantages

- Slow transfer
- Slow confirmation
- Risk of loss, theft or destruction

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Cable / Wire Transfer

■ Notice of the transfer is "cabled"

■ Advantages

- Speed of both transfer & confirmation
- Lower risk

■ Disadvantages

- Cost
- Greater complication

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CHIPS

■ Advantages

- Fastest method
- Safest
 - Test keys

■ Disadvantages

- Most expensive
- Complicated

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Which Method Is Best?

- **Payer**

- Slow & cheap

- **Payee**

- Fast

- Pay for speed, if worthwhile

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