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There I was, on a cold morning in November, in Amsterdam, thinking back to the sunny weekend I'd just spent in San Sebastián, walking along the Playa de la Concha, tapas in La Mejillonera... when the taxi pulled up in front of the group headquarters of my company, a large cosmetics multinational with operations throughout Europe.

I had been summoned by a terse letter from our Global Finance Director, who wanted to tell us about the Group's new centralized treasury strategy. Shoot!, I thought to myself, the euro and globalization have caught up with us at last...

When I walked into the meeting room, I saw that practically everyone else was already there. One of the good things about this sort of meeting is that you get to catch up with your colleagues and exchange ideas.

The Finance Director arrived and gave us a warm welcome. He opened the meeting by explaining the three reasons why he'd called us together: to explain to us about the Cash Pooling Project in Holland; to start a debate and sound us out on the issue; and lastly to give us some "homework" assignments to help him decide what kind of arrangement would be best for each country.

He said that above all he wanted us to understand the purpose of the project. The aim was not to take away our jobs as Local Finance Directors, he assured us. The project had a much broader scope. The company had been having problems with treasury management. While Italy and France had net financing needs, Germany, Spain and the United Kingdom had cash surpluses. Partly for historical reasons and partly because of these financing needs,

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Jesús Gadea, MBA, prepared this case under the supervision of Professor Javier Santomá as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. February 2003.
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the Group companies worked with far too many different financial institutions. As a result, information was highly dispersed and the costs were becoming unsustainable.

The goal was quite simple: to centralize the Group's treasury in Amsterdam so as to limit the financial impact of having cash balances scattered across Europe, and to reduce the number of banks as far as possible without affecting the efficiency of local operations.

The Finance Director warned us that we had a long way to go before we reached the ideal balance, and that it would not be an easy balance to achieve. Because although the introduction of the euro had given most of the countries of Europe a common currency, the goal of legal, fiscal and regulatory harmonization was still a long way off. In fact, that was one of the reasons why they had decided to centralize the Group's treasury in Amsterdam, as Holland, like Belgium and Ireland, had certain tax advantages in treasury matters that other countries such as France or Germany did not.

Obviously, my Finance Director was quite right in choosing this goal. We were currently paying certain costs that could be drastically reduced "simply" by centralizing our treasury (cash pooling), as we were already doing at country level. Not to mention the effect our current cash management system had on our consolidated balance sheet and the ratios that were calculated from it... All the same, a number of questions sprang to mind:

- How did he plan to make this system work? It seemed to me that the way the Group was organized at present, it would be difficult to carry out a project of this kind. The obvious implication was that implementing the project meant changing the organizational structure.

- Would I still have any power to decide how my cash was managed, or was that a thing of the past?

- Was it only cash (liquidity) that was going to be centralized or would the plan also affect my receivables and payables?

- What repercussions would the new treasury structure have on our tax liability and our obligations towards the Bank of Spain?

- How much more paperwork was this going to mean for me?

- How would the fact of working with fewer banks affect my income statement now that I had managed to negotiate excellent terms with my banks by forcing them to compete with one another?

For the first time, I started to realise how this project tied in with another project that had just been completed: we had just changed our computer system so that all the Group companies now had a common platform (adapted to local needs, but still common to all countries) that allowed us to send and receive information to and from our parent company swiftly and securely by electronic means.

I was still wrapped up in my thoughts when I sensed that the background murmur among my colleagues had died down. Apparently, our Finance Director was about to spell out the main points of the project in more detail.

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"What alternatives do we have for centralizing our treasury management?" he inquired, no doubt somewhat rhetorically. "To start with, let's consider four different possibilities:

"1. Concentrate cash in each country and from there concentrate to a central account.
2. Concentrate cash in each country and, through a common bank used by all the subsidiaries, transfer the funds to Amsterdam.
3. Use just one bank in all countries.
4. Use a system of notional cash pooling."

To explain why they had settled for the second option and had rejected the others, he showed us the following chart:

	A.1	**A.2**	**A.3**	**A.4**
Single bank	No	No	Yes	Yes
Multi bank	Yes	Yes	No	No
External banking costs	No	No	No	Yes
High cost (charges)	Yes	No	No	Yes
Homogeneous information	No	Yes	Yes	Yes
Single bill	No	Yes	Yes	Yes
Automation	No	Yes	Yes	Yes
Loss of value	Yes	No	No	No

The first option to be discarded was no. 4, notional cash pooling. In notional cash pooling, the balances of all the country accounts would be transferred at the end of the accounting day to the group's main account. The bank would add up all the credit balances, on the one hand, and all the debit balances, on the other, and calculate what percentage of the debit balances were offset by credit balances, or viceversa. Then, depending on this percentage, it would settle any interest due or payable at the end of the month at more favourable (creditor and debtor) rates than would othewise be available in the market. The "trick" that allowed the bank to offer such favourable interest rates was that in effect it would be financing any debit balances with the group's own credit balances; in other words, the bank would provide no financing and would have no surpluses.

This alternative was discarded for several reasons. Firstly, because it meant that the Group would have to work with just one bank, which was something our Finance Director did not particularly want, although he did not rule it out altogether. Secondly, because it would require certain intercompany legal guarantees that were not consistent with the "philosophy" pursued by our legal department. Thirdly, because the external costs that the bank incurred in providing this service (cash ratio and deposit guarantee fund in some countries such as Spain) would be passed on in their entirety to the company. Fourthly, because the price that the bank charged for this service was very high; cash pooling consumed a lot of the bank's capital, so the bank had to charge high fees in order to meet its ROE targets. Lastly, because it would not help the company to avoid the cost of withholding tax on any interest earned on credit balances.

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