INTERCOMPANY NETTING

Insights That Warrant a Response

PROVIDED BY

COPROCESS

THE NETTING SPECIALISTS :: A GTREASURY COMPANY

Contents

Why Intercompany Netting Matters

BRIDGING THE KNOWLEDGE GAP

Netting is an important tool many multinational organizations use to settle intercompany activity in an efficient manner. Treasury professionals can usually list off some of the key reasons netting is used. However, comprehensive research that explores the reach, use and drivers of netting have been lacking in the industry. Given changes with technology and with enterprise resource planning systems (ERP), treasury management systems (TMS) and bank netting (BN) services, a gap in data-informed insights has continued to expand.

Coprocess commissioned comprehensive research to fully understand the use and drivers of netting on a global scale. What pain points drive organizations to consider the use of these tools? Is revenue size the primary factor pushing companies towards the use of netting? Is the number of FX transactions a top motivator? What are the expectations for netting use for companies in the future? This research seeks to answer these questions and others.

This resource provides the results of recent netting research, but it is also a resource to help you assess your own needs and understand the potential benefits to your organization from adopting a netting system.

SURVEY RESULTS BASED ON A DIVERSE GLOBAL PERSPECTIVE

- **56%** of the corporations were headquartered in North America, and **44%** were based outside of North America.

- **60%** of respondents worked for companies with annual revenues above $1B USD, while **23%** had revenues above $5B USD.

WE DON'T USE A NETTING SYSTEM—BUT SHOULD WE?

NETTING USERS

For those who already use a netting system, the information here about what your peers are doing or not doing can be helpful. As you examine key functions and pain points while reading through this book, you may get additional ideas for cost savings, applicability and value.

VS.

NETTING NON-USERS

*For those without a commercial netting system, the overall question in your mind is likely, **"Does it make sense for us?"** followed closely by, **"How will we know if it makes sense?"** We hope to offer a few points that clarify or help you organize your thinking on this subject.*

WHAT YOU SHOULD KNOW (AND DO)

Most companies with even moderate multi-factor complexity need a netting system. Those with little-to-no complexity across the categories noted below are likely poor candidates for extracting significant value from a formal, centralized netting solution. That said, many low-or moderate-complexity companies can, in fact, benefit from the adoption of such a system.

There is no single reason or trait to warrant a yes or no to the question of netting solutions. The case for a system comes into clarity only when examining a broad framework of factors, where a layered complexity can come into view. For many companies, that need is obvious, but for others, a nuanced look at the potential positive impact is required.

For those on either side of the chart on the next page, the decision against or for a netting system is often easy. For the many with volumes in the middle, it is important not to quickly dismiss the potential benefits of netting without some careful examination.

There are three perspectives:

- Netting is not right for every company.
- Netting is of great and obvious value for many companies.
- Netting is worth a cost-benefit analysis for many with moderate volumes.

FACTORS	NETTING UNNECESSARY (if 3+ factors apply)	EXAMINE THE VALUE	NETTING CLEARLY NEEDED (if 2+ factors apply)
Entities/subsidiaries	1-3	For those of you here in the middle, make an effort to explore whether netting makes sense for your organization. Are you stable or becoming more complex? Do you have moderate levels in 2+ factors? Is manual and decentralized intercompany settlement taking much time? Read on to learn more.	>10
Intercompany payments	<$5mm		>$20mm
FX activity to settle intercompany activity	<10% of intercompany payment activity		>20% of intercompany payment activity
Currencies	1-2		5+

If your company has one factor with moderately elevated complexity, there may not be enough value in securing a netting platform or module (for example: "We only make a moderate level of FX payments"). For the majority of organizations, though, several moderate factors can make a strong, comprehensive case for a netting system. Support for a netting system isn't made based upon a single factor alone, but rather a combination of factors of a moderate or more elevated level of complexity.

To begin, examine your volumes and pain points honestly. This can inform your organizational understanding of the financial and strategic value of centralized netting. Most companies are on a path of increasing complexity across these four factors.

A combination of complex factors compounds the value of moving to centralized netting. If you are in the middle section and unsure whether you need a netting system, rest assured that there is value in examining whether netting makes sense now. If you find you are nearing, at, or past the point where centralized netting makes sense, Coprocess is here to help.

Call us today to discuss your status or continue reading to learn more.

KEY FINDINGS FROM THE RESEARCH

Current Situation and Recent Growth

COMPANIES ADDRESS NETTING IN A DIVERSE OR FRAGMENTED MANNER

- The balance between netting system users (45%) and non-users (55%) is nearly even.
  - *29% use commercial solutions (specialized, TMS, ERP)*
  - *16% use banks or built their own netting system*
- One-quarter of firms let “subsidiaries handle netting” on their own.

USE OF COMMERCIAL NETTING SOLUTIONS IS GROWING AT NEARLY DOUBLE THE RATE OF BANK-PROVIDED SYSTEMS

- Overall growth of commercial netting solutions has been moderate but steady over the past 3 years.
- Banking solutions: 5.7% average annual adoption rate over three years.
- Commercial netting solutions: 10.3% average annual adoption rate over three years.

Use and Drivers

NEITHER SIZE NOR SUBSIDIARY COUNT ARE SIGNIFICANT INDIVIDUAL FACTORS TO USING NETTING SYSTEMS

- Small companies use netting solutions at 80% the rate of their larger peers. 48% of larger firms and 39% of smaller firms use a netting solution.
- The number of subsidiaries is the least important factor.
- Intercompany payment volume, percentage of payments that involve FX and the number of currencies in use are all more highly correlated to netting system use.

A COMBINATION OF ACTIVITY DRIVES THE USE OF NETTING SOLUTIONS MORE THAN ANY INDIVIDUAL FACTOR

- Intercompany payment volume and subsidiaries: Having more than $50mm in intercompany payments combined with more than 50 entities correlates with 71% adoption.
  - *50 or more entities/subsidiaries:* **59%**
  - *$50mm or more in intercompany payments:* **63%**

- Currencies and FX payments: Having six or more currencies combined with moderate FX payment (11% or more) correlates with 68% adoption of netting systems (vs. average of 45%).

FEELING ALL OF THE PAIN POINTS: THE TOP DRIVERS ARE CONSISTENT PROCESSES AND COST

- The top pain point driver to use netting solutions was “consistent intercompany payment processes across subsidiaries.”

- Various cost saving concerns took 2nd through 4th place:
  - *2nd: Banking transaction costs*
  - *3rd: Time savings*
  - *4th: FX charges*

- Each of the seven drivers was ranked on the highly/extremely important level by more than 50% of respondents:
  - *Standardizing common intercompany payment processes across subsidiaries*
  - *Save money on payment transactions*
  - *Save significant time and effort*
  - *Save money on FX rates*
  - *Install regulatory and risk management controls*
  - *Reduce and manage float*
  - *Reduce disputes and late payments between subsidiaries*

Key Concepts and Terminology

For those who may not spend as much time in the world of netting, it seems appropriate to review some foundational terms and concepts. Below are several in-context definitions for terms and phrases commonly used in netting. Keep in mind that some companies and geographies use slightly different terminology for the same concepts.

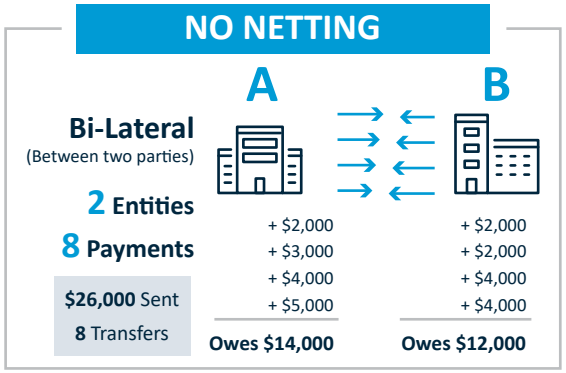
NETTING

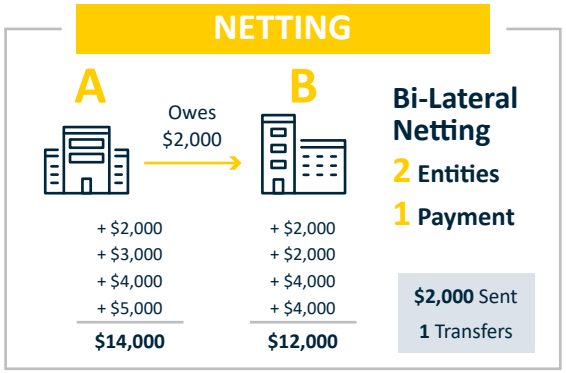
Netting is the process whereby payables and receivables between two legal entities are managed and settled en masse rather than individually. This settling process is almost always performed on a periodic basis, with monthly being the most common time frame.

BI-LATERAL NETTING

Bi-lateral netting refers to the process between two entities where instead of sending multiple payments back and forth, the transactions are added up, and one transaction is made to settle them all. This is settling the net amount owed.

While simple in theory, bi-lateral netting can be challenging operationally. Even when only one currency is involved, bi-lateral netting requires email exchanges regarding balances and settlement dates. When you add in multiple currencies, both parties must agree on exchange rates, additional due dates, and payments. These operational challenges often off-set the benefits of bi-lateral netting.





MULTI-LATERAL NETTING

This is the netting process managed between three or more legal entities, where multiple payments to and from all parties are consolidated in a netting center to make one transaction per entity. The netting center will either pay or receive a single net amount in the currency of the legal entity. The netting center may be an entity that actively trades (invoices) with other subsidiaries, or an entity used for internal financing and services.

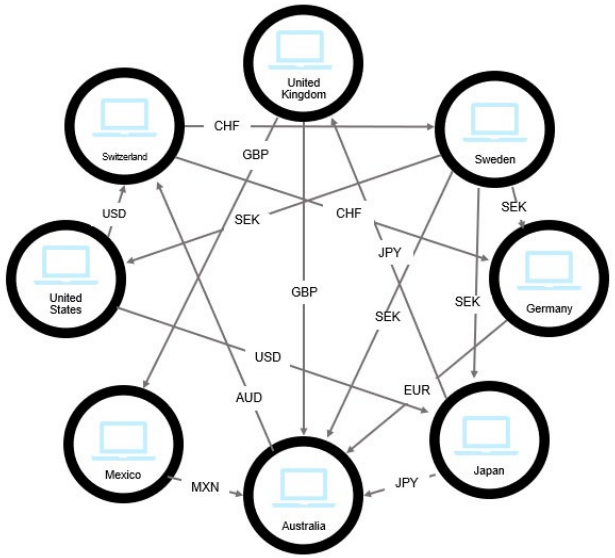
With the use of a robust netting technology solution, the challenges of multiple emails, due dates and currencies is resolved, improving communication and bringing more structure and discipline to the process. Moreover, FX exposures are matched, and non-matched FX exposures are aggregated to larger volumes and traded at better rates by the netting center.

NETTING CENTER

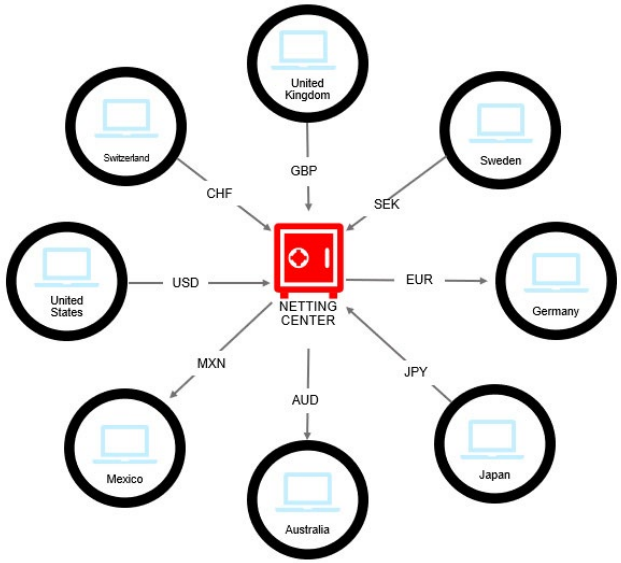
This method of settling the amount due to/from all parties is managed through a single legal entity (either an existing entity that is designated with this role or via a specially established one). Each netting participant either makes or receives a single payment to/from the netting center (or the netting entity).

A *netting center* may be an entity that actively trades (invoices) with other subsidiaries or an entity used for internal financing and services.

WITHOUT NETTING



WITH MULTI-LATERAL NETTING



TYPES OF MULTI-LATERAL NETTING SYSTEMS

Multi-lateral netting can be run in three different ways, each with fundamental differences in what is settled and when.

Receivable-Driven Netting

In a Receivable-Driven multi-lateral netting system, it is the payee (receiver) who inputs, and therefore drives, what is settled in the netting center. This is the most efficient way of running a netting system because the payee wants to get paid, and all Accounts Receivable (AR) invoices will be imported into the netting system in a timely and efficient manner.

Most companies who run Receivable-Driven netting will do it with matching. They will import both their receivable and payable invoices into the netting tool, but only receivable invoices will be settled. Payable invoices are imported for matching purposes only and will allow the users to identify easily any mismatched or missing invoices. Mismatched invoices can be discussed in the netting system and if needed disputed by the payer to exclude them from the current netting cycle and postponed to the next one.

Payable-Driven Netting

In a Payable-Driven multi-lateral netting system, it is the payer who inputs, and therefore drives, what is settled through the netting system. The payer imports its own account payable invoices.

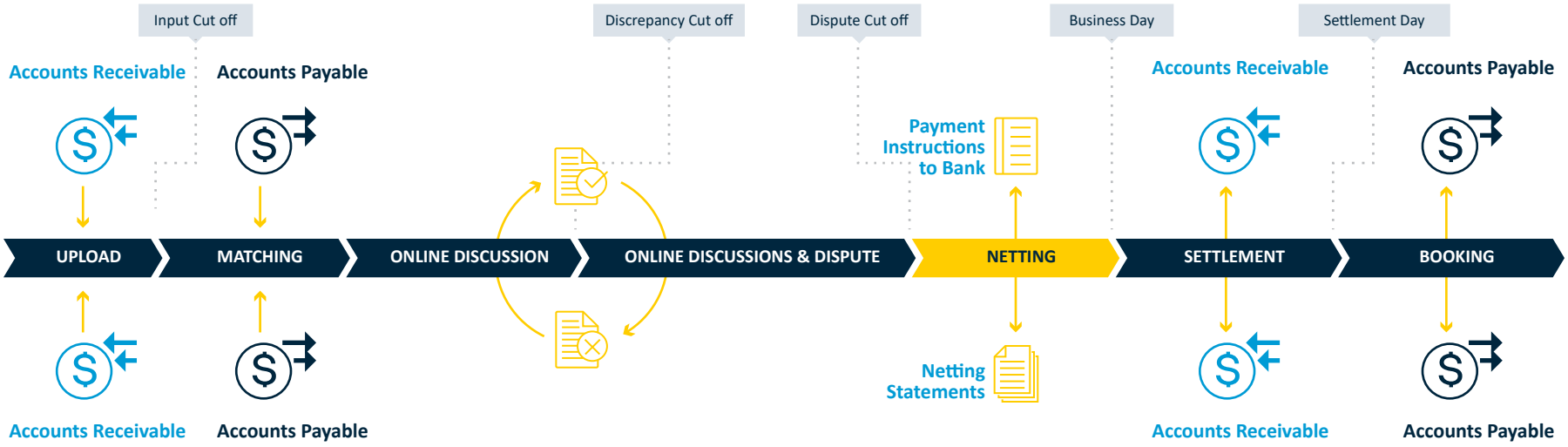
The drawback of Payable-Driven is that it does not address the issue of late payments and intercompany mismatches. If the payer has not booked the invoice in their Accounts Payable (AP) or if they simply do not want to pay the invoice, they can elect to not input it into the netting system, and the receiver will not receive the funds.

Settle Only Matched

Settle Only Matched is a hybrid between Payable-Driven and Receivable-Driven. It settles only the invoices where the Accounts Payable (AP) and the Accounts Receivable (AR) match. Although this can be viewed as a useful compromise between Payable-Driven and Receivable-Driven, there can be difficulties on the payer side. If the payer does not wish an invoice to be paid, then they can simply not put it in the netting system, and since it can't be matched, it will not be settled.

The diagram below provides a more detailed timeline of a Receivable-Driven netting process, including time for matching, discussion, and dispute resolution. When considering netting technology, it is important to look for features that enable all three types of multi-lateral netting. In all three cases, the yellow arrow represents the date when the netting center will finalize the netting, execute FX trades and send out final netting statements to all participants. On settlement date, the netting center will receive payments raised by net payers, and net receivers will receive their respective payments from netting center.

NETTING PROCESS TIMELINE



NETTING CALENDAR

Calendars allow all parties in the netting process to manage their cash flow and activities:

NETTING CALENDAR EXAMPLE

The netting cycle is managed through a stated netting calendar. Key dates include:

INPUT CUTOFF DATE. The final date where invoices are included in the monthly netting cycle.

NETTING DATE. Sometimes referred to as the fixing date, this is the date when the netting amounts are set. This allows all parties to have a clear view to the amounts that will be needed or provided on the settlement date.

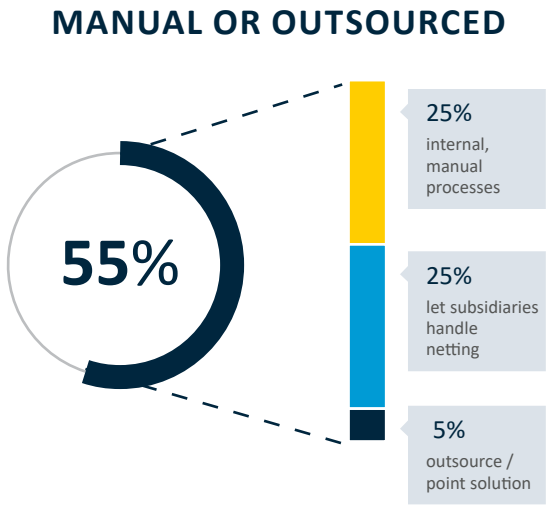
SETTLEMENT DATE. Also called the payment value date, this refers to the day when payments will be debited or credited from participants' and the netting center's bank accounts.

Netting Users

ADOPTION RATES AND TYPES

Almost Half Use a Centralized, Formal Netting System

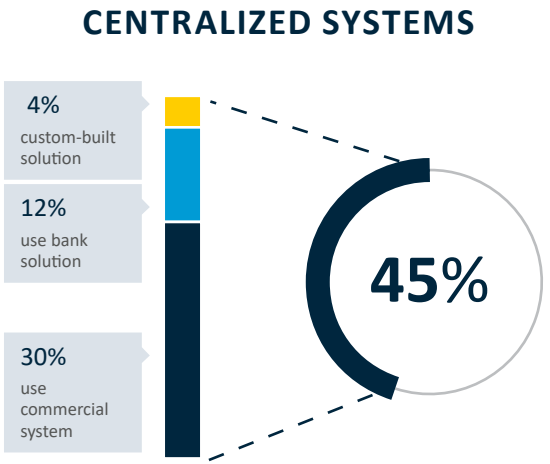
Just under half of respondents (45%) use a centralized, formal technology solution to handle their netting in-house. Within the remaining 55%, forms of netting are still being used: a few (5% of all respondents) use "point solutions" or outsourcing, while the majority are evenly split between 1) using internal, manual processes for netting and 2) letting their subsidiaries handle netting separately.



COMMERCIAL VS. BANK-PROVIDED SOLUTIONS

Two-Thirds Leverage Commercial Solutions

Of the group who do centralize their netting through a technology solution, two-thirds use a commercial system. The remaining third leverage bank solutions or custom built their own.



What Drives Netting?

COMMON BENEFITS

1. Forecasting accuracy and cash flow management.
2. Reduction in banking transfer costs.
3. Reduction in FX costs.
4. Reduction in FX hedging costs.
5. Support for intercompany banking activity.
6. Consistent activity.
7. Centralization of information and skillsets.
8. Brings structure and discipline to intercompany payments.

PAIN POINTS THAT DRIVE USE

When asked to rate their level of concern for seven pain points specifically around intercompany payments, respondents did not overwhelmingly settle on any single issue of greatest concern. This indicates a broad base of problems with significant commonality across all respondents. Intercompany payments, it seems, come with a constellation of frustrations rather than with one or two standout issues.

That said, the rankings were not identical. The two areas with the highest medium-large concern rankings were:

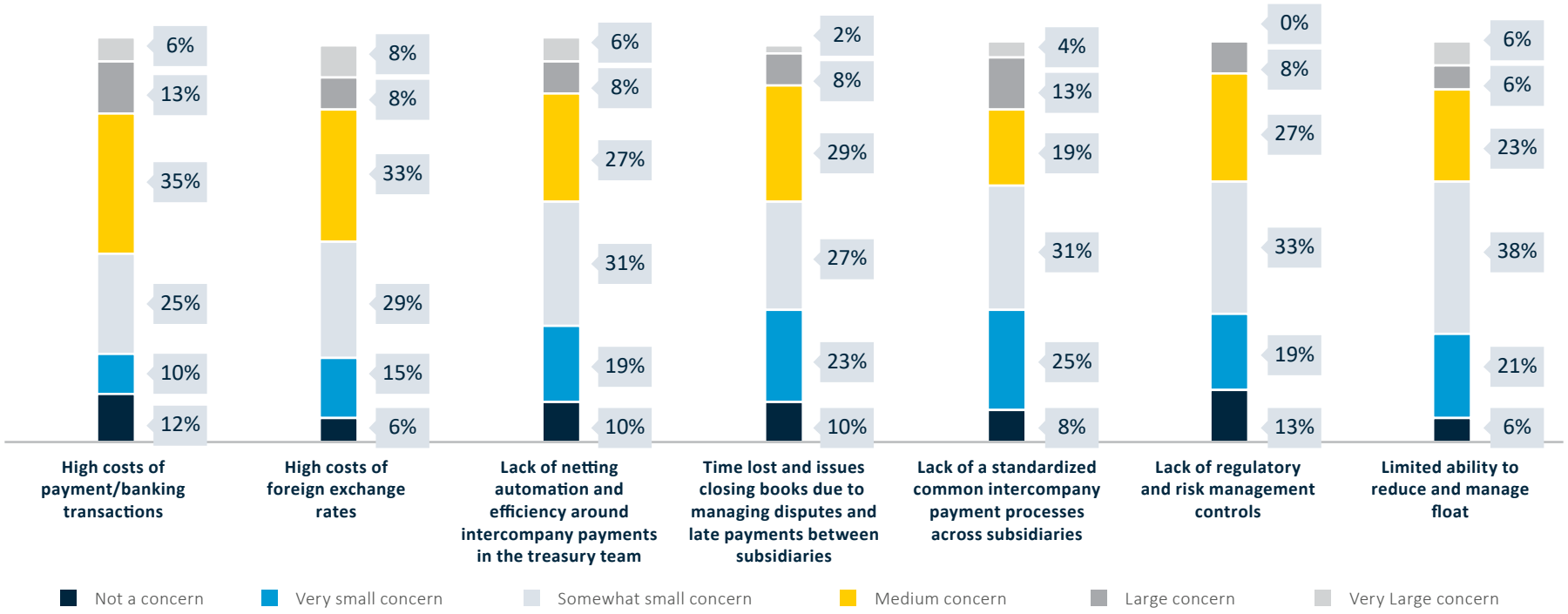
Broad-based concerns show intercompany pain points.

- **High costs of payment/banking transactions** (54% medium to very large concern, 19% large/very large)
- **High costs of FX rates** (49% medium to very large, 16% large or very large)

One option, "lack of standardized common intercompany payment processes across subsidiaries," was in fifth place for the top three concerns but second when looking at large/very large concerns. Smaller organizations were more likely to rank this as a major concern.

NETTING PAIN POINTS

(Shown from most to least concerning)



This chart shows the ranking by level of concern across seven different issues for intercompany payments. For most respondents, nearly all pain points fell in the three lowest concern levels, with the exception (by a narrow margin) of “High costs of payment/banking transactions.” However, for every pain point that was listed, more than 1 out of 3 respondents indicated a medium or higher level of concern.

LAYERS OF COMPLEXITY (NO ONE REASON)

Given that there is a broad set of pain points and drivers around netting, rather than just one driving factor, the research has been further broken down to show correlations between netting system use and a range of different activity levels and corporate complexities. This was done in two steps: 1) on a single-factor basis and 2) on a multi-factor basis. (Note: percentages are rounded and thus may not appear to add to 100%.)

Single-Factor Analysis

Focusing in on one factor at a time provides a clearer view of which groups don't use a netting solution. As may be logically expected, the less complex (fewer subsidiaries, fewer currencies, etc.) a company's netting situation, the fewer the percentage of netting users.

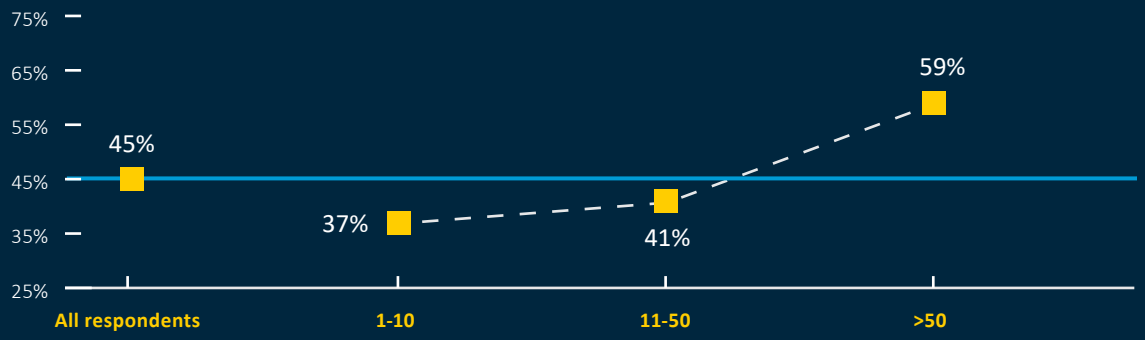
The graphs on the following pages show the breakdown of netting use when only a single factor is considered. For example, what percentage of those with 1-10 subsidiaries use netting? What of those with 11-50 subsidiaries? And so forth.

In each chart, there is a line at 45%, which represents the overall percentage of respondents that use netting. This is a baseline for comparison, showing how each factor correlates to low or high netting use.

The following charts/graphs show the percentage of those using or not using netting out of the total when considering different individual factors.

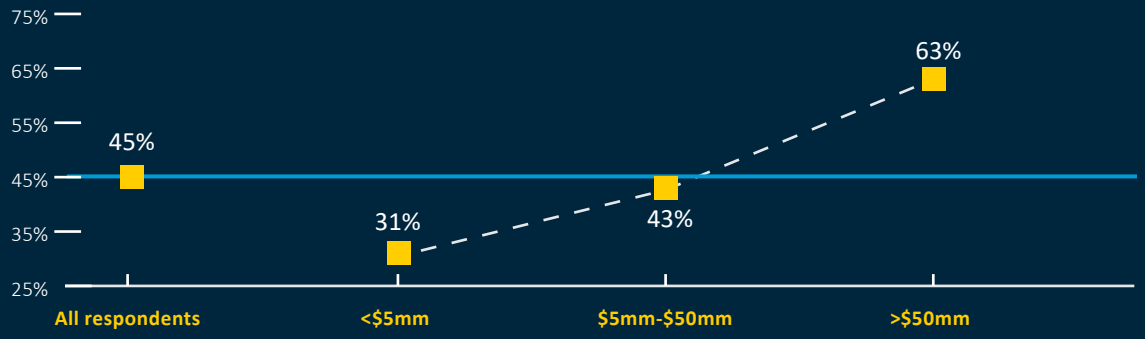
- **59%** of firms with 50 or more subsidiaries use a netting system.
- **50%** of firms with 11 or more subsidiaries use a netting system.

SUBSIDIARIES



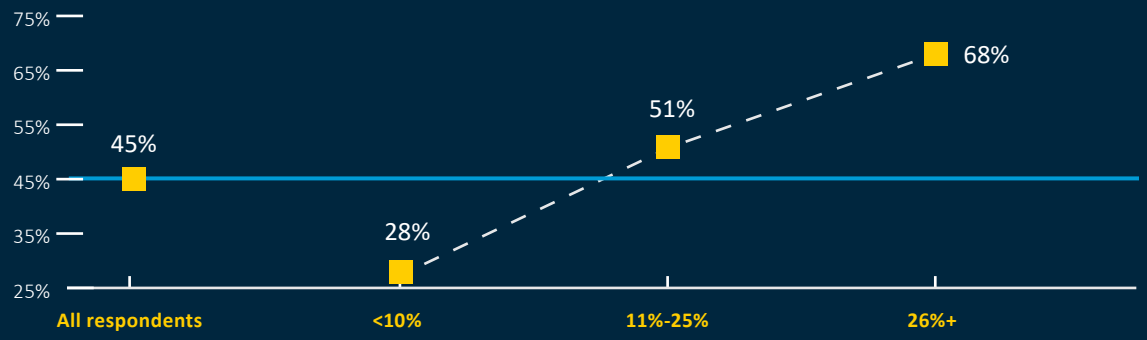
- **63%** of firms with >$50mm in average monthly intercompany payments use a netting system.
- **52%** of firms with >$5mm in average monthly intercompany payments use a netting system.

INTERCOMPANY PAYMENT VOLUME



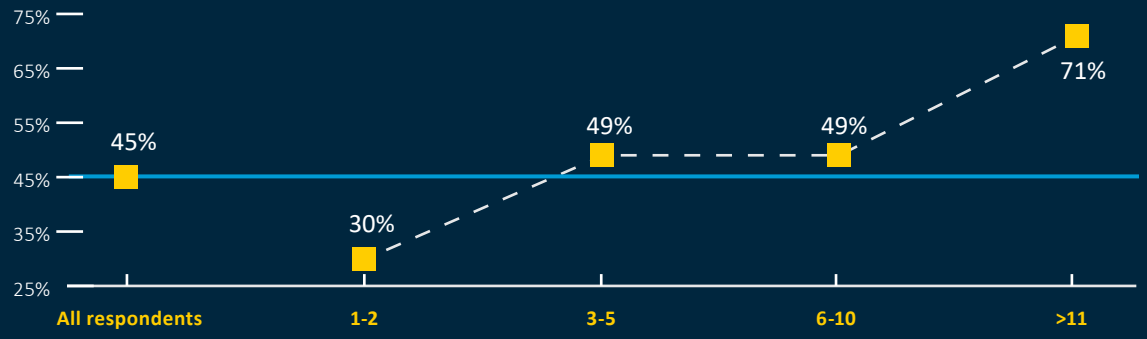
- **68%** of firms with >25% of their intercompany payments involving FX use a netting system.
- **60%** of firms with >11% of their intercompany payments involving FX use a netting system.

FX PAYMENTS



- **52%** of firms with 3 or more currencies use a netting system.

CURRENCIES



Multi-Factor Analysis

When we look at companies that have more than one complexity factor, the use of a netting solution is more prevalent. For example, 68% of respondents who have more than five subsidiaries and also have FX transactions representing 25% or more of intercompany payments use netting. When you look at the single-factor chart for number of subsidiaries, the highest percentage of companies using netting is 59%.

Three additional complexity combinations are shown in the chart below. Again, the line at 45% represents the overall percentage of respondents that use netting. This is a baseline for comparison, showing how each complexity combination correlates to low or high netting use.

Next Steps

BUILD A BUSINESS CASE FOR NETTING

If your company falls in the middle or right end of the chart on *page 5,* you likely have enough moderate factors to justify exploration of an intercompany netting system. Building a business case for any type of new system will involve more than just the financial analysis – there are planning, benchmarking, operational changes and process impacts to be considered, including:

HOW DO YOU WANT TO RUN YOUR NETTING?

Knowing whether you are Receivable-Driven, Payable-Driven or Settle Only Matched will drive technology requirements. For maximum flexibility, you will want to look for the ability to import both AR and AP invoices, automatic matching with flagging of invoices, mismatch analysis with drilldown, and online discussion with auto notification by e-mail. The ability to set your own calendar will also give you control over how often you wish to run your netting activities.

WHAT DO YOU SPEND TODAY?

Benchmark the details needed to understand the cost of payments today. Capture details around payment volume, value dating in days, and interest rates. What are your intercompany FX exposures? How many times are your subsidiaries buying and selling the same foreign currency month after month? Are you raising payments from a bank account denominated in a different currency than that of your payment and at what cost? Also consider and document the time it takes to perform related activities.

WHERE ARE AREAS OF DIRECT COST SAVINGS?

Look at cost saving opportunities related to value dating costs, FX costs, bank fee fund transfer costs, and lifting fees.

WHERE CAN YOU SAVE TIME AND CREATE VALUE?

Don't overlook the administrative costs associated with tracking missing payments, problem-solving and the cost of reconciliation and booking invoices.

WHERE CAN YOU REDUCE RISK?

Consider the positive impacts of more visibility and control over all payments and FX exposures when intercompany netting is implemented. Also evaluate the risk-related benefits of standard centralized payment approvals and improvements to cash forecasting.

IS THERE ADDITIONAL BENEFIT FROM STAFF TIME SAVINGS OR REDEPLOYMENT TO HIGHER VALUE ACTIVITIES?

Use existing internal measurements or benchmark data to estimate the time savings multiplied by full-burdened cost of those activities. Consider activities that can be eliminated or made more efficient by automation or by redeploying more cost-effective resources to other projects. When evaluating technology providers, look for interfaces to ERPs, TMSs, banks and, ideally, an API module to automate imports and exports.

Coprocess is here to help.

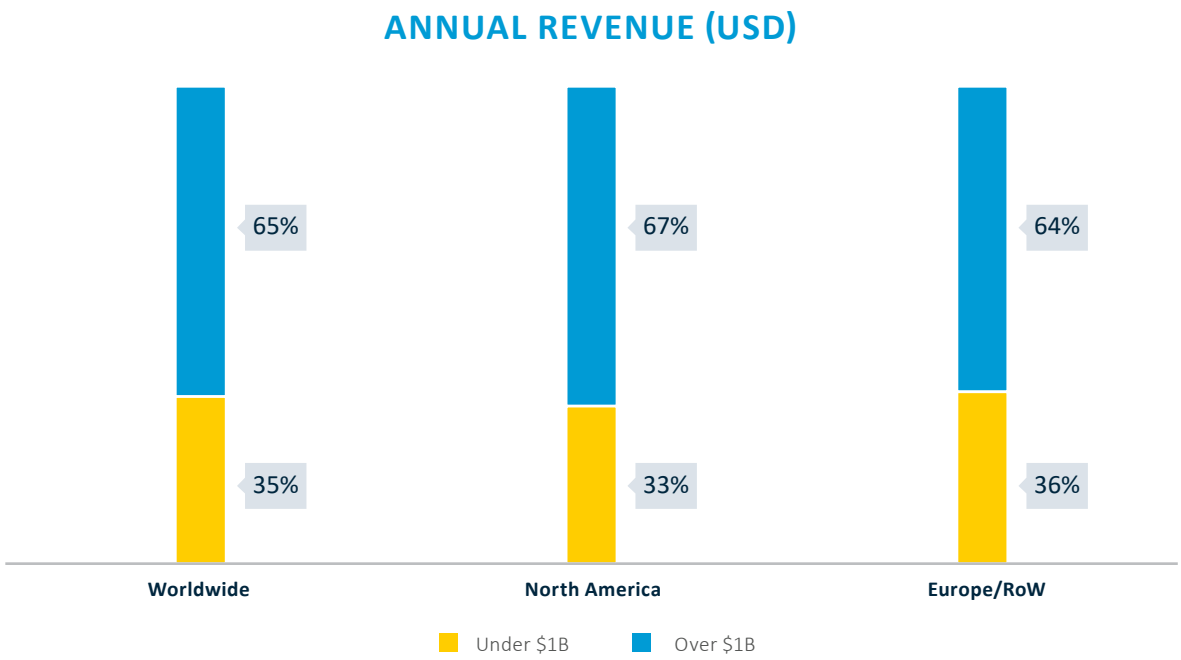
Coprocess offers a free, no-obligation savings analysis to further define the opportunities of intercompany netting and can provide a free trial, using your own data, for qualified companies.

CONTACT US TODAY TO LEARN MORE.

About the Respondents

REVENUE

Survey respondents across geographies maintained a similar 2 to 1 ratio between larger firms (>$1B USD) and smaller firms (<$1B USD).

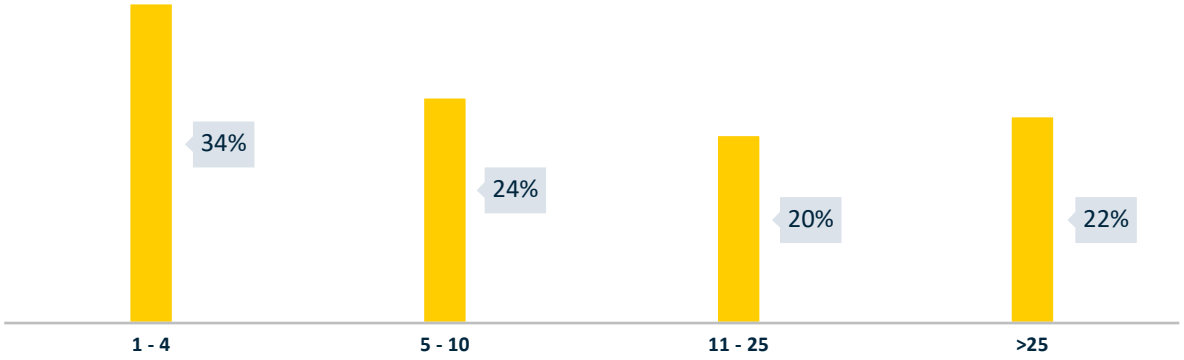


Respondent annual revenue splits (large and small) were comparable across geographies.

TREASURY EMPLOYEES

The majority of respondent treasury teams were small/ lean (staff of 1-10).

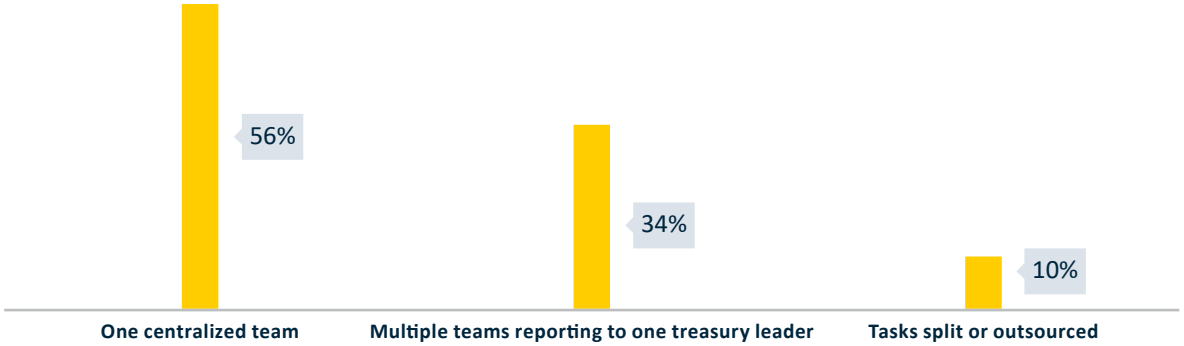
The number of treasury resources varies significantly from organization to organization. More than one-third of respondents are staffed with fewer than five treasury professionals, while four out of nine companies reported 11 or more treasury staff.



TREASURY ORGANIZATION

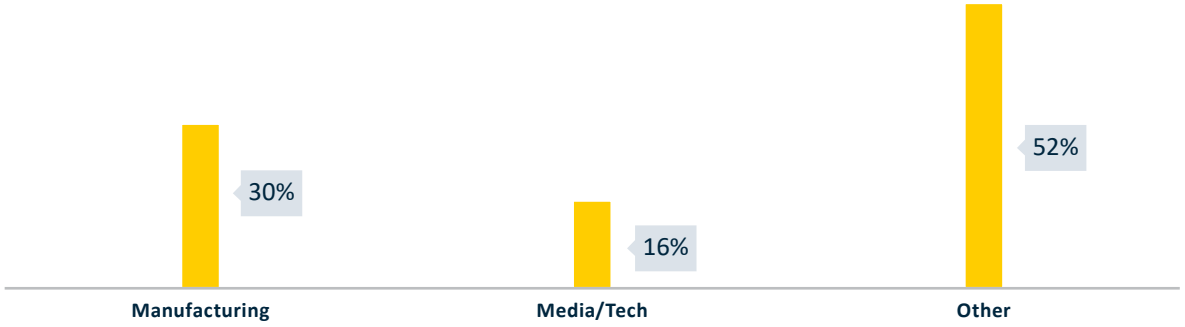
Treasury groups are highly centralized, both in physical location and via reporting hierarchies.

Treasury teams are highly centralized. The vast majority of treasury teams are centralized from a reporting standpoint (90%), and a more modest majority are centralized physically (56%).



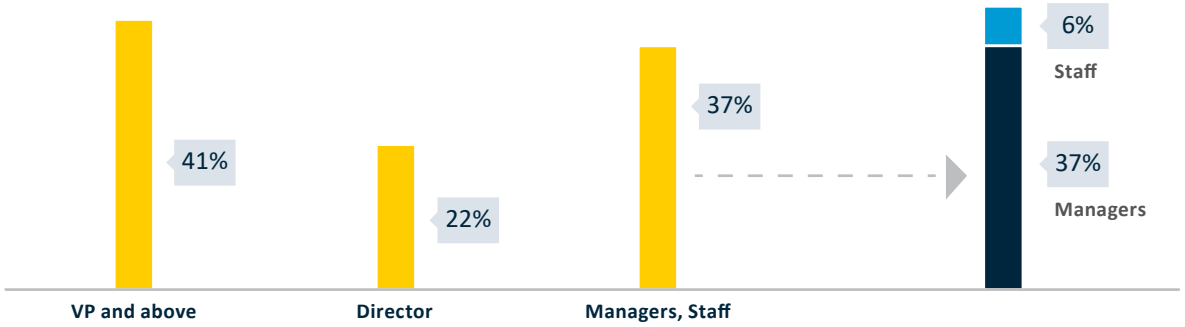
INDUSTRIES

The top two broad industry categories (manufacturing, media/tech) covered 46% of the total qualified respondents. The other 11 industry categories made up 54% of the total. This included government, finance/insurance, retail/wholesale, professional services, construction/ engineering, energy/mining, healthcare/education, and four others.



ROLES

Respondents to the survey were more heavily drawn from senior treasury roles. Executive level titles including VP and above made up 41% of the survey respondents. Director level positions made up 22%, and manager and staff roles totaled 37% (31% and 6% respectively).



Executive management

made up 63% of respondents

(Director level and above).

About Coprocess

Founded in 1991, Coprocess has established itself as the leading intercompany netting, reconciliation and vendor payments provider, helping clients realize greater cost savings, visibility, control and risk mitigation. Headquartered in Switzerland, the company's 180 global clients across a range of industries leverage the Coprocess solution to net millions of invoices per year and save hundreds of thousands of dollars in FX and transaction expenses.

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