LIQUIDITY MANAGEMENT

Pooling Power for Treasury Transformation

Building a Liquidity Backbone at Equinix

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The turbulent business landscape in recent years and decidedly uncertain outlook underscore the imperative for companies to streamline liquidity management and bolster operational efficiency. In this case study, we speak to Equinix and Bank Mendes Gans to understand how pooling solutions can act as vital tools in addressing these challenges head-on. We also shed light on the transformative advantages of such set-ups and how any hurdles associated with their implementation can be easily overcome.

Fuelled by the need for real-time liquidity visibility, efficient capital allocation, and enhanced risk management capabilities, pooling has, in recent years, come to be seen as a vital transformational tool for treasurers, especially those operating in large multinationals. The case for pooling is being further strengthened by the powerful role it can play beyond traditional treasury functions, such as in capital structure optimisation and M&A financing.

Bertie Sanders, Managing Director Clients & Products USA, Bank Mendes Gans (BMG), says his bank is seeing many companies embark on treasury transformation in an effort to mitigate the impact of the challenging business environment. Many of these companies are engaging with the transformation process because they have a global footprint that exposes them to, in particular, doing business in complex countries, he says. Multinational enterprises (MNEs), for example, are currently seeing more and more challenges arise around the world, with mismatches of local cash needs, problems with accessing liquidity buffers, and increasing tax complexities just some of the challenges causing headaches.

Sanders adds: "A common theme for many corporates is the challenge liquidity management represents now in many areas of operation. Increasing transfer pricing requirements, for example, are forcing multinationals to look again at their set-up and implement efficiencies within the organisation. It can sometimes be a daunting task for corporates to be on top of all these issues and figure out the best

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options. They are recognising that an instrument such as intercompany loaning is actually very inflexible, as it cannot be adjusted swiftly in response to changing borrowing patterns. Corporates nowadays want to have as many tool options as possible to address challenges, not least when it comes to liquidity management."

As the only bank in the world to focus exclusively on liquidity and information management solutions for multinationals, BMG's expertise is finding favour among corporates as they continue to adapt to the much-changed business landscape and an uncertain outlook. Its flagship notional multi-entity multicurrency pooling tool, in particular, is proving especially attractive to corporates, not least Equinix, a data centre operator. The company currently boasts 260 data facilities in 33 countries on five continents, illustrating its extensive global footprint.

Explaining the nature of the challenges for her company BMG's pooling tool has helped address, Equinix's Assistant Treasurer Duang Wollring first notes the importance for the company of ensuring sufficient cash is always available in the right place, at the right time, and in the right currency. Just as important for the business, however, given the high interest rate environment, is optimising returns and doing so in a way that mitigates risks and exposures associated with risks connected to counterparties, FX, and repatriation. Additionally, the company must also ensure that where it keeps its cash complies with its internal investment policy and local regulatory requirements.

Solving multiple intercompany funding conundrums

A centralised treasury function at Equinix means it is Wollring and her team that have the key responsibility for knowing where exactly cash is located in real-time and the risks to which it is exposed. She explains: "We open every single bank account in the company. With that responsibility, we can typically fund our subsidiaries through intercompany loans or equity.

"Growth and expansion of operations into new markets, in turn, requires subsidiary funding activities to also grow. That's a great position to be in, of course, but it does mean we had to address the big challenge of how to achieve scale and optimise our funding process to ensure we could meet our liquidity needs on time and in the right currency.

"As Bertie pointed out, intercompany funding is difficult to warm to as a solution. It can require pretty extensive collaboration between treasury, tax, legal, accounting, and FP&A teams. And it does take time and effort to set up and maintain the funding structure. So, in the past, we tried to synchronise our funding effort and finance subsidiaries well in advance, maybe a month before."

A netting solution, which was also provided by BMG, handled that advance funding of subsidiaries, with a safety net added to help avoid being caught out by any sudden need for additional funds. "As you imagine, advance funding plus some buffer means pockets of cash being left here and there. The treasury team does its utmost, of course, to invest this surplus, but that effort can be constrained by country complexities. Sometimes the amount of excess can be too insignificant for investment, so it just lies there," says Wollring.

The challenges faced by California-headquartered Equinix will, of course, be familiar to many MNE treasurers. BMG's Sanders says typical reasons why clients such as Equinix opt for BMG's notional pooling solution include its flexibility, speed of implementation, and scalability needed to support company growth. Importantly, it also aims to extract as much value as possible from the high interest rate environment.

More specifically, Sanders is keen to highlight the powerful impact an effective pooling solution can have on FX exposure management. He explains that BMG often sees that clients have large intercompany loan portfolios. Ideally these should be only in the local currency of the borrower so that, for example, a US corporate treasury grants an IC loan in Mexican Pesos to the Mexican subsidiary. However, in many situations BMG also see IC loans in non-functional currencies not only by US corporate treasury but sometimes also supported by other cash rich overseas subsidiaries. "That can limit visibility significantly. It is more obvious what the net FX exposures are for these subsidiaries when the loans are unwound via a pool."

He adds: "BMG's multi-entity, multicurrency notional pooling tool enables treasurers to notionally offset long and short balances and utilise idle cash elsewhere within the group. At the same time, they avoid recourse to intercompany working capital loans. There's no operational or regulatory burden associated with the solution. And, importantly from a corporate perspective, we are bank agnostic, so our solution acts on top of existing local and regional bank infrastructure, as is the case with Equinix."

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Impressive efficiency gains

Wollring says of the pooling solution "It is a great tool for overcoming the issues we were having, the time and effort it was taking to action funding, arranging company loans, even equity funding. If entities needed money immediately or on the day we just had to say, 'Sorry, it can't be done.' That is a real drag, a constraint that definitely isn't needed by a growing, successful company with a promising outlook that is up against an already very difficult operating environment.

"The pooling has been super-helpful in tackling these bottlenecks, exposing more surplus cash for investment and operational inefficiencies. Thanks to the solution, the money is now there instantly where it is needed, mitigating timing issues. Entities can also now draw funds, or we in treasury can draw money for them, without having to co-ordinate with our FX team, tax team, or legal team first."

The Equinix team has also been impressed by the "tremendous operational efficiency" the solution has generated, says Wollring. "Having a robust pooling solution is like a local credit facility but without the same price tag. It's simple, flexible, and available in an instant. Now, when the M&A team comes to me and asks for money to be ready up close to the actual transaction, it's such a good feeling to be able to say 'Yes, absolutely!'."

Another welcome bonus delivered by BMG's pooling solution is that it has created valuable time for the Equinix team to think more strategically about funding solutions and liquidity management generally. The deployment of cash pooling for temporarily trapped cash is a case in point. Wollring elaborates: "That really helps us as it allows other pool participants to be able to go overdrawn so long as the overall aggregated pool balance does not go below zero. The cash that is there can be used by somebody else."

Wollring also notes that leveraging pooling in the prevailing high interest rate environment has the potential for Equinix to reduce a large portion of its operating cash requirement through the pool. "Because the company can use liquidities in the pool, it is no longer necessary to keep a large cash balance locally," she explains. "That means we can potentially have more cash available for investment activities that earn more than the interest rate. We therefore do not have to borrow as much to fund our operating cash requirements. Those savings on the interest expenses contribute directly to everyone's bottom line."

Setting the foundations for pooling success

When considering advice for peers with similar ambitions for their liquidity management, Wollring notes that all companies will have different legal and tax structures and these can have a major impact on determining the best course of action.

"I would therefore strongly recommend to treasurers that before implementing any solution they talk to their solution provider, in our case, it was BMG, and discuss it all with their tax and accounting advisers. If you do not talk to them and you just start implementing the solution, you might well end up with a structure that does not suit your company. A considerable amount of work needs to be done before any implementation."

Equinix itself, for example, had to consider in detail the demands and implications of setting up two cash pools, one for qualified real estate investment trust (REIT) subsidiaries and another for taxable REIT subsidiaries to avoid co-mingling of funds between the two. Furthermore, any new cash pooling arrangements for Equinix had to be operated on an arm's-length basis. Interest rate charges

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and compensations among pool members therefore had to reflect this third-party arrangement. Wollring and her team worked closely with Equinix's tax advisers to make sure that arrangement was in place.

There are legals to bear in mind too, she says, with several agreements that will need signing with the cash pooling bank. That required the involvement of Equinix's legal team and its approval for those agreements.

Wollring further advises consideration of any existing credit agreements before the implementation of any solution: "Review any credit agreements to make sure that you can enter into cash pooling agreements with the cash pooling bank because sometimes they may ask to have the balances on the accounts pledged to the bank. If you have anything in your agreements that prevents you from doing that, then you must clear that first with your lenders."

There is also an accounting dimension that must be considered before implementation. Equinix's team, for example, liaised closely with the company's auditor to make sure it was happy with the proposed new arrangement. Wollring continues: "They fully understood what we were trying to do by implementing pooling. I highly recommend talking them through the proposal, ascertain your company is allowed to offset surplus and negative balances when the pool is fully operational."

Another vital, often overlooked, ingredient for the successful implementation of a pooling tool is staff training. Sanders says: "I'm a strong proponent of getting things done well right from the start so that people are happy with the implementation of any new tool or processes and therefore keen to exploit them. We spend a considerable time in training the treasury staff around the world and when training local users we clearly stress that they have immediate access to cash deposited in the pool when they need the cash locally again. It is really important to carry everyone with you with any new implementation, and training is key to that."

Sell it to the C-suite first

Last, but not least, one of Wollring's top pooling tips for treasurers is not to lose sight of the fact that any such major change for a function as critical as liquidity management will need to be sold to senior management first.

"From an operational perspective you want to make sure that the pool structure does provide benefits to the company. You must to be able to demonstrate its potential to your management team, put a business case together showing how much in savings the solution is going to generate, and the gain in operational efficiency it could deliver. This will make project implementation far easier if you get that blessing. Otherwise, you run the risk of getting everything in place for the go-ahead with your bank and then management comes back at you, says it does not understand the proposal and will not approve it."

For Sanders, BMG's success in the liquidity management marketplace owes much to the building of long-term relationships as much as the quality and efficacy of its solutions. "That was the case with Equinix – I've been liaising with Duang since 2000 – and so it has been with many other clients. It typically takes years before a company decides to get married to us. Once married though, divorces are very rare. Active dialogue with existing and prospective clients, sharing of ideas and intelligence, and the personal touch are elements BMG sets great store by.

"It's quite a unique focus we have at BMG, a unique service that meets a specific need for clients. Over the years, we have demonstrated incredible staying power with respect to servicing multinationals thanks to the technical quality and efficacy of our solutions.

"We live in an increasingly complex world and, in my view, treasurers are looking for simple tools to manage their intercompany inefficiencies. And in the end, our notional pooling solution is another essential tool that I'd suggest should be in their treasury toolbox. It creates tremendous efficiencies by solving mismatches within the group – the benefits of running such a structure will outweigh the cost of running a pool."

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Assistant Treasurer, Equinix

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