Managing Liquidity and Risk in Asia

TMI and the Hong Kong Association of Corporate Treasurers (HKACT) recently held an inaugural roundtable session hosted by Citi and AIM Global. An impressive panel of senior treasury and finance professionals took part to discuss some of the challenges of managing liquidity and risk in Asia Pacific, chaired by Peter Wong, Convenor of HKACT.

Participants:

Peter Wong, Convenor, Hong Kong Association of Corporate Treasurers
Alex Koh, CFO, McKinsey Asia
Allen Leung, Manager, Treasury Operations - Asia/Pacific, PPG Industries International, Inc
Esmond Lee, Head, Market Systems Development Division, Hong Kong Monetary Authority
Francis Ho, Group Treasurer, CLP Holdings Ltd
Jason Wang, Regional Treasurer, Henkel Asia Pacific
Keith Yuen, Deputy Group Treasurer, The Hong Kong Jockey Club
Lawrence Tse, Chief Finance Manager, Hong Kong Housing Authority
Marc Doman, Managing Director, AIM Global
Nigel Dobson, Managing Director, Global Transaction Services, Citi
Peter C. W. Choy, CFO, Fugro Holdings (HK) Limited
Stefan Harfich, Senior Consultant Risk Advisory & Financing, Siemens AG
Herbert Chang, Treasurer Asia, Philip Morris Asia Limited
Keith Yuen, Deputy Group Treasurer, The Hong Kong Jockey Club
Dominic Siu, Chief Financial Officer, Asia Container Terminals
Stephen Leung, Head of Corporate Treasury and Finance, Hysan Development
Roy Chan, Group Treasurer, Tungtex (Holdings)

Peter Wong:
Welcome to everyone attending this first TMI /HKACT roundtable. Today's event gives us the opportunity to promote active discussion among professionals with wide experience of liquidity and risk management issues in Hong Kong, China and Asia Pacific, to benchmark how we are doing currently and how to face future challenges.

Traditionally people in the finance function were concerned more with completing tasks and transactions. Today, the focus is on innovation, initiative, teamwork, training and retaining your people, which is a real challenge throughout Asia. Our CFOs are becoming more like company diplomats: they manage investor relations, liaise with analysts and rating agencies, and decide how to work with foreign investors if they issue debt in a market outside their own jurisdiction. These demands create issues of how they work with merchant bankers, how they choose banks, and how they engage with the other parts of the company, all of which are different profit centres which want to have their own autonomy.

Today, we would like to discuss how treasurers and CFOs go about managing risk in their operations, whilst still supporting the company's strategic objectives. These risks can often differ substantially in regions such as Asia compared with more established financial markets.

Nigel Dobson:
Citi has personnel based in 18 countries in Asia, servicing a diverse group of customers: multinationals, large Asian corporates, financial institutions, public sector entities and SMEs.

We have seen the evolution of the CFO and the treasurer over the last few years and we recognise that these roles are more challenging than ever. Treasurers are increasingly tasked with optimising the firm's working capital and adding value to the firm's underlying performance. To do this, a treasurer needs to have clear visibility of the operational cash flow, be able to mobilise and optimise working capital efficiently.

In today's forum, we'll touch on how we, as an organisation, can help companies to see their cash balances, how we can help CFOs to best allocate them, what you think the best methods are; and ultimately, what's the value is in terms of optimisation, which may require both bank or non-bank products.

Our comprehensive, on-the ground knowledge of the best practices and varying regulations form a solid foundation for our investment solutions. Citi divested its asset management business some years ago which means we are now a totally 'product agnostic' organisation. We offer convenient channels, whether offline or online, to partners like AIM

(left to right) Patrick Hinnel, Lawrence Tse, Alex Koh, Robin Page, Peter Wong & Esmond Lee

Global and others to allow you to achieve optimisation of excess liquidity as a result of improving working capital management.

Marc Doman:
AIM Global is part of Invesco Plc which is a worldwide fund manager, quoted on the London Stock Exchange. Globally, we have been managing money market funds now for over 25 years and have about $70 bn in assets under management. To put this into perspective, the US market has a volume of around $2 trillion in these types of products, roughly a third of corporate cash is invested in them, and certainly there they are very mature, well respected and well understood products.

Outside the US, equivalent products are growing strongly. By the beginning of 2000, there was around $30 bn in European-based money market funds. That $30 bn has grown to $455 billion today - in just seven years. That tells us that corporates and institutions are increasingly using these types of funds as short-term homes for their cash due to the pressures and changes in the world of banking, and also the very high levels of liquidity that we're now seeing

Peter Wong:
As the CFO and group treasurer, what pressures do you get from the Board?

Peter Choy:
Fugro Group, one of the top three engineering design consultancy companies in the world has developed rapidly in South-east Asia and China, so the Hong Kong operation has become a divisional headquarters. We have established eight companies in China and a recently acquired Canadian company also has a subsidiary in China.

As divisional headquarters, we are now responsible for finance activities across China and South-east Asia region. We have large volumes of funds going through these operational centres with transaction costs of about US $40m per month. We centralise funds in Hong Kong and hedge our FX risk to avoid the risk of currency volatility which can destroy the bottom line of the company very easily.

> Striving for operational efficiency is a continuous challenge.
>
> **Alex Koh**

Alex Koh:
The key contrast between the manufacturing and service industries is that a service organisation has much less tangible assets and liabilities on its balance sheet. People are our key assets and our working capital is driven primarily by debtors and creditors. The challenges of managing the risks in a service organisation are therefore significantly different.

Service organisations face a myriad challenges, influenced by Sarbanes-Oxley, the nature of the specific industry and the scope of services provided. For example in the advertising industry, acquisition is a key driver of growth with global holding companies owning several competing agencies acquired at different points in time. By definition, this creates a complex legal structure that cuts across multiple tax and regulatory environments which needs to be managed to minimise risk exposure.

In addition, the cash flows in the advertising industry, driven by media spend, is large relative to reported revenue. The environment in Asia dictates that activity will continue to grow and regulations evolve, impacting all aspects of operations. This mix of variables ensures a constantly changing business environment where risk management plays an important role and striving for operational efficiency is a continuous challenge.

Ultimately, the risk management process requires a balance between complying with internal and external requirements and the cost of doing so. With the compliance aspect being non-negotiable, the key challenge to CFOs and treasurers going forward is how to manage the process in the most cost efficient manner and act as a business partner to the CEO in addition to the traditional expectations.

Finally, service organisations are about people, so the need to identify, develop and retain talent is crucial. This applies equally to the risk management process, which despite performing a supporting role to headline revenue numbers, has its own part to play in ensuring a successful business proposition in Asia.

Francis Ho:
CLP has developed from a local utility company into a leading regional power company in the past two decades. Over 100 years ago, CLP established itself first in mainland China, and moved to Hong Kong later, where about 80% of the business is done now. Since the 1980s, we have made overseas investments in regions outside Hong Kong including mainland China, Australia, Thailand, India and Taiwan. In most of these countries, we operate power plants in a joint venture structure with local partners to mitigate local and project risks. In Australia and India, our business strategy is to conduct business without partners to optimise our expansion potential.

Because of the diversity of treasury and risk management in CLP, we have an independent group treasury department, the role of which has evolved in recent years. In the 1980s and 90s, our main function was to procure cost-effective funding to support the business growth in Hong Kong. As the business has grown, there is now a wider variety of funding choices. With the development of Hong Kong dollar market, CLP has tapped into Hong Kong dollar bonds in fixed rates for long-term tenures and increased banking facilities to support our local and overseas expansion. We have diversified our funding sources from a mixture of ECA loans, debt capital, money market and longer-term bank facilities.

> Today the focus is on innovation, initiative, teamwork, training and retaining your people, which is a real challenge throughout Asia.
>
> **Peter Wong**

We have comprehensive treasury policies on the liability side for the parent company, subsidiaries and joint ventures. We place a high priority on managing interest rate, foreign exchange, liquidity, counterparty and other forms of risk with regard to the unique circumstances of each project and shareholders' prudent financial management philosophy. This allows CLP to focus our strengths in construction, financing and operating of the power plants so that we can get a good return. In doing so, we need to maintain very good banking relationships so that we can obtain credit facilities for risk mitigation and re-financing.


Wanrawee Nopvichai & Peter Choy

In recent years, we have seen a number of enhancements in treasury control and reporting which include IAS-39 and Sarbanes-Oxley. There also are other requirements for group treasury at CLP. For example, we lead the annual credit review and help our project teams to negotiate with project financiers in our overseas businesses.

CLP adopts a zero cash balance strategy in cash management. We draw down on bank facilities where necessary and repay bank facilities with surplus funds. Group treasury helps project companies to identify appropriate investment instruments with the aim of picking up yield within an acceptable risk level.

Peter Wong:
Whether a company is in an asset-intensive industry like CLP or an asset-light industry like a global consulting firm or a professional engineering service company, you have to manage increasing levels of cross-border risk, such as access to funding, currency matching and so forth. Managing operations in China is a significant element of this for many companies.

Jason Wang:
China is definitely one of our key strategic locations, not only for Henkel's operations in Asia Pacific, but also for our entire global operation owing to its importance in the global supply chain and huge market. The treasurer has a key role to play in supporting the CFO in managing business growth in China, which I see in three parts.

The first role is to be the trusted advisor to the CFO to help him better assess the reality in China. Quite often, there is a gap between the expectation of the business world and the reality of what's happening in China because we tend to focus more on eye-catching headlines such a high GDP growth or large foreign currency reserves. In reality, the financial infrastructure is not as sophisticated as other markets and is also highly regulated. So the treasurer must help to bridge the gap between expectation and reality.

The second role is to be project executor, facilitating business growth in emerging markets like China and India. For example, strong growth in these markets requires a very efficient use of cash resources. For example, Henkel recently set up a domestic cash pool in China so that we can pool the cash of various entities together. This benefits all entities because some are cash-rich while others need cash to finance rapid expansion.

The third role is to be the treasury controller to help reduce treasury-related risks in emerging markets. We all know business and financial risks in emerging markets are quite high compared with those in developed markets. Therefore, the controlling functions of a treasurer are critical to corporate governance and regulatory compliance. In summary, I can see that by adopting these three roles as trusted advisor, project executor and treasury controller, treasurers can help the company to increase efficiency, enhance control and minimize risk.

Allen Leung:
PPG is a US manufacturer with three main businesses - coatings, glass & fibre glass, and optical & chemicals. The capital intensity of these businesses differs significantly and one of our objectives is to minimize the surplus cash and overall debt in Asia especially in China whilst providing each business with appropriate financing.

We adopt various strategies for managing our working capital. For example, we discount bank drafts collected from customers so that we get cash faster at a lower interest rate than direct borrowings from banks. Secondly, we use entrustment loans so that the entities with surplus cash can lend to entities which are short of cash. This reduces our income expense by minimising external borrowings. Thirdly, we manage the spread between the payment terms from suppliers and customers. For example, if our customers ask for longer credit terms, we ask for the same extension in credit terms from our suppliers.

Peter Wong:
Often, key treasury decisions are centralised in headquarters but business unit activities remain decentralised. How can we make sure that business units have access to cash without actually owning the cash?

Nigel Dobson:
We have already mentioned the necessity of visualising, mobilising and optimising cash. Some companies have very large numbers of subsidiaries in the region, hindering visibility over the bank accounts and cash flow and preventing inter-company funding. One of the ways in which Citi helps these companies is using our product TreasuryVision, often in a regional treasury centre. This solution was first delivered to Pepsi with the purpose of increasing visibility over the global cash position and satisfying compliance needs. Treasury Vision allows our clients in Asia to mobilise the cash across their Asia subsidiaries, to the greatest extent possible bearing in mind the regulatory boundaries which exist.

Once visibility has been achieved, we can then help clients to centralise their cash and invest surplus funds within the company's investment mandates. One of the ways we do this is to work with partners such as AIM Global which enables us to provide our customers with a more diverse range of investment products with a good level of return and strong credit.

Peter Wong:
A useful development for Asian companies is to link the current account with the money market fund to combine the advantages of each: the best rates, immediate access, and a highly rated investment instrument. Another advantage of money market funds is that a company with a large number of decentralised operating divisions globally can all set up an account with the same money market fund, so that if one business makes a payment to another internal company, this becomes a virtual transaction without transaction costs.

Keith Yuen:
One difference between the Jockey Club and other corporates is that we are incorporated under the Companies Ordinance but limited by guarantee only. Therefore, we are not owned by

Marc Doman & Francis Ho (background Keng MunLee, Citi)

Jason Wang

shareholders or the Hong Kong government. The day-to-day management is done by a board of management which comprises professionals running different business units.

Treasury is responsible for managing all of the Club's financial assets including our long-term capital and making sure that the surplus that we accumulate is invested prudently and effectively over the long term. Our risk appetite is low for our short-term working capital portfolio. We have a small team of in-house staff who manage this portfolio on a day-to-day basis, monitoring the cash flows and investing in the money market and bonds. We have also set aside a small amount of cash for investing in structured products with the opportunity for yield enhancement subject to principal preservation. We have had experience with money market funds in the past, but the market environment has not been favourable and we would not expect money market fund managers to deliver returns above the benchmark.

In many respects, our financial operations are quite simple in that we have few cross-border payments and most of our income is denominated in Hong Kong dollars. The focus for us, apart from having the right mix of working capital and meeting our liquidity needs, is how to maximise our return subject to a tightly controlled risk budget.

Nigel Dobson , Allen Leung & Herbert Chang

Our medium- and long- term investments are outsourced to external fund managers. In treasury, we oversee the overall portfolio construction in terms of asset allocation and risk budgeting to meet our long-term investment objectives. We then work on the investment management structure including the selection of fund managers. We periodically review and monitor the performance of the managers and change our mandates with them as necessary. Over time, we hope to grow the charity trust to a size that is self-sustaining so that the annual return is sufficient to meet the charitable needs for Hong Kong.

Lawrence Tse:
The public sector also has rather different needs to many private or publicly owned companies The Housing Authority (HA) is a public body established by statue and wholly owned by the government of Hong Kong SAR but it is financially autonomous. We provide subsidised housing to around one-third of the population here. As in many other countries, public housing is a major social initiative, with the challenge of

Esmond Lee of the Hong Kong Monetary Authority gives an update on the development of the US and euro clearing system in Asia that facilitates cross-border real time settlement within Asian time zones.

Esmond Lee: One of our important policy objectives is to make sure that an efficient payment settlement system exists in Hong Kong, to provide a platform for banks and financial institutions in the region to deliver better services to their clients. How to settle US dollar in Asia is always a key issue. Some years ago, we noticed that the great majority of cross-border transactions and also some domestic transactions with an international dimension, are denominated in US dollars. Consequently, we have a single currency to some extent, which is the US dollar, so we need to find an efficient means of settling USD in Asia.

Three initiatives that the Hong Kong Monetary Authority has undertaken: the payments system; securities settlement; and financial products. On the payments side, given the dominance of the US dollar in Asia, it is important to ensure that cross border payments, most of them in US dollars, are conducted as efficiently as domestic payments. Furthermore, we would like corporates to enjoy the same degree of efficiency and convenience in managing foreign currency accounts as if they were managing a Hong Kong dollar account. To satisfy these objectives, we have introduced foreign currency payment systems in Hong Kong but we also need to promote this infrastructure to other parts of Asia so that more banks, financial institutions and corporates use our system and create a critical mass. This will then facilitate US dollar and Euro payments from a corporate in one jurisdiction to another.

Besides treasury payments, commercial payments are also important, so we are going to introduce a regional CHATS service for cross-border commercial payments. This will streamline and provide a transparent and efficient platform for banks in the region to make their cross-border commercial payments.

Another initiative has been securities. The Monetary Authority would like to ensure that securities issued in Hong Kong will be exposed to the international investor banks, so we have a central securities depository (CSD) in Hong Kong called a CMU (Central Money Markets Unit). It's a CSD in the sense that it is a domestic system that caters primarily for domestic financial institutions. We are trying to transform this into an international CSD, so that the securities issued and domiciled in Hong Kong will be exposed to the international investor banks.

Finally, we have been looking at financial products, specifically RMB business in Hong Kong. Currently, the only way that corporates can invest in RMB is through bank deposits. We hope that, in due course, corporates in Hong Kong will be able to engage in different types of investments denominated in RMB. ■

Patrick Hinnel, Lawrence Tse & Alex Koh

how to sustain the public housing programme in the long run, given that this is a subsidised operation.

The treasury team works closely with management on public housing finance and balance sheet management. Like most treasuries, we have three primary objectives: managing liquidity to meet our operational requirements, managing risk, and enhancing the return within those parameters wherever possible.

While we do not have subsidiaries, we have a number of housing estate operations so we have large volumes of payments and receipts. We have to plan our liquidity, cash flows and maturity profiles carefully. We consolidate the information from every operation in our systems to update our cash flow projections. There are occasionally urgent requirements for a substantial payment in the same day. We have to build in the flexibility for these unexpected activities and to do this, we work closely with our major bankers.

Another issue is public accountability and we need to demonstrate prudent financial management, transparency and openness. For example, we seek competitive quotes for our external transactions for which we use an internally-developed system.

Finally, we have challenges in how to enhance our yield. While there are a variety of structured products available, but there are difficulties from the perspective of public accountability in demonstrating pricing transparency and a competitive process when these are quite specific to individual providers. So tools such as money market funds have potentially significant benefits for us.

Marc Doman:
One of the implications of increased regulation and governance for treasuries is that the investment process itself is becoming more complicated and regulated. As boards become more demanding over credit monitoring, credit quality adjustments, and credit reports on the type of cash and holdings that a company has, it will be incumbent on treasury to provide it.

Increasingly, if they cannot bear this responsibility and wish to outsource this to an expert third party, money marlket funds provide the ideal solution to enhance the investment and credit monitoring process.

One issue for companies in Asia is that although US dollar money market funds are settled on a same day basis, with the timezone difference it is late afternoon in Asia before the US market opens. To address this, we have put in place a Singapore trading centre so that when we get a US dollar redemption request, we can immediately send out a SWIFT pre-advice to the client's bank in Asia, which confirms the value and the date in which funds will be deposited in New York, which would satisfy most liquidity requirements for corporates. However, we are still looking at providing a physical same-day settlement in Asia, which is challenging but not impossible.

Peter Wong:
Apart from traditional bank deposits, it is clear that there are alternatives which give a better return, but often companies need a different business model, technology, and ways of forecasting cash to take advantage of these opportunities, and linking money market funds to the payment side may be beneficial.

We would like to thank all our participants today and look forward to another similar event in the future. ■

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