Liquidity Strategies for Asia: Releasing Trapped Cash

Insights | Corporate Clients

The world’s economic center of gravity continues to shift eastward even as general macro-economic conditions remain uncertain. Asia’s economic growth potential offers a myriad of opportunities for companies seeking new markets, making the region a de-facto strategic focus for most multinational companies (MNC) in recent years. As companies increase their investments in the region’s emerging markets, and as revenues earned in countries such as China, India, and Korea increase, trapped cash in these markets increase assets and lower return on assets, thus demanding higher focus from CFOs and corporate treasurers.

**Trapped cash** - money stuck in restrictive markets for diverse reasons such as regulatory constrains, capital requirements, currency convertibility and transferability, and tax issues - is a real barrier to efficient global cash deployment for MNCs that operate in Asia. In fact, the more successful a company becomes, the greater the need to effectively manage and mobilize profits or cash reserves to maintain competitive advantage. Leading companies in the region, whether they are western or emerging markets MNCs, would generally pursue the dual strategy of generating cash and then optimizing the cash generated.

**Exploring Options to Reduce Trapped Cash**

When considering liquidity strategies to leverage Asia growth, treasurers need to determine the blockages that lead to trapped cash. Is cash really trapped completely or merely inaccessible due to regulations, timing, or cost?

The ability to move money across borders in restricted markets such as China, India, Bangladesh, Malaysia, Pakistan, Indonesia, and Sri Lanka, fundamentally hinges on a proactive understanding of rapidly changing yet interlocking local regulations and capital controls. This enables treasurers to develop optimal liquidity management structures or re-engineer business models and processes to prevent, minimize and release trapped cash.

Treasurers also benefit from accurate, efficient cash-forecasting systems that help them to increase visibility of cash requirements in each country and identify situations that create trapped cash. This enables tighter control on fund flows in and out of a country by funding entities only when necessary, placing an efficient domestic liquidity structure to balance cash needs onshore before moving in additional cash from offshore. When financing from offshore is inevitable, treasurers
MNCs operating in Asia are increasing focus on cross-border opportunities to release trapped cash such as cross-border trade flows and cross-border lending.

Cross-border trade flows
Treasurers for companies with large imports and exports with offshore affiliates are well positioned to manage payment terms to repatriate cash from a restricted country. One solution is to lead on payables out of that country and lag on receivables into that country.

Consider a manufacturing company headquartered in the U.S. with a subsidiary in South Korea. Some components that go into the finished product are first made in the U.S. then assembled in Seoul. The Korean subsidiary would pay early for the components (i.e. within 30 days), thus releasing cash from the subsidiary, while the US counterpart would pay as late as possible for the finished product (i.e. 90 days). This strategy delays payment into a trapped cash environment and optimizes the company’s working capital.

Structured trade finance can also be embedded into the U.S. company’s cross-border trade settlement to release trapped cash. For example, the Korean subsidiary could buy goods on a 90 day letter of credit that can be discounted immediately by the U.S. company. The U.S. company then pays its Korean subsidiary on open account after 90 days.

The fundamental principle is to defer excess pools of currency from continuously accumulating onshore in a trapped cash environment, and keeping that cash fungible to be used for other purposes that support business growth.

Cross-border lending
Cross-border lending is an option that more cutting-edge treasurers are looking at as regulations evolve in the Asia-Pacific region. For example, in 2012, the People’s Bank of China (PBOC) initiated a pilot program in Shanghai to help foreign and local MNCs that want to channel surplus renminbi (RMB) capital in mainland China to fund RMB-denominated activities overseas.

Citi recently completed its first cross-border RMB lending transaction for a European food company that operates its treasury center in Singapore. The transaction was structured to optimize the surplus liquidity in the European food company’s operations in China. This helped the company better manage its excess cash and achieve greater efficiency in its global fund usage and allocation.

In the past, MNCs operating in China could not lend their surplus cash to overseas entities in RMB. As a result, this is a significant step for China as it marches down the path of deregulating the RMB and establishing it as an international currency for trading and investment.

In the pipeline, top-level treasurers are now seeking to obtain pilot approvals from the State Administration of Foreign Exchange (SAFE) to allow foreign currency cross-border cash pooling. This will enable their China subsidiaries to directly participate in group treasury pools overseas so as to better utilize their funds and further optimize liquidity management.

Leveraging surplus cash to set up an overseas equity investment is another textbook solution. In practice, this strategy is rarely used as it locks up shareholding in a trapped cash country and may have capital gains implications. Similarly, capital reduction will also free up trapped cash but this strategy is only suitable for exiting a market and does not serve the purpose of business growth. Also, the application process and timeline to reduce capital is extremely onerous in most countries.

Liquidity Strategies that Work in Asia
MNCs operating in Asia are increasing focus on cross-border opportunities to release trapped cash such as cross-border trade flows and cross-border lending.
The Next Frontier – Advanced Treasury and Liquidity Management Structures

Asia offers significant expansion opportunities for MNCs but can also be a minefield of potential liquidity traps for corporate treasurers unaware of the unique circumstances in each market. Capitalizing on growth opportunities is complicated by a host of legal and regulatory issues, and the difficulties are compounded in countries like China with ongoing reforms – what is permissible could change month on month.

Companies need to pay extra attention to navigate the uncertainties – whether to release trapped cash or to preempt the build-up of onshore liquidity in the first place. Strengthening oversight of funding to subsidiaries in Asia, leveraging cross-border strategies to manage working capital and funding, and effective cash forecasting systems all help to avert costly missteps such as pumping liquidity into a country where it will be trapped.

As companies become increasingly globalized and treasury complexity grows, leading corporate treasuries in Asia are also transitioning to advanced treasury and liquidity management structures. In-house banks, advanced financial structures such as intercompany netting and re-invoicing centers, and financially efficient trading company models are unquestionably the next frontier to overcome the trapped cash obstacle.

Many of the U.S. and European MNCs that we work with have already incorporated Asian entities into these advanced structures while our Asian MNC clients continue to increase adoption of these structures as they become available. Trapped cash may result from external factors, but treasurers are becoming more equipped to manage and mitigate this problem, effectively turning obstacles into opportunities for growth.

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