Evolution of Corporate Treasury

Corporate treasury has transformed from a mechanical processing unit of a company, to a data provider that aids financial reporting and risk management, and increasingly into an internal advisor to the business, contributing to corporate strategic planning. In its earliest form, corporate treasury functioned in a decentralized manner where companies engaged in cross-border business. Typically they established local treasury teams in the countries they operate. Many processes such as settlements were performed manually, and treasury communication with headquarters was often delayed and inadequate.

With the collapse of the Bretton Woods system in the 1970s where countries no longer linked their currencies to gold, exchange rates and the global financial markets became more volatile. Meanwhile, advances in treasury technology, improved banking infrastructure, and rise of network computing rendered the processing, recording, and reporting of financial data and transactions more transparent, and efficient. Treasury centralization became a possibility as corporates expanded their businesses globally. Treasury’s scope also broadened to include financial risk management, which requires enhanced dialogue between treasury and various internal and external stakeholders. The treasurer’s influence to a company elevated as treasury became closer to everyday business operations.

The Global Financial Crisis of 2007 - 2009 saw treasury evolve from a support function into a trusted advisor to the company. Rising risks due to financial market turbulence and supply chain instability compelled corporates to increase focus from earnings growth to cost saving, from pursuing acquisitions to strengthening internal controls, and from relying on external funding to mobilizing internal sources of liquidity. The Crisis heightened the prominence of treasury as a provider of real-time data analytics - not just a collector of historical financials - for forward-looking strategic planning by top management. To provide useful analytics, treasury needed to gather timely and accurate information on the flow of funds and financial data across the company. Centralization was the enabler.

Treasury Centralization as a Journey

The first functions a company typically centralizes are netting of foreign exchange transactions, interest rate management, and long term funding arrangements. As a treasury center evolves, it tends to become an intermediary between internal and external counterparties such as subsidiaries and banks. It involves taking charge of bank relationship management, bank account rationalization, intercompany funding (taking deposits from cash-surplus entities and lending to entities that require funding), and cash pooling. The most sophisticated form of treasury center is the In-House Bank which accepts deposits from and lends...
funds to group entities via virtual accounts. The In-House Bank acts as the company’s single contact point with external banks and thus reducing bank fees on currency exchange and other financial transactions.

Along the journey of centralization comes the decision of where to locate treasury. Traditionally, treasury centers of multinational companies resided in the same country as their corporate headquarters for proximity to senior management. As companies expanded geographically, it became difficult for a single treasury center to manage fund flows and support group entities in locations with little to no overlap in time-zone. Operations were further complicated by heterogeneity in local languages, regulations, business customs, and financial market practices. To address these issues, corporates began to establish regional treasury centers.

Regional treasury centers facilitated global expansion of US multinationals. They later became popular with European corporates as well, especially following Euro’s introduction, to reap economies of scale in consolidating Euro-denominated funds. In Asia, treasury centralization remains a challenge due to marked differences in country regulations and languages in the region. However, the emergence of Asian multinational companies and expansion of their western counterparts into the region have led to an increase in the number of treasury centers in Asia.

### Treasury Center Location Considerations

The decision of where to set up a treasury center is usually a tax-driven decision, although non-tax factors are also equally important.

To facilitate efficient cash pooling and intercompany lending, treasury centers should ideally be located in low-tax jurisdictions. Countries with low corporate income tax and wide tax treaty networks are favorable treasury center locations, given benefits such as reduced or exempted withholding taxes on interest between treasury and other group entities. Governments may also offer additional tax benefits in the form of incentive programs to attract corporate treasury centers to their respective countries.

A company’s legal entity structure has significant tax implications. For foreign affiliates, their identity as a branch or subsidiary of the parent company and status as resident or non-resident of the local jurisdiction affect the amount and nature of taxes levied. When cash is physically concentrated or notionally pooled, interest income allocation from the header entity to individual pool participants should be done on arms-length basis. Aside from permanent establishment and transfer pricing issues, controlled foreign company (CFC) and thin capitalization rules – measures by tax authorities to prevent companies from shifting profits and therefore tax revenues to other (often lower-tax) jurisdictions – also need to be considered where applicable. Thus, it is crucial for multinational companies to consult in-house as well as external legal and tax advisors before implementing treasury centers.

Non-tax treasury center location considerations include financial costs (bank transaction fees, treasury staff salary, office rental), central bank and other regulatory reporting requirements, access to financial markets, degree of currency restrictions, availability of skilled employees, time-zone compatibility with respect to business operations under coverage, quality of physical and IT infrastructure, political stability, sophistication of banking system, and reputation of the location being a financial hub. By adding up weighted scores of the above tax and non-tax criteria, companies can identify the optimal country for treasury center establishment.

### Popular Locations for Treasury Center Establishment - Asia

#### Hong Kong

Hong Kong and Singapore are the two most popular locations in Asia for treasury centers. Other countries considered by Citi’s corporate clients are Malaysia and Thailand, both of which offer tax incentives with financial and commercial flow benefits.

**Hong Kong** - While tax incentives for treasury centers are not offered and double tax treaty network is limited, companies are attracted to Hong Kong's territorial taxation regime characterized by a low corporate income tax rate, waiver of tax on interest income, and lack of withholding tax on interest payment. Hong Kong is also favored as a treasury center location due to its dynamic financial sector and superior physical and technological infrastructure. Hong Kong's status as an offshore RMB hub and close proximity to China make it an ideal location for companies that have or are planning to establish business operations in the mainland.

**Singapore** - Tax incentives are available to companies that use Singapore as a regional base, global headquarters, or a center from which to conduct Research and Development or higher value-added activities. In particular, the Finance & Treasury Center (FTC) Incentive administered by the Economic Development Board (EDB) is most relevant to companies wishing to establish a treasury center in Singapore. Companies with FTC status enjoy income tax concession and withholding tax exemption for a period of 5 to 10 years. Singapore's wide double tax treaty network, low corporate income tax rate, and sophisticated banking sector also make the Garden City a choice location for treasury operations - so long as corporates are comfortable with the higher costs in Singapore relative to its South-East Asian neighbours.

**Malaysia** - Unveiled in Malaysia’s 2012 Budget is the Treasury Management Center (TMC) incentive. Under this scheme offered by the Malaysian Investment Development Authority (MIDA), companies that establish TMC in Malaysia providing financial and fund management services to related companies will benefit from income tax reduction and withholding tax exemption for five years. A broad double tax treaty network and relatively low cost environment also render Malaysia a treasury center location of choice. Compared to Singapore and Hong Kong, however, Malaysia’s banking infrastructure is still at a developing phase, and there may be fewer tax and legal professionals with regional expertise.
Thailand - In 2010, the Thai government substantially improved incentives under the Regional Operating Headquarters (ROH) scheme to boost Thailand’s competitiveness as Asia’s operating hub. Foreign companies locating their ROH in Thailand can now enjoy a 15-year tax break on foreign-sourced income and tax concession on income earned in Thailand, although withholding tax on interest payment is not waived. Expatriate ROH staff can also benefit from reduced personal income tax for 8 years.

Thailand shares similar issues with Malaysia on banking infrastructure and availability of tax and legal professionals. The country also has fewer fluent English speakers than Malaysia, Singapore and Hong Kong, which might impact the efficiency of communication between company headquarters, subsidiaries, and the treasury center. Despite these challenges, Thailand’s low-cost environment and efficient labor market have made the country an emerging destination for corporate treasury management.

Creating Value from Within
Cash has become a crucial corporate asset in today’s volatile external operating environment, marked with concerns over global economic uncertainties, currency and commodity price fluctuations, and increased regulatory scrutiny, in addition to heightened industry competition. Faced with these hurdles, multinational companies are realizing the necessity to drive shareholder value from within. Meanwhile, globalization and digitalization have narrowed the gaps between time zones and geographies, allowing more convenient extraction, processing, and communication of data. By adopting the right policies and technologies, treasury activities can be centralized, and treasurers can effectively manage fund flows and related risks from various physical locations without having to be based at company headquarters. This location flexibility opens up opportunities for corporates to re-think their treasury strategies.

As Citi has observed from its multinational clients, more and more companies are looking to set up treasury centers in countries with a favorable tax regime or which offer tax incentive programs. Though the choice of treasury center location varies between companies, treasury centralization has indeed become a corporate priority as companies increasingly seek to reap the benefits of well-managed financial flows.

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