



Positioning For Growth: Treasury's Evolving Role

For Corporate Clients

INDUSTRY INSIGHT



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Asia in Context

Corporates around the globe are looking at Asia as the key engine for their future growth. The region is rapidly growing in stature as a consumer center, a business leader and as an innovator in everything from finance to technology.

With a population that is over half that of the world and is increasing in wealth, technology adoption, and knowledge at a faster pace than anywhere else, the region is increasingly central to most company's growth ambitions. Not only does Asia have three of the top four most populous nations in the world, it also has three of the top four economies in the world (based on purchasing power parity).

The rise of the Asian consumer and the pace of wealth creation in Asia are well documented. In 2009, according to the 14th Annual World Wealth Report 2010, there were over three million millionaires (with net worth of over USD1 million) in Asia Pacific (up 26% year on year) - surpassing Europe and only just behind North America's 3.1 million millionaires. The region is also quick to adopt new technology. Internet usage in Asia grew by more than 650% from 2000 to 2010, double the pace of the rest of the world. While these numbers already look impressive, the potential remains far from exhausted. As an example, while Asia Pacific has the highest number of mobile phone subscriptions in the world, the mobile phone penetration rate - i.e. the number of phone subscriptions as a percentage of the population - remains well below the global average (of 67.3% in 2009), measuring 38.6% in India, and 53.2% in China.

Forces at Work

Rising literacy rates, improving infrastructure, and adoption of new technology means that companies operating in the region need to evolve their business models in Asia very rapidly to stay ahead of the market. As companies position themselves to benefit from that growth, they are faced with treasury and working capital challenges unique to the region. Asia's variety of currencies - some of which remain under foreign exchange controls - as well as its wide range of regulatory structures and areas of underdeveloped infrastructure create a series of challenges for CFOs and treasurers seeking to maximize efficiency for their businesses.

Most companies have moved beyond the crisis-management mode they were in during the global financial crisis and are now looking at ways to put the lessons learned to use in their growth strategies. One of the greatest lessons learned in 2008 and 2009 was that "cash is king." Maximizing working capital efficiency became the key to survival and companies are now seeking ways to build that lesson into their operational models to support their growth plans.

There are five key forces at work in Asia that most progressive companies are facing, and their CFOs and treasurers are focused on:

- 1. Evolving Business Growth Models** – As companies look towards Asia for growth, the business models for many companies in Asia are evolving. Many large companies are also expanding inorganically in Asia, which poses a new set of challenges to integrate new businesses with different processes and technologies. The need to manage costs prudently is stronger than ever before as companies look to maintain and improve profitability in their businesses against rising costs and high inflation in Asia.
- 2. Cautious Credit Environment** – The credit environment remains tight, especially considering the ongoing pressure on the global economy and the concerns that exist around the true strength of the economic recovery. In turn, the uneven pace of global economic recovery is creating uncertainty around funding flexibility and stretching the supply chains of many companies.
- 3. Technology Evolution** – Asia is at the forefront of technology evolution and awareness, and adoption of new technology in Asian businesses is second to none. In many cases, companies are looking at their Asian business divisions to lead the way in terms of new technology adoption, not just in their core businesses but also in their finance and treasury organizations.
- 4. Focus on Risk and Control** – Risk awareness and management has grown multi-fold over the past few years. Companies are focusing on how they develop their institutional ability to “respond to and manage for chance.” This includes supply chain disruptions by natural disasters such as in Japan, and geo-political events such as those in the Middle East. As desire for business growth drives companies into Asia, solutions for fraud prevention and disaster management are of growing interest.
- 5. Evolving Market and Regulatory Environment** – The regulatory environment in Asia continues to evolve, and new developments such as renminbi internationalization are good examples of this. The need to stay close to the end market is stronger than ever before. In the finance and treasury industry in Asia, companies are looking towards their partners to help them stay nimble. This is where an embedded bank partner with a proven track record, strong access to regulators, and continued commitment to Asia is critical. Most of the regulators in Asia welcome dialogue regarding the organizational challenges facing companies, and banks such as Citi can be strong partners, helping companies engage with regulators.

There are a few themes that CFOs and treasurers are focused on as they streamline their companies for growth:

- To simplify the financial processes and adopt new technology to automate the processes.
- To improve the working capital cycles
- To manage risk more effectively
- To monitor the rapidly evolving reform regulations

Treasury Themes

In response to these market forces there are a few themes that CFOs and treasurers are focused on as they streamline their companies for growth, and all of them challenge the traditional thinking and have the potential to change the role that treasury plays within a company.

Firstly, companies are looking for ways to simplify their financial processes and to adopt new technology to automate their processes. The scope of this automation spans the entire spectrum of working capital from order to cash to procure to pay. Many companies are also automating their supply chain processes, reconciliation, and trade and foreign exchange management.

Secondly, companies are focusing on improving their working capital cycles. They are looking at how they can reduce the time between the sale of goods and the point at which they have those revenues in their accounts. This involves more innovative collection methods, centralized processing, and better foreign exchange monitoring. A great example of these innovative methods is mobile collections where Citi has helped its customers to eliminate physical cash from their receivables processes and improve the cash velocity in their working capital cycle. Companies are also looking at how they pay their suppliers and how they can reduce “friction” in their payables processing and stretch their day’s payables without adversely impacting supplier relationships. A number of companies are implementing supply chain finance solutions to unlock working capital. There has also been a strong resurgence of in-house banks to self-finance group companies and act as the first port of call for any investments and borrowing for the subsidiaries. All of the above mean that treasurers need to pay more attention to operations than they have in the past.

Thirdly, as they expand into new territories and remote parts of countries, companies are concerned about risk. Adopting best practices across the business, creating greater transparency and monitoring new standards and regulations are all ways to manage risks that are inherent in a diverse region such as Asia. With many corporate governance requirements, CFOs are on the frontline when it comes to preventing and detecting fraud. Companies are also developing centers of excellence to manage risk more effectively, and are building redundancies into their processes to prepare for chance events. This includes having strong business plan continuity for shared service centers.

Finally, CFOs are closely monitoring the rapidly evolving reform regulations on capital management, foreign exchange and accounting such as Basel III and the Dodd-Frank Act. Treasury departments must plan ahead to respond to these developments and also changes in Asia such as RMB internationalization that present unique opportunities. Treasurers are spending an increasing share of their time on regulation.

Sharing the Responsibility

The financial crisis brought fundamental changes to the way companies look at working capital and the cash that is trapped in the working cycle. Companies are looking for ways to better manage that cash and put it back to work.

One result has been that CFOs and treasurers are educating the broader organization on the issues surrounding the working capital cycle and tapping departmental expertise to find ways to expedite the collection of funds and lengthen payment times for procurement. Some treasurers have instituted cross-business meetings with the goal of making treasury a part of the business rather than just an end-of-chain department. In many cases, educating non-treasury management departments about cash-cycle constraints can change their decision making processes as they become aware of how their habits have a greater impact on the company's profitability. This encourages each department to take responsibility for its own working capital, creating company-wide awareness of the cash management issues facing the company and potentially reducing the need for outside financing.

Measuring Performance

Companies are also paying much more attention to how they measure performance. In the past they used one-dimensional metrics, such as evaluating salespeople based on the value of their sales rather than on how soon they are able to collect the money for those sales. The sales force can keep selling but if the money is not entering the company's accounts quickly enough they are not optimizing the cash flow.

Similarly, on the procurement side, some companies have looked solely at the cost of the goods being purchased, with a constant focus on bringing that cost down. As progressive companies move towards strategic sourcing, many are looking at the cost of purchase more holistically and including the working capital impact in the metrics of the procurement folks.

Citi has developed an award-winning treasury diagnostics tool that allows clients to benchmark their cash-cycle performance to others in their peer group and industry. Once they know where they stand compared to the competition they are able to identify their areas of inefficiency, whether that is technology, treasury management, sales and revenue generation, or procurement. Citi then works with the company to address these problem areas to improve overall treasury efficiency.

Supplier Support

Our clients are finding that their businesses are so reliant on their suppliers that the suppliers have practically become part of their organizations, and financing problems within supplier companies can quickly become problems for our clients. Rapidly growing suppliers may find that their growth aspirations are outpacing the bank financing available to them, based on the credit evaluation of their balance sheets. Smaller suppliers may face more difficulties in accessing credit than our clients do, or when suppliers do find credit it comes at a higher cost, which is eventually passed on to our clients. If our clients, who are often multinational buyers, can step in and give the bank assurances on the size of order flow and security of future payments, suppliers, in turn, can access more financing at better terms than they can obtain based on their own credentials. Citi has been able to help clients support financing of their suppliers in the form of pre-shipment or post-shipment financing, as well as provide advice on how to manage their working capital more efficiently.

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Reviewing Receivables

Asia is becoming an increasingly important consumer market, rather than just a center of cheap manufacturing, meaning that more companies are faced with creating receivables systems to collect payments from the distributors of their products.

Physical payment networks relying on cash or check collection can be unreliable in rural or developing markets, creating delays in getting receivables into the company's accounts. Citi has helped clients complement their existing branch networks through alliances with local banks or even non-financial organizations such as postal offices and convenience stores, creating a network of convenient payment points that increase the efficiency of their receivables. Leveraging technology such as mobile telephony and the Internet to address the challenges of physical infrastructure is a proven mantra for many companies.

Many companies are looking at their supply chains and recognizing that market volatility has raised the risk level of dealing with some of their customers. To some extent this risk can be mitigated through documentary trade, taking the risk away from the client and transferring it to the banks. Another option is creating a financing solution for receivables that takes the financing off the company's balance sheet, allowing them to register a true sale from an accounting point of view.

Centralization

Re-invoicing centers and the centralization of treasury functions are growing in popularity with companies in Asia. Citi recently helped a global electronics company set up a re-invoicing center in Hong Kong to handle all of its Chinese trade. This was a rapid response to recent regulatory changes to renminbi exchange rules, allowing companies to manage their renminbi cash flow outside of China.

Using a re-invoicing center allows the company to consolidate its foreign exchange risk in a more liberal jurisdiction such as Hong Kong, rather than have each one of their many Mainland entities handle it on an individual basis. Centralizing this cash flow in a place with more flexible currency exchange rules means they can operate with less cash because they have less currency exchange risk. It also increases supply chain transparency. As renminbi liberalization increases there will be more intercompany trade in the currency and easier settlement procedures, improving overall cash-flow transparency. A centralized, shared service center that handles all banking functions such as foreign exchange, payments and collections for all business units can also make working capital management more efficient. A company's treasury can then monitor this unit in conjunction with its bank to ensure efficiency and constant development of best practices and processes.

Conclusion

Asia's rapid economic growth is creating a myriad of opportunities for companies seeking new markets. Citi's innovative working capital solutions help to overcome the challenges of accessing those opportunities.

For more information about Citi's Global Transaction Services, please visit www.transactionsservices.citi.com.

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