IT'S ALL ABOUT LOCATION

JAN HUSSMANN OF SHELL, AND **RICKY KAURA** AND **SIMON JONES** OF JP MORGAN OUTLINE HOW OIL GIANT SHELL OVERCAME THE COMPLEXITIES OF SETTING UP A SUCCESSFUL REGIONAL TREASURY CENTRE IN ASIA.

In recent years, the proliferation and interest in treasury centres within Asia has intensified – not that the use of these structures is new, but the complexity and scale of the environment within the region has often been touted as the barrier to an effective utilisation of these approaches. The Asian region does indeed boast complex legal and regulatory challenges, against a backdrop of a plethora of withholding duties and stamp taxes (especially in the South East Asian countries). Despite this, the environment continues to evolve generally for the better, although in some cases taking some small steps backward.

The complexity of the region has been a large contributing factor to the reasons why Asian treasury centre structures have differed from their European and US-based brethren, where the former draws on a rich history of centralised functions within tax-efficient centres such as the UK, the Netherlands and Ireland, being three popular locations. A number of converging trends are coming together to produce quantum benefits to organisations that are willing to fully leverage and unlock the potential of a well-structured regional treasury centre (RTC) shareholder value and technology are the two key facilitators that will enable the true potential of RTCs to be achieved.

In examining the interest in these structures, we find cases of best practice and success stories where much is being achieved despite the complexity of the region, and in this article we outline some of the enabling factors that are facilitating success.

HISTORICAL BACKGROUND. RTCs in Asia have been located in centres that offered the most incentives, and in recent times much attention has focused on Hong Kong and Singapore. Examining and extrapolating recent statistics, one can see Singapore emerging as the de facto location to establish an active RTC for multinational companies (MNC). The reasons are numerous, but can be categorised as:

- the obvious and headline grabbing favourable tax regime;
- a robust and wide withholdings tax treaty network with Asian countries (this has put Singapore in an advantageous position versus Hong Kong);

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- the quality of life and infrastructure;
- the broad application of technology; and
- a predictable political environment;

The reasons for establishing these structures are again numerous, but almost certainly include:

- **Financial –** effective working capital management of a region's activities can provide significant savings. Of course, there are savings associated with staff reductions, but simply eliminating the bid/offer spreads for various borrowing requirements of group companies with surplus liquidity can yield startling savings.
- **Productivity –** deploying standard practice and uniform procedures across the globe via regional treasury structures provides effective and efficient productivity gains. This also allows the effective management of banking relationships. Additionally, the opportunity to re-engineer processes and more effective utilisation of technology provides value.
- **Risk and control –** this is an important area and one that can be the principal driver for the establishment of these structures. Financial risks can be significant, and effective regional and global controls provide the solid foundation for the minimisation of risk.

Given these benefits, casting an eye backward, many treasury centres in Asia were predominantly engaging in activities that provided some benefits but did not really provide the potential quantum results that could be achieved. Principally, activities were centred around fulfilling the role of a co-ordinator from the regional headquarters, within boundaries established by head office. Value

FIGURE 1
SHELL GLOBAL TREASURY LINKAGES.

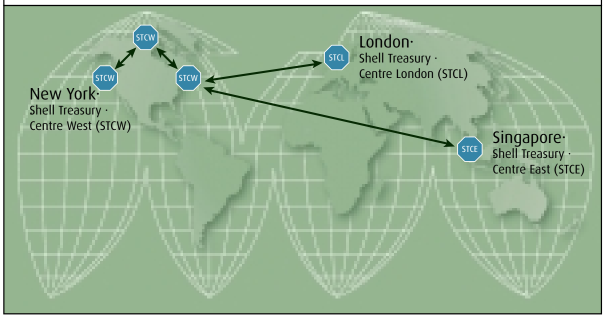
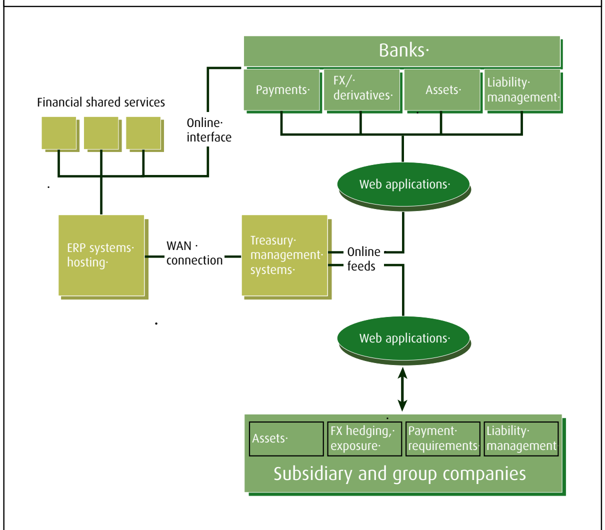


FIGURE 1
REGIONAL TREASURY CENTRES – TECHNOLOGY STRUCTURES.



was provided for regional banking pricing negotiations, and basic advising to group companies. However, activities did not fully leverage real liquidity (or borrowing) concentration or daily management of cash and positions to accelerate the benefits of effective management of working capital.

Typically, foreign exchange was still conducted from multiple legal entities in each country, with treasuries in each country still prevalent and remaining autonomous. Some RTC activity did encompass FX exposure monitoring, but did not engage in any execution or active hedging in the name of the RTC. Where FX services were provided, many local group companies often treated the RTC as yet another bank competing for their business.

A number of organisations established re-invoicing entities, but this added complexity to trading flows and continuing changes in regulations made them less effective to manage FX exposures (an example being Malaysian Ringgit trade flows after exchange controls were reintroduced in 1997).

There have been plenty of cases of organisations simply not realising the benefits promised, especially in the financial area where savings were disappointing (typically only in the region of some $100,000 a year dependant on the size of the organisation in Asia, and scale of operations).

WHAT'S CHANGED? Organisations are looking more carefully at treasury structures to realise larger cost savings and financial benefits. In the past, turnover increases in Asia were flavour of the day, whereas today many organisations are increasingly adopting more rigorous measurements for shareholder value and deriving acceptable returns for shareholders. This has resulted in an increased focus on costs being examined more closely and risk minimised.

This has been against a backdrop of intensive growth and/or acquisition that has led to many MNCs being faced with a substantial increase in turnover, which has warranted more direct control of funds and risks.

Evidence of the in-country treasury being scaled back, or eliminated, as they represent duplication of infrastructure, is becoming more prevalent with large corporate entities, and an evolution of many structures becoming in-house banks – similar to those which are common in Europe, but adapted for the regulations and complexity of the region. This follows the underlying trend of businesses which are increasingly being managed regionally or even globally.

Increasingly, there has been a positive movement away from the sentiment of it all being too complicated due to regional complexities. To form optimal regional global structures requires the regional treasurer to be willing to reach out to regulators, and issues should not arise if they are forming the structures for all the right reasons.

Typically, treasurers are not speculators of currencies and interest rates, simply wanting to manage risks in the most appropriate manner to maximise returns for their shareholders. There is a growing acknowledgement and acceptance of this from central banks, although a well thought out and prepared case aids the process, more progress is still required, but regulator openness has increased substantially in the past five years in Asia.

That said, some countries (such as China and India) will still continue to be the most difficult, but even these have been showing signs of more openness. As Jan Hussmann of Shell states: "Even though some central banks are prepared to listen, you should bring some patience along. One of the big pluses is always to demonstrate that you don't want to speculate against the local currency, and no additional liquidity will be taken out of the FX-market by executing swaps."

Treasury centres have become more global and some Singapore based treasury centres manage global liquidity (a number of US and Japanese companies are good examples) linking liquidity in Japan, Asia and Europe with the US. Passing a global book of positions between Europe, Asia and the US is increasingly becoming the norm.

A key success factor is the bank partnerships forged that allow this to happen in an automated and seamless manner, and hence access to the right banking capabilities. Also important are approaches that facilitate best-in-class account and banking structures being built, with currencies domiciled within their native locations (for example, US dollars in New York, euros in London, Japanese yen in Tokyo), rather than in inefficient multi-currency location structures where charges can be high and value dates less flexible so float can be trapped in the system.

A key aspect is the bank's own capabilities and specifically those of its treasury to be able to provide this. JPMorgan built its multi-regional cross border automated platforms some years ago, and today these are being increasingly leveraged by numerous US, European & Asian clients to provide a global US$ daily position, typically being invested (via an automated sweep) in an off-balance sheet AAA-rated money market fund.

THE SHELL STORY. Following on from the success of its European treasury centre, Shell now supports RTCs in Asia and the Americas. Its substantial RTC in Singapore was established in 2000 (one of the largest in Asia from an infrastructure and capital perspective) providing a tax-efficient structure that today services more than 40 operating companies in 17 countries, with a turnover of $25bn per month. All cash and risk management functions are in the process of being migrated to the RTC, with a change in focus of bank relationships from local to regional.

Shell has been working extensively to more deeply integrate the three treasury centres, enabling 24-hour coverage and the globalisation of key currency (such as the US$) cash management. With sub-treasury structures to alleviate regulatory challenges in specific countries, it has in place a structure that is providing quantum savings. As Jan Hussmann of Shell states: "The overall savings for Shell on bank-spreads retained in-house from the three centres is more than $10m per annum, and the trend is upwards."

'IN ADDITION TO MONETARY SAVINGS, ANOTHER REASON FOR SETTING UP TREASURY CENTRES FOR SHELL IS IMPROVED CONTROLS'

In addition to monetary savings, another reason for setting up treasury centres for Shell is improved controls. Shell had numerous accidents where the company lost money due to mismanagement in local treasuries. As Jan Hussmann explains: "In one instance a company lost around $1.8bn predominantly due to lack of controls." Financial aspects are not alone in terms of achievements. The treasury centres have delivered on all their stated promises – a process facilitated by having a clear business case before the RTCs were established, based on various objectives.

TECHNOLOGY, A MAJOR ENABLER. The advent and use of technology has had a major impact on what is possible, and building a hub (RTC) and spoke (sub-treasuries) structure is more possible than before. Web-enabled treasury management systems are feeding this trend and information centralised on one database regionally or globally, allowing access from multiple locations in the region continues to fuel this transformational change. Real-time wide area network interfaces to multiple enterprise resource planning (ERP) applications are now common, and online dealing access to all in-country markets in Asia, regardless of where the RTC is located, is becoming more feasible.

Increasingly, RTCs are interacting more closely with back office and accounting operations in shared service centres (typically in India, Philippines or Malaysia).

As an example, in the case of Shell, an entity in Australia lays off any FX-exposure, as well as any funding or depositing needs with Shell Treasury Centre East (STCE) by recording the required deals in a web-based treasury application. The pricing for all deals is pre-agreed using market benchmarks to ensure arm's length pricing and making price negotiations on a day-to-day basis obsolete. The deal is automatically downloaded from the web-based application into the global treasury management system for both entities and currently automatically recorded in the ERP system of STCE. In the near future, the deal for the Australian entity will be automatically booked into their ERP system as well (outsourced to an in-house shared services centre in Malaysia) across the wide area network (WAN). The accounts between STCE and the Australian entity will be cleared automatically, the daily balances are recorded in an in-house interest bearing current account.

Historically, this would have been by fax, phone and manual accounting entries into both ERP systems. Additionally, banking systems are increasingly being seamlessly integrated into the core operations and system infrastructure of the organisation. In the case of Shell, JPMorgan's EFT-system is currently fully integrated into the treasury management system, as well being utilised in a WAN that encompasses many centres, including the shared service centre in Kuala Lumpur.

Shell is in the process of implementing host-to-host connections with its banks. The treasury centres will use the SWIFT-network for payments by setting up closed user groups within their main cash management banks.

A GLOBAL CONCERN. A highly competitive environment, against a backdrop of extensive investments in technology, is providing increased focus on increasing shareholder value. Treasury functions are becoming ever more strategically important to the organisation and tools and techniques to maximise the effective management of working capital are more accessible.

Technology infrastructure is being used more widely, with more focus on integration into ERP systems dove-tailing functions within treasury (much of which is increasingly outsourced internally or externally) with that of accounting, procurement and sales administration – itself being consolidated within shared service environments.

The conundrum of the RTC is no longer just regional, but very much an integral discussion on the globalisation of certain treasury activities. These trends are providing more focus on the activities, and potential activities of RTCs, where substantial benefits can be enjoyed with a robust and pragmatic approach. Key success factors centre on the right partners, internally from executive sponsorship, as well as the appropriate banking partnerships that facilitates these processes.

With the right tools and intellectual resources, quantum benefits can be achieved, and as Shell's example illustrates, unlocking significant value to the stakeholders of the organisation.

Jan Hussmann is Director of Shell Treasury Centre East.
Jan.Hussmann@shell.com
www.shell.com

Ricky Kaura is Vice President and MNC Team Head, South & South East Asia, JPMorgan Treasury Services.
ricky.kaura@jpmorgan.com
www.jpmortan.com/ts

Simon Jones is Vice President and Asia Head, Financial Advisory & Consulting at JPMorgan Treasury Services.
simon.jones-sg@jpmorgan.com
www.jpmortan.com/ts