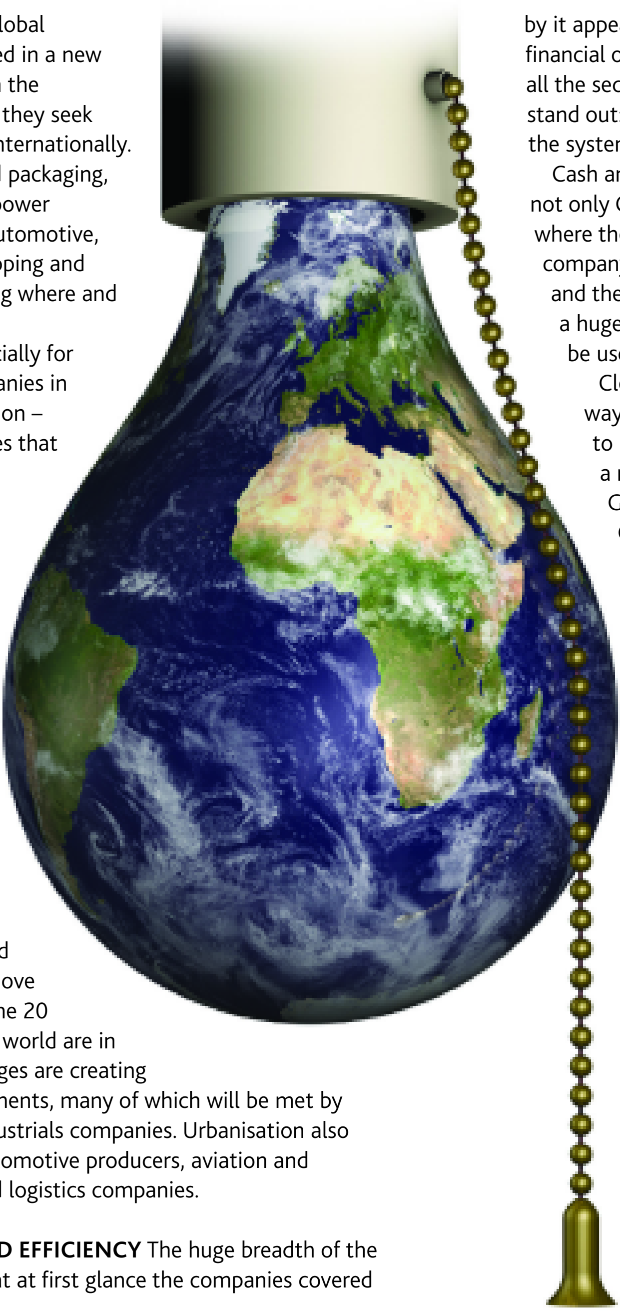
The new thinking

AS THE WORLD MOVES INTO A GROWTH ENVIRONMENT DOMINATED BY THE GLOBAL GROWTH GENERATORS, **DAVID ALDRED** AND **BRENT FLYNN** CONSIDER HOW COMPANIES SHOULD OPERATE AND MANAGE THEIR CASH TO SEIZE THE OPPORTUNITIES.



The recovery of the global economy has ushered in a new era for companies in the industrials sector as they seek new growth opportunities internationally. Companies in the paper and packaging, heavy machinery, cement, power technology, construction, automotive, aviation and aerospace, shipping and logistics sectors are changing where and how they do business.

The opportunities – especially for diversified industrials companies in manufacturing or construction – now lie primarily in countries that Citi calls Global Growth Generators. These countries have the greatest growth potential based on domestic saving and investment, demographic outlook, health, education, quality of institutions and policies, and openness to trade.

One important phenomenon that is driving corporate investment in Global Growth Generator markets is urbanisation: an estimated 100 million people a year move to urban areas while 17 of the 20 fastest growing cities in the world are in these countries. These changes are creating huge infrastructure requirements, many of which will be met by international diversified industrials companies. Urbanisation also creates new markets for automotive producers, aviation and aerospace, and shipping and logistics companies.

CONTROL, VISIBILITY AND EFFICIENCY The huge breadth of the industrials sector means that at first glance the companies covered by it appear to have little in common. However, for chief financial officers (CFOs) and treasurers of companies from all the sectors contained within industrials, three themes stand out: the need for control, visibility and efficiency of the systems they use to manage cash.

Cash and how it is managed is now a board-level concern: not only CFOs and treasurers but also CEOs want to know where their company's cash is at any given time, who the company's counterparties are, how their cash is collected, and the risks inherent in the company's processes. There is a huge appetite for information and knowledge that can be used to improve liquidity.

Clear, accessible information – delivered in a timely way using a consistent format – is essential to be able to make informed decisions. As the world moves into a new global growth environment dominated by Global Growth Generator countries such as India, China and Brazil, information has become ever more important. These markets are often highly regulated and it is crucial to understand the implications of that in terms of moving cash.

Notwithstanding regulatory barriers and exchange controls, developments in technology mean there is now the potential to deliver control and visibility of cash positions located almost anywhere in the world. However, surprisingly many large multinationals still do not have structures in place – outside the developed banking markets of North America and Western Europe – to enable them to oversee and manage their cash globally.

Necessarily, the challenges associated with gaining control and visibility of cash in rapidly growing Global Growth Generator markets in Asia, Latin America, the Middle East and Africa are greater than in developed markets with mature banking sectors. Moreover, it is important to understand that these markets are very different, not only from more developed markets where companies have operated centralised cash management structures for decades, but also from one another.

NEW THINKING FOR NEW MARKETS Working out what treasury model is most advantageous for a company can be a significant challenge. Often industrials companies are decentralised and have complex corporate structures. For example, in the auto sector, there may be multiple entities in a single country that are involved in manufacturing, sales, reselling, franchising and finance. In addition, there may be scores of companies operating as part of the manufacturing supply chain.

AS THE WORLD MOVES INTO A NEW GLOBAL GROWTH ENVIRONMENT DOMINATED BY GLOBAL GROWTH GENERATOR COUNTRIES SUCH AS INDIA, CHINA AND BRAZIL, INFORMATION HAS BECOME EVER MORE IMPORTANT.

With companies now more global than at any time in the past, many are asking whether they still need people on the ground to manage local regulatory and compliance issues. In Global Growth Generator markets the answer is invariably yes. Local treasury hubs are essential for many large industrials companies because of timezone concerns and issues associated with trapped cash and the regulatory environment.

Corporates in all industrial sectors need to assess the extent of their business in these new markets in order to understand the scale and growth potential of their operations. They then need to consider whether it is worth investing to gain control of their cash and liquidity in these countries and regions. This process must take into account the potential regulatory and tax issues, but ultimately must be driven by the potential economic benefits to the company.

Companies in industrials sectors are increasingly finding that the scale of their operations in China, for example, warrant the creation of a treasury hub in-country separate to the rest of Asia.

Similarly, depending on the scale of their operations in Brazil, some companies are realising that it makes sense to separate their business there from the rest of Latin America or that it is appropriate to set up a hub in Dubai covering the Middle East rather than try to manage it from Europe. Essentially, the decision comes down to the importance of visibility in that particular market to the overall group.

This new thinking does not affect existing treasury hub structures in western Europe and North America, which have developed over many years and are effectively set in stone. However, it does run contrary to common practice over the past decade, which has relentlessly emphasised the importance of centralisation through shared service centres and common ERP systems, for example.

What has changed is the focus of many businesses. Centralisation strategies were developed for markets in North America and western Europe. Both regions are essentially homogenous in terms of rules, requirements and operating conditions (in Europe, the integration of the EU economy has driven this process). In contrast, Asia and other Global Growth Generator markets are far from homogeneous.

While it is important to consider the diversity of countries in which a company operates and to develop treasury structures accordingly, that should not be at the expense of visibility and control. While day-to-day treasury management might be conducted in Brazil, for example, because the country is becoming a core part of the company's global revenues, it is essential to be able to aggregate the information from Brazil with operations elsewhere in the world.

DIVERSIFIED INDUSTRIALS For diversified industrials companies in the paper and packaging, heavy machinery, cement, power technology and construction sectors, the rapid growth of Global Growth Generators offers enormous opportunities. Many of the world's largest engineering firms, for example, are already among the most global of all companies – often operating in more than 100 markets. Nevertheless, the pace of their expansion internationally continues to accelerate. In particular, infrastructure spending in the Middle East and Asia is booming as countries bid to keep pace with rapid economic growth.

Similarly, in the US, infrastructure spending is a core element of the stimulation package designed to boost the economy. The American Recovery and Reinvestment Act of 2009 is worth $787bn and covers roads, bridges, public transport and dams, as well as the electricity grid and investment in alternative power generation. The package is the largest since the 1950s, when the interstate highway system was created.

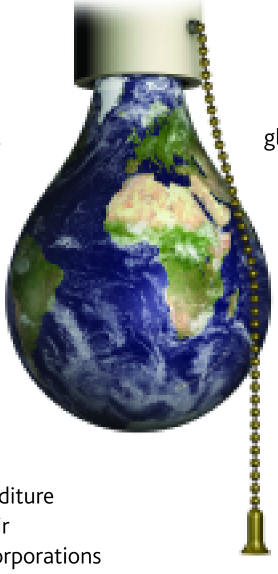
As opportunities arise – both in the US and in the Global Growth Generator markets – some of the companies that win contracts will be operating in a new market for the first time, raising familiar issues about how capital will be raised and how they will manage cash.

Likewise, the range of banking solutions required by a German engineering company embarking on a major infrastructure project in water or renewable energy in Africa, for example, is vast and changes throughout a project lifecycle. In the early stages of a project, corporates may need help with financial instruments to facilitate bidding, such as bid bonds or performance bonds. Once a bid has been won, a joint venture may be established that will require risk mitigation or escrow facilities to manage cashflows – something that often requires the involvement of a trusted third party, such as a bank.

Capital expenditure for a project may be partly funded by export credit agencies – which have become increasingly important in recent years – debt finance from banks or capital markets, or use of internally generated cash. Then, once a project is operational, the company will need accounts payables and receivables and liquidity management solutions. There may be opportunities to use electronic card solutions to pay employees (as frequently occurs with migrant workers in the Middle East, for example). Throughout the lifetime of a project, companies may require sustainability solutions, such as carbon trading and associated settlement services.

Although many of these product areas are delivered by different parts of a bank, each is linked and – from the corporate's perspective – is inseparable. Citi, for example, is focused on understanding the ecosystem of products and services that are required by companies in different industries and at different stages of their development to help clients achieve their goals. Equally, corporates need to ensure that they work with a bank that not only understands the home market of the company expanding but is also an integral part of the market it is expanding into.

GLOBALISATION IS NOW ABOUT ACCESSING MARKETS AND MAKING DECISIONS BASED ON LOCAL CIRCUMSTANCES.



AUTOMOTIVE Diversified industrials companies are tapping the unique opportunities of a rapidly urbanising population in Global Growth Generator countries. Companies in other industrials sectors such as automotive, aviation and aerospace, shipping and logistics also face challenges in their own global operations, which are often expanding into many of the same fast-growing territories.

The complex nature of automotive fabrication makes it the archetypal industrial sector in terms of highlighting broader trends. For example, many leading global automotive manufacturers have announced plans to open new plants in China – which is now the world's largest auto market – in response to a phenomenal growth in sales in the country. Facilitating that growth – and the construction of a new plant – is inevitably a major challenge.

Automotive companies expanding their manufacturing capabilities into China in order to increase capacity significantly are likely to require funding for capital expenditure and careful consideration of treasury requirements as their businesses grow. Given the exchange controls in China, corporations need to work with their banks to assess how cash can best be used in-country or whether there are opportunities to expatriate cash through dividends, for example, given the nascent liberalisation of the renminbi.

Automotive companies expanding on such a scale should also effectively manage their supply chains. For example, they must be flexible in their approach to sourcing materials. Initially, sourcing components for production may be done both locally (for instance, in China) and from Europe, but as the scale of production in China increases, it may become financially efficient to source a greater proportion of parts domestically. However, an expanding company needs to be aware of the potential implications of such a decision in terms of quality control and consistency.

Similarly, companies will need to consider the credit risks associated with new suppliers: an assessment of the robustness and quality of suppliers must extend beyond the parts they will produce for their cars. An auto manufacturer must also make decisions about costs. Will it aim to source parts at a lower cost to those sourced in other regions? What payment terms will it set for suppliers in China and how do they differ from common market practice?

More generally, automotive manufacturers are under pressure to innovate continually, especially in relation to environmental performance. Given the financial constraints that many companies in the sector face, such a responsibility can be onerous. Freeing up cash for new investment in plant and model design through more efficient management – and ensuring a cost-effective supply chain – is therefore crucial.

TRANSPORTATION The transportation sector, which includes passenger travel, freight and logistics by air, sea or land, is central to the globalised economy. Transportation companies inevitably go where their customers need them to operate. Consequently, in recent years, as customers' supply chains have become more complex, so transport companies have expanded to cover larger swathes of the world. Trade routes have been opened that only a decade ago would have seemed impossible.

The challenges faced by transport companies are therefore the same as those faced by their clients. As global trade expands, new facilities (such as ports) will be required and they will need capital expenditure. From a treasury perspective, transport companies also face the same kind of challenges as their clients. As they expand into new markets, they need to consider how they will manage new cashflows from operations. Will a team be required to manage them in-country? If so, will they be local hires or will international expertise be necessary? To what extent will it be possible to take cash out of the country, and, if it can be taken out, how will it benefit the group?

A NEW GLOBALISATION As the world moves into a new growth environment dominated by Global Growth Generator countries, companies have reassessed how they need to operate in order to harness the opportunities available. Moreover, they have reconsidered how to manage their cash to reflect their ever more complex operational footprints and the need for financial flexibility.

Citi understands Global Growth Generator countries – and the enormous implications of their rapid growth for the global economy and trade dynamics – and is therefore well positioned to offer its clients the suite of solutions they need.

Globalisation is now about accessing markets and making decisions based on local circumstances. The only constant across all markets in which a company operates must be information. While cash may not be easily transferable from some Global Growth Generator markets, timely and accurate data is. Consolidation of that data is the key to success in the new global economy. Without that aggregated information, companies cannot make effective and informed decisions and therefore cannot continue to prosper in what is an ever more competitive environment.

David Aldred is managing director, EMEA industrials sector head, client sales management, Global Transaction Services, at Citi.
david.aldred@citi.com

Brent Flynn is managing director, North American industrial sector head, client sales management, Global Transaction Services, at Citi.
brent.flynn@citi.com

www.transactionservices.citi.com