# Nothing to fear

**ESTABLISHING BANKING ARRANGEMENTS IN AN EMERGING MARKET MAY SEEM A DAUNTING PROSPECT, BUT IT'S EASIER IF YOU KNOW WHAT TO EXPECT, SAYS SALLY PERCY**

First the good news. Your company, a manufacturer of market-leading widgets that are radically transforming the lives of consumers around the world (insert more effusive marketing speak as applicable) has just opened a subsidiary in an emerging market. You have never seen the CEO this excited since you started at the organisation as a lowly treasury analyst some 15 years ago. Double-digit growth is virtually assured for the next decade, he tells the (somewhat disbelieving) workforce assembled for the usual quarterly update meeting. And the share price is about to go through the roof.

Now for the bad news. The new subsidiary will need bank accounts, FX services and to be able to move money across borders and repatriate it to the centre. Did the CEO think of these matters before he formed the subsidiary? Was treasury even consulted on the strategic plan? Not this time, unfortunately, and it's down to you to make the best of a potentially bad situation. So what do you do? Well, if ever there were a situation that required you to reach for your copy of *The International Treasurer's Handbook*, then surely this is it.

Establishing banking arrangements in emerging markets can seem a daunting prospect for a treasurer who is used to working with the familiar banks, relationship managers and product offerings that exist in Europe. Despite the heightened concerns over counterparty risk that have arisen since the collapse of Lehman Brothers in 2008 and the fact that most treasurers monitor their banks closely as a result, they may naturally feel more comfortable dealing with global brand names rather than with institutions of unknown quality and questionable creditworthiness located thousands of kilometres away. But is this wariness justified? Not entirely, it seems.

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"Treasurers need to lose the fear of going into emerging markets," observes Juan Pablo Cuevas, head of global transaction services for Latin America and the Caribbean at Bank of America Merrill Lynch. "Emerging markets are very different from how they were 25 years ago. The Asian, Latin American and South African markets have made many changes over recent years, and incorporated lessons learned from the more mature economies."

"In many emerging markets, there is pretty good banking," concurs Raj Agrawal, president of business solutions at money transfer service Western Union. "The banking infrastructure is there, but it's not as developed in local markets, especially in financing."

## Global versus local

Nevertheless, there is still plenty for treasurers to consider when banking in an emerging market. For example, do they use a global bank, a local bank or a mixture of both? With a global bank, treasurers get the comfort of dealing with an institution they are familiar with and people with whom they may already have existing relationships. Often, global banks won't have a presence in an emerging market beyond the capital city, however, and in some countries they won't operate at all. By contrast, local banks have indigenous knowledge and usually maintain an extensive branch network, which is invaluable for making payments to suppliers and employees. But their credit ratings may be lower than those of global banks and they are more vulnerable to political intervention such as sequestration. Fortunately, one upside of the eurozone crisis and the Cyprus bailout fiasco is that treasurers are acutely aware of the political risks that come with doing business in different jurisdictions.

It usually makes sense for treasurers to work with both a global bank and a local bank or banks where they can. Typically, companies will set up collection accounts with various local banks and then move their cash into a concentration account with a global bank. "Global banks know their clients and understand what they're looking for," says Cuevas. "But global banks can't normally fulfil 100% of the client's needs and neither can local banks. So an integrated partnership of both global and local bank services is necessary." Luckily, global banks tend to have established relationships with local banks and can advise treasurers on which ones to work with and set up valuable introductions.

The strength of the local branch network that your organisation needs will vary from location to location, says Sanjay Dalmia, executive vice president global cash management and CEO of

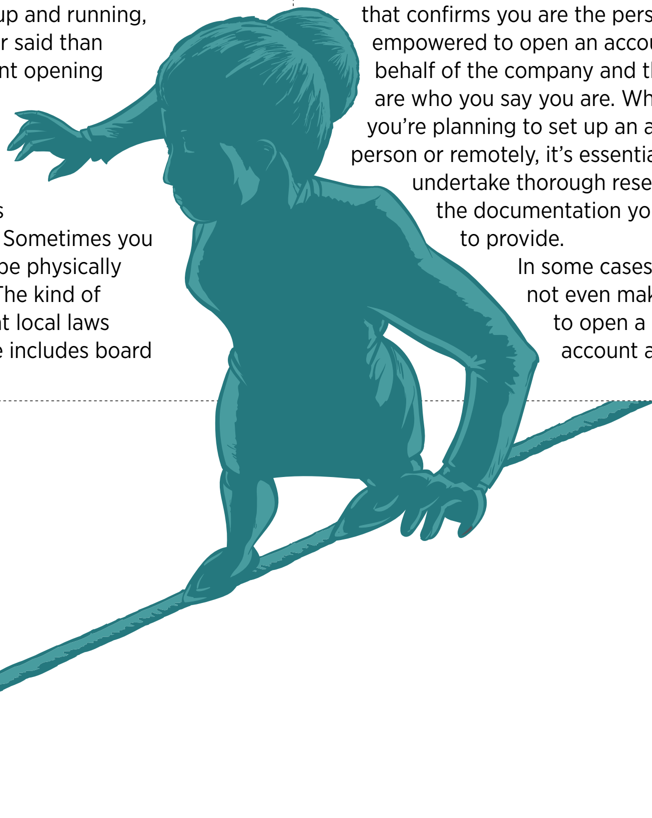
banking software developer Fundtech India. "If you're in Singapore or Hong Kong, it may not be as important as in other regions. In India or Thailand, however, it is very important because it affects whether you can get money to and from remote locations." He also points out that companies that need to process e-commerce and credit card payments will have special technology and integration requirements that all local banks might not be able to meet.

Richard Martin, global head of transactions product management, cash management at Barclays, points out that global banks provide a consistent level of service and have standardised terms and conditions with a supporting schedule for each local country. They also offer their clients a range of connection solutions that local banks might not provide, such as host-to-host channels and corporate connectivity, particularly SWIFT. "We take it for granted in many ways. But one of the things that you have to look at with a local bank is what is its usage and connectivity into SWIFT," advises Martin.

Once you have identified the bank you want to work with, the next thing to do is to get an account up and running, which can be easier said than done. "Bank account opening procedures can be arduous," says Martin. "You may need to present original documents or certified copies. Sometimes you may even need to be physically present yourself." The kind of documentation that local laws are likely to require includes board resolutions, the company's certificate of incorporation, and its memorandum and articles of association, as well as evidence that confirms you are the person officially empowered to open an account on behalf of the company and that you are who you say you are. Whether you're planning to set up an account in person or remotely, it's essential that you undertake thorough research on the documentation you need to provide.

In some cases, it may not even make sense to open a bank account at all. "The advantage of having your own bank account is that it allows you to locally source money to make payments more effective so you don't have to go through the correspondent banking system," notes Agrawal. "But there are costs involved with having local bank accounts. You have to monitor the accounts and the funding that goes into or out of them."

All emerging markets are not the same, of course, and some inevitably present greater problems than others. Venezuela is notorious for being difficult to move money out of because it has strict exchange controls to avoid the flow of capital abroad. Argentina also dislikes US dollars leaving the country. In Africa, there are nations that do not even



## CASH POOLING

- **The feasibility of cash pooling in Asia will differ according to the market in question. "Cash pooling regulations in Asia vary from country to country," says Faisal Ameen, head of treasury management product, Asia Pacific, global transaction services at Bank of America Merrill Lynch. Some of the more liberal countries allow for cash repatriation and participation in regional pooling structures, while in others, regulations are still evolving and can restrict the options available where cash pooling is concerned.**
- **Across Africa, physical cash pooling is restricted by local exchange controls, which prevent efficient cross-border sweeping of cash, as well as the risk of a tax or other charge being incurred. Notional pooling is either extremely limited or not possible at all.**
- **The currency risks associated with Latin America mean that most trade takes place in US dollars, which facilitates cash pooling in those countries that will allow it.**

have a functioning banking system – Somalia, for example – while others have exchange controls, such as Mozambique, South Africa and Zimbabwe. In those countries, there are restrictions affecting cross-border payments – for example, a payment must relate to a trade transaction, rather than just be a movement of corporate funds. Regulations in Egypt, meanwhile, prohibit initiation of payments via online banking. Then there are countries affected by economic and trade sanctions imposed by the US Office of Foreign Assets Control, such as Cuba, the Democratic Republic of the Congo, Iran and North Korea. It can be extremely difficult to make payments that involve those countries or to establish banking relationships within them.

Another challenge posed by emerging markets is the quality of the infrastructure that exists, particularly with regard to telecoms and connectivity. Online banking can be very unreliable in markets where connectivity is an issue. And fraud is a perennial risk, whatever the nature of the market that you are operating in – developed or emerging. "There are some markets where fraud is more prevalent," says Martin. "You can protect yourself by ensuring that you have strong operational security controls. You have to reconcile bank accounts strictly and ensure that those who are authorised to initiate payments are monitored and controlled."

## Repatriation

Repatriation of funds back to the centre is inevitably a major concern for treasurers whose companies have subsidiaries in emerging markets, especially when there are also concerns around the counterparty risk posed by local banks. "If you can't sweep money out of the country, you're more than likely to be left with deposits in those banks," observes Martin. "You could invest money in other instruments, for example, central bank bonds. But you probably don't want to tie up your money in government securities." Agrawal believes that where there is a will, there is a way. "There are controls and regulations," he says, "but they are never insurmountable. It's a cost of doing business in those markets."

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Cuevas advises treasurers to ensure that they have a good understanding of cash repatriation processes, as well as local tax and legislation, in the emerging market where they are operating. For example, a transaction may be subject to tax because it is viewed as a payment to the corporate centre. "Every time a treasurer thinks about repatriating cash, they will need to consult with a tax adviser," he says. "Some companies do an effective job of moving money out of emerging markets." He also says it's important that treasurers get a firm handle on the market practices that exist locally and don't assume that processes that worked for them in developed markets will work in an emerging market. "We've seen treasurers try to do things that have worked in Europe and they have failed," he warns.

FX risk is an ongoing issue for treasurers with activities in emerging economies since those markets will often lack the liquidity to support large-value transactions. In addition, local currencies can be very volatile, particularly if an election is taking place. Opportunities to hedge FX will vary according to the country, but because hedging is a sophisticated activity, it scarcely exists in some economies, particularly in Africa. Besides FX risk, there can be huge variations in interest rates and inflation rates in emerging markets, which European treasurers will not necessarily be used to managing. In addition, borrowing to fund local operations can be very expensive since central bank rates in some emerging markets are higher than 10%.

Banking relationships can be tricky to handle at the best of times, but even more so if you are a long-haul flight away from your bank manager and operating in a different time zone. That's why Dalmia emphasises the importance of having personnel on the ground, who "understand the rules". "You need to localise as much as you can," agrees Agrawal, "so that you can take advantage of local regulations."

Inevitably, there will be headaches along the way, but the opening of a subsidiary in an emerging market is ultimately an exciting project for treasury to be involved in. As Cuevas puts it: "The emerging markets are growing. This is a great opportunity to expand and look for acquisitions." And given economic conditions in Europe at present, that's surely the best news of all.

**Sally Percy is editor of *The Treasurer***

## HELP WITH EMERGING MARKETS

**For useful advice on banking in emerging markets, see *The International Treasurer's Handbook* and *The Asia Treasurer's Handbook*, which are both published by the ACT, and *The Treasury Managers' Handbook for Africa*, produced by Barclays.**