Out of reach

TRAPPED CASH IN FOREIGN COUNTRIES MAY BE ONE OF TREASURERS' BIGGEST BUGBEARS. BUT IS IT SUCH A HEADACHE AFTER ALL? GAVIN HINKS REPORTS

Sometimes the money is just out of reach. You've done all the hard work, invested in distant shores, built up a business and reaped the rewards. But now, when you need to get a grip on that money, it's not as easy as you had hoped. This is the crux of trapped cash: it's money your company legitimately earned overseas but, for diverse reasons, you just can't bring it back.

Treasurers in companies with overseas operations will be all too familiar with the problem. And with Europe's economy still wracked by uncertainty, the issue of managing trapped cash has been given a new urgency.

For revenues earned far afield in countries such as China, Brazil and India, factors including FX controls, capital requirements, taxation (overseas as well as at home in the case of US companies) and regulation can all play a part in executives concluding that money is well and truly stuck. The cost and regulatory hoops seem like real barriers to repatriating money.

In the US, where companies often choose not to repatriate cash earned abroad for taxation reasons, and not because of controls in foreign jurisdictions, so-called 'trapped cash' is a major point of contention between global companies on one side, and regulators and the government on the other. Investment bank JP Morgan estimates that anywhere between 25% and 40% of cash held by non-financial S&P 500 companies is sitting in offshore jurisdictions. That could be somewhere between $400bn and $1 trillion in cash deposits. (For more on the US and trapped cash, see Trapped cash: a US perspective on page 34.)

There are no similar figures for UK and European companies for money apparently stuck overseas. Anecdotally, however, the crisis in the European banking system has meant that cash and liquidity management has become more important to treasurers than ever and the significance of trapped cash is re-emphasised each time there is a new twist.

The problem of trapped cash is exacerbated by the historic legacy (a distant memory for many) of happy economic times

According to Simon Jones, head of sales for treasury services at JP Morgan, the issue is an up-to-the-minute concern because, despite reports of faltering growth, operations in emerging markets are the ones producing significant results for international businesses.

"Because of the challenges in Europe, the key markets that have grown have been those more regulated markets. A lot of multinational companies have been doing very well and generating lots of cash in those markets. But the difficult thing is managing that cash," he says.

The financial crisis has not only thrown a spotlight on what treasurers do, but it has also given them extra weight in the boardroom, says Naresh Aggarwal, a senior manager at Big Four firm PwC. "They've gone from meeting the board once a year to meeting them each month. It's an opportunity for treasurers to shine."

The problem of trapped cash is exacerbated by the historic legacy (a distant memory for many) of happy economic times when money was easily made, funding was freely available and managing cash was not a major priority.

According to Martin Hoad, a director in treasury services at Deloitte, ready supplies of cash and debt in the past meant the effort to 'extract' was not well disciplined. "The emphasis has been on cash generation, not on usable cash flow," he says.

But is cash really trapped?

While the moniker 'trapped cash' implies money that is incontrovertibly captured, the position is in fact not quite so emphatic. Advisers prefer to use terms like 'restricted' and 'inaccessible' to better describe the qualities of overseas cash piles. In other words, trapped cash is hampered rather than completely blocked. There are few places where foreign currency is in such short supply that money simply cannot be moved at all.

Cash can appear trapped for a multitude of reasons. For example, some countries may need capital to remain onshore for a fixed period of time or they may have rules governing debt-to-equity ratios; resident companies can be blocked from holding foreign currency accounts offshore; intercompany lending may be restricted; FX controls may exist in some form; or there could be taxes on cross-border cash flows.

Enthusiasm for moving the money will therefore depend on a company's business model, its cash needs, local law and regulation, the cost involved and its willingness to plan its liquidity strategy. Aggarwal says it "becomes

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a commercial decision as to where I leave it – somewhere else, or bring it home".

Bringing money home may feel like a priority. Cash could be in demand to support working capital, service debt or be put to more profitable use than loitering in a bank account, earning unimpressive rates of interest. JP Morgan's head of global liquidity, Robert Deutsch, points out in a paper, *Trapped Cash: Local Market Challenges*, that ensnared cash is difficult to include in a global 'liquidity strategy' or into any kind of normal corporate cash use. According to Deutsch: "It can be particularly frustrating when positive balances in these markets cannot be used to offset borrowings elsewhere."

Offsetting debt is an obvious driver for wanting your money right here and right now, but the crisis has also provided two other critical reasons for having it tucked up where it can be closely watched. These reasons, says Aggarwal, are the prospect of fraud and counterparty risk. Fraud is an unwelcome bedfellow to straitened economic times; when times get tough, the incidence of financial crime rises. Meanwhile, the crisis of 2008 and the current plight of the eurozone have heightened concerns over where you keep your cash on deposit.

HOW TO FREE YOUR CASH

Metrics
Advisers say it is important to make sure that all the right information is available (visible) before deciding that cash is 'trapped'. Leon Cane, a director in the treasury tax group at KPMG, says: "This is looking at the parameters by which companies judge cash is trapped. Companies don't always accurately quantify the level of constraint."

Processes
Often, dealing with FX rules is not a matter of cost, but procedure, especially when a business has to notify or seek permission from a regulator, or a central bank, to move money. The difficulty may not be the jurisdiction, but local offices of the company itself. Cane says: "Even if there are procedures to get cash out, how efficiently are they being undertaken?" He suggests treasurers aim to understand processes, and how long they should take, and ensure local staff are on top of them.

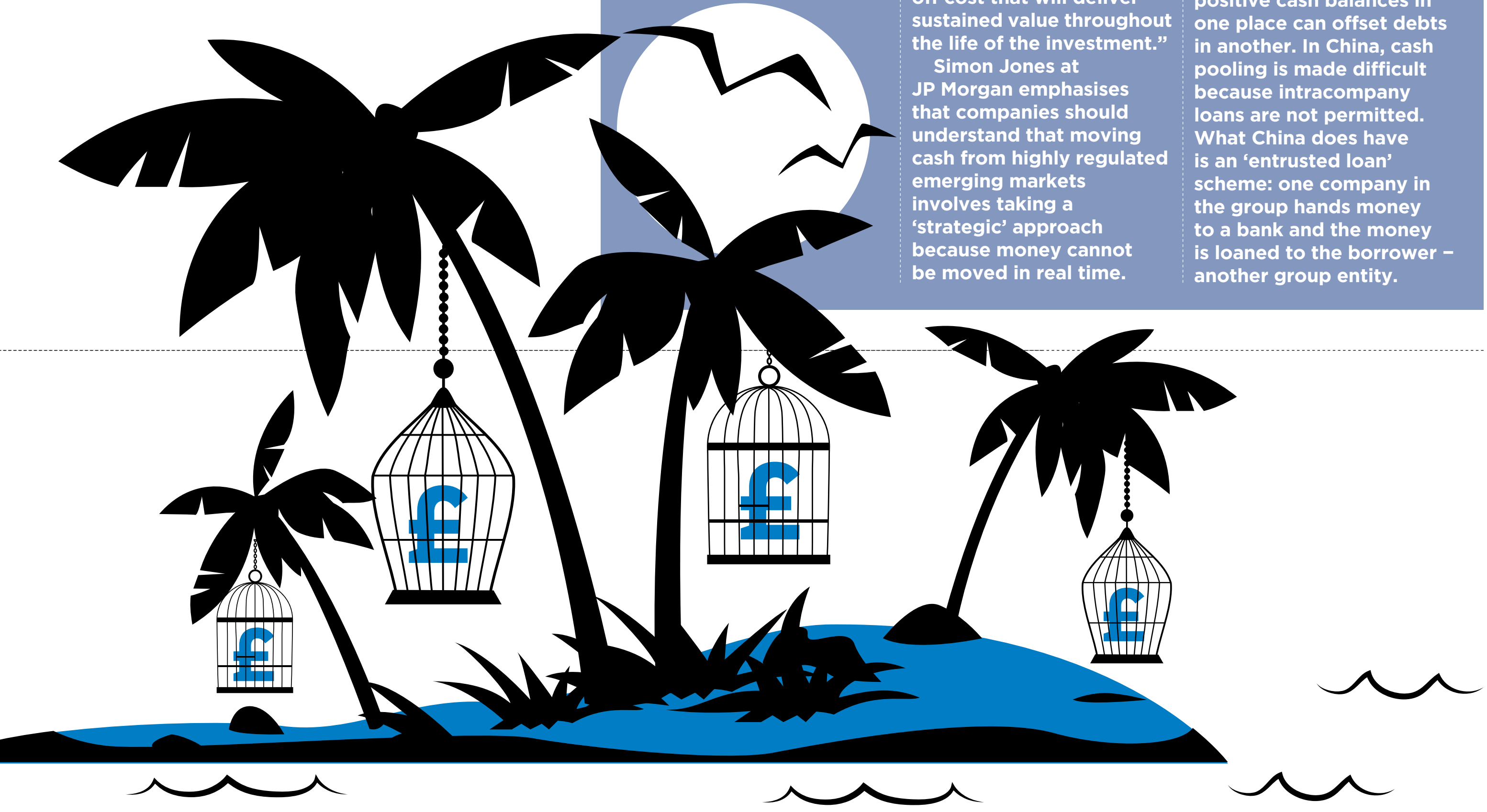
Business model
Business models can be adjusted to reduce the stock of cash that is trapped. One way of doing this is by generating costs in the local currency in which revenues are being earned. Mark Raddan, a partner at KPMG, cites car manufacturers who have moved their manufacturing to China. According to Raddan: "Once you get into structurally changing business models, it's time intensive, but it's a one-off cost that will deliver sustained value throughout the life of the investment."

Simon Jones at JP Morgan emphasises that companies should understand that moving cash from highly regulated emerging markets involves taking a 'strategic' approach because money cannot be moved in real time.

Dividends
For many companies, the main route for managing revenues is to send them via dividend payments. Some countries allow only a single dividend per year. One way to tackle this is to manage the business through multiple entities, each with different year ends. Payments can then be staggered.

Dollar accounts
Emerging economies may be less restrictive with dollars than their own currencies and may allow companies to hold offshore dollar accounts, which can be used for making payments for imports.

Recycling cash
In many cases, companies look to 'pool' cash so that positive cash balances in one place can offset debts in another. In China, cash pooling is made difficult because intracompany loans are not permitted. What China does have is an 'entrusted loan' scheme: one company in the group hands money to a bank and the money is loaned to the borrower – another group entity.



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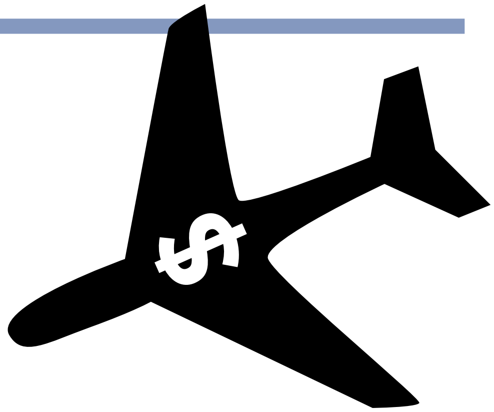

arrivals

According to Aggarwal, our view of banks and the risks associated with them changed dramatically after the collapse of Lehman Brothers: "When we used to see something called a bank, it had a certain reputation and the fact is that we now know that that is not the case," he says. Or, as Martin O'Donovan, deputy policy and technical director at the Association of Corporate Treasurers, puts it: "People are far more credit conscious. We want to make sure we are dealing with the right banks. Credit isn't quite as easy as it used to be." Indeed, advisers note that the reaction among some companies has been to reduce the volume of working capital they hold in an institution overseas from a supply of money that would typically last two or three months to one that would keep the business going for a precautionary four weeks.

The recent scandal over fixing Libor rates will have served to further undermine bank reputations. But that doesn't necessarily mean it's sensible to wing the money home as fast as a bank transfer will carry it. Jones points out that there may be good reason to leave it in-country because it could well form part of a plan to spread risk with diversified banking providers. Repatriating it could also present an FX risk. A stable institution in an emerging market might therefore be the right place for it. That said, liquidity issues are enormously complex, ranged, as they are, across a variety of regulatory factors. But the reasons to act are clear: better use of cash and the amelioration of risks from FX through to counterparty problems.

Deutsch concludes in his paper that "with research, planning and a carefully conceived investment policy, companies can ensure that their cash is invested effectively and appropriately in each market in which they operate and avoid getting trapped in restricted markets". But then he would say that.

Gavin Hinks **is a business and finance journalist and the former editor of *Accountancy Age* and *Financial Director* magazines**

TRAPPED CASH: A US PERSPECTIVE

1

The term 'trapped cash' has a different secondary meaning for US companies than companies elsewhere in the world. In the US, 'trapped cash' also means money that companies choose not to repatriate for domestic US tax reasons. As a result, it has become the subject of newspaper headlines, concerted lobbying of government and regulatory enquiries.

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The simple fact is that the sum reportedly held overseas by US companies is vast. JP Morgan says it could be anywhere between 25% and 40% of total US corporate cash stockpiles. That could be somewhere between $400bn and $1 trillion, depending on which reports you read.

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One notable example is Apple, which in 2010 reported its cash invested overseas amounted to $30bn. By 2011, Apple reportedly had $76bn in cash, $41bn of which was in jurisdictions outside its home country. In April, the company's total cash pile was in excess of $110bn.

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Such figures cause concern, because the US government worries that it is money not being invested in the US and because US companies are not obliged to disclose how much of their money is abroad.

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Last year, the US financial watchdog, the Securities and Exchange Commission, requested that companies reveal just where their liquidity was being held.

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According to Aswath Damodaran, a professor in finance at New York University's Stern School of Business, the sums held in foreign countries are an open secret.

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The problem, everyone accepts, is the US corporate tax rate, which, at 35%, is one of the higher rates in the world. US companies pay tax on overseas earnings only when it is repatriated home, unless they declare that the money will never make it back. This is a strong incentive to keep the cash where it is.

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But that is not the full story. US corporates lobby hard for amnesties, allowing them to bring their money home to face much lower tax rates. During 2004 and 2005, a short-term amnesty prompted companies to bring as much as $400bn back to the US.

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Damodaran rejects the idea that trapped cash stifles company growth overall. "The growth for many of these firms is also overseas. So real growth in the US is unaffected by the trapped cash. There is plenty of cash in US corporates that is not trapped, if they found investment opportunities in the US," he says.

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