The new frontiers

EMERGING MARKETS ARE STILL POPULAR WITH WESTERN COMPANIES DESPITE THEIR ECONOMIC WOBBLES. WHAT ARE THE CASH MANAGEMENT CONSIDERATIONS FOR TREASURERS? BEN POOLE ASKS

Projections from the International Monetary Fund (IMF) *World Economic Outlook* point to a slight slowdown in growth for emerging-market and developing economies in 2015. Chinese GDP growth is projected to dip to 6.8% this year, down from 7.4% in 2014. Meanwhile, growth for Latin America and the Caribbean in 2015 is expected to come in below 1%, whereas it stood at 1.3% in 2014 and 2.9% the year before.

Despite the air of gloom that is pervading emerging-market economics and the stress that this can add to the financial system, treasurers are working to ensure that cash management practices in all markets function as efficiently as possible.

Activities in Asia

Take the treasury team of FTSE 250 technology company Laird, for example, which is looking to expand an already successful cash-pooling programme in China.

Laird has a fully centralised treasury function, with two people based in Asia-Pacific, who deal with day-to-day treasury matters. The company would rarely use cash-pooling structures if it had only one or two entities in a country, but in China the company has both US dollar and renminbi cash pooling. “Our cash pools in China sweep every day and, in general, this operates like any other cash pool,” says Lucie Harwood, Laird’s group treasurer. “The difference is that, in the background, the movements are treated as entrusted loans and have to be administered by the bank. There are more fees attached, and more taxes to consider as intercompany loans are set up between the entities. Operationally, however, this works pretty well.”

China has certain cash-pooling restrictions – netting is not permitted, for example. So treasurers with a deficit in one currency and a surplus in another have to sell renminbi and buy US dollars at the site that has the deficit, and vice versa.

Having used cash pooling in China since 2008, Laird is now looking to implement cross-border pooling. This brings in the element of funding in and funding out of China, and it has been made possible through the Shanghai Free Trade Zone. “Cross-border pooling is a big leap forward, allowing corporates to have cross-border party funding into, or taking cash out of, the cash pooling from China,” says Laird’s Harwood. “We should certainly see benefit in that.”

Opening accounts in Korea

Korea has a unique operational landscape for treasurers, both in terms of the business-to-business environment within the country, and also in terms of how treasurers operate their own banking systems. Certain types of certificates are required within some banking systems in order for Korean payments to be compliant.

“In Korea, a lot of business-to-business transactions occur and you end up having to open a lot of bank accounts,” explains Harwood. “Automatic payments are very popular, but these are made to nominated bank accounts. Consolidating the number of accounts held is a challenge in Korea. You need to avail yourself of other structures, such as sweeping structures. Also, while this doesn’t apply to our company, you can do ‘shadow’ sweeps. This is where people pay into accounts that appear to be with one bank, but they automatically go through to your group bank.”

Expanding into a new territory in Asia can be daunting, even if you have experience of operating in other countries in the region. There are several avenues for research and hands-on experience that can benefit treasurers in this regard.

“About a year ago, Laird set up a site in Vietnam, which was a jurisdiction that I wasn’t familiar with,” says Harwood. “The way to go into it is to accept from the outset that it isn’t going to be the same as anywhere else and try to find out as much as you can about how the operating rules work. I relied a lot on my team in Asia to do their research and to work closely with the people on the ground.”

THE SEPA EFFECT

While some may perceive the Single Euro Payments Area (SEPA) as a predominantly Western European concern, SEPA has had an effect in Central and Eastern Europe (CEE). Many companies have moved their euro accounts from CEE to a SEPA country with cash pooling in place, while the corporate only has a local currency account in the CEE country.

“Some CEE companies have already made the move to consolidate their euro accounts in a SEPA country, while others are focusing on converting their systems to be SEPA-ready, before making this move as a second step,” says Susanne Prager, executive director and head of cash management at Raiffeisen Bank International. “Corporates are looking to their local accounts to understand what they have in-country. The euro is cheaper to manage when it is held in a euro country. Here it is billed as a SEPA payment, rather than having an FX transfer fee applied.”

Looking ahead, corporates need to be aware that the SEPA migration for euro payments within non-euro area countries is due to come into effect on 31 October 2016.

LATIN AMERICA'S STORY

For Latin America, the revised IMF growth forecast reflects the impact on the region of China's slowing growth rate and the falling oil price. Against this volatile backdrop, the pressure is on treasurers to protect their cash. Cash management techniques that are commonplace tools in some markets may be harder to implement here, however.

"The challenge that Latin America has had is in regard to the movement of liquidity and how to take advantage of global structures such as pooling or netting," says Juan Pablo Cuevas, head of global transaction services for Latin America and the Caribbean at Bank of America Merrill Lynch (BAML). "Some countries still have the old style of protectionism in place, but there is a move to open things up. With the pace of globalisation, you cannot be separated from the good practices that are happening elsewhere in the world."

Multinational corporates try to generate efficiencies around cash management flows, but to achieve this, the cash has to be moving in and out of countries successfully. "The push is going to come from the local needs of banks," says BAML's Cuevas. "This will accelerate the creation of more efficient ways to move cash cross-border, particularly for investment purposes, benefiting large multinationals with a presence in the region."

CASH POOLING

Latin America does not offer many efficient cash-pooling propositions for local currencies. The only country that allows certain types of domestic currency pools and offers the ability to use the currency abroad is Mexico. The positive story for treasurers, however, is that Latin America mainly does business in US dollars. "Treasurers can see this region in one single currency," says Cuevas. "All the currencies in Latin America can be easily converted into dollars, so treasurers can plan cash flow in terms of dollar flow. Of course, it is important to be aware of the local currencies that the company is generating and the costs associated with converting these to dollars."

CAPITAL REPATRIATION

Repatriation of capital is more cumbersome in some countries than in others, although all have different tax implications. "Some companies will be happy to manage these taxes, while others are maintaining more global positions abroad that are managed by their in-house bank or treasury centre," says Cuevas. "Even if the country you are in has a 'closed' economy, treasurers can have positions in dollars and then do payments-on-behalf. This may not always be perfect, but it works."

REGULATORY ENVIRONMENT

Latin America is moving to align with the global financial standards that treasurers are familiar with from other regions. "Eighteen months ago, nobody was talking about the Basel reforms, but over the past six months, this has changed," says Cuevas. "Banks in Chile are adapting their liquidity positions based on Basel III, and the same is true in some other countries. Banks are now trying to generate more short-term assets. In addition to this, the local regulator has already implemented some rules in terms of concentration of liquidity on certain structures."

One area that treasurers need to be aware of when moving into Latin America is the hands-on role of most tax authorities in the invoicing process. In many countries, every invoice must be sent to the tax authority prior to shipment of goods and then again prior to payment. "This allows the tax authority to have real-time tracking of every sale and every payment in the economy," says Scott Lewin, president and CEO of electronic invoicing provider Invoiceware International. "These processes are in place in a majority of the Latin American countries and the rest are soon to follow."

Porto Seguro, Brazil

Leveraging the relationships that treasury has with its key group banks can also help to provide a detailed picture of what is possible in a new market. "One of our group banks is very much our Asia bank, so we would tend to leverage their local expertise when going into a new country," says Harwood. "They have a presence on the ground already, so we want to talk to them to understand what it is possible for us to do. By doing this and also talking to advisers – legal advisers and the Big Four accountancy firms – you can build up a pretty good picture, work out where the inconsistencies are and get to the bottom as to why you might be hearing slightly different things."

Europe's shifting sands

In Central and Eastern Europe (CEE), the fees associated with moving cash cross-border can vary markedly depending on which country you want to move cash in and out of. While the Czech Republic, Hungary and Slovakia have been moving to a similar pricing structure to Western Europe, pricing can jump elsewhere. "The further east you go, you can find a different world on the fees and pricing side," says Susanne Prager, executive director and head of cash management at Raiffeisen Bank International. "The same applies to countries such as Serbia and Bulgaria."

An increasing trend in CEE is the demand for pooling, particularly for cross-border pooling structures. "A lot of multinationals want executive cross-border pooling to master accounts located in places like Germany and Austria," says Prager. "This is particularly possible with countries that are in the EU, but can also be arranged in places you may not necessarily expect, such as Russia. This can be a hassle to implement at times, but it is possible."

Russian legal requirements mean that treasurers have to submit a 'passport of deal' to the central bank for each cross-border transaction. The key is to automate this process – treasurers with a daily cash-pooling transfer cannot afford to use the excess time and energy required to manually send all these documents on a daily basis.

Favourable locations

Corporates that have business operations across CEE face different challenges, according to the markets in which they operate. Foam manufacturer Vita Group, for example, has major operations in Hungary, Lithuania, Poland and Slovakia, as well as satellite operations in Bulgaria, Croatia and Serbia.

"Poland is generally a relatively easy place to operate in as a UK treasurer," says Chris King, group treasurer at Vita Group. "The key consideration there is how best to structure your European pooling system to make most efficient use of any surplus zloty. It is also important to factor in that, along with Hungary, Poland is now one of the more expensive operating locations in CEE, due to the availability of skilled workers and numbers of foreign businesses establishing strategic operations there."

Hungary itself is quite sophisticated as a result of the foreign businesses that have placed major headquarters and finance hubs there. Payments are based on modern systems, although this approach is geographically limited outside Budapest. This focus on major centres rather than the country as a whole is also seen in Romania. "Virtually all Western businesses are concentrated around Bucharest," says King. "The geography is challenging and there is little interest from foreign banks in any kind of bank network, since the business case does not exist."

Vita's operating businesses are largely autonomous, with a consultative or steering operation applied from operational headquarters in the UK and Luxembourg. "Pooling structures operate across the group for US dollars, euros and British pounds," explains King. "Outside of this, the group still requires funds to be moved physically to the UK, which then become part of the UK multi-currency pool. This is in the process of being overhauled so that operational business cash flows in local currencies – Polish zloty, Hungarian forint and Romanian leu – will also form part of the UK pool by the end of 2015."

Treasuries that have significant non-local currency flows can look to route these to the home jurisdiction using the company's local cash management bank. "You have to take it territory-by-territory thereafter for routing the domestic currency into the UK for the overseas subsidiary, but, as a minimum, the local subsidiary needs to maintain a local bank account in the domestic currency," says King. "It is advisable to obtain advance tax rulings for any currency repatriation routes that are proposed in CEE, as things are changing rapidly and do not necessarily conform to the principles that treasurers operating purely in Western Europe are used to."

"The further east you go, you can find a different world on the fees and pricing side"

Secret to success

With the economic and regulatory environment across the emerging markets changing rapidly, the pressure is on for treasurers to remain up to date on what is and is not possible with regards to cash management. Input from relationship banks and, most importantly, the local team on the ground, can make all the difference between success and failure in this respect.

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