# Breaking with tradition

## Chinese corporations are beginning to improve their cash management procedures, but there is plenty of work to be done

*By LiLi Tan*

Throughout the current global downturn, China has marched to the beat of a different drummer. It has proved many pessimists wrong, managing to outperform most economic forecasts and gobbling up additional manufacturing market share as other economies stumbled. Many expect China to maintain this new leadership position.

But finance managers at multinationals and corporates operating in China are glum; some even bracing for tougher times next year. Many of these companies are turning inward, examining their cash management structures, to prepare.

Fergal Power, partner and cash management advisory services executive at KPMG China, said he was surprised by the results of a recent survey the firm conducted on liquidity management in China. "In the next two or three years, though there will still be great growth opportunities in China, export businesses will find it difficult going forward because of stagnant demand in Europe and the United States," he said.

According to initial results, 74% of the survey's 180 participating corporations expected to see a decline in customer demand in China during the coming 12 months.

"There was reason for concern at the height of the economic downtown with some of our clients seeing drops of as much as 40% to 50% in December 2008," said Teoh Jin Kok, head of global payments and cash management at HSBC China. He explained that though companies have recently been more optimistic, they almost all agreed "it may be some time before prior volumes are reached".

### Rooted in the past

Given the sceptical outlook, corporations in China have a newfound interest in cash management. According to KPMG, nearly 90% of respondents considered the area of strategic importance to their organisation and almost 95% of these intend to expand their treasury teams in China. But many executives are only just beginning to come to grips with what cash management truly entails.

Fergal Power of KPMG China

The root of Chinese corporates' mentality lies in the history of the People's Republic. "After China opened up 30 years ago, cash management wasn't something companies paid attention to because revenue was not the focal point of the state-owned enterprise," said Lisa Robins, China treasury and securities services executive at J.P. Morgan. "They did not need to pay so much attention to their top and bottom line." In short, the concept of working capital was a relatively new one to Chinese businesses, both state- and privately-owned.

Legacy systems are also an issue at China's corporate groups. KPMG's Power agreed that the country's major groups are similar to its booming cities. In Beijing, more than five ring roads have been built to accommodate population growth but the neighbourhoods in between have developed in a somewhat less orderly manner, impacting the efficiency of the capital's roadways. Likewise, Chinese corporations have often simply tacked on various new subsidiaries, leading to unwieldy structures.

> How long it will it will take corporations in China to modernise their treasury system is anyone's guess

While some parts of China's business world are modern, other elements, such as cash management, have not yet caught on

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## New interest

A tighter credit environment has prompted many businesses in China, even well capitalised ones, to review their traditional views of cash management. KPMG reported that 70% of corporations operating in the country were adversely impacted by delayed payments and 50% by demands for earlier compensation from suppliers.

As a result, more Chinese corporations suddenly grasp the importance of cash management. Bankers report more enquiries about the best ways to structure their accounts, manage working capital, gain visibility on their cash flows, and better manage both their domestic and global cash.

But the biggest issue facing many companies in China has been visibility of cash that sits in different bank accounts at numerous institutions—something that the current regulatory structure hampers.

## Big brother

Regulation is a key differentiator in China from other markets. One practice that is especially onerous for corporates is cash pooling.

Typical pooling structures allow businesses to sweep balances directly from operating accounts to a central treasury. However, in China companies must use entrustment loans involving intermediary banks. While this is designed with the good intention to facilitate lending and borrowing of cash surpluses, it adds an unnecessary step where pooling is concerned.

Exacerbating the situation is corporate executives' lack of understanding. According to KPMG, 57% of respondents do not use pooling simply because they don't understand it.

China's rapidly evolving regulatory structure also creates difficulties. HSBC's Teoh explained that the bank receives regulatory updates from the government on almost a daily basis.

"The regulators' primary objective is to help the corporates run their businesses smoothly but at the same time protect the country's interests," he said. "We meet with the regulators [often] asking them to explain the policies so we understand them better."

While China's goal of making Shanghai an international financial centre by 2020 is prompting gradual liberalisation, even that is not straightforward. The State Administration for Foreign Exchange and the Shanghai Pudong City Government's joint October 2005 Pudong Nine Measures are designed to enable multinational corporations to pool both renminbi and foreign currency – but there's a catch; you have to locate your regional headquarters in Pudong.

## Cash to the forefront

As Chinese companies prepare for rainy days ahead, cash management will remain a priority. Both domestic and international banks are likely to be enlisted to help corporates gain visibility over their accounts, determine whether they should employ a centralised or decentralised treasury policy and work with them to develop solutions that maximise cash efficiency.

But Chinese companies still have a ways to go in terms of cash management. "It doesn't matter how sophisticated the systems are that banks offer," said Power. "A lot is dependent on the company's own existing IT platform and its ability to link up with a bank's cash management platform [to make it work]."

How long it will take corporations in China to modernise their treasury systems is anyone's guess. KPMG's Power threw up his arms at the question and joked that he may be retired by the time that happens. "Rome wasn't built in a day," he said. And neither will China. ■