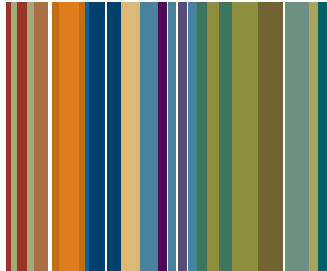


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TRANSFORMATIONS IN TREASURY IN CHINA

TABLE OF CONTENTS

- 1 Introduction
- 2 Part One. Treasury Benchmarking
- 7 Part Two. Treasury Opportunities for Foreign
Multinationals in China
- 12 Part Three. Future of RMB Trade

About the Author

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INTRODUCTION

If people were sceptical of China's importance as an economic powerhouse before the global financial crisis, there are now few if any disbelievers. With China continuing to demonstrate impressive growth throughout 2008 and 2009¹, despite a reduction in international demand for Chinese exports, China is tipped to surpass Japan as the world's second largest economy by the end of 2010 and has already exceeded Germany in export terms. China is important for every treasury professional, in almost every industry, firstly as a source of supply and a major consumer market. Companies headquartered in western economies (such as North America, Europe and Australia) are therefore increasing their focus on China compared with more mature economies with slower growth. However, as Chinese multinationals seek to expand their geographic footprint, they are becoming increasingly competitive in foreign markets, both organically and through acquisition. Consequently, western competitors need to refine their strategy and enhance their efficiency to compete effectively. Furthermore, as China is proving to be the world's most buoyant market for mergers and acquisitions, with considerable incoming and outgoing investment, many more treasurers of western companies need to manage the cash and financing for China-based subsidiaries, while treasurers of companies headquartered in China have increasingly international cash and risk management requirements.

This white paper considers a variety of issues relevant to treasurers with activities in China, and is divided into three parts.

- Firstly, it outlines the results of some recent benchmark research comparing the approach to treasury management in companies headquartered in China with those in western economies. This is important intelligence for treasurers of both Chinese and foreign companies, as by understanding where the company may need to enhance its approach to treasury management, or where it already demonstrates best practices, there can be considerable competitive advantage.
- Secondly, the white paper discusses some of the opportunities introduced recently for foreign companies dealing with companies in China, and vice versa.
- Thirdly, it considers the implications of the trend towards economic liberalisation in China and the opportunities that these developments may present.

¹2007 – 13%; 2008 – 9%; 8.7%. United States Central Intelligence Agency, August 2010

PART ONE. TREASURY BENCHMARKING

In 2009, SunGard commissioned independent research, consultancy and editorial company Asymmetric Solutions, specialising in global treasury management, to undertake an in-depth study of cash, treasury and risk management in ten major Chinese companies. This was a detailed survey comprising 111 questions, the full results of which are available from SunGard. This white paper provides some of the key findings from this study, and compares them with a similar study undertaken by Asymmetric Solutions of treasury management in western multinationals.

The study, referred to herein as the “China Benchmark” covered a wide range of issues, including: organisational and treasury structures; cash management and banking; currency and commodity risk management; debt and investment management; credit risk management; treasury strategies and plans, some of which are covered in this report.

1.1 Treasury Responsibilities

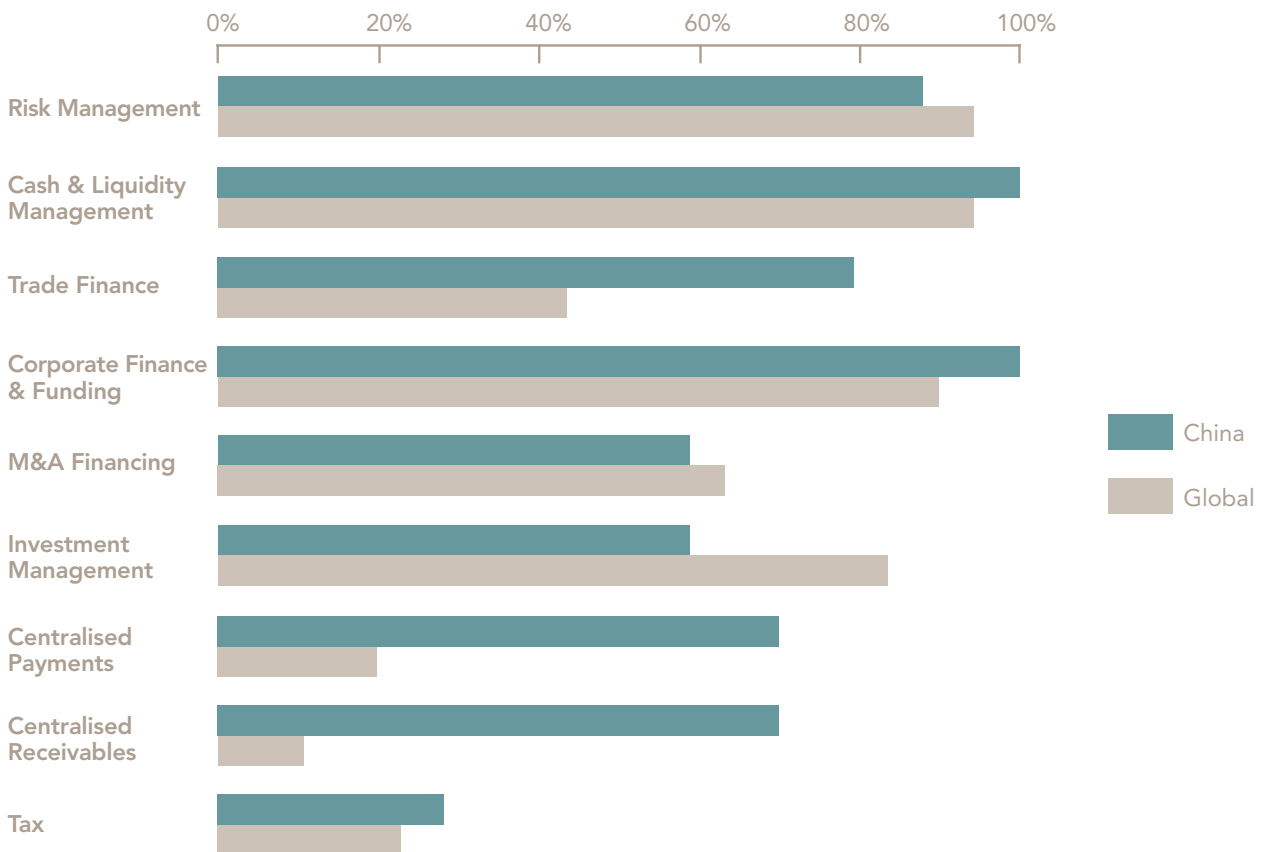
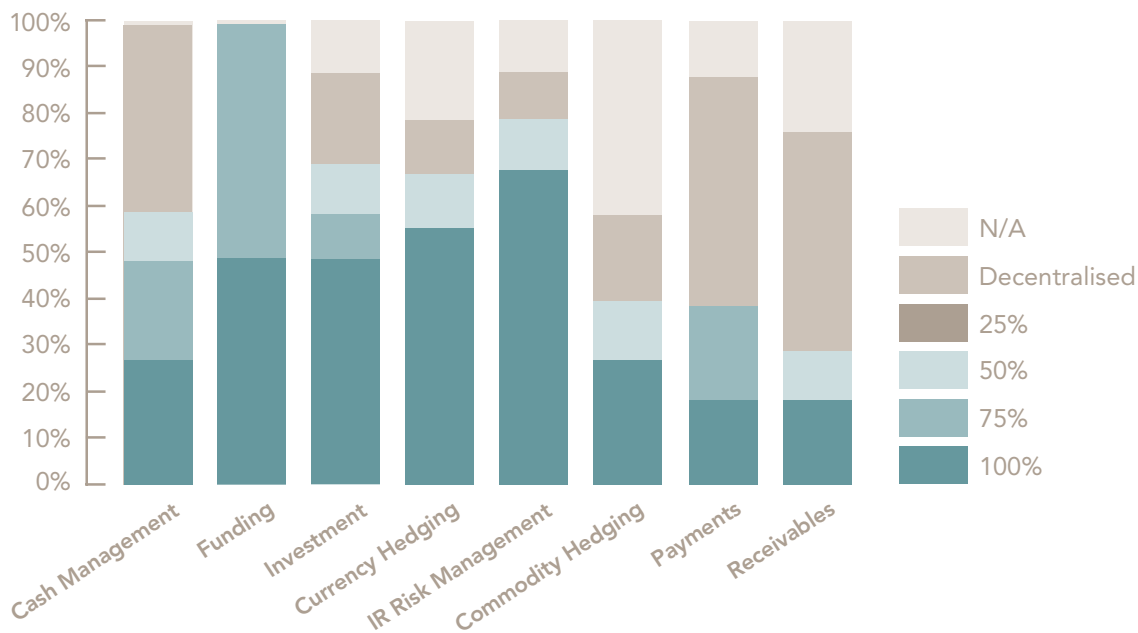


Fig 1.1.1 Treasury Responsibilities – China & Global

In general, the responsibilities of treasuries in China mirror those in other parts of the world i.e. cash, risk and funding are all core activities. Trade finance is frequently managed by treasury in China, whereas it is more commonly managed in a separate department in western multinationals. A siloed approach to trade finance and cash management is potentially a disadvantage for western companies seeking to optimise working capital and forecast cash flow, as treasurers often lack control or oversight of trade flows, which are often for large amounts.

In payments and receivables too, Chinese treasurers often have a significantly larger role, although these areas typically are less centralised (fig 1.1.2) than their foreign peers. These areas are traditionally the most difficult areas to centralise and few companies anywhere in the world have achieved complete centralisation as the second chart illustrates. However, companies in China are starting to look at payables and receivables centralisation, either within treasury or as part of a separate financial shared service centre (SSC), and centralisation remains a priority for companies globally. Chinese treasurers who have direct responsibility or oversight of payments and collections have a significant advantage over many foreign companies as they are in a better position to centralise these areas, whereas in other parts of the world, responsibility for payments and collections is often fragmented, making it difficult to implement consistent business processes and technology, and achieve visibility across the business.

Degree of Centralisation - China



Degree of Centralisation - Global

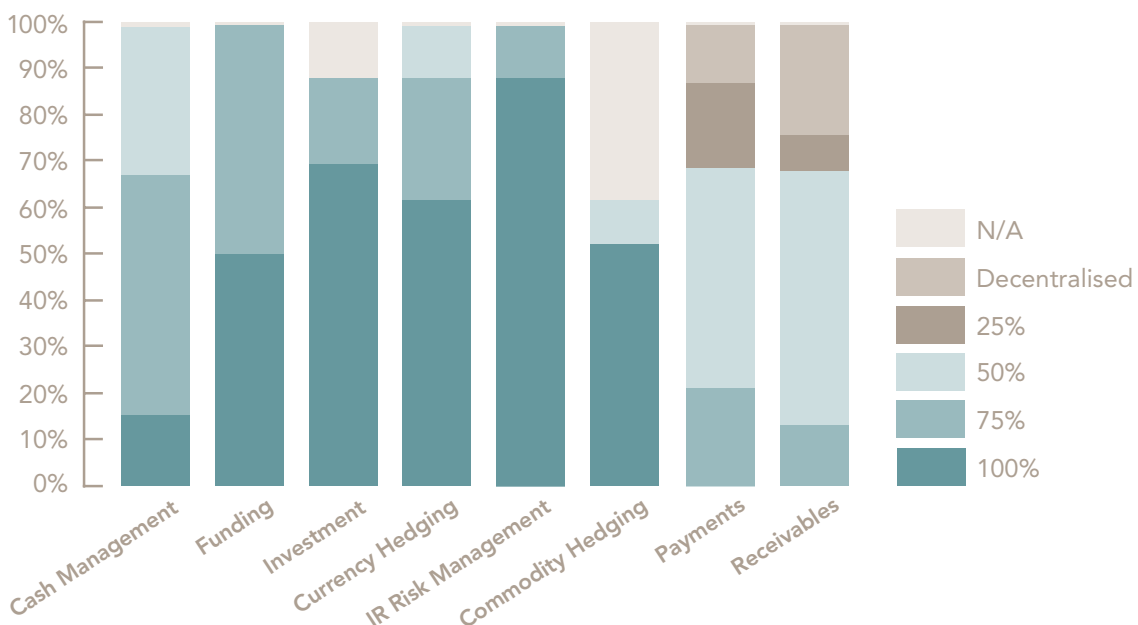


Fig 1.1.2 Degree of Centralisation – China & Global

1.2 Treasury Technology

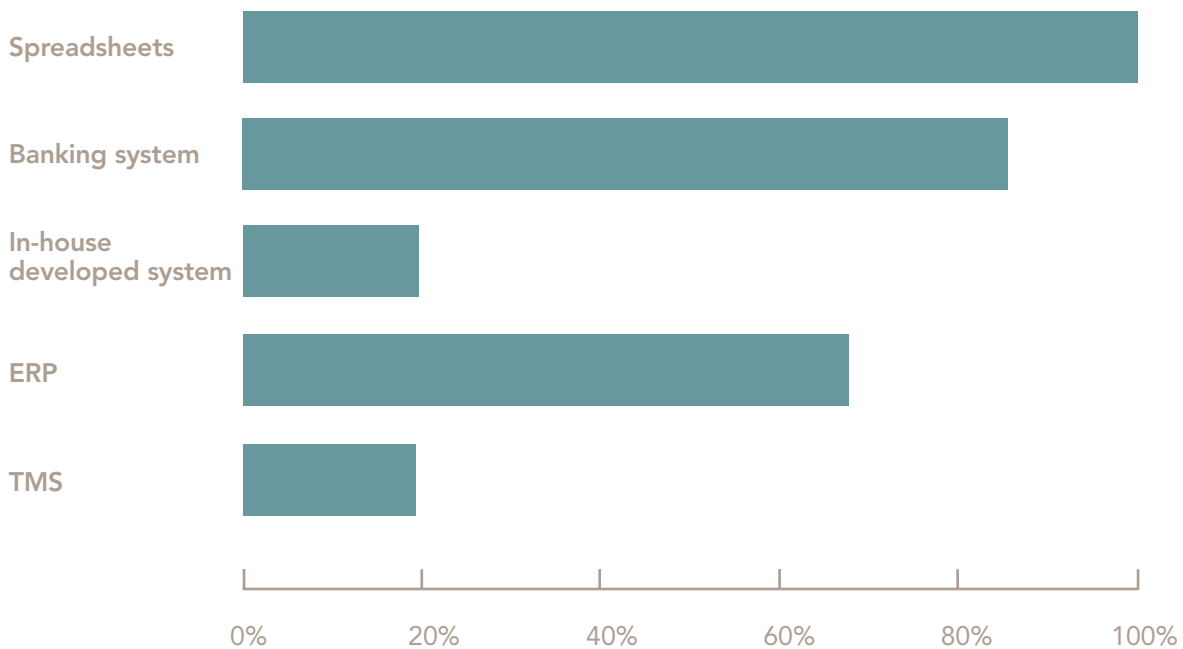


Fig 1.2.1 Treasury Technology

A significant difference between companies in China and their foreign peers is the use of treasury technology, specifically the use of treasury management systems (TMS). While over 90% of large foreign corporates make use of a TMS or an ERP for treasury management, only 20% of companies in the China Benchmark sample used a TMS. Companies which indicated that they use an ERP typically do not use it for treasury management except for sourcing cash flow and exposure information. While 90% of participants indicated that they used systems provided by their banks, 50% still sent payments to their banks manually (fig 1.2.2).

As fig 1.2.2 also illustrates, the majority of treasury tasks are conducted manually or using spreadsheets by Chinese companies. This is a particular concern in areas such as cash flow forecasting (which 90% of firms conduct manually or using spreadsheets) checking credit limits (100%) and reconciling bank statement (100%). With companies globally seeking to increase control, manage liquidity and monitor risk, the lack of automation and auditability in these and other areas is significant.

1.2.2 Treasury Tasks

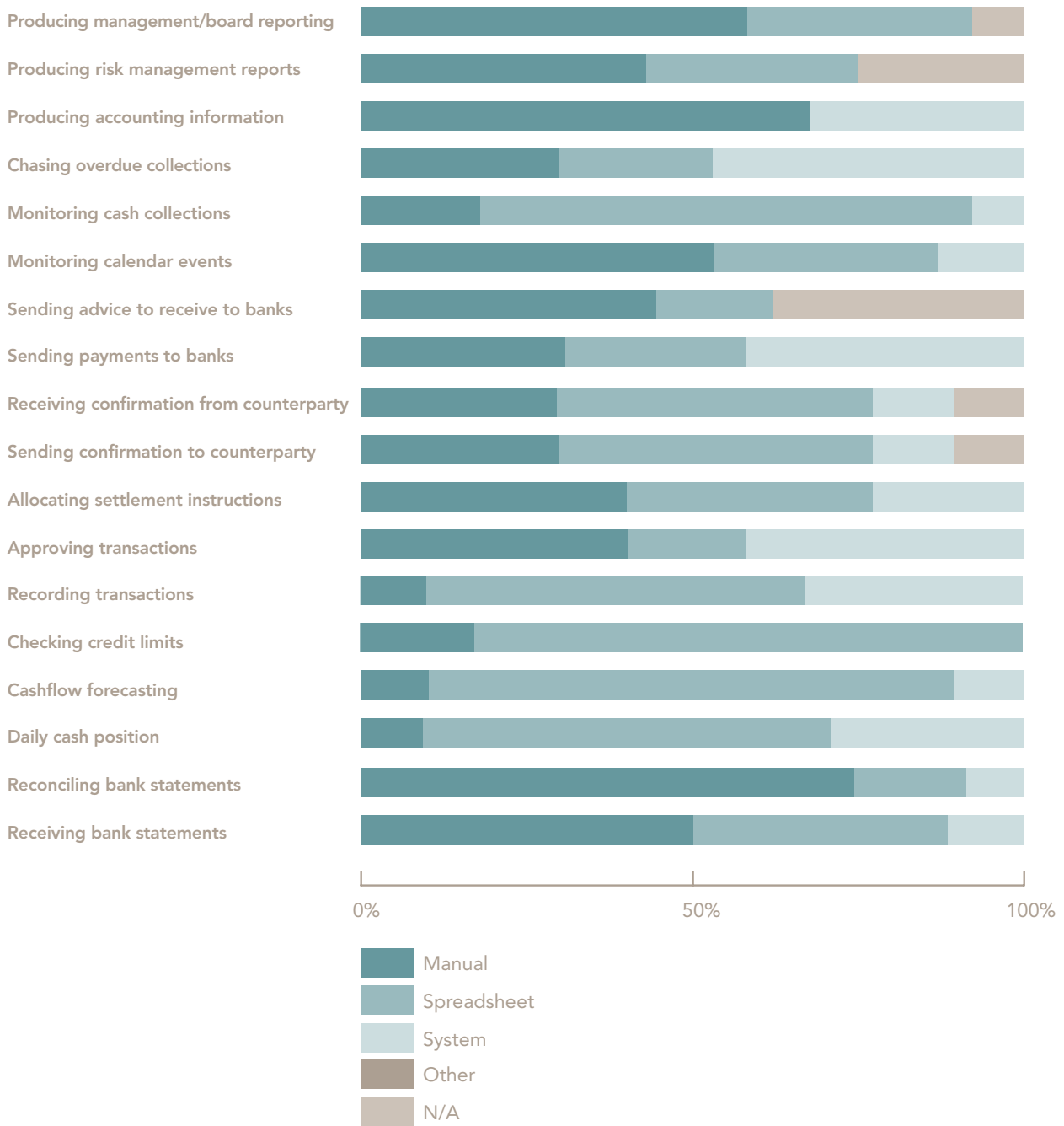


Fig 1.2.2 Treasury Tasks

However, while many western economies potentially have a competitive advantage today in their use of technology for automation, visibility and control over both cash flow and information, this advantage is likely to be short-lived. Chinese companies lacking the legacy processes and technology of their foreign peers have the opportunity to 'leapfrog' their western competitors and quickly leverage best practice technology and processes.

1.3 Number of Cash Management Banks

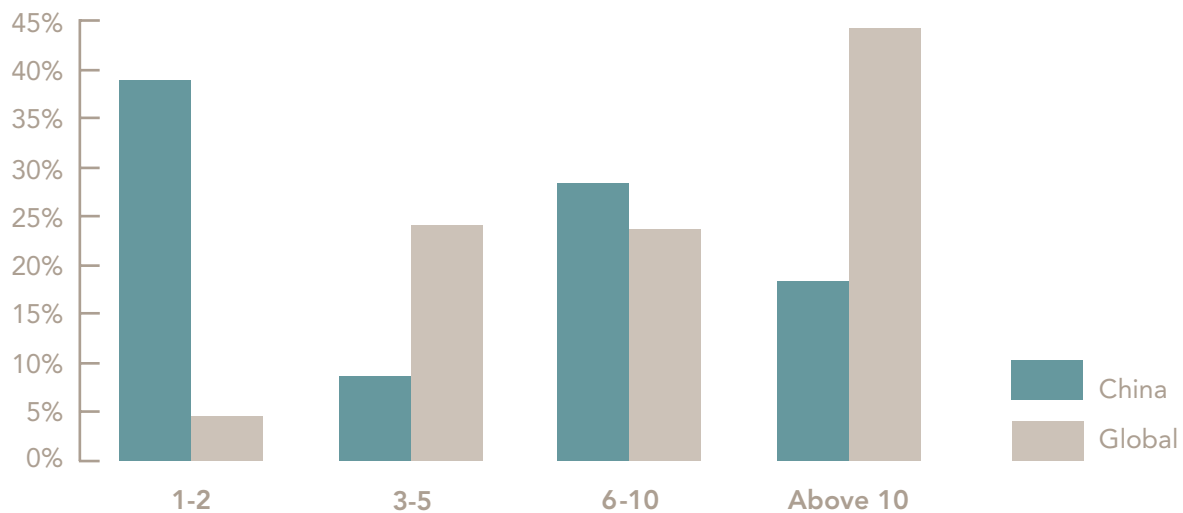


Fig 1.3.1 Cash Management Banks

Another outcome of expanding internationally relatively late compared with western firms is that Chinese companies tend to work with fewer cash management banks. For example, 40% of Chinese companies versus 5% of foreign companies worked with only one or two cash management banks, while a high proportion (45%) of western companies had over 10 banking relationships (and often significantly more) compared with 20% of firms in China.

In Europe and North America, 75% of companies indicated that they aim to rationalise their banking relationships (although few, if any, large firms are intending to work with a single cash management bank globally). In contrast, an equal proportion – 40% each respectively - of companies in China are looking to reduce or increase their banking relationships. Western companies have often found that working with a large number of banks globally has created a variety of challenges in terms of connectivity, financial messaging, ensuring visibility of balance and cash flow information and maintaining up-to-date mandates. Increasingly, large multinationals are turning to SWIFT as a means of connecting with their banking partners, and leveraging XML-based formats (ISO 20022) to achieve more standardised communication and greater visibility and control over cash. Larger Chinese companies too are looking to SWIFT as a mechanism for maintaining common standards of connectivity when developing new bank relationships.

As many Chinese companies have been largely domestic in focus until relatively recently, there has been little need for cross-border cash management structures in the past, while techniques such as physical and notional pooling are familiar to western multinationals. However, as Chinese companies expand their geographic footprint, they are actively planning to implement sophisticated cash and liquidity management structures to centralise their international cash as they expand, avoiding many of the problems of fragmented cash balances that many of their peers are still having to address.

1.4 Risk Management

Risk management is a less developed discipline amongst Chinese multinationals than amongst their foreign peers. For example, they often deal with a smaller number of currencies, so they have a simpler approach to FX risk management. Furthermore, hedging is more difficult in China than elsewhere. Counterparty credit risk is also less developed, with little focus on this area currently. As companies develop their treasury technology infrastructure and business processes, and expand internationally with new trading partners, this is likely to change rapidly.

1.5 Summary of Treasury in China

Treasury departments of companies headquartered in China are often highly professional, with a broad scope of responsibility. There is a strong focus on best practices, and as these companies develop their activities internationally and invest in new processes and technology, they will increasingly prove highly competitive compared with their western peers. As working capital continues to be a priority for companies, with constrained, expensive external financing, establishing efficient financial processes, visibility and mobility of funds will be paramount to maintaining competitive advantage. The lack of specialist technology is currently an impediment in China, but this is changing rapidly, and western competitors will need to continue pursuing higher levels of sophistication and automation in order to maximise their position.

PART TWO. TREASURY OPPORTUNITIES FOR FOREIGN MULTINATIONALS IN CHINA

Cash and liquidity management is frequently cited as a major challenge by multinational corporates operating in China, primarily due to regulatory constraints on the flow of RMB out of the country, leading to the problem of “trapped” liquidity that cannot easily be repatriated or used to finance the business elsewhere. However, while significant challenges remain, there are important regulatory developments that are making it easier for foreign and Chinese firms alike to conduct international business in China. This section outlines two key initiatives of interest to treasurers: opportunities for cross-border trade and multilateral entrustment loan cash pooling.

2.1 RMB Cross-border trade settlement

Most cross-border trade in Asia takes place in USD. For China, as it becomes the world’s largest exporter and the third largest importer, creating the optimum conditions for exporters and importers has become a major priority. Although the United States is currently China’s largest trading partner, the need to trade in USD is still a major hindrance for many Chinese companies and their international trading partners, not least due to restrictions on the convertibility of RMB. However, at the same time, the Chinese government and central bank are keen to avoid deregulating the market to the extent that the currency is put at risk through speculation.

The RMB cross-border settlement pilot scheme was launched in 2009 as a way of supporting cross-border trade transactions without creating currency risk issues for Chinese companies. Initially, the scheme applied to authorised companies (Mainland Designated Entities or MDEs) based in five cities in China (Shanghai, Guangzhou, Shenzhen, Dongguan and Zhuhai) known as Trade Settlement Enterprises (“TSEs”) but two additional cities, Tianjing and Hainan, have since been added. Trade with authorised entities (i.e. those which have demonstrated genuine trade transactions with Pilot Enterprises) in Hong Kong and Macau was covered under the scheme, but this was quickly extended to the ASEAN countries (Brunei Darussalam, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam).

The scheme supports two-way trade in RMB, including both trade instruments (such as letters of credit) and open account. A number of international banks have now received Settlement and Agent Bank licenses, and are actively conducting cross-border trade and account opening in RMB.

KEY BENEFITS

Companies in China

- Reduces transaction costs
- Eliminates FX risk
- Enables more transparent pricing
- Enables international and domestic activities to be aligned more closely
- Increases efficiency in terms of cash management, technology and accounting

Foreign Companies

- Increases competitiveness to customers in China
- Reduces FX costs, therefore:
 - Commercial terms to customers can be improved,
 - Better terms can be negotiated with suppliers in China
- Natural hedging for those with two-way trade
- Reduces reliance on USD

In many ways, the RMB cross-border trade settlement scheme is a logical extension of pre-existing business practices. Before the scheme existed, Chinese corporates with sufficient bargaining power were already pricing their international sales in RMB. When settled, the buyer would pay in an agreed foreign currency based on the settlement date exchange rate. Today however, the seller can keep their receivables in RMB and use them to fund their RMB payables, which will help hedge their FX position. Companies in China will prefer to sell in RMB as it is tied to their manufacturing costs. They will therefore be in a better position to maintain a stable margin for their product without incurring other hedging costs to protect the value of their receivables.

For corporates in China therefore, the scheme enables them to eliminate FX risk, to reduce transaction costs, to receive and provide transparent pricing, and to align their international and domestic activities, increasing efficiency from a cash management, technology and accounting perspective. Overseas businesses can become more competitive to customers in China, particularly as any FX costs can be stripped out of pricing, and seek better terms from Chinese suppliers. For those conducting two-way trade, transacting in RMB creates a natural hedge, avoiding the issue of 'trapped' cash as well as reducing reliance on USD. Furthermore, offshore demand for RMB is likely to increase significantly as RMB is gradually liberalised.

In addition to the cash and risk management benefits for both domestic and overseas firms, the RMB cross-border trade settlement pilot scheme is helping to improve the efficiency of the transaction process. Outside the scheme, documentation can be time-consuming to prepare, and verifying receipt can take a number of days, involving various regulatory bodies. By using RMB cross-border trade settlement, processes can be streamlined, with no need to suspend funds in EFV³ (Export Funds (subject to) Verification) with the resulting working capital efficiencies. The He Xiao sheet no longer needs to be completed and tax rebates can be claimed earlier.

Although the project is still in its infancy, and it will take some time for corporates and financial institutions to adapt to the idea that RMB is an international currency, demand is likely to continue to increase. The range of industries that have been attracted to the pilot scheme range widely, and initial concerns that the scheme would simply be a means for state-owned enterprises to compel counterparties to accept payment in RMB has been far from reality. For example, it is seen as a way of helping low-margin industries that are already being squeezed by increasing labour costs in China.

2.2 Changing regulations for liquidity management

With USD still the predominant currency for international trade in China, many companies experience the problem of “trapped” cash, and/or difficulties in financing businesses in China. Intercompany lending has been a particular issue for foreign companies operating in China. Since 2004, one-off, bilateral foreign currency entrustment loans have been permitted for both Chinese companies and subsidiaries of foreign companies (figure 2.2.1); however, multilateral cash pooling structures could only be established by multinationals with a holding company or qualified regional/global headquarters in China. Under a bilateral RMB foreign currency entrustment loan structure, a bank acts as an intermediary between the lending/borrowing parties to avoid the transaction being treated as an intercompany loan. Entities with surplus funds place cash on deposit with the bank, and request that the bank lends the funds to a designated company and specifies the terms of the loan. The process is frequently time consuming, bureaucratic, and separate documentation needs to be produced for every transaction.

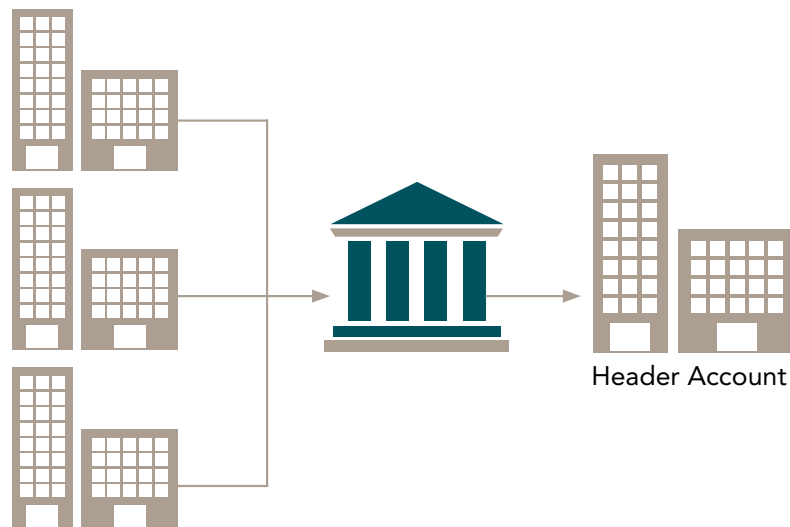


1. Entity places cash on deposit with bank.
2. Requests that bank lends cash to designated entity (defined purpose; interest rate at arms length)
3. Process/documentation replicated per entity, per loan
4. Bank acts as intermediary (no credit risk)

Fig 2.2.1 Bilateral entrust loan agreement

³EFV refers to the SAFE requirement that foreign currency proceeds resulting from export trade from China should be credited to a special EFV account for verification before being credited to the exporter's account

In 2009, a new regulation was passed that increases the availability of multilateral foreign currency entrustment loan cash pooling structures. Any company incorporated in China can now manage their foreign currency balances centrally by making use of multilateral entrustment loans and overnight overdraft facilities. Under a multilateral arrangement (fig 2.2.2), the traditional bilateral structure can be expanded to multiple entities, with multiple entrusted loans covered under a single legal agreement, reducing administrative overheads. Using this structure, foreign currency cash concentration or pooling can be achieved by sweeping positive and negative balances to a header account where they can be concentrated at the end of each business day to determine the group cash position. Then the balances can be swept back to the respective accounts at the start of the following day.



1. Single process/documentation covers multiple entrust loans
2. Sweeping of funds into header account each day, swept back following day (reverse sweep)
3. Enables visibility of cash and investment ability
4. Overdraft facility allowed to cover intraday activities
5. Approval delegated from SAFE head office to local offices

Fig 2.2.2 Multilateral entrust loan cash pooling

Furthermore, while regulatory approval for cash management structures was previously undertaken by the Beijing head office of the State Administration for Foreign Exchange (SAFE), approval for multilateral entrustment loan cash pooling structures has now been delegated to local SAFE offices. This will significantly reduce the approval time from 4-5 months to 1-2 months. The agent bank will continue to be responsible for the structural design, approval and reporting for multilateral entrustment loan cash pooling structures.

2.2.3 Further initiatives

The continuing relaxation of liquidity rules in China, and RMB cross-border trade settlement pilot scheme are indications of the Chinese government's intention to promote the RMB as a global currency and permit trade on an even footing with its international trading partners. These are not isolated initiatives; for example, while regulation of the RMB was formerly the sole responsibility of SAFE, this has now been decentralised to provincial People's Bank of China (PBOC) offices and tax bureaus in 20 approved cities, leading to reduced approval times, greater responsiveness and communication.

Offshore RMB financing is now permitted for up to 30 days and offshore RMB deposits can be used as collateral against any other credit facilities. This increases companies' financial flexibility and enhances liquidity management. Offshore foreign exchange conversion is also now freely permitted, subject to foreign exchange caps allocated to onshore clearing bank agents. These caps are aimed at limiting the size of the offshore market, so that growth can be controlled, but there are no limitations on offshore activity.

PART THREE. FUTURE OF RMB TRADE

While there has been much discussion and speculation around the future of the RMB, only time will tell the outcome. While economic liberalisation is slowly taking place, with a huge volume of new regulations and modifications, the path will not be a short or an easy one, especially as there is much focus to avoid destabilising the RMB, and to protect economic stability. With that said, the RMB is a very hot topic amongst thought leaders and industry pundits that say they foresee the RMB as a major international currency, and potentially the currency of choice for trade in Asia in the future. There are talks around the relaxation of currency controls progressing, however there is also the view that RMB flows cannot be restricted only to regulator-approved trade in goods or services, and major FX banks have to be able to trade in RMB with market-driven exchange rates.

As talks around the liberalisation of the currency continues, an increasing number of firms in Asia are considering holding RMB as their alternate currency, as well as whether financial institutions will consider to hold it on their balance sheets. Already, with RMB appreciation becoming a reality, and more foreign companies state that they are willing to hold RMB than in the past.

The immediate issues discussed by many treasurers of both Chinese and western firms are: firstly, how to mobilise cash across the business easily, to repatriate cash and manage risk; and secondly, how to remain ahead in a fast-changing competitive landscape. Cash and liquidity optimization, efficient, cost-effective financial processes and risk management are all essential elements in achieving and maintaining competitive advantage; however, this requires constant reassessment and revision to leverage best practices and innovative technology.

About AvantGard

SunGard's AvantGard is a leading liquidity management solution for corporations, insurance companies and the public sector. AvantGard provides chief financial officers and treasurers with real-time visibility into cash flows and increased operational controls around receivables, treasury and payments. AvantGard helps companies drive free cash flow and reduce inefficiencies across the EcoSystem of suppliers, buyers, banks and other trading partners. For more information, **visit www.sungard.com/avantgard**.

About SunGard

SunGard is one of the world's leading software and technology services companies. SunGard has more than 20,000 employees and serves 25,000 customers in 70 countries. SunGard provides software and processing solutions for financial services, higher education and the public sector. SunGard also provides disaster recovery services, managed IT services, information availability consulting services and business continuity management software. With annual revenue exceeding \$5 billion, SunGard is ranked 380 on the Fortune 500 and is the largest privately held business software and IT services company. For more information, please **visit SunGard at www.sungard.com**.

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