



China, Asia and Globalisation - A Paradigm Shift for Treasurers

Theme article for the Global Treasurers Summit
Hosted by IACCT (China) and HKACT
in partnership with the Hong Kong Monetary Authority

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We may not be able to confidently predict 10 years from now the level of oil prices, the dynamics of geopolitics and whether the world can cope with the threat of epidemic diseases and global warming. However, we can be sure that on the economic front China and Asia will become more integrated members of the global community. "One World, One Dream" is not only a slogan for the 2008 Beijing Olympics. It will be the common theme for collaboration among nations. Globalisation and the development in China and Asia are creating a new paradigm shift for treasurers.

The New Asia: Going From Strength to Strength

Asia has gone from strength to strength, as evident in the increase in foreign exchange reserves, the strengthening of Asian currencies and sovereign rating upgrades. Foreign exchange reserves among Asian nations amounted to USD3.7tr as of mid-2007, representing around 60% of the world's total and more than double the combined USD1.8tr of the G8 nations (Canada, France, Germany, Great Britain, Italy, Japan, Russia and the US), of which USD0.9tr is from Japan. Outward foreign investment from Asia will further increase as foreign exchange reserves in many Asian markets have exceeded the threshold required to stabilise their currencies.

The importance of Asia as a provider of liquidity lies not only in its size but also its sustainability. Driven by high national savings and increased integration among Asian economies, Asia is becoming a self-contained market and an independent engine of growth. The latter is evident in both cargo and passenger flow, and the booming intra-Asian trade has now exceeded transpacific trade.

Asia is also an attractive destination for investments. The mountain of pension and long-term insurance funds are seeking a home. Chances are they will land on projects in China, India or Vietnam that may, one day, become winners in the transformation process of these economies. The deepening of the asset management industry in Asia introduces the professional discipline to intermediate investors like hedge funds, private equity, traditional fund managers and a spectrum of institutional and individual investors with different risk appetites.

In terms of purchasing power parity (PPP), Asia represents one-third of the world's gross domestic product (GDP). More Asian corporations made their way into the Global 500 (128 in the 2007 ranking) and Forbes Global 2000 leagues. Cross-border investments within Asia by Asian corporations are capturing headlines. The need for a regional treasury centre in the Asia time zone is true now for Asian corporations

and not just confined to US or European multinationals. Both Singapore and Hong Kong can serve as regional treasury locations and each has its own attraction.

Financial Reform in China: No “Lost in Translation”

This year is a milestone for China’s financial reform in its efforts for globalisation: its foreign exchange reserves set a world record and ICBC became the world’s largest bank by market capitalisation. China is proving to the world it can effectively and efficiently manage economic change. It has continued its open-door policy (which it began three decades ago), despite the 1997 Asian financial crisis and the 2004 SARS epidemic, and its success serves as a model for other emerging economies.

China is accelerating the pace to embrace market discipline and increased competition to spur the development of its financial markets.

- The renminbi (RMB) has assumed a new trajectory of “managed floating” within an enlarged band for the first time since 1994, when the dual exchange rate system was abolished.
- Foreign banks are now able to incorporate locally in China, and there is now foreign equity in over 30 Chinese banks.
- All Chinese banks have been mandated to meet an 8% capital adequacy ratio and large banks to meet the requirements of Basel II within five years.
- Regulators are promoting transparency and management accountability in the public market. Local accounting standards applicable to banks are now reaching closer to International Accounting Standards (IAS).
- Listed companies have been mandated to adhere to a new set of statutory accounting rules and internal control standards. The listed companies serve as best practice benchmarks for non-listed companies.
- A dedicated State-Owned Assets Supervision and Administration Commission of the State Council has been created to monitor the corporate restructuring, acquisition and overseas expansion of the top 155 state-owned enterprises.

In addition, China has created a mechanism of “two-way managed capital account flow”, prior to the RMB becoming fully convertible, as it does not need all its foreign exchange reserves to maintain the stability of the RMB:

- Overseas investment can be made through either the State Administration of Foreign Exchange or the State Investment Corporation.
- A quota has been approved for private companies to acquire foreign currency assets overseas. Mainland individual and institutional investors can now do this under the Qualified Domestic Institutional Investors scheme through Hong Kong.
- Infrastructure is in place for a direct link between China Government Securities Depository Trust & Clearing Co. Ltd (CDC) and the Hong Kong Monetary Authority’s (HKMA’s) Central Monetary Unit system (CMU) to allow CDC members that are authorised to invest in foreign debt securities to settle and hold Hong Kong and foreign debt securities through the CDC’s account with the CMU.
- Investing in China’s growth can be done either through investing in mainland Chinese companies listed in Hong Kong or in other Hong Kong-listed companies that have China exposure. It can be done also through investing in mainland China listed companies through the Qualified Foreign Institutional Investors scheme.
- In June 2007, the first RMB bond in Hong Kong was launched. This was the first time that RMB assets were made available for investment in RMB outside the Mainland. A RMB-clearing system is established in Hong Kong to cater for the settlement needs of RMB business in Hong Kong.

- Approved institutions can issue RMB bonds in the Mainland and convert them to foreign currency for use overseas.

As China's economy marches along, it will soon realise its potential as "the world's market". In the last five years, since its accession to the World Trade Organization, China has doubled its GDP per capita and received over USD300bn of foreign direct investment (FDI). The average GDP per capita of USD2,000 may disguise the fact that the figure could be four to five times higher, according to the International Monetary Fund, if measured by the PPP method. Also the coastal cities where reform took place earlier enjoy a much higher-than-average standard of living.

A Paradigm Shift for Treasurers

Globalisation has expanded the frontier for doing business as shown from the relentless efforts of successful companies to build global brands, footprint, talents and partnerships. With growing activities in Asia, we need to step up treasury resources at a regional level for change leadership, oversight and control, and at a local level for efficient execution and resolution of issues. We also need to invest in technology to centralise bank accounts, bank statement information and treasury transaction records in a single treasury management system, in order to achieve better compliance, fulfil fair-value accounting requirements and centralise treasury risk management. Gross and net exposures by counterparty, by currency and by duration, have to be made available in a timely manner.

For treasurers of Asian and Chinese enterprises, globalisation introduces a new dimension of banking relationships, cross-border currency and liquidity risk management, and funding challenges beyond the basic need of establishing a centralised treasury management system and organisation structure. Access to global financial market information and a trusted circle of market participants to make quality and informed decisions will be a new challenge. In hedging currency exposure against the US dollar (USD) for example, a treasurer can consider proxy hedges and cross hedges, taking advantage of the relatively higher correlation among Asian currencies. Money market funds (MMF) offer the opportunity for treasurers to pool cross-border liquidity and perform inter-company netting in the form of MMF unit book transfers, saving the cost of physical transfer.

Treasurers should take note of the opportunity to increase financing flexibility arising from the supply of liquidity from Asia. There is an interesting analysis from Standard & Poor's that, after deducting short-term debt, China, India, Korea, Malaysia, Taiwan, and Thailand together had excess reserves of USD1.5tr based on 2006-end figures. Indirectly, the banking sector is facing a reverse "crowding out" effect, and domestic interest rates in Asia are generally lower than their counterparts in the US and Europe.

Hong Kong is well positioned to be an international funding centre in the region. First, China, which contributed the majority of this "excess reserves", aims to promote Hong Kong as China's international financial centre. Second, the HKMA has built up in the city a multi-currency payment and settlement platform that can efficiently process a) treasury and capital market settlement; b) cross-border payments between China, Hong Kong and other economies in the region; and c) the settlement of securities in international markets through links to international central securities depositories such as Euroclear. Third, Hong Kong has a successful track record in raising funds for Chinese enterprises. In 2006, it was second to London in raising initial public offering (IPO) funds.

Within mainland China, a transformation of the payment system is taking place. The central bank has created, for the first time, a unified and efficient nationwide RMB payment infrastructure across cities and across banks (both foreign and domestic). The China National Advanced Payment System (CNAPS), a real-time gross settlement system, and the Bulk Electronic Payment System (BEPS), an overnight batch clearing system, are designed to cater respectively for large and small denomination electronic fund transfers. This will fundamentally change cash

management solutions in China, including the design of bank account structures and customers' choice of banks. Treasurers can receive and pay counterparties no matter which banks they use, and a national treasury centre can be used to centralise all payment activities in China. Banks are expected to invest more in cash management products in this open architecture environment, and training needs for bankers and corporate treasury personnel will increase.

Financial reform in China has introduced many benefits and opportunities for treasurers and banks:

- Risk in dealing with cash has been reduced through the e-payment procedure, and e-banking will result in more payment activities outsourced to banks.
- Collection can be automated and centralised by using the BEPS for direct debit, which means multiple banking relationships can be consolidated.
- Collections data can be transmitted electronically from multiple alternate cash collection channels (banks, post office, convenience stores) to a company's accounts receivable (A/R) system. This means an integrated receivables management solution can be used to reduce reconciliation efforts and the risks related to handling in-transit cash.
- Treasurers use service-level agreements and performance scorecards to monitor and manage operational risk. Banks that run a successful matrix accountability structure and provide dedicated nationwide support are better positioned to meet the needs of treasurers.
- In addition to e-banking, electronic wallets (mobile payment, automated teller machine transfer and pre-paid cards) will in time become a viable alternate to cash. Electronic commerce will leapfrog the paper-based cheque system. In other emerging markets, payment using the mobile phone is being promoted in rural areas, thus easing payment needs in micro-finance and micro-insurance businesses.
- A shared service centre can help achieve scalable advantage to support an expanding footprint.
- On liquidity management, more companies, foreign investors and domestic Chinese enterprises are becoming cash rich. Investing surplus cash, in foreign currency and RMB, is now a priority.

The Crystal Ball and Wish List

Much like the "political dividend" attributed to the end of the Cold War, we expect Asia to continue to enjoy the "economic dividend" resulting from the progress made in financial reform and economic growth. Reduced risk premiums for investors will be translated into improved market valuation and lower funding costs. This will add impetus to the future development of Asian stock markets. Investment through FDI and by private equity may one day turn companies into new IPO listings. As Asia increases its share of weightings in global stock indices, allocation from foreign fund managers will provide additional liquidity to the market. Increased participation of institutional investors, including pension and insurance funds, will also add depth to the market as they have a longer duration tolerance. The growing importance of the capital market will build in a stronger check-and-balance mechanism as investors demand higher transparency, such as the application of the Global Investment Performance Standard and IAS. The use of market discipline to reform the state-owned sector through privatisation will continue.

As Asia becomes more open through globalisation, there will be increasing volatility in the currency and interest rates. Treasurers will need better hedging tools to manage such risks. The treasurer is becoming more involved in enterprise risk management decisions beyond the traditional forward, swap and option contracts. There is a need to stress test the financial consequences of such tail-end risks. Treasurers need to know what risk should be transferred through insurance

contracts and what should be retained. The Basel II accord imposes higher capital charges to banks lending to small and medium-sized enterprises. Risk transfer via trade credit insurance will enhance the quality of A/R portfolios and reduce bank fees, just as securitisation will help smaller companies to be more capital-efficient while reserving its primary book of business.

In China, as well as the promotion of e-commerce, a robust infrastructure for paper-based payments is also needed, including cheques that have six-month validity. To efficiently manage a current account, treasurers need an overdraft facility. For USD paper payments, there may be opportunity to shorten the turnaround time if the instrument is cleared, say, in Hong Kong. We also wish to be able to fix our long-term funding costs. In other markets, such as Malaysia, a treasurer can borrow from insurance companies through a bank-guaranteed fixed rate loan (with a five-year maturity, for example). The RMB commercial paper (CP) market allows treasurers to issue CP with maturity up to one year. We wish that treasurers would be allowed to issue RMB corporate bonds in China.

Asia, as an economic unit, is becoming less fragmented than it appears to be compared to the US and Europe. We should promote increased communication among Asia-based treasurers. National treasury associations (NTAs) can participate in activities that promote partnerships between the private and public sector. In some emerging markets, NTAs can promote the level of treasury management professionalism that is needed to go hand in hand with domestic banking and financial reform. As treasurers, we would like to be able to manage regional cash pooling efficiently but need local governments to cooperate to create a mechanism that can minimise the cross-border withholding tax burden. Education and professionalism of treasury management are other efforts that NTAs can promote.

In recognising the globalisation of the treasury profession, the International Group of Treasury Associations (IGTA) was formed to enhance the activities of treasury associations across nations. IGTA aims to encourage the highest standards of professional ethics and best practices among treasury professionals worldwide and to promote the exchange of information, business practices, and details of various local regulations. With the support of IGTA, two new initiatives were implemented in 2006: the collaboration among Asia NTAs to start-up a pan-Asia treasurer network called the Asia Pacific Treasurers Forum, and the creation of IACCT China, which provides a platform for treasurers to share best practices related to development in China.

Each year an IGTA meeting is organised either in the US, Asia or Europe. This year, the Hong Kong Association of Corporate Treasurers and IACCT China are hosting an event - the IGTA "Global Treasurers Summit Week" (5-10 November) - in Hong Kong. Treasury bodies from Australia, Europe, Japan, Singapore, the UK, the US and many other countries will be represented.

Conclusion: From "Economic Dividend" to "Social Dividend"

Globalisation is more than the law of comparative advantages. It is about realising the potential of each nation and its people. International transfer of know how and best practices, market access and collaboration in solving common problems has proved to be a remarkable experience for Asia, and China. The future is even more promising if we reach out further.

People should work to live rather than live to work. Most Asian nations are in the second quartile of the Satisfaction For Life Index ranking. The three most populous countries: China, Japan and India ranked 82, 90 and 125 out of a total of 178. While the "economic dividend" of economic growth may be great, Asians want to live a happier life with a rewarding job and secure retirement. The road towards "social dividends" with more happy faces is a long but worthwhile journey.