

The Reinvention of the New Asia

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- Asia learnt lessons the hard way during the 1997-98 financial crisis. It has remained resilient and rebounded gracefully. However, the momentum of financial reform has to continue. Asia needs to invest for the future.
- The future holds many opportunities and risks. Of particular importance to the region's financial health will be the increase in interdependence between Asian economies and the surge in liquidity the region has experienced in recent years.
- Further challenges to be overcome in the next ten years include the changing risk profile of corporations and the increased competition for banks.
- Corporate treasurers and banks that take business to the next level of sophistication will be highly rewarded.

Asian treasurers were shocked during the Asian financial crisis in 1997-98 when Asian currencies sharply devalued and domestic interest rates increased to reflect higher risk. The publication in 1998 of HSBC's Guide to Cash and Treasury Management in Asia Pacific was therefore very timely and has served an important purpose of promoting treasury best practices among financial market participants. Today we can be impressed by what has happened in the intervening ten years – Asian economies have rebounded and gone from strength to strength. Asia Pacific has foreign exchange reserves in excess of USD2.5 trillion and is becoming an engine of growth in its own right, led by China and India. HSBC has to be congratulated for its foresight and vision, as well as its contribution to raising the level of professionalism in treasury and cash management in the region.

What has Changed?

Development of the cash management industry throughout the past decade has been remarkable. On the buy side, we witnessed the evolving of a more developed corporate treasury sector.

Firstly, we have seen more multinationals setting up new or strengthening their Asia-Pacific treasury operations at both regional (in Hong Kong, mainland China and Singapore) and local levels. Asian corporations like CLP, CP Group, Esprit, Li & Fung, Hutchison and Samsung are expanding their corporate treasury to cope with their growth in Asia-Pacific and around the world. The number of newly rated entities (by Fitch, Moody's and Standard & Poor's) in

Asia is on the rise. Many issued corporate bonds to take care of 40 to 50 per cent of their borrowing needs, thanks to the regulators' efforts in promoting the government bond market to create a benchmark yield curve. In the near future, we expect more mainland Chinese enterprises to follow

the examples of China National Offshore Oil Corporation, Haier, Lenovo and TCL in developing international treasury operations to support their “Go Global” strategy. Many Chinese enterprises have re-capitalised through initial public offers (IPOs) in international financial centres, primarily Hong Kong, where over 300 of them have been listed since 1993 raising USD150 billion in equity financing.

Secondly, the demand for China treasurers has increased significantly. After becoming a member of the World Trade Organization in 2001, China adopted economic liberalisation measures which have created many new business opportunities. It was ranked first (in 2005) in terms of attracting foreign direct investment (FDI) in Asia, followed by Hong Kong. Together the two received close to USD100bn of FDI in one year. Starting in 2007, the demand for treasury professionals in China will surge as China accelerates its banking reform and the barriers to international banks providing renminbi (RMB) services are gradually relaxed. In 2004, the Hong Kong Association of Corporate Treasurers (HKACT) started the China Treasury Forum, whose initiative is to promote treasury best practices in China. The forum evolved to become the International Association of CFOs and Corporate Treasurers (China) [abbreviated as IACCT China] with membership from both mainland Chinese enterprises and China treasurer/CFOs of foreign investors in China.

On the sell side, we have seen more sophisticated products being offered to meet the needs of the corporate treasury sector to cope with higher transaction volume, a more robust internal control environment post-Sarbanes Oxley and enhanced customer payment convenience.

With regard to new products, the global development of web technology has resulted in increased acceptance of e-banking in the market. HSBC’s flagship Hexagon, for example, has migrated to HSBCnet. E-banking is more than balance reporting and fund transfer. It is being deployed as an extension of the enterprise resource planning (ERP) system to integrate receivables and payables management. Users like insurance companies can send a bulk payment “direct-credit” from their mainframe directly to the bank through the web. The benefits of straight-through processing will significantly increase the receptiveness of corporate users to consider payment outsourcing. Similarly for collection, a mobile phone company will accept multiple channels of collection for customer service reasons. The attraction of outsourcing receivables management is now about integrating customer payments information from different channels in addition to pure efficiency gain from converting an in-house, fixed cost to a variable cost, such as using a “lockbox” solution to streamline cheque processing.

What are the Opportunities and Risks?

Intra-Asian trade has grown significantly in terms of cargo and passenger (business and tourist) flow. Despite the Asian financial crisis, exports from Asia (excluding Japan) to China increased from USD64bn in 1994 to USD245bn in 2004. This is equivalent to a compound growth rate of 14 per cent, much higher than the overall growth rate of 10 per cent. In 2006 such exports will exceed USD300 billion. During the same period when Japan was experiencing economic slowdown, the exports from Japan to China increased from USD19bn to USD74bn. This represented a compound growth rate of 15 per cent, as against the 4 per cent growth in Japan’s total exports.

The conclusion is that China has become a new engine of economic growth for Asia, and the implication of this in terms of trade and capital flow is going to be far-reaching.

As Asian economies become more inter-dependent, there is risk that one market dipping may choke the growth of others. On foreign exchange rates, what will happen to the other Asian currencies if RMB changes its value against the US dollar? With a few exceptions, Asian domestic interest rates are below US rates. It seems one has to trade off short-term cash return with currency outlook. Where should the line be drawn? For cross-border cash management, should we keep a “master cash pool” in US dollars and hedge the domestic net currency exposure? How can financial regulators facilitate the development of a currency swap market?

The Asia growth story has resulted in a surge in liquidity, partly resulted from increased activity from private equities and hedge funds. FDI will remain essential to the infrastructure needs of Asia's emerging markets. The right policy response in terms of liberalisation of foreign ownership rule and further privatisation of state-owned enterprises is important so as not to constrain the supply of businesses that can benefit from the effective use of FDI in bringing in management expertise and market discipline. In turn, successful private equity deals will result in further growth of domestic stock markets (through IPOs) and subsequent bond issuance. On the other hand, too much money chasing too few assets may distort market valuation and impede future fund flow.

What are the Future Challenges?

Risk management has become more complex. Globalisation means Asia Pacific – as part of global supply chain – will have to learn how to respond to changes in overseas demand, commodity price shocks and event risks (such as bird flu, terrorism and geopolitical conflict). Corporate treasurers have to maintain the backup liquidity needed to keep businesses running at all times.

The appreciation of Asian currencies will have an adverse effect on Asian export competitiveness. A robust foreign exchange risk management process is required to manage the risks arising from currency mismatch. For example, a business process outsourcing operation in India receiving US dollars will need to develop a hedging policy, as its primary cost base is in Indian Rupee.

Post-Enron and the new Basel II regime require banks to be more vigilant in meeting compliance standards. The Know-Your-Customer rule mandates higher transparency and financial disclosure from corporate customers. Rating agencies, institutional investors, auditors and stock market regulators demand stringent corporate governance and financial reporting standards. Some listed companies are investing in new treasury management systems to capture front office trade, middle office confirmation and back office settlement of derivatives transaction to fulfil FAS133 and IAS39 hedge accounting requirement.

The age of electronic money is slowly developing in Asia. In many Asian economies particularly in rural areas, cash dominates as the preferred method of payment. However, technology can make a difference, exemplified by the use of “Octopus Card” as an electronic wallet in Hong Kong. Electronically linking ATMs to permit retail customers (payers) to transfer funds to merchants (beneficiaries) is becoming popular. For the sake of public interest, domestic bank associations should encourage sharing of terminals particularly when they want to focus their branches on selling wealth management products. ATM cards, in the form of payment cards, can be used to disburse cash to cardholders (beneficiaries) who don't need traditional bank accounts. This is being done in the Philippines. Mobile phone usage is growing at a break neck pace in Asia. How such technology can be adapted for retail payment is going to be interesting.

On the wholesale side, real time gross settlement (RTGS) in Asia first took off in Hong Kong in 1996, thanks to the Hong Kong Monetary Authority (HKMA). HKMA also created the Central Monetary Unit (CMU) which links to the clearing system in China (CDC), Europe (Euroclear) and other Asian countries. The availability of US dollar clearing in Hong Kong means “Payment versus Payment” (PvP) against US dollar can be done more efficiently within the Asia time zone. This role as a regional clearing/settlement/custody centre is likely to grow as China relaxes its rule of overseas investment. RTGS streamlines PvP and “Payment versus Delivery” (PvD) settlement, improves liquidity, and reduces systemic risks. Today most Asian countries including China and India have implemented RTGS.

As the footprints of corporate customers expand, banks should follow. International banks will be at a crossroad. It will not be economical for them to expand their branch networks. Therefore forming new partnerships with local banks are likely to be the future solution and new development.

The age of “free (transaction) service” is no longer sustainable. Banks find it viable to maintain a branch only if that can be modelled as a “wealth management” centre. Gone are the days of “cross-

subsidy” as mortgage margins shrink and loan growth slows. In the future alternative collection channels such as post offices, convenience stores, kiosks and ATMs will be popular. Some historical barriers should be reviewed. For instance, Hongkong Post should adopt the same practice as in other Asian countries (such as PT Post in Indonesia) to broaden its “PayThruPost” service (not deposit taking activity) to service more than just utilities.

The growth of the financial services industry in Asia Pacific will outpace gross domestic product (GDP) growth. The same can be said about the demand for treasury management talent. Employers in Asia have to invest more in education, training and professional development. The HKACT has been involved in a number of initiatives to increase the qualifications available to those working in treasury management, including promoting the ACT’s Certificate in International Cash Management qualification, which has run annually in Hong Kong since 2001. Over 150 students from the banking and corporate sectors have enrolled in the course in Hong Kong and demand for the qualification continues to grow.

Cooperation within Asia Pacific at the government level has expanded. The recycling of national savings, within Asia, through the creation of the Asian Bond Fund is a step in the right direction. There are synergies and opportunities to accelerate reform if we can develop the platforms to promote and transfer best practice within the region. At the World Bank/HKMA “Conference on the East Asia Financial Markets: the Next Frontier” in June 2006, the findings of the World Bank Flagship Study of East Asian Financial Markets were presented and discussed. It highlighted the need for Asia to invest for the future to achieve sustainable growth. For example, development of the private pension and medical insurance will reduce future funding gap and fiscal imbalance for governments. Some regulations have to be revised like the withholding tax rule on bond repo in order to help the development of the secondary bond market.

There is a need to forge closer partnerships between the public and private sectors. In 2004 the HKMA pioneered a new initiative called the Hong Kong Treasury Markets Forum (HKTMF). HKACT was invited. HKTMF’s four sub-committees are working on issues related to product development, market standard and education of financial market participants. This has helped build dialogue with mainland Chinese regulators including the Peoples’ Bank of China, State Administration of Foreign Exchange (SAFE) and China Banking Regulatory Commission (CBRC). In January 2006, HKTMF was institutionalised into the Treasury Markets Association.

Given the rise in intra-Asia economic activities, there are benefits to be seen by promoting pan-Asian cooperation within the private sector. The HKACT and the ACT (Singapore) co-founded a new pan-Asian initiative – the Asia Pacific Treasurers Forum (ATF). Both are members of the International Group of Treasury Associations. Our missions include the formation of new NTAs and strengthening existing ones.

Asia should take cues from the experience in Europe to maximise the potential of further financial integration of the economies within the region. By January 2008, a Single European Payment Area (SEPA) will be formed to allow pan-European euro credit transfer and direct debit payment instruments to be launched (also debit card) across Europe. By the end of 2010 all national, technical, and legal barriers are to be removed to enable the migration of domestic payments to SEPA instruments through the pan-European automated clearing house. While I am not advocating an Asian version of the Euro, Asian governments should work closer together (such as eliminating cross-border withholding tax) to improve the efficiency of cash movement at least within the region. Banks can then provide an efficient region-wide pooling and netting cash management products.

Conclusion

Asia learnt lessons the hard way during the 1997-98 financial crisis. It has remained resilient and rebounded gracefully. However, the momentum of financial reform has to continue. Asia needs to invest for the future. Removing tax disincentives and market impediments to efficient cash

management as well as the development of a corporate bond market will go a long way towards promoting a financially healthy private sector and using market discipline to raise the level of corporate governance and transparency. A clean, lean and effective government is important to continue to attract private sector capital internally as well as abroad. Public-private sector partnerships should therefore be further promoted. We should support the pioneering effort being carried out by institutions such as the Asian Development Bank.

The hard-working Asian work force, the high savings rate and the growing middle class should generate the virtuous cycle of growth and prosperity. However Asia is still a combination of countries with per capita GDP ranging from USD500 to USD30,000. Therefore policymakers should stay vigilant on priorities such as the eradication of poverty, preparation for the fiscal demand from an aging population and achieving environmental harmony.

While the hard economic numbers are important, corporate treasurers should also be aware that social and political events could shape the course of the economy and vice versa.

HSBC's Guide sheds light on what good lessons practitioners can learn to benchmark the best in class treasury and cash management solutions. The past ten years was a remarkable period for the development of the cash management industry. The next ten years will prove to be challenging because of the changing risk profile of corporations and the increased competition for banks. Increased efforts, however, will be highly rewarding as Asia-Pacific business is gaining significance due to its higher rate of growth. For treasurers this means they can now take business to the next level of sophistication. For banks it means they should innovate (new products), develop (customer) relationships and gear up their (staff and resources) support.

For further information:

www.treasurers.org

www.worldbank.org

www.tma.org.hk

www.igta.org