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Steps Towards Operational and Financial Efficiency in China

by Jürgen Lutz, Head of Cash Management Asia Pacific Region, UniCredit S.p.A. Shanghai Branch

With China’s position as the world’s second largest economy firmly established, few companies can afford to ignore the opportunities for both sourcing and sales that China represents. UniCredit has more than 30 years’ experience in Asia and we have always been proactive in supporting our customers in both their day-to-day and strategic operations. Indeed, many people sent from treasury organisations from overseas are surprised when they first start working in China how different it can be to organise automated day-to-day cash and treasury processes in a regulated market. In this article, we offer some realistic insights into the challenges and opportunities for companies seeking to enhance their operational and financial efficiency.

The efficiency challenge

Treasury and finance has a major role in facilitating both day-to-day activities and strategic growth in every part of the world, including China. Although in many cases, treasury is centralised at either a global or regional level, companies typically set up a separate treasury and finance function in China. The primary reason for this is regulatory: RMB is not a fully convertible currency, and the cash and treasury management environment differs substantially from those of Europe and North America. Despite this, it may still seem surprising that so few companies have achieved a comparable level of operational efficiency in China to their treasury operations in other parts of the world. After all, the country-wide clearing system in China (CNAPS) is efficient and automated, for the purpose of domestic settlement. And for better interoperability between domestic and international clearing system, PBOC has announced the development of a new China International Payment System (CIPS) which aims to overcome manual overheads between SWIFT and CNAPS due to local language requirements for RMB cross-border settlement. The banking sector in China is extensive, with a variety of full-service domestic and international banking partners. Electronic banking tools are widely available from domestic and international banks and major technology vendors provide local capabilities and support in China.

There are, however a variety of reasons why levels of efficiency and automation amongst corporate treasuries remain low. Many corporations launched their business in China a number of years ago, often on a small scale initially. Legal and regulatory requirements were (and often still are) challenging. For example, supporting documentation for transactions needed to be submitted to banks, and this remains an obligation for most companies. ERP (enterprise resource planning solutions such as SAP and Oracle) and TMS (treasury management systems) were not used extensively in China and therefore these systems did not necessarily support local instruments. In addition, the initially small scale of some cash and treasury management functions did not justify an investment in automated systems, particularly when labour costs were low.

Building momentum

Despite the challenges, both historic and current, treasury and finance managers are becoming increasingly motivated to improve the automation of their operations and visibility over cash and risk. Firstly, with the increasing cost of labour, automation of processes and reporting is becoming a higher priority for local management. Secondly, the scale and value of companies' activities in China have reached a level that senior management outside China are seeking greater visibility over positions and processes, and greater confidence in the quality of the control environment. Finally, while the regulatory environment remains challenging, the pace and nature of liberalisation are gaining significant international attention, so there is now a greater awareness at head office of the opportunities to enhance both operational and financial efficiency.

While the regulatory environment is becoming more liberal in China, it is becoming more stringent globally. Senior finance executives therefore need the same degree of confidence in compliance and controls in their China business as in other parts of the world. This is prompting many treasurers and finance managers, both in-country and at the company's group treasury, to focus on rolling out the corporate ERP and/or TMS to standardise processes and reporting, and achieve greater visibility over financial positions in China. While treasury and finance processes may need to be adapted to local conditions in China, a common platform enables a consistent approach to control and reporting and oversight over cash and risk at a global level.

In addition to implementing internal systems, the need for integrated, secure bank connectivity is as compelling in China as in any other region to optimise payment efficiency and security, to ensure prompt access to balance and transaction information and enable processes such as cash positioning and reconciliation to be automated. Some local banks are not yet in a position to fully understand this integrated approach and respective communication with corporate overseas HQs, but these capabilities are typically an essential element of most international banks' offering in China.

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Challenges of centralisation

While process automation and control are becoming a little easier, treasury centralisation and rationalisation of

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banking relationships remain challenging. Entities in China are obliged to maintain a variety of bank accounts for specific purposes, some of which must be held with local banks. Supporting documentation for cross-border trade transactions still needs to be submitted physically to the banks. On the other hand a pilot programme was launched in July 2012 that aims to streamline and simplify the need for supporting documentation. This is currently only available to a limited number of organisations; however it has the potential to make centralisation easier once the programme is rolled out more widely.

Financing the business in China

Financial efficiency is just as important as operational efficiency, if not more so, to treasurers and finance managers operating in, or responsible for China. For example, financing local entities remains a major priority. The rules for intercompany lending are very tight and many companies do this through bilateral or multilateral entrust loan arrangements; however, obtaining external financing is often still required. During periods of constrained market liquidity, it can be difficult to access local financing, so companies need to look beyond China for credit. At other times too, locally-incorporated banks, which includes many of the major international banks, need to comply with a formal loan-deposit ratio, which ties lending closely to the level of deposits. UniCredit, operating as a branch, rather than a locally-incorporated bank, is not subject to the loan-deposit ratio, and we fund our customers in China through an integrated approach between our headquarters and operations in China. This is of considerable value to our customers, as we can leverage our existing relationship and therefore the process of obtaining financing is more rapid and straightforward.

To limit the need to borrow externally, working capital optimisation is a parallel priority for treasurers and finance managers of companies domiciled outside China. There is a growing awareness of this, as it is for example brought in from group treasury as a vital company policy. It needs also education of local employees in the importance of working capital and the ability to question existing workflows. Efficient and well-integrated processes and information flows are therefore essential in order to ensure visibility and control over working capital.

Evolving regulation

Regulatory change in China is taking place steadily, not least due to the government's publicly announced objective for Shanghai to become an international finance centre, targeted to be by 2020. Typically, regulatory change is introduced through pilot programmes that involve three or four banks and 15 or 20 corporations, typically in Shanghai or Beijing. As this represents a very small minority of the total commercial population, and it can often take many months before a pilot is expanded universally, most treasurers and finance managers cannot benefit immediately from emerging developments. However, these initiatives demonstrate the government's commitment to market and currency liberalisation, and should give treasurers and finance managers confidence that they will increasingly be able to meet their operational and financial efficiency objectives.

There are some opportunities that are currently available to all companies that may offer considerable benefits. The most significant of these is RMB cross-border settlement for trade and capital. The potential to settle international trade in RMB brings commercial opportunities when dealing with both suppliers and customers in China, as these companies can reduce FX risk. Furthermore, with an active offshore RMB market, particularly in Hong Kong and increasingly Singapore and London among other places, and frequent opportunities for companies that both source and sell in China to net RMB exposures, RMB trade settlement can be very advantageous. The liberalisation of RMB cross-border transactions does not extend only to trade transactions but also to the movement of capital. For example, overseas companies can now fund their start-ups in China not only in foreign currency but also in RMB raised offshore.

A pragmatic approach to innovation

Some banks are discussing the potential for treasury centres in Shanghai or Beijing to become regional treasury centres for Asia Pacific as a whole. There are examples amongst the largest multinational corporations that have had extensive involvement in pilot programmes and other regulatory concessions where this is feasible. The more and faster China is moving towards a fully convertible currency, the more companies will be attracted to move their regional finance headquarters to Mainland China. At UniCredit, we are proactive in understanding our customers' business, and their needs and constraints. We help our clients understand the evolving regulatory environment and ensure that our customers are able to take advantage of emerging opportunities that impact them positively. In some cases, these are strategic developments that bear fruit over the longer term, while in others we enable improvements in day-to-day efficiency and control that have an immediate benefit to the business. □

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Jürgen Lutz is a senior cash management specialist with UniCredit and has more than fifteen years' experience in cash management with a profound knowledge of client requirements in this area. From 1998 to 2001 he was responsible for cash management sales at HypoVereinsbank, where he oversaw multinational and institutional clients. From 2001 to 2004 Jürgen was the head of a small sales team with focus on insurance companies and European headquarters of US based corporates. From 2004 to 2009 he focused on the industrial sectors telecommunication and energy and he also took on responsibility for all international cash management-activities of mid-sized corporates. In 2009 he served as the Head of Cash Management Sales Global Business. Since 2011 he has been the Head of Cash Management Asia Pacific Region, located in Shanghai.

Jürgen graduated from the University of Bayreuth in 1995 with a degree in Economics.