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Connecting China into the Global Business

by Bruno Francois, Head of Transaction Banking, Greater China, and Laura Milani, Liquidity Management Marketing Director, BNP Paribas

The past five years have witnessed enormous developments towards currency and fiscal liberalisation in China, with the RMB now the fifth largest global payments currency, and the second most popular currency for trade finance, (source: SWIFT). This reflects growing confidence in the use of RMB as a trade and investment currency amongst market participants, with an increasing range of opportunities for mobilising RMB, not only within China but across borders. In 2014, PBoC (People's Bank of China) took a major step forward in encouraging corporations to invest in China and adopt RMB by permitting onshore RMB balances to be connected to cross-border cash pooling structures.

Background to RMB cross-border cash pooling

The RMB internationalisation programme first started in 2009 with the initial launch of the pilot cross-border trade settlement programme, and gradual progress towards currency liberalisation has been ongoing since then. A key milestone in this process was in September 2013, with the launch of the China (Shanghai) Pilot Free Trade Zone (SFTZ). The intention was to expedite regulatory and administrative transformation, stimulate trade and investment and gain experience of an open economy. The inclusion of 'China' and 'Pilot in the title is important, reflecting that the free trade zone is intended to be an incubator for trialling new regulatory and administrative measures before expanding their scope more widely across China.

A milestone development

In February 2014, entities in the SFTZ were allowed the opportunity to include onshore RMB (CNY) balances in two-way cross-border cash pools for the first time with only limited conditions. Specifically, a registered entity in the SFTZ needs to act as the pool header, and only cash flows generated from operating activities (i.e., not borrowed funds) can be included. No approval is required, and flows within the cash pool are not subject to a quota. As a major step in the journey towards currency and fiscal liberalisation, it is perhaps surprising that the announcement was initially met with relatively little enthusiasm from the corporate community. There are a variety of reasons for this:

Firstly, the SFTZ at that time comprised 28.78 km^2, consisting of four existing bonded zones: Waigaoqiao Free Trade Zone; Waigaoqiao Free Trade Logistics Park; Yangshan Free Trade Port Area; and Pudong Airport Comprehensive Free Trade Zone. For many organisations, these areas were not necessarily the best location for their business, and did not match the aspirations of many corporations.

Secondly, with a rapid pace of regulatory change in recent years, many treasurers have adopted a 'wait and see' strategy, fearing that acting now could make it more difficult to take advantage of further changes ahead.

Thirdly, there are examples of corporations where treasury centres outside China are not made fully aware of evolving opportunities by the treasury centre in China, perhaps fearing a loss of autonomy.

An expanding reach

In July 2014, the ability to include CNY balances in cross-border cash pools was extended to entities across China, a move that was widely welcomed. However, the restrictions are far more stringent. For example, entities need to have been incorporated in China for a minimum of three years, with a minimum turnover both in China and globally. In addition, the sweep amounts are subject to a quota. Together, these conditions are considered overly restrictive for many corporations. Now that market participants have become familiar with the two options that are available, they are in a better position to make a decision about how important cross-border cash pooling is for their business.

For many organisations, this decision has become easier with the recent suggestion that the geographic reach of the SFTZ would be expanded to an area of 120.27km^2, include the Lujiazui financial district, Jinqiao development zone and Zhangjiang hi-tech park, all of which are in Shanghai's Pudong district, although this has not yet been officially confirmed. With the inclusion of Lujiazui, in particular, the city's financial hub and the location of a large number of regional headquarters for both multinational and Chinese companies, a far larger number of corporations have become part of the SFTZ and can therefore leverage the opportunities. In addition, as treasurers become more familiar with the progress of currency and fiscal liberalisation in China, they recognise that as the pace of progress is unknown, it is better to act on the opportunities now rather than wait for an uncertain future.

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Determining the value

Although cross-border cash pooling is a major step forward for cash and liquidity management within China and

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more widely, it is not a panacea for every organisation, and the benefits need to be considered in comparison with other liquidity management solutions that are available, such as intercompany lending. For example, amongst BNP Paribas customers, we are seeing the following trends:

Cash-rich corporations with large cash balances in China are successfully using cross-border intercompany lending as a way of leveraging cash in China for the benefit of overseas entities. This is already a flexible and straightforward solution to adopt, and we would expect most companies already doing this to continue.

Cash-short corporations that need to access surplus cash offshore to fund working capital (as opposed to capital expenditure or M&A) in China are likely to be most attracted to cross-border pooling, as this is most flexible solution for this purpose.

'Bridge-building' corporations are large corporations or conglomerates in particular that may have no immediate need for cash pooling, but want to have the infrastructure in place to support their cash and liquidity requirements as they evolve.

Assessing the opportunity

The specific solutions offered by each bank for managing RMB liquidity vary, so treasurers need to ensure that their chosen bank's approach will allow them to meet their liquidity objectives. For example, BNP Paribas provides a fully automated solution for domestic and cross-border cash pooling, including RMB. Offshore pool participants are set up in Hong Kong or Singapore, as these locations share a common time zone with Shanghai. This allows funds to be swept at the end of each day, leaving either a zero or target balance on participant accounts, therefore complying with the rule that the overall pool cannot have a negative balance. Consequently, European or North American entities will typically set up a non-resident account in one of these locations, which can then be linked into a global liquidity structure as required. As BNP Paribas uses the same robust liquidity management platform in China as every other jurisdiction, customers are able to pursue a regional and global approach to liquidity without the need to navigate different conditions or service levels in different parts of the world.

We are now seeing considerable interest in RMB liquidity optimisation, including cross-border cash pooling, amongst corporations of all sizes. In particular, treasurers now recognise the opportunity to include RMB in a cohesive regional or global liquidity management strategy, which is giving corporate decision-makers greater confidence in pursuing strategic growth plans in China. While it is typically the larger multinationals that have the capacity and flexibility to be 'early adopters', cash pooling is straightforward to set up, so we expect a wider range of customers to do so in due course. In addition, we expect the remaining regulatory restrictions to be relaxed in the future, such as the condition that only surplus cash can be included in cross-border sweeps and, outside the SFTZ, limitations on the size of companies that are eligible to participate. We would further anticipate that corporations will be able to link RMB accounts to cash pool header accounts beyond the immediate time zone in due course.

A catalyst for market confidence

Greater ease in mobilising RMB is likely to encourage corporations that are not yet using RMB for cross-border trade to do so, where there are commercial or financial benefits for doing so. Furthermore, while the ability to include RMB balances (both on- and offshore) in cross-border cash pools is a major step forward for treasurers, there are complementary opportunities that are equally important. For example, BNP Paribas' global electronic banking tools enable visibility over cash balances and flows across all countries, currencies and entities. Cash management structures such as payment and collection factories, including payments-on-behalf-of (POBO) and collections-on-behalf-of (COBO), and multilateral netting, are becoming a realistic proposition in China. Treasurers and finance managers are therefore able to implement centralised structures, such as financial shared service centres (SSCs), or connect China into existing SSCs.

Key to the success of cash and liquidity management initiatives in China is the ability for partner banks to provide solutions that offer value to an organisation at both a local and global level. Dialogue and collaboration between treasury operations in China with the wider group typically results in tailored solutions that directly support the corporation's commercial objectives. By working with a global bank such as BNP Paribas that has the local presence and expertise in China and in the corporation's home market, we are able to facilitate this dialogue, understand local and global objectives and constraints, and construct tailor-made solutions to connect China into the global business. □

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