



Solutions for Releasing Trapped Cash



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Why does trapped cash matter?

Both 2014 and 2015 have been inflexion years for corporates at multiple levels.

From a macroeconomic perspective, emerging markets have started to slow down after decades of leading global economic growth, with more developed markets, like the US, now assuming the mantle of growth generators.

Similarly, low oil prices have slowed infrastructure development and expansion in resource-driven economies in the Middle East and in parts of Africa, and have prompted increased consumption in oil-consuming countries.

And, while the Middle East and North Africa continue to see security and political risks, Europe has seen its share of political turmoil, whether in Ukraine or in the challenges posed by a potential Greek – or even British! – exit.

However, global corporates continue to expand operations in search of growth. This raises new opportunities but also new challenges. And for treasurers, what seems to sit at the top of the list here is almost certainly the issue of “trapped” or “inaccessible” cash.

While the traditional challenges of trapped cash have remained largely market-dependent, even as they have become more pertinent, newer issues have also surfaced, issues that are also affecting the accessibility of liquidity around the world.

Trapped cash is therefore of increasing importance to treasurers and CFOs not least because of the impact it can ultimately have on enterprise value, but also because of the implications of “releasing” liquidity and the solutions needed to do so.

Trapped cash represents an asset that is underutilised, which raises issues of opportunity cost, working capital efficiencies and risk considerations.

What can drive trapped cash?

Before discussing potential solutions to releasing trapped cash, it's worth understanding just what the issues are that trap liquidity in the first place. These issues can include or be tied to a range of factors from regulation to geopolitics to taxation.

Regulation

Regulation limiting or prohibiting cross-border movements, including FX controls, capital controls, foreign investment laws, restrictions on intercompany lending, corporate finance considerations and regulatory approvals are just some of the factors that prevail here.

Geopolitical

Geopolitical risks that change a country from a liberal to a restricted market (e.g. Ukraine, Cyprus, Egypt, etc.) are also factors. Moreover, increased geopolitical risk has resulted in an increased focus on cash in certain markets. Ironically, some of those markets may be the most challenging to repatriate cash from. Related to this are other risk considerations such as fraud mitigation, especially in an economically challenged region.

Interest optimisation structures allow banks with a local country presence to compensate clients globally with minimum implementation hassle.

Taxation

There are a range of tax implications that can affect trapped cash, from corporate tax rates (e.g. in the US) to withholding taxes on dividends (a common tool used to repatriate cash) to capital gains taxes in certain jurisdictions.

Strategy

There are also strategic considerations that may drive cash to remain in certain countries to meet future growth and investment requirements.

Structural

Sub-optimal liquidity structures, typically decentralised or not-fully-centralized arrangements, can create fragmented positions to exist in multiple countries, while other parameters can include multibank set-ups or inefficient payment structures that require liquidity to be held locally in order to process transactions.

In short, trapped cash represents an asset that is underutilised, which raises issues of opportunity cost, working capital efficiencies and risk considerations. This makes it imperative, where appropriate, to explore what strategic or tactical solutions there are to enable treasurers to repatriate or utilise this cash so it can be better deployed to meet more lucrative investment opportunities.

What strategic solutions are there?

Stretching payables, contracting receivables

Structural or more strategic approaches can include the deployment of legal vehicles that allow companies to stretch trade payables and shorten trade receivables. One such solution is to pay early on payables out of a restricted jurisdiction (releasing trapped cash) and pay late on receivables into that country (delaying trapped cash). For this solution, local regulatory and tax oversight and market FX movements must be taken into account.

Buying from restricted areas, selling to the world

Some companies also use an internal company located in a free market to buy from restricted jurisdictions and sell to the rest of the world. This creates intercompany loans of the underlying trades. Arm's-length and trade terms will need to be set in ways to avoid the potential characterisation of receivables as loans. Some of the frequently used structures here include procurement, re-invoicing and netting centres.

What tactical solutions are there?

Cross-currency

Interest optimisation structures allow banks with a local country presence to compensate clients globally with minimum implementation hassle. This is a popular solution and one of the major drivers for the single-bank strategy that many clients select for their global cash management arrangements. Balances are treated favourably when held with the same bank, even if they are in different countries.

Optimisation

Global liquidity optimisation through an efficient cash management structure helps corporates who frequently find themselves with scattered balances as a result of sub-optimal multi-bank set-ups. In situations like this, clients do not take advantage of true end-of day-concentration solutions, or else they lose days of value for balances that are managed in different time zones. However, there are options in the market that, if utilised, can minimise or even eliminate these fragmented positions, generating working capital and cost-efficiencies for users in the process.

Corporates, together with their trusted advisers and appropriate banking partners, can put innovative structured solutions to work to repatriate liquidity.

Pooling

Cross-border pooling solutions for markets that become liberalised is a good tactical solution. A good example is the RMB and China's fast-evolving regulatory reforms. Roche, partnering with Citi, participated in People's Bank of China's pilot RMB cross-border pooling programme in 2013. Citi, as the first bank to offer cross-border RMB sweeps and pools, set up Roche's RMB cross-border pooling structure with a fully automated sweeping platform between China and Hong Kong, where the global pool header had an offshore RMB account. Today, the RMB can not only be part of a cross-border structure: it can also participate in notional pooling products, maximising the liquidity value of the currency.

Repatriation

This can ensure timely regular capital and dividend repatriation within allowable jurisdictional limits allowed by each jurisdiction. For example, in South Africa, due to exchange control restrictions, ZAR balances cannot be pooled cross-border in liquidity structures, and South African companies are not allowed to hold ZAR offshore without special approval from the Reserve Bank. Here companies would seek the advice of banks to accurately prepare the documentation required prior to repatriation. For dividends, a board resolution is required along with the latest audited financial statements of the local subsidiary. Sufficiently retained earnings must be available in the local subsidiary.

It is important to note that these solutions do not result in the complete and comprehensive repatriation of the all trapped liquidity. However, to the extent that cash is released, they do result in risk mitigation and they allow corporates to more efficiently deploy this cash. Moreover, there may be some instances, where it is more effective to leave cash in certain countries for further growth.

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So what can we conclude?

While there are numerous drivers behind situations that result in trapped cash, corporates, together with their trusted advisers and with appropriate banking partners, can put innovative structured solutions to work to repatriate liquidity where it is feasible and deploy it more productively in line with internal finance and investment policies and external regulations.

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