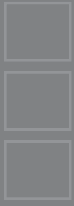

Asian Banker Research

TEMENOS
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Payments and Cash Management: The Asian FI Perspective

THE ASIAN BANKER®
STRATEGIC BUSINESS INTELLIGENCE FOR THE FINANCIAL SERVICES COMMUNITY

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Table of contents

Where to go Shanghai? Sheer economic power will not turn a city into a global financial centre 2

- Fierce domestic competition
- Competiveness of Shanghai's exchanges
- Regulatory framework
- Financial centres represent a concentration of minds and international institutions
- Tokyo's experiences
- Perception of Shanghai as a global financial centre by Chinese and foreign bankers
- Conclusion

Access to the renminbi: Meeting changing customer requirements through effective liquidity management solutions and innovative products 10

- Turbulent waters ahead
- Views from the ground
- Changing customer expectations
- Leveraging technology
- Conclusion

National and cross border payment systems infrastructure in Asia: Advances and perceived challenges 15

- China: China National Advanced Payment System (CNAPS)
- Thailand: Payment systems roadmap 2010
- Malaysia: Electronic payments roadmap

Optimising payments, liquidity and cash management capabilities in Asia: Key trends and outlook 20

- Shifting from crisis management to recovery
- Meeting increased customer expectations
- Emerging trends in payments, liquidity and cash management
- Domestic and foreign player dynamics
- The increased strategic importance of corporate treasurers
- Regulatory constraints on the way forward

Optimising retail payments in Asia: Key trends and outlook 25

- New technologies
- Channel strategies—going mobile
- Online payments and the future of retail banking
- Conclusion

Where to go Shanghai? Sheer economic power will not turn a city into a global financial centre

The number of cities that have announced their desires to become global financial centres far exceed the handful that have truly become one. Most of these cities aspire to develop the same stature as New York, London and Hong Kong, but only a few will become more than local bourses. In April 2009, China designated Shanghai to join the race and aspires to turn the city into a global financial centre by 2020.

Unsurprisingly, many bankers in China and Asia Pacific believe that whether Shanghai transforms into the dominating financial centre in the Asian region is not a question of if but when. Others go as far as proposing that Shanghai is capable of closing the gap between the more established centres of London and New York. Such unbridled optimism might result from foreign bankers' expensive investments and capital expenditures in Shanghai and local's brimming national pride.

But it is critical to note that the realisation of Shanghai as the site of the next global financial centre in Asia is not only driven by factors within the financial realm. A careful survey of the rise of past and current financial centres such as the rise of the Italian city states between the 14th and 16 century and its supremacy in banking and the ascent of London and New York in modern times, proffers us with the insight that a unique combination of financial and non-financial factors propelled them into the premier league of finance centres above all others.

The nature of the achievement of Florence, London or New York as financial centres – creative hubs that are receptive to change and innovation, was a revolution less based on rapid accumulation of wealth and innovation in technology than it was on innovation in organisation of production and finance. Its catalysts were a blend of multilingualism of the financial workforce and international mobility, a concentration of the best minds in the industry, a drive for constant experimentation and innovative approaches in producing new sets of financial knowledge, and an open climate in which ideas were disseminated without being dominated or controlled by a single tradition of thought or group.

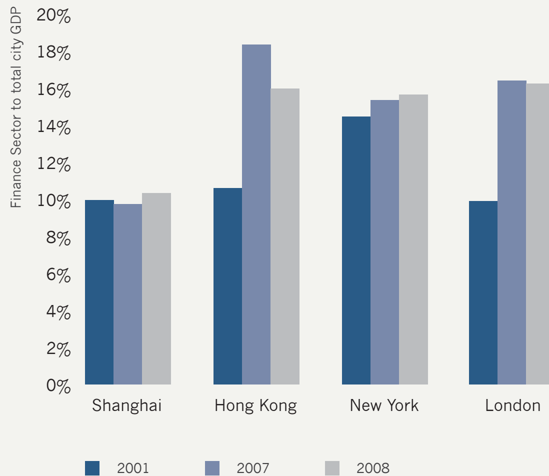
It will therefore take more than China's sheer economic weight for Shanghai to succeed in its goal of being a financial centre. It involves aiming for improved infrastructure, the internationalisation of the workforce, a national development strategy tailored to Shanghai, the centralisation of China's financial services, and further liberalisation of its currency, interest rates and exchange regulations.

Nonetheless, the sheer power with which the Chinese economy has developed for more than two decades is an important underpinning. China overtook the US as the main source of potential investment capital in the world. Chinese savings reached a landmark annualised $ 2 trillion in the second quarter of 2009, while US savings, negatively impacted by the financial crises, declined to a level of $ 1.4 trillion at the same time.

Despite the crises, the three major Chinese banks are among the global top 5 in terms of market capitalisation size. China's IPOs accounted for 46% of the global IPOs for the first three quarters of 2009 and seven out of the top 10 global IPOs this year have involved Chinese issuers.

Figure 1.1

Contribution by financial centres to local economy (%)

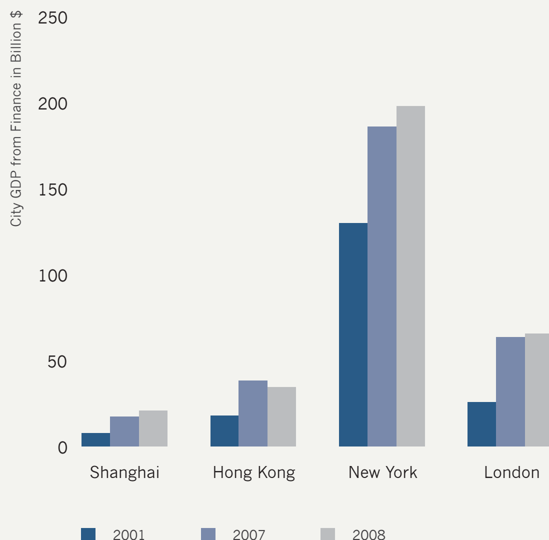


Source: Asian Banker Research

Shanghai's financial sector grew steadily with a compound annual growth rate of nearly 13% from 2001 to 2008, in line with the overall city GDP [see figure 1.1]. A specialisation towards the financial sector is not yet conceivable. The established financial centres are more focused on the financial industry and their finance sector contributes around 16% to the city GDP 2008, whereas for Shanghai, it remained stable around 10% in these eight years.

Figure 1.2

Contribution by financial centres to local economy ($)



Source: Asian Banker Research

Despite the growth of Shanghai's financial industry, it does not seem to have caught up with other financial centres such as London and New York growing at similar rates during the same period [see figure 1.2]. Absolute figures of Shanghai's financial sector remain relatively low, accounting for only a tenth of New York's finance GDP, a third of London and a half of Hong Kong.

Fierce domestic competition

Lack of government support for Shanghai's financial sector development in the past and tough rivalry in financial services between major Chinese cities may be seen as a major reason for this. Although there have been talks for the past 20 years to turn Shanghai into a financial centre, not much has happened before 2009. In a policy shift, China's State Council announced on 25 March 2009 that Shanghai will be built into an international financial centre and a global shipping hub by 2020.

Compounding the challenge is the closeness of finance to politics in China and a banking sector firmly grounded in Beijing. All big four mega banks have their headquarters in Beijing, and only Bank of Communication, Shanghai Pudong Development Bank and the foreign banks are located in Shanghai.

The Chinese government has also supported several other cities such as Beijing, Tianjin and Shenzen to develop their financial services sector. As a result, China's financial industry is widely scattered across the country, and it is by no means clear that Shanghai will emerge from the intra mainland competition as the only dominant financial centre.

If China wants to build Shanghai into a global financial centre, it has to centralise the currently fragmented efforts throughout the country. There are currently two major stock exchanges in Shanghai and Shenzhen, and a third one, off-shore in Hong Kong. The State Council is currently debating whether to build a common capital market between Shenzhen and Hong Kong, allowing Shenzhen's fi nancial institutions 1to tap the international market through Hong Kong, while allowing more fi nancial institutions in Hong Kong to set up branches in Shenzhen as their springboard to expand business in the mainland. This might enable both centres to cooperate more closely in order to attract dual-listing of enterprises at home and overseas. Once enforced, this will seriously challenge Shanghai's position as the leading equity exchange in China.

The derivatives and commodity trading business is shared across three major derivatives exchanges: the Shanghai Futures Exchange, Dalian Commodity Exchange, and Zhengzhou Commodity Exchange, with Dalian and Zhengzhou still trading higher volumes than Shanghai by end of 2008.

Tianjin is another player snapping on Shanghai's heels. Due to its close relationship to the central government, it has evolved into a pilot site for testing foreign exchange reform policies and insurance reforms. "Important reforms for financial enterprises, financial businesses, financial markets and financial opening may first undergo trials in Tianjin's Binhai District," the State Council said in March 2008. The decision triggered the launch of the $ 2.9 billion Bohai industrial investment fund. The establishment of an over-the-counter (OTC) market is an important part of the approved reform scheme. Tianjin aims to become the "third pole" of China's capital market by setting up an OTC market.

Currently the Chinese government has officially flagged Shanghai to become the financial centre in China but on the ground it is far from reality. No seminal and final decision has been made to favour any of the cities – something which is subject to the individual preferences and obligations of senior members of the Chinese government towards these cities.

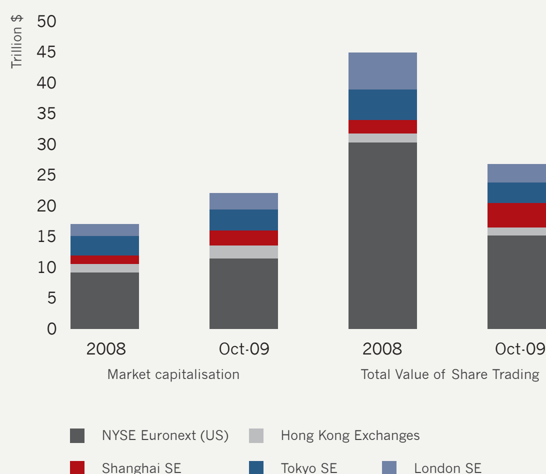
If Shanghai is to be taken seriously as a global financial centre, it needs to rise from the inter-city competition, and become "the" national financial centre of China, before it can even think about its regional and global leadership role. One might be inclined to argue that at least for now, Hong Kong serves as a complimentary centre to Shanghai as Hong Kong is an offshore centre and gateway. This does not seem to be the case with the other Chinese cities which compete and even undermine the potential of Shanghai.

Looking at established global financial centres, there is only one in North America and one in Europe. Asia might be big enough to hold space for two global financial centres. China does not have space and time for several standalone centres, competing internally and internationally. Like their peers in the UK and the US, they need to be assigned specialised, complementary centres, directed towards Shanghai as key hub. The Chinese government will have to commit sooner or later to Shanghai by centralising China's financial markets and banking sector.

Competiveness of Shanghai's exchanges

Figure 1.3

Market capitalisation and value of shares traded for selected stock exchanges ($)

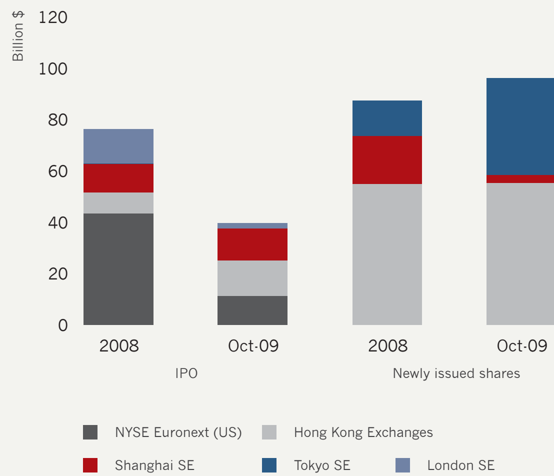


Source: Asian Banker Research

In terms of market capitalisation, Shanghai overtook London in February 2009 for the first time and remained ahead of it until July 2009. The same applies to the value of shares traded as New York's and London's values halved in 2009, whereas Shanghai's doubled [see figure 1.3]. Thus Shanghai outperformed London, HK and Tokyo y-t-d until end October 2009 with a value of shares traded of $4 trillion. While this may eventually be seen as a temporary strength due to the current weaknesses of Western economies, it certainly reflects the current strength of the Chinese economy, the potency of Chinese investors, and hints towards a possible long-term change in the mindsets of international investors.

In terms of capital raisings, Hong Kong and Shanghai were the dominant locations in 2009, globally [see figure 1.4] While in New York and London IPO offerings declined, China has seen an upsurge throughout 2009. China State Construction Engineering, which raised $7.3 billion in Shanghai in July 2009, was also the world's biggest IPO in 16 months. Aluminium products maker China Zhongwang Holdings tapped $1.3 billion in Hong Kong in April 2009. Hong Kong benefitted from its role as a gateway to China and thus was the world's most popular place for IPOs, before Shanghai, Sao Paolo and New York. It is highly unlikely that Shanghai will outdo Hong Kong in terms of capital raising anytime soon.

Figure 1.4
Capital raising in selected stock exchanges ($)



Source: Asian Banker Research

The listing of foreign shares domestically continues to be blocked. China has talked for at least a decade about allowing foreign firms to do so, but has hardly made any progress. It is more likely that 2010 will be the year for the first foreign IPO in China with HSBC hoping to be among the first as it currently awaits Beijing's approval to get a Shanghai listing.

While Shanghai lacks in investment banking, international corporate banking, asset management, and debt and bond trading, it has been developing its competency in stock trading of Renminbi denominated shares and commodities trading. It was the top city in the futures trading of rubber, and ranked second to London's Metal Exchange in trading of copper, aluminium and zinc.

In case the Chinese government decides to liberalise the Renminbi, the foreign exchange market, although nascent, offers opportunities. The Renminbi developed a considerable influence in Asian countries with high bilateral trade volumes or common borders with China, even despite the current convertibility and reserve restrictions. An internationalisation of the Renminbi would enhance the strategic importance of Shanghai. A senior executive from the Bank of Communications agrees that "central and local governments need to put out more detailed and effective policies to promote Shanghai's proposition as a financial centre. Capital flows should be freed and the Renminbi needs to be widely circulated as a regional trading currency."

Moving forward, Shanghai needs to focus on a few core competencies to build up its standing. New

Figure 1.5
Focus areas of global financial centres

	London	New York	Hong Kong	Shanghai
Investment Banking	● ● ●	● ● ●	● ●	●
Int. Corporate Banking	● ● ●	● ●	● ●	○
Asset Management	● ● ●	● ●	● ●	●
Trade Finance	● ● ●	● ● ●	● ● ●	● ●
Derivatives/ Commodity	● ● ●	●	●	●
Equity trading	● ● ●	● ● ●	● ● ●	● ●
Forex Market	● ● ●	● ●	●	○
Debt/ Bond Trading	● ● ●	● ● ●	●	●
Sharia compliant investment	● ●	○	○	○

● ● ● **Strong position** ● ● **Medium position** ● **Weak position** ○ **Not an issue**

Source: Asian Banker Research

York for instance, has its particular strengths in the stock market and the bond market. London, on the other hand, is the centre for international finance operations, with major US banks coordinating their international operations from London. The British Capital is also strong in commodities trading and Islamic finance.

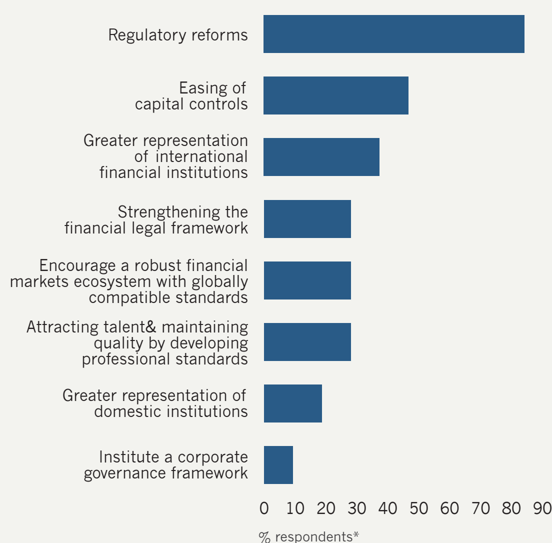
Hong Kong is currently popular in equity trading and initial public offerings due to its rule of law, good infrastructure, regulatory governance, low taxes, and the government's neutrality towards world policy. The latter makes it a preferred place for foreign IPOs, in particular from countries with ambiguous or tense relations to the West, such as Russia. In the short term, Hong Kong will continue to benefit from its position as a window to China and its offerings of Renminbi trading services. In the long-term, it will find its place as an offshore banking centre.

For Shanghai the most obvious specialisation of course will be the stock market for Chinese enterprises denominated in Renminbi. As companies will increasingly be interested in Chinese capital, Renminbi denominated lending and trade finance will become more important for Shanghai, as China will try to avoid exchange rate risks.

Regulatory framework

Figure 1.6

Urgent priorities for promoting Shanghai as a global financial centre



Source: Asian Banker Research
** Please select the top 3 most urgent priorities*

Although China is getting more self-confident, largely due to the failure of the Western regulation to avoid the crisis and to counter it, the government is aware that the Chinese regulatory framework and protectionism of state-owned enterprises is a reform area. In a survey conducted by Asian Banker Research, the need for regulatory reforms has been identified as the most urgent priority that the Chinese government should address. "Shanghai should have a good regulatory environment, where financial risk is strictly managed and where innovation and development are encouraged", says a general manager of a joint-stock commercial bank in China.

Major concerns in this regard span corporate governance, such as auditing and accounting standards, compliance, and efficacy of the board; the legal framework such as regulation of security exchanges, intellectual property, and contract enforcement; the liberalisation of interest rates. Efforts to strengthen the judicial system are essential to enforce the rule of law. The unpredictability, discrimination and delays in judicial processes remain among the biggest concerns of foreign investors in China.

The determination and openness of the Chinese authorities towards these topics have to be seen positively and the progress made in the last five years, such as the Anti Money Laundering Law and the Anti Monopoly Law, have to be recognised.

As China is further opening its financial sector, enhancing the transparency of both its outward investment and greater foreign access to Chinese assets becomes increasingly important. The region's financial services sector has repeatedly drawn criticism for its lack of disclosure and transparency. The recent events in Dubai underscore the need for transparency and open communication between banks, regulators and investors. There is currently insufficient publicly available information pertaining to China's compliance with the Principles and Guidelines for Effective Insolvency and Creditor Rights Systems set forth by the World Bank.

Reporting standards in China have been improved and enforced in the last years. The Chinese Ministry of Finance has even adopted auditing standards similar to the International Standard of Accounting, and which now apply to all Chinese accounting firms.

Financial centres represent a concentration of minds and international institutions

A total of 375 foreign-capital financial institutions and Chinese-foreign equity joint financial institutions set up headquarters or branch offices in Shanghai by the end of June 2008, accounting for 44.1 % of the city's financial institutions. There are 17 foreign banks and five foreign insurance companies among them. These institutions comprise more than 66% of the foreign-funded banks and 71% of foreign insurance companies in China. But there are restrictions on domestic private banks and foreign banks on how far they can extend their business.

A major barrier for the development of Shanghai is its small international workforce and the unavailability of high calibre financial professionals. There cannot be a global financial centre without internationalisation of its human assets, a matter that Shanghai has not sufficiently addressed to date. "It is not the question that Shanghai is becoming a financial centre. It is only a matter when. This depends largely on the extent to which the government continues its liberalisation. I mean to allow foreign talent as well as to train local talent", says a foreign bank with strong presence in China. Shanghai's capability to attract high-quality, foreign senior executives will be a crucial aspect for its 2020 deadline. But the city does not have the appeal of being an attractive place to live in unlike London or New York. This is further aggravated by the disappointing quality of public transport and the troublesome traffic, air pollution, lack of international educational institutions, limited entertainment options and the pervasive language barrier. Shanghai needs to act decisively in the next years to increase its international mobility, yet CBRC, the Chinese regulator, demands foreign executives to prove their Chinese language proficiency.

Tokyo's experiences

In developing Shanghai as a global financial centre, it is instructive to look at Tokyo's experience. The Japanese capital was expected to become a global financial centre more than 30 years ago, but for a variety of reasons it never lived up to this expectation. The Japanese government did not intend to internationalise Tokyo and relied on the financial resources and powerful banks to be the main drivers for Tokyo's development. The lack of an international workforce is evident in both Tokyo and Shanghai, with Tokyo having only 3% of its population from abroad and Shanghai with only 0.8%. This is clearly far from the proportions in London and New York where it is 27% and 36%, respectively.

The inability to reform complex rules and poor government structures by the Japanese government and too much bureaucracy caused a decline in the development of the stock market, in particular for international listings in the last twenty years. The constant low interest environment affected the capital markets negatively. Slow deregulation and lack of technological innovation at the exchanges impacted the range of financial products and made Tokyo unattractive as a trading location. Soon, hedge funds and investment banks avoided Japan as a base and operated from the neighbouring countries to do business there.

Shanghai starts with a similar proposition and similarly great ambitions. But unlike the Japanese government, Beijing appears to be more open towards change and globalisation.

Perception of Shanghai as a global financial centre by Chinese and foreign bankers

Despite ongoing concerns, local and foreign banks see Shanghai's ambition to become a financial centre optimistic and conceive the city as the global gateway to mainland China.

Local banks see the city as a place where they can interact and manage incoming assets and investments from key global players, as well as forge new partnerships for local businesses. Conversely, foreign financial institutions have rushed to secure a stable foothold in order to capture even a segment of the country's $3.4 trillion strong economy.

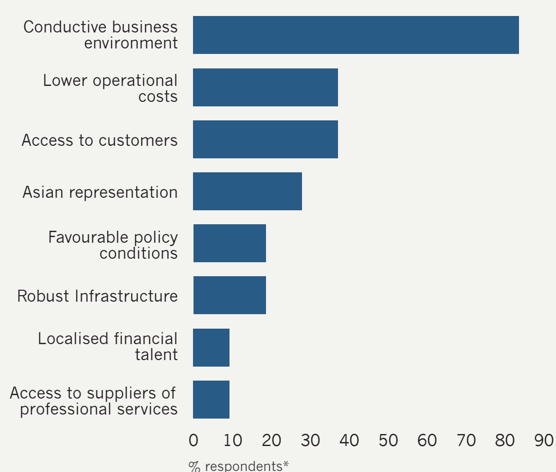
Foreign banks' expectations of their Chinese presence widely differed, however, from what their engagement turned out to be. The main reason is that the Chinese welcome foreign capital and technology insofar as it helps the country to develop itself. Most of the partnerships do not translate into long-term profitability for the foreign institutions. This is because local partners eventually use the expertise shared in the joint venture with a foreign institution, to the local institution's exclusive advantage. It is not uncommon in China for former partners to become fierce competitors. A good example is the credit card business of Shanghai Pudong Development Bank and Citibank. The Chinese bank now offers the joint venture card and a similar own card. However the popularity of having a China pres-

ence among international banks remains unchanged, though the returns should be examined more closely. Foreign bankers seem to justify their presence in China in order to keep the faith that their investments will pay-off in the long-term. This might be one reason why most of the foreign bankers interviewed attest Shanghai the greatest opportunities in their development towards a global financial centre.

Deutsche Bank China, which already has facilities in Hong Kong, sees its establishment in Shanghai as a big step. "I think the central government has sent out many positive signs for foreign companies. Making Shanghai one of the Renminbi cross-border settlement centres, together with Hong Kong, is one big step. With the help of this convenience, the interbank business will be more vigorous than ever and will help increase the transaction volume of Renminbi among banks. This enables us to proceed to our next step which is developing a deep network of trust with our institutional clients in China."

Figure 1.7

Shanghai's competitive advantage as a global financial centre



Source: Asian Banker Research
** Please select the top 3 competitive factors*

The low operational costs in Shanghai, compared to other up-and-coming financial centres elsewhere, are another advantage named by Société Générale in Hong Kong and Deutsche Bank in China.

On the other hand, domestic bankers regard Shanghai as an issue of national pride. Sources at Agriculture Bank of China (ABC) state that Shanghai's mandate to become a financial centre should never be divorced from China's national development strategy. As one senior ABC executive says, "I view Shanghai's rising to be a regional financial centre as one of China's national strategies. It has attracted billions of dollars in foreign investment each year and it is naturally viewed as a gateway to tap the ever-growing Chinese market. With the continuous rise of the Chinese economy in the global stage, the advantages of Shanghai will become even more apparent. The city is capable of accommodating many domestic-level exchanges as well as serving as an important channel for foreign capitals that want to get into China." The city's role as an access point for more capital flow to and from foreign institutions should always be seen in the greater context of stimulating growth for the Chinese domestic economy.

The domestic banks stand to gain most from the internationalisation of Shanghai as it allows the Chinese banks, who are currently in a low competitive environment, to test their strengths with international banks. One senior executive from Industrial and Commercial Bank of China said: "We will take advantage of the liberalisation of Shanghai's financial markets to test and promote our financial innovations. With Shanghai playing a bigger role in the global stage, there will be more competition and challenges from our global peers in the market. This requires us to deliver to clients a more efficient and less costly way while continuously bringing new solutions to solve our clients' problems. This can be done only through productive cooperation opportunities with leading banks in the market from which we can generate more value for clients. Challenges at this current stage will be mainly from effectively communicating our goals and building up our network of trust across the industry."

Conclusion

Shanghai's transition from a city characterised by rapid accumulation of wealth and economic power into an international finance hub needs clear commitment, focus and centralisation of China's financial services industry around Shanghai. There is a great deal to expect from Shanghai's future role as a financial centre if the country successfully manages its currency convertibility issues and infrastructure challenges, and if it attracts world-class personnel and international companies. The determination of China's government and its resources, as well as the growing clout of China and its banks are critical factors to ensure that Shanghai become the next birthplace of a global financial centre based in Asia.

Access to the renminbi: Meeting changing customer requirements through effective liquidity management solutions and innovative products

China is currently the world's second-largest trading country and third-biggest economy. Its position as a creditor country has been buoyed by strong growth prospects, large current account surpluses and a relatively small budget deficit, which has propelled it rapidly to a position of prominence in the international arena in a short period of time.

Compounding these strengths, China is rapidly accelerating its efforts to internationalise the renminbi in international trade and finance, effectively challenging the long-held supremacy of the dollar. Indeed while renminbi internationalisation may be a long-term goal, increasing concern in China on the global monetary system's over-reliance on the US dollar has bumped this initiative to the top of the agenda. This is understandable, considering the manner in which the global economic crisis has exposed China to unprecedented risks through the more than $1.2 trillion in foreign exchange reserves it has accumulated, exacerbated by the Fed's remedial actions of quantitative monetary easing that has created a 'dollar trap'. This has, in turn, generated a growing consensus in Beijing that one of the fundamental reasons the country has fallen into this trap is that its own currency is not yet international. Indeed, some industry observers are of the view that the internationalisation of the renminbi is long overdue, considering China's rising economic power relative to the limited use of the renminbi overseas.

There is already speculation that the renminbi could eventually become one of the top three traded monetary units in the world, and that by 2012, as much as $2 trillion worth of trade flows may be settled using the "redback".

The rising financial prominence of the renminbi could also prove to be a lifeline to Hong Kong, which claims Mainland China as its hinterland. Given its absence of capital and exchange controls in China, Hong Kong appears well-positioned to be the de facto hub for a renminbi-denominated capital market, and since mid-2009 it has been positioning itself as a market for renminbi-denominated bonds. This will certainly ameliorate the intense pressure Hong Kong faces in its 'rivalry' with Shanghai as a global financial center.

Turbulent waters ahead

Political analysts believe that full international currency status for the renminbi will not be immediately forthcoming, as time will be needed to gain widespread acceptance from the Communist Party, and they caution that significant policy hurdles surrounding the perceived loss of currency control could impede the progress of renminbi internationalisation. However, China's economic recovery and a reluctance to be further mired in the dollar trap have been pushing the process ahead nonetheless.

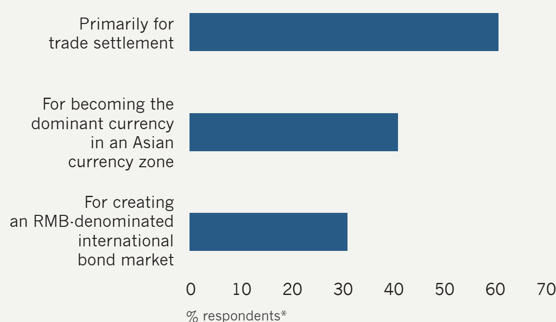
To date, China has enacted bilateral currency swap agreements worth $95 billion with Argentina, Belarus, Indonesia, South Korea, Malaysia, and the Hong Kong Special Administrative Region. In July 2009, China also nominated five mainland cities—Shanghai, Guangzhou, Shenzhen, Dongguan and Zhuhai—accounting for 45% of the country's foreign trade with permission to trade with Hong Kong and Macau in renminbi. Approximately 200 Chinese corporations were involved in the programme. The Chinese government explained that this move is intended to help reduce the risk from exchange rate fluctuations and give impetus to declining overseas trade. The programme is expected to be rolled out to cover all of China's trade with Asia except Japan. In addition, China has permitted institutions in Hong Kong to issue renminbi denominated bonds, a necessary move towards creating a deep domestic and international market for its currency.

Cynics however question China's dedication to these initiatives, given that many of them were mooted and implemented as a response to the ongoing economic crisis, and have not been in existence long enough to fully evaluate.

Views from the ground

Within China itself, banks have rather mixed opinions on the prospects of renminbi liberalisation. Unsurprisingly, domestic banks and foreign banks seem to have divergent views and concerns on what renminbi internationalisation represents. While Chinese bankers seem to treat the issue with more caution and are more sceptical of the initiative's success, foreign bankers have expressed much more confidence and enthusiasm at its prospects.

Figure 2.1
Source of pressure for Renminbi liberalisation



Source: Asian Banker Research
** Please select all those that apply*

Chinese banks are displaying a natural inclination to view liberalisation of the currency as a political issue that requires the trade-off of national interests for longer-term strategic benefits. The liberalisation of the renminbi will require the currency to reflect its true values and purchasing power, indicating that the long anticipated appreciation of renminbi will come about more efficiently and rapidly, observes both respondents from Industrial and Commercial Bank of China (ICBC) and Agriculture Bank of China. On the other hand, Chinese banks warn that this advantage will be eroded by the pricing issues that Chinese exporting and manufacturing enterprises will invariably face. Of more immediate concern to Chinese bankers is the practical issue of whether the renminbi will be openly accepted by China's trading partners.

According to a senior executive from Agriculture Bank of China, "the liberalisation of the renminbi will create large fluctuations in the foreign exchange rate which will damage the already-fragile exporting SMEs in China. Another difficulty comes from the willingness to accept the renminbi as a settlement currency by China's major trading partners, like the ASEAN nations and Russia."

Echoing the sentiment of foreign banks operating in China, the senior executive from JP Morgan is more optimistic however. "It opens up opportunities, but it also opens up challenges. The opportunities are a new currency coming to play for banks and corporations who are not as familiar with China. That means understanding how the renminbi works. Also adding a new currency to the tool kit and working with people who understand the China market a bit better."

Senior bankers at HSBC also believes that renminbi liberalisation poses wider benefits for China, particularly in its efforts to transform Shanghai into a global financial centre.

Changing customer expectations

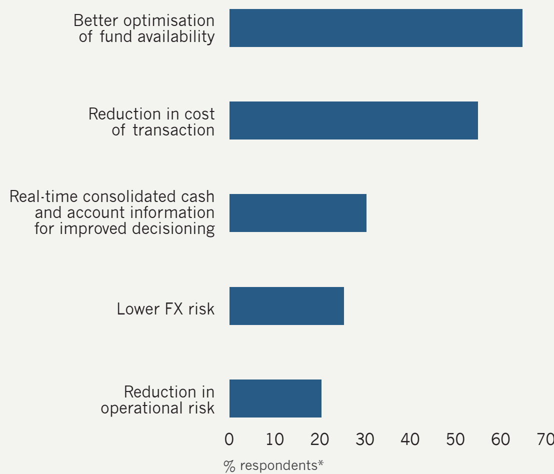
From an operational perspective, before the currency was liberalised, banks had to treat renminbi dominated and foreign currency dominated cash accounts separately, and deals made in foreign currency had to be converted into renminbi immediately post-transaction, incurring a certain degree of currency risk.

Post-efforts to liberalise the renminbi, banks expect a more benign operating environment in light of the anticipated pick-up in business brought on by op-

portunities afforded by increased international trade. Client expectations and requirements of liquidity management, however, are likely to also be increasingly demanding.

Figure 2.2

Shifts in customer expectations and requirements of liquidity management in line with renminbi liberalization



Source: Asian Banker Research
** Please select all those that apply*

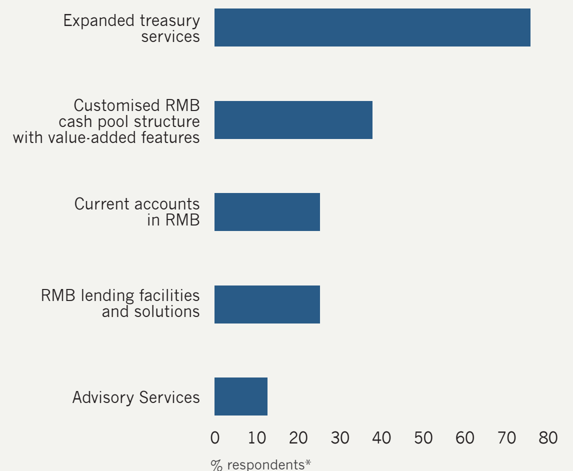
Chinese cash management clients are proving to be savvy, and have already expressed that they expect cost of transactions to reduce as a direct result of liberalisation of the renminbi. "Our clients have already told us that since exchange rate risk will be successfully eliminated, they should benefit directly from reduced transaction costs" says the respondent from Agriculture Bank of China. The respondent from ICBC also predicts that clients will expect "more choices in terms of financial tools for cash and liquidity management". HSBC also observes that Chinese clients have become more demanding in their expectations of better optimisation of fund availability and overall management of liquidity positions.

Foreign bankers appear to be more prudent in this regard, particularly with respect to their foreign cash management clients. Liberalisation of the renminbi—and hence renminbi-denominated invoices—still pose foreign exchange risks to those corporations outside of China, doing business in US dollars. The imminent appreciation of the Chinese currency further compounds this risk. The respondent from JP Morgan sums it up nicely. "It just changes the nature of the relationship, and moves the risk from China and the Chinese buyers and sellers. That is, if the buyer and seller outside the country agree to the renminbi as the trade settlement currency (in the first place)".

Nonetheless, there appears to be a silver lining for foreign banks, such as JP Morgan, who hope to act as settlement banks. "The Chinese government has indicated that it will allow foreign-invested banks onshore to become clearing banks, so we will be a clearing bank. Being that we are a scaled player in the US dollar, we have a lot of good tools in place to support the renminbi as well."

Figure 2.3

Expansion of liquidity management solution portfolio with renminbi liberalization



Source: Asian Banker Research
** Please select all those that apply*

For banks operating in China, the trend seems to be that innovation of liquidity management products will remain fairly limited in the near future. "The majority of export destinations for our corporate clients are still centred around the EU and US, meaning that we still need to offer them similar products as we did previously," explains the Agriculture Bank of China executive. China Merchants Bank, similarly, does not expect product portfolios to change, but is gearing for a shift in strategy instead. "We still stick to our policy of strategy adjustment. So, overall, we do not change. But from an application pint of view, we plan to gain more share in the area of international settlement of international business." ICBC similarly does not expect product portfolios to change, but is placing more emphasis on customer service and value-added services to improve customer satisfaction instead "We will persuade clients to use our

“It just changes the nature of the relationship, and moves the risk from China and the Chinese buyers and sellers. That is, if the buyer and seller outside the country agree to the renminbi as the trade settlement currency (in the first place)”.

Senior Executive,
Foreign Bank in China

renminbi-denominated cash management solutions and put their renminbi cash pools with us. We will also promote our advisory services in renminbi cash management in order to help clients reduce risks, use capital effectively and generate extra margins. We need to improve our services to compete.”

One solution that is slowly gaining traction as a result of currency liberalisation is cross-border renminbi settlements with neighbouring countries, which is currently only offered to on a trial basis to approved pilot enterprises in the five pilot cities in China. However, many bankers consider this solution as one of the ‘baby steps’ needed to expand their portfolio offerings, since actual transaction flows chalked up by the 400 approved pilot enterprises are really very small at this point.

Managing liquidity in China has always been a challenge for corporate treasurers, and this situation looks likely to persist into the near future. Direct inter-company lending is not allowed, and banks offer entrusted loan arrangements as a way to allow companies to manage their surplus funds. Cross-border sweeping is also not currently allowed in China. These constraints are most heavily felt—or at least most sharply vocalised—by the foreign banks approached in the survey, where the general sentiment is that product portfolio enhancements possibilities are still less clear.

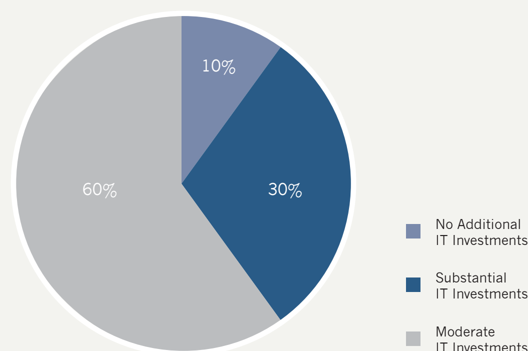
“Going forward, depending on how much more broadly the renminbi becomes convertible, it would have implications for other products as well.” The respondent from JP Morgan explains. OCBC Singapore and UOB Singapore are more straightforward in their expectations that these are still early days, and that they do not foresee an evolution in the area of liquidity management in China in the near future.

More entrenched foreign players with significant regional presence such as HSBC, however, are pushing for a globally integrated platform in anticipation of future possibilities. These integrated platforms are designed to host the group’s global liquidity management proposition for customers to access various domestic, regional and/or global services for pooling, cash concentration and investment services. “In conjunction with renminbi internationalisation efforts, this integrated platform will enable our Chinese corporate customers to better monitor and more importantly manage, their local and regional, local currency and foreign currency cash and funding positions.” says HSBC.

Leveraging technology

Given that Chinese banks in general do not have plans to dramatically increase liquidity management solutions on offer, nor expect much innovation within existing solutions sets, IT investments are not currently top of mind.

Figure 2.4
Leveraging technology to deliver on planned service and product enhancements



Source: Asian Banker Research

Foreign banks in China who are rapidly acquiring new clients are investing heavily, not only on technology infrastructure but on surrounding delivery ca-

pabilities as well. "Footprint and (IT) capabilities go hand-in-hand. When you open a new branch, it's almost like there are a package of things that you need to make that branch run and to acquire clients. So, we focus on liquidity, cash management needs and trade finance. They are all inseparable", explains the JP Morgan executive.

Later entrants to the wholesale payments business in China, such as OCBC, are also in a hurry to build up their basic infrastructure and connectivity to local clearing systems in a bid to catch up with the mega banks in China, and more established foreign players such as Citi, HSBC and Standard Chartered Bank. In an attempt to shorten time to market, OCBC is relying on investments in the latest technology, coupled with the incorporation of build-and-transfer knowledge from their operations headquartered in Singapore.

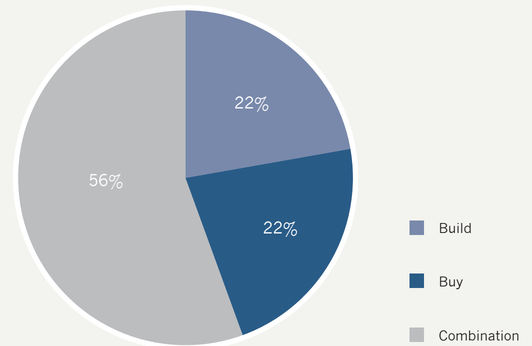
HSBC is quick to reiterate the need to closely monitor changes to existing regulations and the introduction of new regulations in this emerging market as one of the key basis to drive decisions on IT investment and product innovation.

For domestic Chinese banks, investment in IT capability appears to be driven more by product portfolio decisions than capability and capacity building. "Our bank is not planning to add many new products to the current service portfolio, so I anticipate only moderate IT investments will be required in a medium term, and not on a very urgent basis," states the respondent from Agriculture Bank of China.

On the issue of "build versus buy", Chinese respondents are demonstrating a preference for the combination approach where internal development occurs concurrently around a third party purchase.

Figure 2.5

Technology implementation approach to deliver on planned service and product enhancements



Source: Asian Banker Research

Conclusion:

For banks in China, the most important factor impinging liquidity management solutions is that of the regulatory environment, which is currently still dynamic and subject to frequent change. A tight balancing act is required between compliance and proactively anticipating and managing regulatory change. "In China, because regulations are promulgated so quickly, we find ourselves understanding as much as we can and anticipating the best we can. But often times, we have to react very quickly too" offers the respondent from JP Morgan.

> "We will persuade clients to use our renminbi-denominated cash management solutions and put their renminbi cash pools with us. We need to improve our services to compete."
>
> *Senior Executive,*
> *Big Four Bank in China*

National and cross border payment systems infrastructure in Asia: Advances and perceived challenges

In order to catch-up with their peers in the Asia Pacific region, regulators in China, Thailand and Malaysia have recently undertaken greater concerted efforts to step-up their payment systems infrastructures, especially in the area of e-payments enablement. While there are specific concerns and solutions that are particular to a country by virtue of legacy characteristics of its respective financial system, there are critical challenges that persist. In the effort to encourage systems upgrades and uptake of the latest e-payment initiatives, both regulators and banks have had to collaboratively address the structural, financial and user reorientation issues that emerged.

China: China National Advanced Payment System (CNAPS)

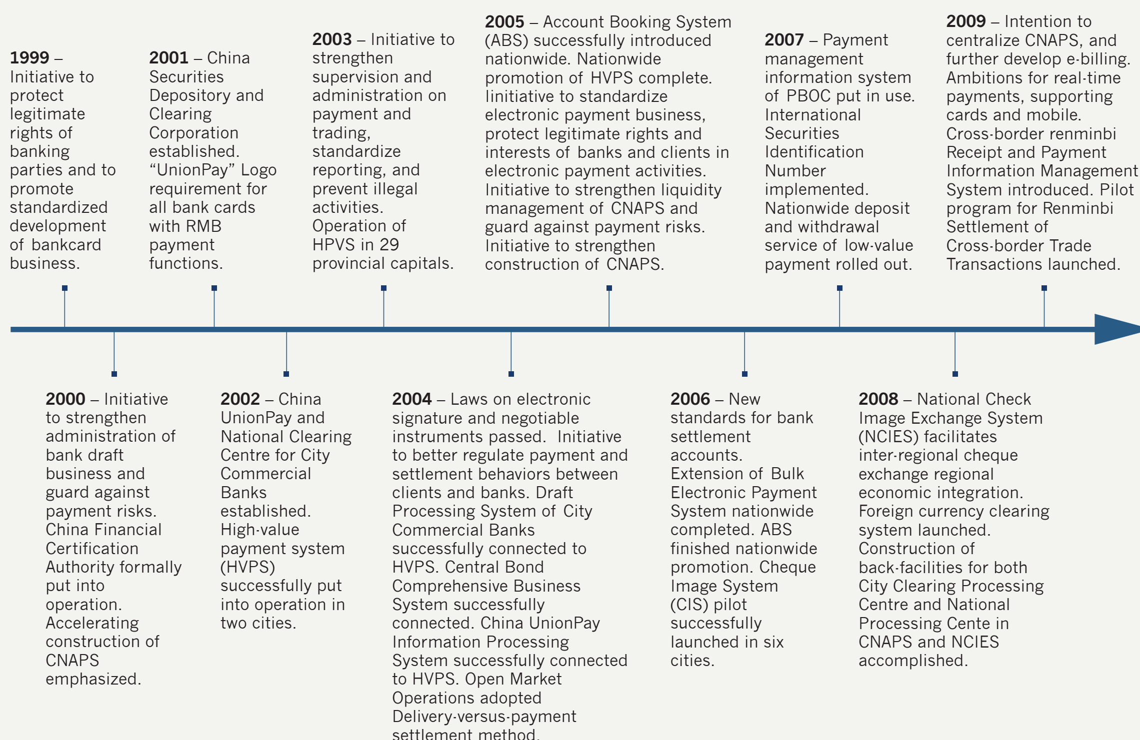
As China's remarkable and momentous growth continues in the midst of the global financial crisis, it is remarkable to note that this growth is being realised is spite of a relatively young banking system. And while China remains a largely cash-based economy, the authorities have made significant headway in encouraging set-up and adoption of e-payments at both the corporate and consumer level.

Up until 2008, transactions processed by the large-value real time payment system (LVPS) and the intra-bank payment systems of financial institutions continued to maintain a momentum of rapid growth. Affected by the global financial crisis however, transaction volumes for these 2 systems grew at a slower pace in the second half of 2008 followed by transaction value decreases in the last quarter of 2008. During this period, transactions processed by the bankcard payment system also grew at a slower pace while transaction volumes processed by the small-value bulk electronic payment system (BEPS) grew steadily quarter by quarter.

The Chinese regulator, People's Bank of China (PBOC), developed a nationwide RTGS system called China National Advanced Payment System (CNAPS) in 2005. CNAPS was designed to automate and modernise the payment system throughout China, handling both bulk electronic payments and large-value fund transfers. CNAPS does not differentiate between intra or inter bank payments, local or national, and enables an integrated national payments infrastructure that provides same day settlements.

Figure 3.1

China payments system development: A timeline perspective



Source: Asian Banker Research

Whilst a much needed payments system framework, the benefits of CNAPS have been dampened by the lack of reliable data and information transparency as well as sluggish progress in financial legislation system reform. To address these concerns and enhance the advantages of CNAPS, the PBOC has come forth with plans to set up a comprehensive financial statistics system, an economic and financial survey and statistics system, and an analysis and forecast system.

Even as the central bank improves its data mining and analysis, it is also set on developing and building the second-generation payment system, the central bank accounting data centralisation system and contingency backup systems.

Risk and security issues impinging on China's payments system infrastructure will also be addressed with the PBOC implementing a joint bankcard regulation mechanism, strengthening the information technology infrastructure and issuance fund distribution monitoring system, and upgrading the network that monitors RMB circulation. Additionally, credit references will be standardised, credit ratings more tightly regulated and the methodology of credit rating agencies put under more regulatory scrutiny.

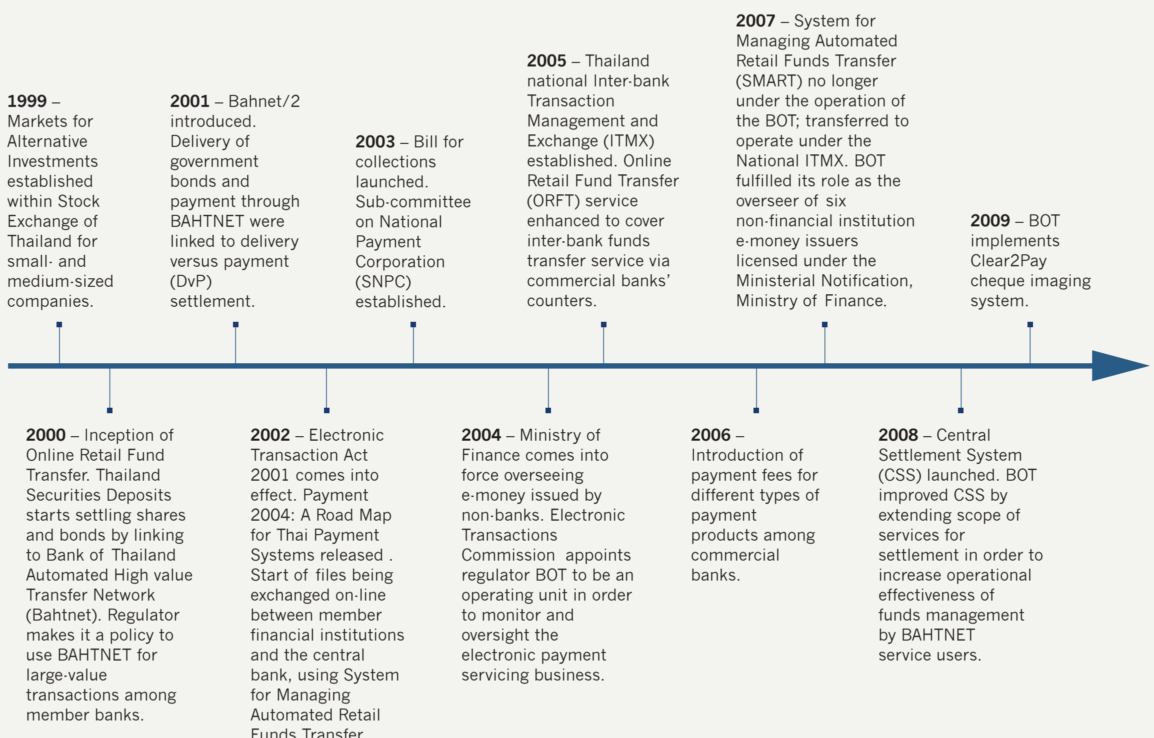
Education will be an integral part of the modernisation programme as users especially those in the rural areas will have to be brought up to speed with education programmes such as counterfeit currency detection and credit management education programmes.

As for banks, they are required to strengthen their lending practices to crack down on corruption and promote the credit information reference system. Nationally, the regulator has required banks to improve their payment and clearing networks including the electronic commercial drafts system.

As banks are challenged to improve payments infrastructure and rural access to financial services, they together with regulators, are well aware of the vital need to ensure robust measurement, monitoring, and evaluating of the operational, legal and IT risks tied to these new systems.

Figure 3.2

Thailand payments system development: A timeline perspective



Source: Asian Banker Research

Thailand: Payment systems roadmap 2010

While Thailand does not see the kinds of transaction volumes as China, it has nonetheless found it necessary to develop e-payment platforms to fully serve the nation's growing e-commerce activities and ensure that they are compliant with the Bank for International Settlements Core Principles

The Bank of Thailand (BOT) has initiated a number of projects to create a conducive environment to foster the orderly transition towards greater use of e-payments. A guiding framework is the three-year plan aptly named Payment Systems Roadmap 2010, which lays out the details on encouraging the increased use of e-payments by major market participants such as individual customers, businesses and government agencies.

Specifically, the major aims of the Payment Systems Roadmap 2010 are:

- To encourage a greater use of e-payment by government and business sectors;
- To gain more acceptances of e-payment transactions as legal-accepted evidence by Revenue Department;
- To put in place the system of inter-bank bulk payment (debit transfer);
- To strengthen standard on information exchange in case of bulk payment.
- To grow reliance on the use of pricing policy to encourage greater use of e-payment;
- To facilitate and foster changes in legal and regulatory framework.

In the desire to reduce cash and cheque transactions, e-payments have been promoted as a more cost-saving option through the regulation of payment fees to reflect actual costs of services of e-payments. Retail payments have been noticeably shifting towards the use of the Online Retail Fund Transfer (ORFT) which has seen a ten-fold increase in its transaction volume over the past seven years.

Yet the BOT has encountered resistance as users have retained cash and cheque usage as the preferred mode for transactions. Merchants, themselves have shown a reluctance to adopt e-payment instruments for fear of the increased service charges.

Apart from these, there are additional concerns regarding system interoperability and IT security. The use of pricing policy alone to encourage the shift towards the increased use of e-payment products may not be enough unless concerted actions are taken to improve the conditions of related non-price factors.

There are also concerns about the lack of changes in the country's legal and regulatory framework related to the payments system. A sound legal and regulatory framework is vital for moving towards a growing use of e-payment and e-money. Like many central banks, BOT and other concerned government agencies are well aware of the rapid pace of development in ICT and e-payment developments. The financial authorities in Thailand have over the past few years put forward changes in laws and regulatory framework governing e-payments to ensure that the legal framework is capable to handle the growing introduction of e-payment developments. The recent proposal of the Royal Decree Regulating E-payment Business is a good reflection of this. However, this law which will not only strengthen the oversight power of the authorities but also promote the reliability of e-payments and consumer's confidence has yet to be passed in parliament. In addition, the lack of laws governing the use of e-receipts and e-documents has resulted in the slow adoption for the use of e-payments by market participants. Plans are now under way to encourage the wider acceptance of e-receipts by working closely with the Revenue Department and provide monetary incentives for migration.

The migration to e-payments has to also address two further concerns by market participants. The first is the data security and integrity concerns shared by merchants and consumers. As e-money related activities proliferate, it is prone to several internal and external threats. The recent experiences of data leakage or theft have only served to diminish confidence on the security of such systems. Merchants themselves are wary of leaks where information can be mined from electronic transactions and used to their competitors' advantage.

The second concern is the need for more financial incentives to be put in place. As seen by the general reticence of merchants and consumers to migrate onto the e-payments system, the only option for regulators is to further make e-payments more cost-effective while encouraging the perception that cash and cheque transactions more labour and cost intensive. This will hopefully create the necessary conditions to facilitate the push towards e-payments as a reliable and cost-effective solution for payments.

Malaysia: Electronic payments roadmap

Malaysia has demonstrated a steady shift from paper-based payments to electronic payments as evidenced by the rising trend in the number and share of e-payment transactions recorded in 2008. About 95% of the volume of payments made by the Government are now conducted using electronic channels. Over time, there has been an increasing awareness of the various costs that add up at each stage of the cash handling process, including 'hidden' costs that are borne by merchants, making e-payments a more attractive option.

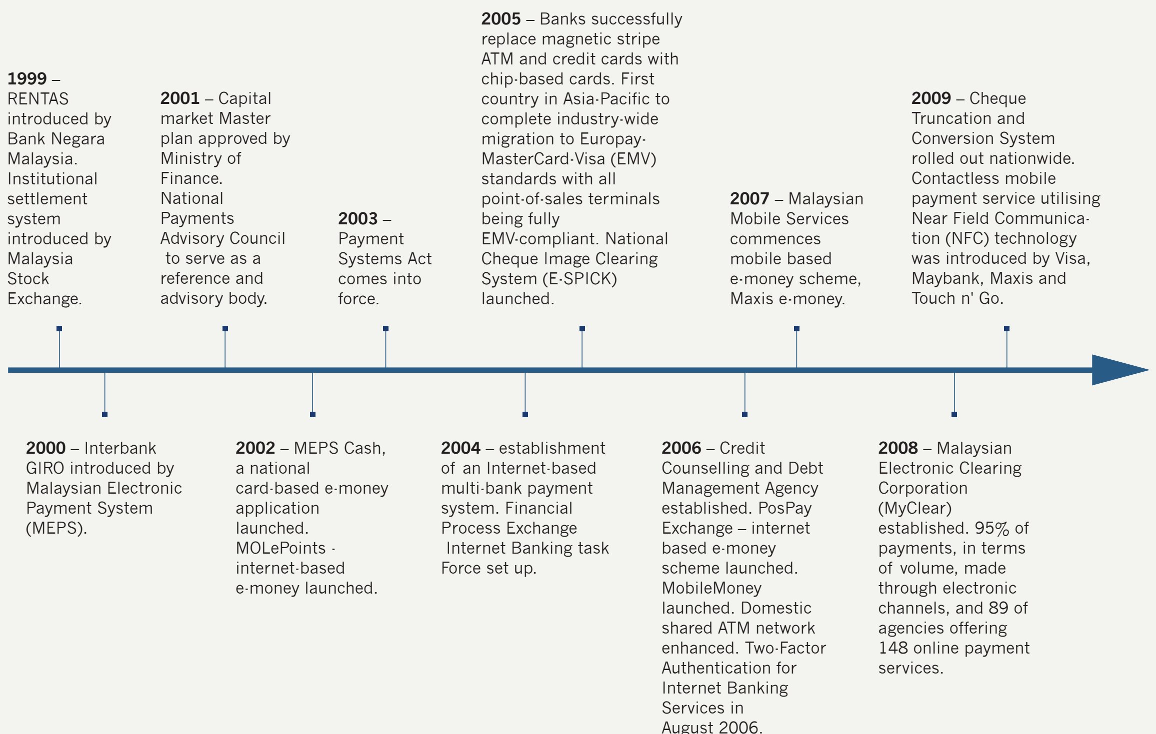
Given the cost saving benefits of the migration, Bank Negara Malaysia (BNM) then shifted focus to promoting the use of e-payments for Government collections, working closely with the Ministry of Finance, the Accountant General, and the Malaysian Administrative Modernization and Management Planning Unit (MAMPU). BNM also participated actively in the Special Taskforce to Facilitate Business sub-committee (PEMUDAH) for Streamlining E-Payment Implementation in the Public Sector chaired by the Secretary General of Treasury.

Given the importance of a well functioning payment system in maintaining financial stability, the promotion of a secure, reliable and efficient payments system remains the focus of regulator. In 2008, BNM established a payment subsidiary known as the Malaysian Electronic Clearing Corporation (MyClear) to operate the Real-time Electronic Transfer of Funds and Securities (RENTAS) and the Cheque Truncation and Conversion System (eSPICK) and spearheaded the Bank's migration to e-payments agenda. The establishment of MyClear allows the Bank to focus on oversight responsibilities of RENTAS and eSPICK, thereby facilitating effective surveillance, independent assessment, evaluation and monitoring of the different types of risks on the major payment systems.

Meanwhile, payment cards are still the most popular e-payment mode used in Malaysia with electronic money (e-money) recording the highest number of transactions and credit cards leading the way in terms of transaction value. The preference shown by consumers in using credit cards to make payments is mostly supported by its long-established presence in the payments industry.

Figure 3.3

Malaysia payments system development: A timeline perspective



Source: Asian Banker Research

Internet banking is also expected to contribute strong growth in 2009 following the Government's myBayar initiative as well as various promotional campaigns including desktop banking packages for corporate customers and small and medium enterprises.

Going forward, focus would be directed towards addressing both price distortion between paper-based payments and electronic payments, and having in place effective incentives to drive the migration to electronic payments. The role of the financial sector as an effective growth catalyst will be reinforced by leveraging on Malaysia's competitive advantage in Islamic finance. In pursuing the liberalisation agenda, lessons will be drawn from the current global financial turmoil to ensure that the degree of liberalization should be commensurate with the capacity of the financial sector to cope with the consequent changing landscape. To better withstand institutional and systemic risks in the financial sector, BNM will undertake further enhancements to its surveillance systems, strengthen the institutional arrangements for dealing with emerging threats to the financial system, improve the incentive structure, promote sound corporate governance and risk management practices, and develop the necessary conditions for increased market discipline.

Malaysia, while to a lesser degree than Thailand, has also encountered resistance in the migration towards e-payments. The use of cheques remains as a popular payment mode. The price distortion between paper-based payments and e-payments has hindered the shift to e-payments. Price incentives need to be provided to the users of payment services if their payment habits are to be changed. Given the substantial costs of cheque processing and handling, it would not be cost-effective for the country to continue in its high adoption of cheques as a payment medium. Therefore, addressing the price distortion and having in place effective incentives to drive the migration to e-payments will be one of the main areas of focus moving forward. The efficiency of e-payment mechanisms would also be given emphasis to further increase the uptake by consumers. Further initiatives have been identified in the Electronic Payments Roadmap as priority areas, which include promoting an environment that is conducive for greater adoption of e-payments in financial transactions.

The authorities have made considerable efforts to address the rise in fraud, but more needs to be done to offer consumers highly secure payment options. Existing security programs and tools will not meet its objectives, if enforcement by the card schemes is lacking, and compliance by the relevant players is not meaningfully observed.

The issuers and acquirers, who are the key drivers in the issuance and acceptance of electronic payment instruments, need to properly implement relevant security measures in their systems and processes. This includes continuously educating their cardholders and merchants on the relevant risks involved in the use and acceptance of payment instruments. Issuers also need to remain vigilant, and enforce sufficient controls over consumers' data, particularly while such data is in the possession of outsourced or third party agents. While issuers are expected to undertake due diligence on the cardholders to minimize credit risk, acquirers should similarly undertake continuous due diligence on the merchants, to ensure the payment instruments are not used by merchants for the purpose of conducting any fraudulent or illegal activity. There is a need for acquirers to deploy proper card acceptance processes, and ensure that these processes are complied with by their respective merchants. Acquirers are also expected to promote continuous merchant education, to ensure that merchants are aware of fraud risks in payment instrument transactions and the proper procedures for accepting payment instruments.

While consumers can determine their preferred choice of payment instruments, it is important that their decisions are based on, and supported by, a sound understanding of the risks associated with such instruments, and how they can protect themselves from falling prey to perpetrators or unnecessary fraud losses. This includes utilizing the relevant security tools and authentication methods made available by issuers, particularly for online transactions, proper safekeeping of cards and personal data, as well as their own monitoring of payment transactions to identify any possible suspicious transactions.

Optimising payments, liquidity and cash management capabilities in Asia: Key trends and outlook

It is now one year since Lehman Brothers collapsed under the weight of billions of dollars of toxic subprime mortgage securities. Following on the heels of Lehman's bankruptcy, a wave of panic swept through financial markets in September 2008, triggering the failure of several renowned financial institutions. The extraordinary collapse of confidence globally then sparked an economic crisis that reverberated throughout the world. Lehman's failure had undeniably accelerated what was originally a widely anticipated global slowdown into the worst post-war recession the world has ever seen.

Asian financial institutions, meanwhile, were fortunate not to hold much toxic subprime debt or have many built up any serious asset bubbles before the credit crunch hit. It is widely believed that lessons learnt from the 1997 Asian financial crisis served remarkably well to protect Asian economies this time round. Because of this, the impact of the financial markets fallout was dampened in Asia.

On the ground, however, it is widely acknowledged that today's working environment is one of the most challenging for company treasurers. Many companies in Asia, particularly China, trade with organisations in affected regions such as the United States and Europe where the economic crisis had either dampened demand or restricted the availability of credit. On top of juggling these challenges, Asian companies have also turned a more critical eye on their financial service providers, keenly monitoring any possible impact the credit crisis may have on banks in Asia. This is evidenced by the debates at the local level of corporates openly querying whether their banks are actually capable of supporting their payments, liquidity and cash management needs.

Domestic banks have benefited in this regard, with corporates being more willing to consider local players for payments, liquidity and cash management solutions. OCBC in Singapore, for instance, has seen an uptake in the demand for their services, which would otherwise have gone to foreign global players. As the senior executive explains "OCBC continued to extending credit to the market—selectively, of course—which puts us in an improved position now, compared to before the crisis." The same has also been true for domestic banks in China, observes the senior executives from Industrial and Commercial Bank of China (ICBC) and Shanghai Pudong Development Bank.

Meanwhile Asia, led firmly by China, is making remarkable progress in leading the way out of global recession as evidenced by second quarter GDP figures for key Asian economies growing by an average annualised rate of more than 10%. Against this backdrop of recovery, industry players must carefully manage their relationships with corporations in order to navigate the increasingly competitive environment as corporates place increasingly significant demands for efficient domestic and international cash management.

Shifting from crisis management to recovery

As the global economy recovers, further opportunities for cash management providers will materialise as businesses shift focus from simply surviving the recent turmoil to regaining and increasing market share.

Corporates had been closely assessing the counterparty risk of their banks at the height of the credit crisis, and as business outlook continues to improve, corporates are turning their attention to risk diversification once again.

"This will present a multitude of opportunities for banks and to a large extent create a more level playing field for many," HSBC believes. This sentiment is widely echoed by other banks such as ICBC, OCBC (China and Singapore), UOB (Singapore) and Maybank (Malaysia). There is a minority contrarian view however coming from Agriculture Bank of China. "During this crisis, many clients asked for a more stringent cash management services from us, due to increasing pressure on their cash positions and liquidity. I believe this kind of conservativeness will last a relatively long time, even after the crisis passes…negatively impacting opportunities for cash management providers."

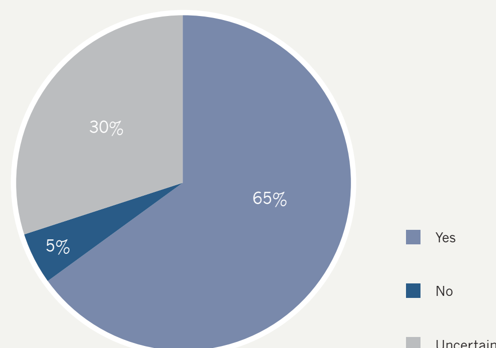
> "During the darkest days of this crisis, most of these firms faced sizable counterparty payment risk; but with the relieving of the crisis, they will once again turn their attention to securing more contracts from overseas clients"
>
> *Senior Executive,*
> *Big Four Bank in China*

When asked about which industries represent the greatest opportunities for cash management as the economy recovers, it is no surprise that Chinese banks expect export-oriented industries like manufacturing and technology to pick up most rapidly in their international cash management needs. "During the darkest days of this crisis, most of these firms faced sizable counterparty payment risk; but with the relieving of the crisis, they will once again turn their attention to securing more contracts from overseas clients" observes the respondent from Agricultural Bank of China. Domestically, Chinese banks tend to favour infrastructure and construction-related companies, as they will pick up in their requirements of more efficient cash management services.

Elsewhere in Asia, OCBC (Singapore) is banking on the continued cash management requirements of the public sector. "Because the government is virtually the only one that is able to sustain some level of economic activity, even during this downturn, we foresee that at least into the middle of next year, they would still be very active, and hence very promising from the cash management perspective." They are seeing a revival of demand for cash management services from the service and real estate sectors in Singapore. Rival UOB (Singapore) meanwhile is seeing signs of initial pick-up in the business activities of the construction, electronics and fast-moving consumer goods industries.

Figure 4.1

Expectations that the cash management business will pick-up in the next 9 to 12 months



Source: Asian Banker Research

In spite of the optimism of recovery, banks are proceeding with caution. "A key lesson learned from the recent crisis is that even some of the biggest and most prestigious organisations are not immune to a severe downturn," notes the respondent from HSBC.

Meeting increased customer expectations

As economies shift into recovery mode, cash management clients are also becoming increasingly demanding of their financial service providers.

A key expectation for the Chinese corporate is integrated/consolidated cash management solutions offered at the enterprise level, rather than for specific business lines, observes both Agricultural Bank of China, ICBC and OCBC (China). “Besides efforts to streamline their cash management practices, our clients also face external pressures from regulatory bodies to maintain appropriate cash positions, especially for state-owned enterprises” explains the executive from Agricultural Bank of China.

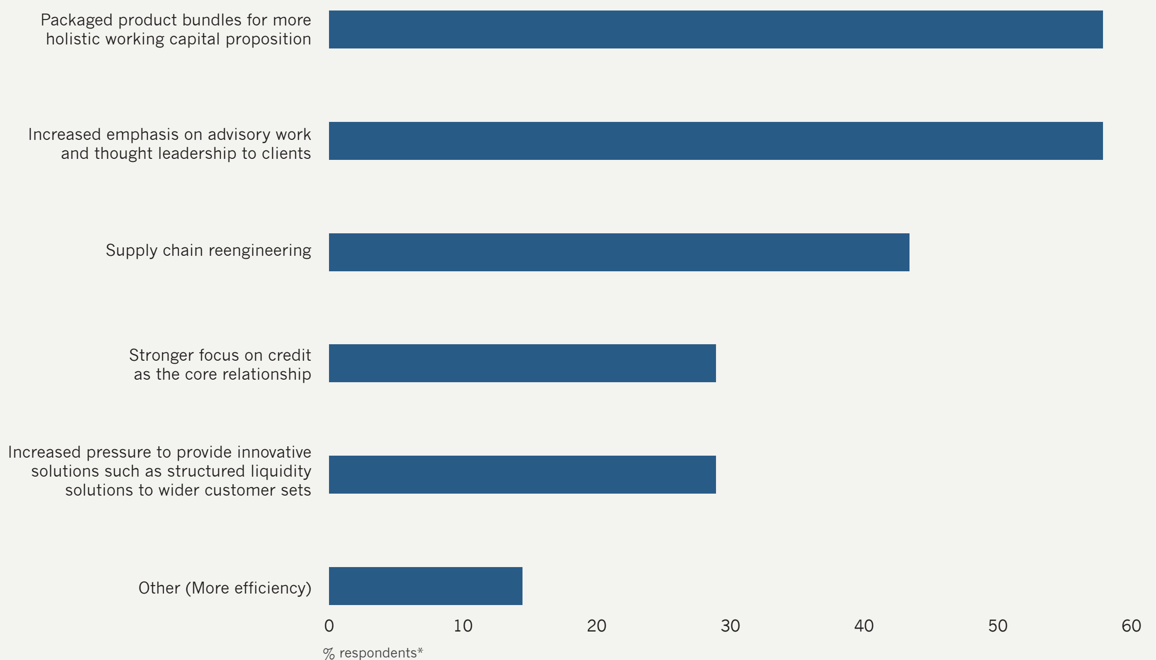
For foreign corporates who work with local Chinese banks, the emphasis lies in greater efficiency in handling of payment and cash receipts. This contrasts with Chinese corporates who are “generally content with the multichannel services we provide and seldom request for a higher service standard” notes the executive from Agricultural Bank of China. There are early indications on the horizon, however, that Chinese corporates are beginning to expect the larger domestic banks to provide advisory and thought leadership beyond the basic mix of solutions.

Another area where corporates operating out of China are demanding more from their financial service providers is optimising investment decisions. As the executive from JPMorgan explains “in China, making payments is fairly easy; collecting cash is sometimes a bit more difficult, just because of the size and enormity of the country, and then figuring out what to do with it once you collect it.” Indeed, current short-term cash opportunities are restricted to deposit products like prime deposits, call deposits, contract savings accounts, all of which are regulated. There is no current solution at present, however, unless China’s financial and banking system undergoes more liberalisation, whereupon banks hope that opportunities to efficiently invest cash will become more prevalent.

To meet changes in customer expectations and to raise service satisfaction levels in general, banks are most focused on collaborating with corporates on automating cash management processes with minimal manual intervention in order to reduce

Figure 4.2

Increased client expectations of payments, liquidity and cash management solutions



Source: Asian Banker Research
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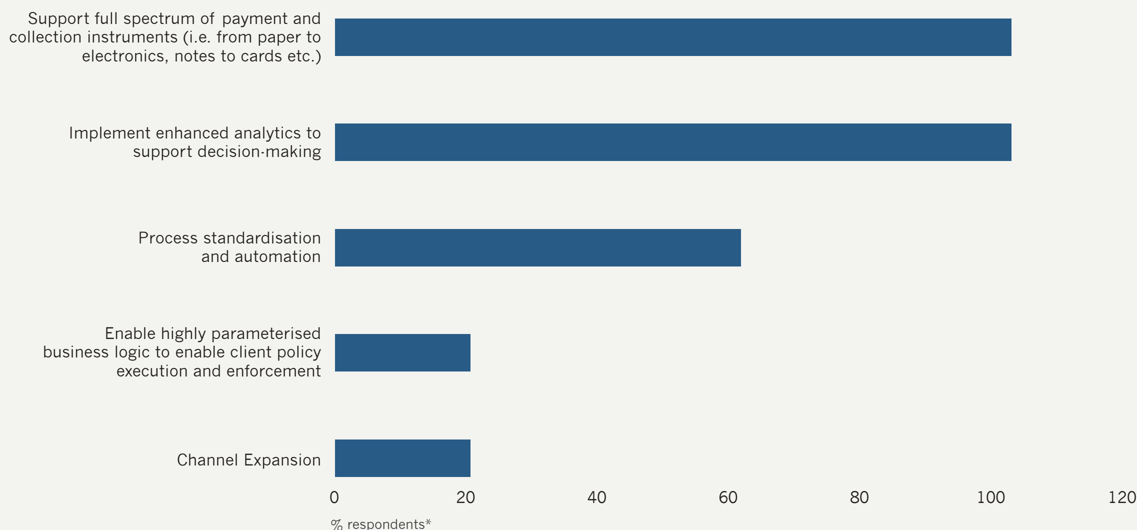
Figure 4.3
Priority areas for improving client service



Source: Asian Banker Research
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costs and improve controls and efficiency. ICBC believes that one size does not fit all, and it is careful to emphasise that it makes extra efforts to design customised solutions to fulfil each of its clients' unique demands and requirements.

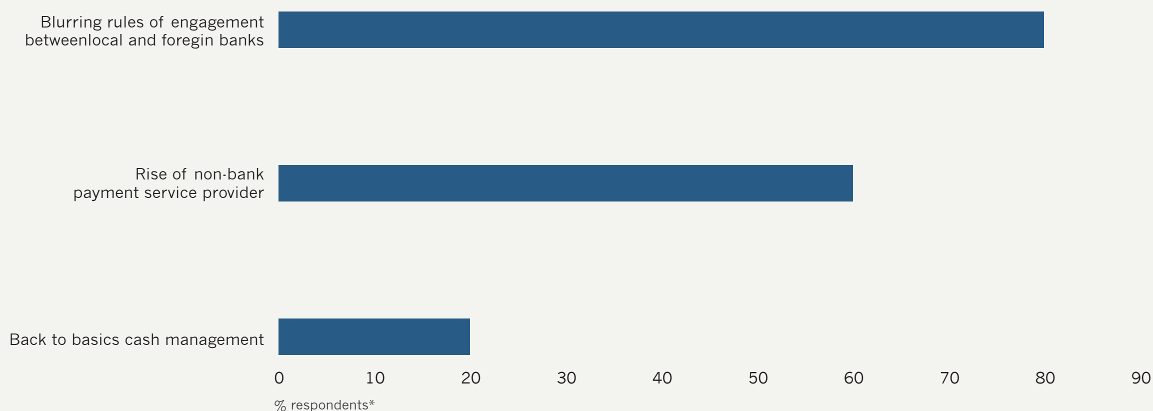
Efforts are also underway at domestic Chinese banks to provide real-time online account information, which will help corporates manage cash flows, working capital and late collections in a timely manner.

Emerging trends in payments, liquidity and cash management

Domestic and foreign player dynamics

When it comes to their domestic territory, Chinese banks remain confident of their hold over local corporates, given their benefit of local insight and sensitivity to cultural nuances over foreign players. The senior executive from ICBC also reveals that "we even go overseas with our Chinese clients and stand shoulder to shoulder to help them build up

Figure 4.4
Emerging trends in the payments, liquidity and cash management business



Source: Asian Banker Research
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their presence on the international stage." The advances made by Chinese banks in terms of technology and expertise have also helped to close the perception gap of foreign banks' superiority in this area.

Likewise, when it comes to serving foreign corporates in China, it is the foreign players who currently wield the advantage, particularly leveraging on long-held relationships with the corporates' foreign headquarters. Their extensive global network relative to their Chinese counterparts' also makes for an attractive proposition to foreign corporates. Foreign banks' lead over domestic Chinese banks may soon be diminishing, however, given their limited geographical reach. As the executive from Agricultural Bank of China observes, "when foreign companies invest in inland China, foreign banks cannot reach those places. In this case, foreign companies will select a combination of a foreign bank and a Chinese bank to serve their cash management needs in China".

Indeed, the rules of engagement are blurring between domestic and local players, particularly for corporate banking clients. For instance, ICBC would help clients keen on international expansion identify and bridge collaborative relationships with foreign banks. It is also commonplace for foreign banks to identify Chinese partners to serve clients' business in China. "I would say there is more cooperation than competition in this field. However, there are also a few foreign banks which are very aggressive in entering the market where Chinese banks dominate," observes the senior executive from ICBC. When it comes to cash management for SMEs, however, competition between foreign and domestic players is rife, with pressure increasingly being asserted by the foreign players keen to increase market share. "You really feel the heat brought on by those foreign banks. So, to improve SME cash management, we are working collaboratively with the wealth management department on cross-sell and complementary product portfolio" offers the executive from Agricultural Bank of China.

The increased strategic importance of corporate treasurers

Another trend that is gaining prominence is the increased strategic importance of corporate treasurers. At the height of the credit crisis where there was a sudden contraction in available liquidity, UOB observed that corporates opted for a "back-to-basics" approach, where treasurers focused predominantly on maintaining day-to-day liquidity by optimising the use of cash balances and minimising external borrowing. The crisis however also served to prompt many treasuries to reconsider their existing liquidity strategies.

Accordingly, as business conditions stabilize, banks are expecting corporates to take the opportunity to implement sophisticated liquidity management structures on a regional or global scale that will deliver long-term benefits in terms of return, flexibility and risk management. To further address counterparty risk concerns, HSBC also believes that corporate treasurers will begin to source for bank independent platforms and open standards to support a multi-banking environment. "SWIFTNet for corporates and the ISO 20022 XML standard are central to this trend," observes the senior executive from HSBC.

JPMorgan (China) has also observed that corporate treasurers are taking greater interest in their risk management frameworks and practices. "I think it is something that people are really concerned about. They want to know that the banks that they are dealing with are safe and sound place to put their money. They are interested to know what our risk management practices are so that they can be satisfied that they are working with an institution that is solid and stable," says JP Morgan's senior executive.

Regulatory constraints on the way forward

In spite of the headway that banks offering payments, liquidity and cash management solutions in China have made, the way forward for banks is yet unclear due to the tightly regulated environment.

Indeed, unless capital controls are relaxed, banks in China will be limited in terms of the cash management solutions they can offer and execute. Inter-company lending via interest loans, which allow loans between related or unrelated entities who have different cash balances, reduces companies' need for cash management services from the bank while bringing higher default and counterparty risks. Again, as interest loans are heavily regulated, they limit banks to act only as intermediaries. Finally, netting and cash pooling are worrying domestic banks in light of increased transactional and operational cost, and interest rate risks and regulatory risks.

Optimising retail payments in Asia: Key trends and outlook

With the consumer of the US and Europe set back by a sharp financial crisis that has turned them—especially the US consumer—from net spenders to net savers, hopes have been high that the Asian consumer will start to play a larger role in feeding a return to significant global economic growth for goods and services. Especially for European companies, which may never again see the growth they had experienced up to 2007 as a new era of slow economic growth, harsher environmental impact rules, and an aging population take their toll on their businesses, Asia is seen as a new world, and retail payments are seen as an opportunity for banks in Asia.

There is some debate about the momentum of the payments realm. While the RBS CapGemini payments report cites that non-cash payments had grown throughout the crisis where worldwide volume of payments made using non-cash instruments grew 8.6% in 2007 with other data showing that the field continued to grow in 2008 despite the crisis, others such as McKinsey have noted that growth in the same space had remained flat at best. Nonetheless, opportunities in underpenetrated and rapidly growing markets do exist, especially in Asian giants such as China and India, as well as more developed markets like Singapore, Hong Kong and Australia.

New technologies

Certainly, a growth in retail activity in Asia will come with affluence, although this is still impacted strongly by social conditions in many Asian economies where a poor social safety net means that Asians tend to save out of fear for their retirement years and possible health care issues. But the opportunities for growth are significant as retail payments are underpenetrated in many markets, and banks have opportunities to provide payments, which include

> "China is more advanced than the other parts of the world. It is because China adopts the latest technology immediately."
>
> *Senior Executive, Foreign Bank in China*

credit card payments and debit card payments, as well as micropayments via growing networks for contactless RFID payments, often boosted by transportation infrastructure.

Contactless transportation payments have exitsed in Hong Kong since 1997 and in Singapore since 2002, and there is an estimated customer base for mobile phone payments, contactless payments, e-payments and biometric-enabled payments of 85 million in 10 Asian markets. Visa and MasterCard are the most geographically ambitious in their plans, offering contactless payments in five and four Asian markets respectively, though their customer base is relatively small compared with other national initiatives.

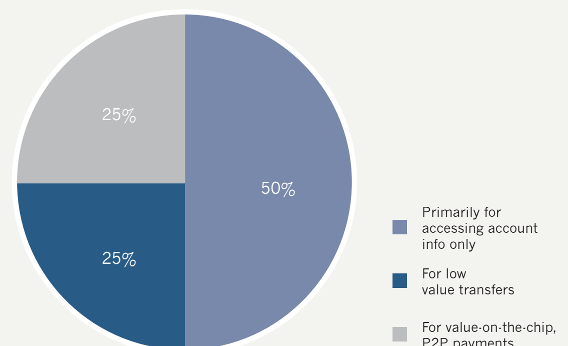
The growth trend for debit product is the most striking: it has been a raison d'etre for national infrastructures like China UnionPay, which is making moves to become a regional player through tie-ups with banks all around the region. Indeed, in these conservative times, even the foreign banks in China have taken to promoting debit products aggressively as a way to introduce clients to their brand and eventually cross-sell other services.

Channel strategies—going mobile

One of the greater opportunities for banks is in the mobile banking space, which will include payments. As evidenced in the great channel wars of the last 20 years, when banks wavered on which channels they would provide to clients and experimented with closing branches, it was learned that banks that didn't stay on top of the multi-channel game stood to lose customers (or at least stood to lose out on opportunities for growth when demanding clients passed them by in favour of competitors). IT companies are ramping up their mobile banking offerings to promote the channel, with some of them claiming that in surveys, 85% of bank respondents indicated that they were in some stage of implementing a mobile banking offering. While the number of banks outside of Korea and Japan that currently offer the channel may seem small, even in developed markets like Australia, it is apparent that banks will be unveiling their offerings in rapid succession in due course. Clearly, the ubiquity of the mobile phone—customers may live without access to the internet, or may be miles form a bank's branch or ATM, but very few are without a mobile phone—is starting to catch on. Unlike the ATM and the branch, it is also channel infrastructure that the client can be persuaded into investing in.

While some banks may find the investment required to add mobile banking to a stable of expensive channels prohibitive, a lot would depend on the architecture of the systems and the bank's approach to a multi-channel strategy. According to some sources, OCBC did not need to spend a lot of money to become the first bank in Singapore to offer mobile phone banking, which it now reports has turned a profit as a business. Citibank and Standard Chartered Bank in Singapore have also become the first foreign banks to offer the channel, helping them get around the fact that they have much smaller branch networks than local banks.

Figure 5.1
Asian banks' current mobile banking proposition



Source: Asian Banker Research

With its experience in Singapore, OCBC is finding that the channel is also helpful in getting around its branch limitations in China, but also that it has a lot of competition from IT-savvy local banks that are running slick new systems. "China is more advanced than the other parts of the world. It is because China adopts the latest technology immediately. In Singapore, Europe and US, the banks have got legacy systems, whereas as China starts from scratch, immediately it adopts the latest technologies. I think the rate of adoption is faster in China than in anywhere else," says a source at OCBC in China.

For Chinese banks, the channel is also the source of some trepidation. One source at Industrial and Commercial Bank of China (ICBC) notes that "for Chinese banks, I believe no bank is currently making money through this channel yet, but we are all optimistic about its future performance in terms of cost savings and productivity enhancement. However, I think this channel can hardly replace or compete with internet banking due to its natural limitation, such as small browsing screen and not easy to use." Another source at Agricultural Bank of China (ABC) echoes the thought perfectly.

For mobile phone banking in China, banks currently offer both SMS functions, as well as WAP-based P2P payment transactions. ICBC has noted that P2P transfers may exceed 10 million in 2009, although the bank seems to be more bullish on internet banking, along with its peers, largely due to the limitations of the screen size.

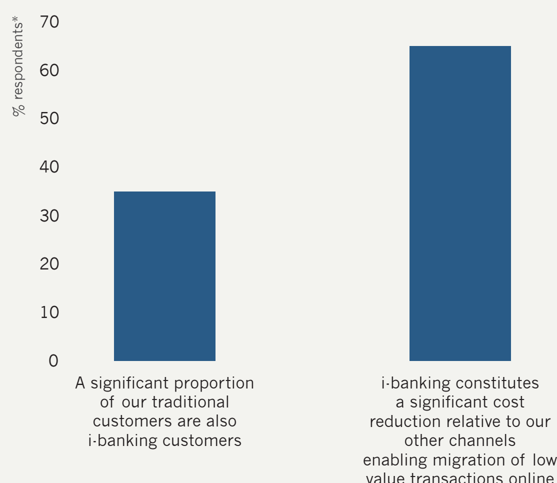
Online payments and the future of retail banking

For banks, especially emerging market banks that are ready to leverage the expansion of online penetration, the revenue component is clearly in enabling payment functionalities. But some banks are still weighing the pros and the cons of actively pushing the service.

According to a source at Shanghai Pudong Development Bank (SPDB), "real-time online payments are the development priority for the bank and they can help the bank to migrate low-margin customers from counter to internet banking, reduce the operational cost and enhance the efficiency of capital usage effectively. It will facilitate the banks' segmentation of its current clients and provide different offers tailored to different consumer groups. But the updating of online payment system is not an urgent task and the bank will evaluate the relevant cost more carefully especially when they have to allocate limited funds into various investment options."

Figure 5.2

Asian banks' current internet banking proposition



Source: Asian Banker Research

ABC has a similar challenge, especially considering its large rural client base, but banks like ICBC need no convincing. "Our internet banking platform has already become very mature no matter in terms of technology adopted or customer base. We are recognized as a very good provider of an effective transaction platform for low value deals and real-time transactions will help us to reduce the resources occupied and free up more for other businesses. The investment on this field, especially the updating of technologies adopted, will be an on-going process within our bank."

Conclusion

While retail banking and retail payments have been growing in the Asia Pacific region, they are still nowhere near the levels of most developed markets. Banks, non-bank financial institutions and other players such as telcos have been investigating the field of payments, be they credit, debit, RFID-enabled, online or mobile phone-enabled. Although most of these initiatives are national, some regional initiatives are developing as well. Banks will need to strategise how they approach the space, while being mindful of how to do it in a cost-effective manner.

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