Corporate cash balances grew at an extraordinary pace during the recent financial crisis as companies aimed to protect their lifelines and reduce liquidity risk. At the end of 2010, with uncertainty still in the air, cash balances remained very high. Adding to the growing wall of cash were new regulatory changes requiring banks to hold more capital, and money market funds to boost one-week liquidity. Today, depending on whom you ask, anywhere from 25% to 40% of that cash is trapped overseas in a web of interlocking regulations that govern investments, lending, currency exchange and cash repatriation both locally and domestically.

Why is so much cash accumulating overseas?

More than 70% of U.S. manufacturers sell to foreign markets. The growth of the Asian market has been particularly striking—since 2000, corporate cash in Asia has more than doubled (Exhibit 1, on the following page). The heavy investment in overseas markets has led to cash surpluses for three principal reasons:
Portfolio 2011: Trapped Cash: Local Market Challenges

- **Operational imbalances**
  Companies have injected large amounts of money into overseas local markets to fund their expansions there, but major expenses such as R&D are still borne by the home market.

- **Restrictions by local markets**
  Some developing markets offer incentives to attract foreign direct investment, such as highly favorable tax treatment for profits. In order to reap the full benefits of direct investment, however, the same authorities may also impose tight restrictions on taking money out of the country.

- **Tax treatment by home markets**
  A company’s home market authorities may tax monies repatriated from overseas. As a result, companies often prefer to delay repatriation or only repatriate cash at intervals, causing cash reserves to build up in the overseas market in the meantime.

The accumulation of cash balances overseas, particularly in those markets where restrictions on cash movement apply, presented a number of challenges to corporate cash management teams in 2010. The most significant, obviously, was the unavailability of their cash. Cash trapped in local markets cannot be included as part of a company’s global liquidity optimization strategy. Likewise, profits generated in these markets cannot be readily redeployed into normal corporate cash uses. It can be particularly frustrating when positive balances in these markets cannot be used to offset borrowings elsewhere.

Working with unfamiliar counterparties posed a second test. In some restricted markets, companies did not have access to their preferred global banking partners. This meant it was necessary to become familiar with the local banking organizations and to conduct the appropriate due diligence. Companies had to assess how using local banking entities would impact their tolerance for counterparty risk, particularly since they may have had to partner with a different bank in each local market. Maintaining visibility and control was also more difficult. Because it is harder to link restricted markets into a global or even regional cash management and investment process, investing had to be conducted at the country level, creating monitoring and control issues for headquarter treasury teams.

**Promising Developments from One Restricted Market**

In 2010, the Chinese government, taking steps toward loosening regulations and internationalizing its currency, the renminbi (RMB), began to offer investors greater latitude in local liquidity management. In response to growing demand, China issued new rules in June that:

- Expanded the offshore trade settlement scheme to 20 provinces and cities in China, plus a number of foreign jurisdictions;
- Lifted restrictions on RMB settlement for all overseas countries;
- Allowed enterprises of all types to establish commercial RMB accounts in Hong Kong;
- Eliminated limits on buying and selling RMB in Hong Kong; and
- Lifted restrictions on inter-bank transfers of RMB in Hong Kong.

**Cashing in: U.S. corporate cash piles up in Asia as American business participates in the region’s rapid growth**

**EXHIBIT 1: CORPORATE CASH IN ASIA FROM 2000 TO 2009**

Source: Bloomberg. As of November 26, 2010.

1 Countries in Asia include Australia, China, Hong Kong, India, Japan, South Korea and Singapore; corporate cash defined as top 20 companies by cash balances across target countries at each year end.

**How Trapped Cash Can Trip up an Organization**

The accumulation of cash balances overseas, particularly in those markets where restrictions on cash movement apply, presented a number of challenges to corporate cash management teams in 2010. The most significant, obviously,
In effect, corporations and other enterprises can now open offshore RMB accounts either to settle trade flows in RMB and/or convert foreign currencies freely into RMB. As a result, demand for the offshore RMB (designated “CNH”) grew quickly; CNH deposits jumped 66% in the second quarter of 2010 alone to total $22 billion (USD equivalent) (Exhibit 2).

In response to the growing demand, the CNH bond market, dubbed the “Dim Sum” bond market, doubled during the year. In July and August, Hopewell Highway Infrastructure and McDonald’s became the first Hong Kong and foreign corporation respectively to issue CNH bonds in Hong Kong. Caterpillar followed in November with another 15 issuers reportedly seeking approval to bring offshore proceeds into China. At the end of November, a total of 43 CNH bonds for $11 billion (USD equivalent) were outstanding from 18 issuers. The leading issuers were the Ministry of Finance of the People’s Republic of China, China Development Bank and Export-Import Bank of China (China Exim), which announced on December 15, 2010, that it will issue one-year and five-year bonds of $1.9 and $1.8 billion (USD equivalent). So many larger issuers coming to market figure to provide investors with more options for their cash management. We expect the primary market, as well as other alternatives, such as CNH-denominated pooled funds, to continue developing rapidly.

### Preventive Measures to Avoid Getting Trapped

While the loosening of restrictions in China is encouraging, the best approach for handling cash investments in local markets is to avoid getting trapped in the first place. By drawing up specific investment policies for local markets, companies can retain control in overseas markets and ensure that their investment standards are duly maintained.

A well-executed investment policy stipulates an organization’s agreed-upon approach to investing its cash. It helps to ensure investment consistency, whatever the market environment, and provides internal clarity so that all parties share a common and clear understanding of the organization’s objectives and how to achieve them.

Ideally, a company will have a global investment policy that applies across all markets. However, restricted markets may require their own considerations. A company may decide to specify parameters in the global investment policy or to draw up stand-alone investment policies for each individual overseas market. In some cases, separate policies for each different currency pool may be prudent. To determine the most appropriate investment strategy, treasury teams should assess how much cash is available for investment and how soon it will be required by the local business or whether it can be repatriated as, for example, dividends. The strategy will necessitate an accurate picture of cash flow in the market and require segmenting cash into operating, reserve and strategic buckets.

### Trends for 2011

In 2011, corporate cash balances will likely remain high:

- We expect investor appetite to grow for domestic currency money market funds, or “cash equivalents,” and increased interest in tailored strategies (discretionary investment accounts) in strong local currency markets—like Singapore, Australia and Japan, as well as China—that go beyond cash equivalents.

- Watch for further development in local currency bond markets, particularly in China, both onshore in RMB and offshore in CNH.
Companies expanding into new territories will continue to encounter obstacles when investing cash locally. Organizations may have to consider what resources and personnel they have to invest locally and how central oversight of local markets will be achieved. But with research, planning and a carefully conceived investment policy, companies can ensure that their cash is invested effectively and appropriately in each market in which they operate and avoid getting trapped in restricted markets.