




FINANCING OPERATIONS IN CHINA - CASH MANAGEMENT IN A CRISIS



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1. GET YOUR NUMBERS RIGHT!
2. CASH MANAGEMENT
3. FINANCING IN CHINA



GET YOUR NUMBERS RIGHT!

First things first, you need to understand the situation. You need **accurate, complete** and **timely**:

- Financial statements
- Management reports
- Bank / cash journals
- Receivables / payables reports (including an ageing, payment terms analysis)

Understanding the situation may also require **analyzing trends**, by comparing financial statements over several periods.



Questions you want answers to:

- What impact is this crisis having on my company?
- Aside from cash, is the company's activity affected?
- Has this crisis slowly escalated or brutally erupted?

GET YOUR NUMBERS RIGHT!

Of course you need to know where you are heading too, so **update cash forecast** (refer section 2 “Cash management”).

If this crisis is affecting other areas of your business or you anticipate that it will, you need to go back to your projections and **compare actual results versus forecasts**. This exercise may lead you to **reassess your ambitions** (forecasts) – important to manage shareholders’ and creditors’ expectations.

	B	C	D	E	F	G	H	I	J
1	A								
2	Account	Forecast (Q1)	Q1	Forecast/Q1	Forecast (Q2)	Q2	Forecast/Q2	2018	2017
3	Domestic income	5,889,629.62	4,142,765.79	-30%	5,889,629.62	4,639,897.68	-21%	889,629.62	885,310.15
4	Overseas income	11,879,707.49	13,259,649.46	12%	9,697,019.88	13,730,807.40	42%	10,799,734.08	9,697,019.88
5	Cost of sales	8,560,453.00	7,840,254.00	-8%	8,560,453.00	8,781,084.48	3%		
6	Travel expenses	317,979.05	499,910.46	57%	167,047.95	111,899.72	-33%	264,982.54	167,047.95
7	Meal	61,322.77	19,027.75	-69%	36,557.30	21,311.08	-42%	51,102.31	36,557.30
8	Reception expenses	1,188.00	9,100.00	666%	5,130.00	10,192.00	99%	990.00	5,130.00
9	Membership fee	36,112.62	41,634.17	15%	43,875.27	46,630.27	6%	29,512.62	43,875.27
10	Promotion fee	65,943.41	154,679.00	135%	981.13	-	-100%	43,962.27	981.13
11	Taxi fee	75,866.26	18,546.16	-76%	47,767.50	20,771.70	-57%	63,221.88	47,767.50
12	Visa fee	3,097.60	3,051.00	-2%	2,846.30	3,417.12	20%	2,816.00	2,846.30
13	Meeting fee	76,738.01	67,294.56	-12%	(11,214.47)	75,369.91	-772%	69,761.83	690,992.53
14	Telecommunication fee	22,575.07	6,216.15	-72%	21,756.62	6,962.09	-68%	20,522.79	21,756.62
15	Printing	4,770.00	1,009.24	-79%	6,784.04	1,130.35	-83%	3,975.00	6,784.04
16	Office supplies	36,429.79	25,452.06	-30%	94,076.29	28,506.31	-70%	33,117.99	94,076.29
17	Mobile fee	10,350.00	10,350.00	0%	10,350.00	11,592.00	12%	-	-
18	Depreciation	33,097.36	11,809.99	-64%	23,742.78	13,227.19	-44%	30,088.51	23,742.78
19	Courier fee	15,212.08	12,716.34	-16%	12,543.19	14,242.30	14%	13,829.16	12,543.19
20	Internet service fee	21,607.14	21,607.14	0%	19,307.14	4,941.73	-74%	41,607.80	19,307.14
21	Amortization of intangible assets	1,000.00	1,000.00	0%	509.36	-	-100%	112.96	509.36
22	Training fee	229,946.45	259,050.00	13%	164,142.65	82,968.37	-49%	191,622.04	164,142.65
23	Social contributions	17,019.02	25,486.00	50%	18,291.70	19,061.31	4%	15,471.84	18,291.70
24	HR service fee	1,458,600.00	744,128.37	-49%	1,084,603.87	744,128.37	-31%	910,071.11	1,084,603.87
25	Labour fee	1,409,100.00	980,560.00	-30%	1,167,000.00	980,560.00	-16%	(207,300.00)	575,000.00
26	Labor protection fee	282,388.90	185,000.00	-34%	222,947.40	185,000.00	-17%	235,324.08	222,947.40
27	Welfare	500,000.00	800,000.00	60%	500,000.00	750,000.00	50%	-	-
28	Office rental	899,147.77	899,147.77	0%	899,147.77	899,147.77	0%	817,407.06	584,091.88
29	Property management	17,250.00	17,250.00	0%	17,250.00	17,250.00	0%	-	-

Going through tables and numbers can be a painful exercise for entrepreneurs and managers without a financial background, so **do not wait for a crisis to:**

1. **Surround yourself with a savvy accountant**, who will get the work done, analyze results and blow the whistle early enough
2. **Implement a reliable reporting, define KPIs and other metrics** that are relevant to your business and environment
3. **Spend some time with your accountant**, it will be useful to both

There are a number of metrics you want to keep an eye on in a period of crisis, here are 3 simple ones:

Metric	How do I calculate it?	What am I looking for?
Working capital	= current assets - current liabilities	A result superior to 0 means that the company's current assets (cash, receivables) can cover current liabilities (payables)
Current ratio	= current assets / current liabilities	Same as working capital but result is a ratio. A ratio equal or greater than 1.0 means that the company's current assets can cover current liabilities
Quick ratio	= (current assets - inventory) / current liabilities	More conservative than the current ratio, as it considers inventory as less liquid than other current assets. A ratio equal or greater than 1.1 means the company's most liquid assets can cover current liabilities

If results from the above tests are positive (and cash is low), you need to concentrate your efforts on:

- Recovering receivables – ageing analysis and payment terms analysis will be useful here to target debtors;
- Scheduling settlement of payables – here again ageing analysis and payment terms analysis will be useful for you to prioritize payments.

If results from the above tests are negative, your business is facing the risk of defaulting (refer to section 3 “Financing in China”).

CASH MANAGEMENT

In a normal context, we recommend a SME operating in China to have a **cash forecast of 6 months** minimum to anticipate potential financing needs. When there are tensions on liquidity there is a need for both **short-term and mid-term / long-term visibility**. Short-term visibility to manage the crisis. Long-term to manage the sustainability of the business and plan for the future.

Short-term forecast		Long-term forecast	
<ul style="list-style-type: none"> • Estimate cash requirements • Plan short-term financing • Scheduling payments • Planning purchases 		<ul style="list-style-type: none"> • Plan long-term financing • Assess availability of investable surplus • Planning capital expenditures • Planning raising of funding 	
Advantage	Disadvantage	Advantage	Disadvantage
<ul style="list-style-type: none"> • Good picture of expected cash flows • Essential to manage day-to-day transactions 	<ul style="list-style-type: none"> • In the context of a crisis needs to be updated regularly • No long-term visibility 	<ul style="list-style-type: none"> • A must when discussing with shareholders and creditors • Essential for long-term planning 	<ul style="list-style-type: none"> • Not adapted for short-term planning • Not adapted in the context of a crisis

Here again, **do not wait for a crisis to:**

1. **Prepare realizable cash forecasts**, both for short-term and long-term financing.
2. **Implement internal controls**, to ensure you get early warnings if a shortage looms.
3. **Implement solid processes**, notably on invoicing and collection.

Capital increase		Shareholder loan	
Increase the registered capital		Contract a loan from shareholder	
Advantage	Disadvantage	Advantage	Disadvantage
<ul style="list-style-type: none"> • No third-party involved • Non-taxable 	<ul style="list-style-type: none"> • 2-3 months to implement • Funds immobilized in China 	<ul style="list-style-type: none"> • No third-party involved • Funds are not immobilized in China 	<ul style="list-style-type: none"> • Limited • 2-3 months to implement • Taxable

The amount a foreign-invested company can contract as a loan from its' shareholder is capped. A company can opt for either of the following measurement:

1. Borrowing gap (= total investment - registered capital)
2. Macro-prudential financing system (risk-weighted approach involving 2 concepts, cap and balance)

The above solutions are most commonly used by foreign-invested SMEs. In both cases you need to **be mindful of the implementation time**. Registrations with the authorities are required before funds can be received. Documents also need to be signed by the shareholder.

Make sure you are **assigning this project intelligently**, to someone familiar with the formalities and who can handle them efficiently.

Bank loan		Related-party agreement	
Contract a loan from a bank in China		Charge services rendered to group	
Advantage	Disadvantage	Advantage	Disadvantage
<ul style="list-style-type: none"> • Quick set up • No registrations / approvals required 	<ul style="list-style-type: none"> • Finding a willing bank • Conditions (interest rate, guarantees) 	<ul style="list-style-type: none"> • Quick set up • No registrations / approvals required 	<ul style="list-style-type: none"> • Substance of transaction • Taxable • Transfer pricing considerations

Related-party transactions are of course permissible, but there needs to be **substance to the services rendered**. Banks are receiving clear instructions from the State Administration of Foreign Exchange (SAFE) to look out for such transactions that are purely for financing purposes and do not actually have substance. The bank will require the service agreement and invoices. In case of doubt additional documents may be requested or the bank may simply refuse the funds (returned to payer).

 Q&A





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About Mazars

Mazars is an international, integrated and independent firm, specialising in audit, accountancy, advisory, tax and legal services. Operating in 89 countries and territories, as of 1 January 2019, the firm draws on the expertise of 23,000 professionals to assist major international groups, SMEs, private investors and public bodies at every stage in their development.

