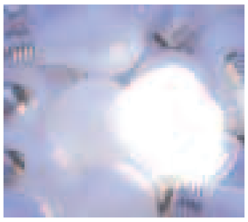


When every little helps

CORPORATE TREASURERS IN THE MIDDLE EAST ARE STRIVING TO STREAMLINE THEIR CASH MANAGEMENT, TRADE SERVICES AND TRADE FINANCE FUNCTIONS TO ACHIEVE MORE EFFICIENCIES AND BOOST WORKING CAPITAL, SAY **SANJAY SETHI, FARAZ HAIDER** AND **SURENDRA BARDIA**.

While the Middle East may not have been as badly affected by the global economic downturn as other parts of the world, it has had its fair share of problems. Some countries have been in recession, concerns arose in November about the ability of one of the region's most dynamic companies to service its debts – though its immediate problems were resolved in mid-December – and local stock markets have experienced some volatility.

Oil exporting countries of the MENAP region (Middle East, North Africa, Afghanistan and Pakistan) in 2009 were "directly hit by the global financial crisis through a sharp decline in oil prices and a sudden drying up of capital inflows", stated the IMF in its *Regional Economic Outlook* in October. Fortunately, the impact has been greatly mitigated by countercyclical government spending largely on infrastructure, healthcare and education, using substantial reserves.

Real GDP growth among MENAP oil exporters is projected to fall to 1.4% in 2009, considerably down on the 4.6% achieved in 2008, but is expected to bounce back to 4.1% in 2010, although these aggregate figures disguise the fact that three countries are expected to have negative growth in 2009 – the UAE, Saudi Arabia and Kuwait, with negative GDP rates of 0.2, 0.9 and 1.6 per cent respectively.

As for the oil importing countries of MENAP, they are expected to see growth fall from 5% in 2008 to 3.9% in 2009, and to 3.8% in 2010 – still good by many standards.

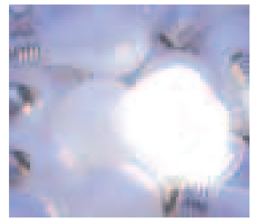
IMPLICATIONS FOR CORPORATE TREASURERS In these unusual times, how should corporate treasurers in the Middle East be reacting? The answer is twofold: on the one hand they should be acting as if it is business as usual, in the expectation that the regional economy will recover in 2010, as widely forecast; but, on the other hand, they should still be planning for further unforeseen events that could cause the economic recovery to falter.

In preparing for both scenarios, but especially the second, treasurers will need, among other things, to optimise their working capital. Given increased credit spreads and the benign interest rate scenario, they must be sure that their cash management and trade activities are carried out as efficiently as possible in order to maximise the amount of internal working capital available, and minimise the amount of external credit needed. Short-term credit is relatively expensive, and medium- and long-term credit is not readily available unless guaranteed by an export credit agency.

Many Middle Eastern companies have found that their customers have used the economic downturn to negotiate lower prices, a trend that may accelerate if uncertainty in the region lingers. Lower prices translate to lower revenues if volumes do not increase, which puts pressure on companies to implement cost saving measures where they can, including in their treasury departments where cash management efficiencies can make a significant contribution.

EFFICIENT CASH MANAGEMENT So what aspects of cash management should treasurers seek to improve?

- One objective should be to enhance payment efficiencies, in particular by speeding up receivables and streamlining payables. A typical opportunity is to work with suppliers to create finite payment cycles in a month. Another would be to standardise the number of handoffs required to make a payment or reconcile a receivable. If multiple subsidiaries adopt the same processes, this can lead to the creation of shared service centres within an organisation. If such payment efficiencies are achieved it should lead to a



reduction in days sales outstanding (DSO) and an increase in days purchases outstanding (DPO), thus generating significant amounts of incremental working capital.

- Another objective should be to rationalise the number of banks used for cash management and switch to a bank with a global network, infrastructure and platforms. Using a different bank for each country is inefficient, because treasurers have to use a variety of payment products, platforms and non-standard connectivity. Even if the global bank does not have a presence in every country where the company operates, it will often have partnership arrangements with local banks. The treasurer will only have to deal with the global bank, and the global bank – either through its own network or its partnership arrangements – will then deliver the local capabilities the treasurer requires.
- Increasing visibility across accounts in various geographies should be another aim. Treasurers need the right tools to allow them to see their working capital positions, help them map their cash flows across banks effectively, and ensure they make timely and accurate investment and borrowing decisions. It is also important to have the correct umbrella structure of accounts to centralise liquidity. A global bank with a good cash management platform can act as a trusted adviser and work with treasurers to create structures that allow liquidity generated in multiple overseas businesses to be optimally upstreamed back to the parent company. The bank can also help identify and manage trapped liquidity.
- Treasurers may also want to look at Islamic banking, either with wholly Islamic banks or conventional banks with Islamic windows. Some conventional banks can provide cash management through a segregated Islamic treasury operation, where cash surpluses are invested in Shariah-compliant assets kept separate from conventional assets.
- Finally, treasurers should negotiate with their bankers to ensure they are paying a fair price for banking services. Getting the banking pricing points right, and standardised across the organisation's subsidiaries, is a critical component of the liquidity structure.

TRADE FINANCE EFFICIENCIES On the trade finance side, Middle Eastern importers may find their suppliers are refining and realigning their trade processes given the unusual perceived counterparty risk. Suppliers may therefore want to switch from open account trading to trade instruments like letters of credit (LC), which provide increased surety and protection against counterparty risk.

Open account trading had increased dramatically around the world in recent years, causing LCs to fall into relative or even absolute decline. In today's fragile trading environment, LCs have come back into vogue in certain cases, even though they are less efficient than deals conducted on open account. Managing the LC cycle creates extra work and costs for treasury departments, but using a transaction bank with a global network, experienced staff, and robust platforms and processes will ease the burden. Trade finance and services provided by banks also include documentary collections, inventory finance, receivables finance, supplier finance and loans guaranteed by export credit agencies.

GETTING THE BANKING PRICING POINTS RIGHT, AND STANDARDISED ACROSS THE ORGANISATION'S SUBSIDIARIES, IS A CRITICAL COMPONENT OF THE LIQUIDITY STRUCTURE

Supplier finance, for example, is used by large corporations not only to provide cheaper liquidity and enhance relationships with smaller suppliers, but also to extend their own DPO. It is therefore ideally suited to the more difficult trading conditions that currently prevail in the Middle East.

Export credit agencies (ECAs) have taken on a more important role in the finance of trade in the past couple of years. First, ECAs are guaranteeing more banks loans used in the support of short-term trade, rather than guaranteeing only medium- and long-term export contracts and projects. Second, government-owned ECAs have extended their services to cover exports from other countries, not just their own. Third, ECA-guaranteed loans are often the only form of long-term or project finance available to exporters because the international capital markets had largely dried up in 2009.

Corporate treasurers should work closely with their bankers to select trade finance structures that help the corporation meet its key strategic objectives, namely enhancing the supply chain efficiency and reducing risks in the transaction life cycle, while all the time focusing on improving the business bottom line.

THE VALUE OF PARTNERSHIPS In periods of economic hardship corporate treasurers need to generate more working capital and unlock internal liquidity wherever they can find it. To do this, they need to analyse their cash management and trade finance and services practices across the spectrum of their operations and make them more efficient.

Transaction services from banks have a pivotal role to play in all this. With their expertise in moving cash around the financial system, they provide treasurers with increased visibility and control over their activities, greater operating efficiencies and improved risk management. And with their long histories of facilitating cross-border trade flows and extensive international networks, they are well-equipped to create end-to-end solutions ranging from short-term financing to complex structured trade models.

One of the best ways for a corporate treasury department to optimise its working capital is to work closely with its transaction banking partner to maximise the positive impact.

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