



# Get your head in the game

NOW MORE THAN EVER, TREASURERS HAVE A CENTRAL ROLE TO PLAY IN KEEPING THEIR COMPANIES' GOODS AND CASHFLOW RUNNING SMOOTHLY. **SCOTT LANDER** OFFERS A CHECKLIST.

Given the fallout of recent events in Dubai it is clearly a concerning time to be a treasurer in the Middle East. The credit crunch and economic downturn have made treasurers significantly more visible within organisations given their critical role in guarding against financial risk and ensuring cash is continually and readily available to the business.

Whatever the external conditions, my perspective remains the same: It is now time to help treasurers and treasury employees broaden their understanding of regional risk in both the physical and financial supply chains.

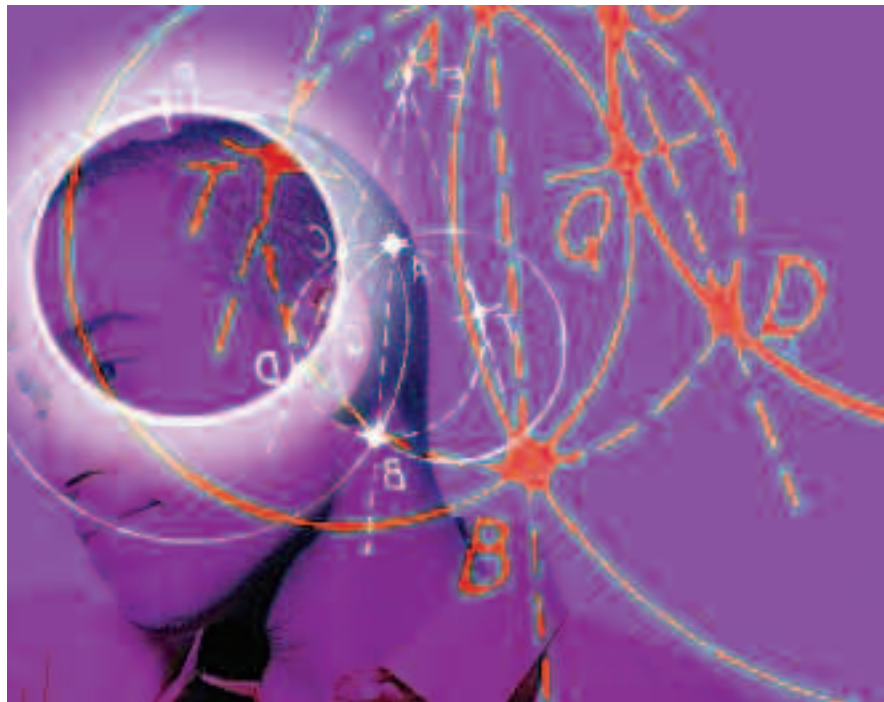
Listening to treasurers recently it has been encouraging to hear the physical supply chain more widely discussed. In forward-thinking organisations we observe the emergence of working capital champions who are responsible for core elements making up the total supply chain, from procurement through to customer delivery. Unfortunately, our research indicates that two out of three treasurers are still not formally communicating with their supply chain director on a regular basis, except perhaps at monthly management meetings.

One way treasurers can add value within their companies is to ensure that they connect with their supply chain colleagues, build closer relationships with them and gain a better understanding of what each others' roles entail.

If a company wants to improve working capital optimisation, clearly the physical and financial supply chains need to be linked within the business.

**RISKS: NEW THINGS TO CONSIDER** One of the reasons for the nervousness we witnessed at the end of 2009 was a perceived opaqueness in general business operations in the

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Middle East. From the perspective of inward investors, key Middle East government organisations and businesses, still tend to lack transparency in terms of accounting and financial reporting. Traditional instruments such as performance bond guarantees and letters of credit still go some way towards mitigating the payment risk in a normal environment. However, in the volatility we have experienced voices are being raised suggesting that even these traditional methods of providing assurance may not be enough. Previous issues of the Middle East Supplement have looked at the need for treasurers to consider their counterparty risk in all financial areas of business, which included partners such as banks during 2009. In 2010 it is time for treasurers to take this a step further and consider the counterparty risk in terms of the physical supply chain as well.

One main danger now, as before, remains payment risk. If customers raise the possibility of deferring payments,



## middle east supplement

### OPERATIONS AND CONTROLS

treasurers and their management colleagues have to consider this risk. Our advice would be that before any such consideration or agreement, the request would have to be accompanied by some detailed transparency from the counterparty on what was happening in its underlying business.

**MIDDLE EAST TRADE GATEWAY** As inventory makes up a major component of working capital, it is now wise for the treasurer to focus on helping to minimise the level of stocks held.

In terms of traditional operations risk, the treasurer needs to consider what factors may cause disruption to the flow of the inventory through the physical supply chain and the increased stock holding that follows.


It should be remembered that the Middle East has undergone phenomenal change in recent years. In essence, the region has taken advantage of its geographical position between Asia and Europe, imposing itself on the global physical supply chain. This has to some extent been driven by the key trend in world economic growth of manufactured goods production moving from west to east. The Middle East is attempting to turn the region into a key staging post and transshipment hub for multimodal transport and has built the physical infrastructure to meet that strategic objective. The result has been enormous development of the region's warehousing capacity and related transportation hubs.

Furthermore, greater freight volumes will transit through the region. As these warehousing facilities come on stream, it will be increasingly important for companies to understand what is happening in the region.

Questions remain over the level and the quality of services

provided by logistics organisations in the region. While it is always difficult to compare different levels of service across the globe, from our assessment of the region it is fair to say that sometimes the service quality falls short of the benchmark handling standard in other geographies. Documentation standards may also fall short of those experienced by companies in other locations, which tends to cause delay at importation in the country of destination. Investment in facilities, systems and training had been improving the situation but the recent crisis may see a fall off in that investment. Whatever the outcome, companies need to be aware of these shortcomings and should be involved with supply chain partners to improve working practices in key areas.

Until recently there was a severe shortage of warehouse space with all the facilities working at full capacity, causing commensurate high pricing. However, the recent drop in consumer confidence across the globe, as well as the particular problems in the region, has seen this completely reversed and instead large areas of warehouse are now empty. Jebel Ali, the free trade zone in Dubai, is much quieter with some logistic providers now only charging handling and associated services in order to stay in business. Such fast expansion and contraction is not good in any industry, particularly logistics. Like anywhere on the globe there are very real operational risks, as highlighted last year by a spate of regional warehouse fires. These were attributed to extremely high temperatures and problems with electrical systems. Such matters will often land on the desks of treasurers if they have overall responsibility for insurance within their organisations. Questions then arise as to the type and nature of the insurance cover in force and treasurers need to be up to speed with the detailed issues.



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**BORDER REGULATION** Bearing in mind that most freight in Dubai is in transit, it is important to take into account the import/export regulations which apply to cross border movements. Take for example the UAE/Saudi Arabia border, where it is common to see trucks sitting at crossing points while the stringent Saudi documentation requirements are fulfilled. Restrictions are in place on what can be imported into certain countries in the region, and a failure of companies to understand the regulations that are in place can be costly. As well as the formal rules, Western treasurers have traditionally struggled to understand the culture and local customs which ensure the smooth movement of goods and services. Treasurers need to immerse themselves in the local ways of doing business and understand that it is difficult to apply those "traditional" ways normally practiced in the West. For instance, in the West it is common practice to be able to pay a fee in order to expedite something to ensure it happens by a certain deadline. This concept is unavailable in parts of the Middle East and any attempt to pull certain levers may not have the desired result. Things often just take the time they will take.

**HUMAN RESOURCES** There are also some interesting challenges to human resources relating to the effects of such growth changes. The region has suffered a shortage of skilled professionals in logistics and finance so traditionally expatriot workers have made up the shortfall. These staff have used this situation to their advantage by becoming very mobile in search of salary and title raises, resulting in high staff turnover. New staff are being trained, but once training is complete they in turn become mobile. Staffing therefore looks set to remain a key issue and companies need to ensure they have strong procedures to negate potential HR issues over recruitment and retention.

**POLITICAL RISKS** Treasurers, who are based in the UK but who work for subsidiaries of US corporations with business dealing in the Middle East, have a specific geo-political risk which they need to recognise and mitigate. Iran, being a neighbour in the Middle East, is subject to a US embargo. Therefore certain companies need to be acutely aware of the practicalities of these trade restrictions day to day as they ship goods across borders within the region. They must avoid falling foul of OFAC (Office of Foreign Asset Control) compliance regulations or be perceived to be facilitating trade with Iran. While all companies must be satisfied as to the final destiny of goods under their control, this is particularly important for US-owned corporates.

Treasurers also need to be involved in pricing policy and help give their colleagues an overall understanding of the duties and taxes which apply in the region, especially as they have a material impact on pricing policies and, ultimately, profitability. Treasurers must ensure the business is able to reliably source up-to-date duty and tax information in order to make sensible commercial decisions.

**CURRENCY RISK** While many specific regional variations need to be managed, at the same time it is important not to forget some universal treasury issues, such as exchange rate risk management. Many corporates will still be running

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currency risk management out of a central treasury operation based outside the Middle East, yet there will be times when either local knowledge is needed or a local decision made. It is important that a management communication structure is in place, especially after recent events where there has been an exodus of staff that would have fulfilled those functions.

**COMMUNICATION LINKS** This underlines the increasing need for the treasurer to ensure that a correspondingly robust treasury and finance structure is in place to cope adequately with the day to day local demands placed on the function. In particular the crisis in Q4 2009 alerted companies to the need to have resources and systems in place which would provide "red flags" alerting them to upcoming problems in the business and finance environment. Given the track record of communication between the regional office and head office this clearly is an ongoing challenge for 2010. Treasurers should be involved in improving communication and in helping to refocus their organisation on key risks. They should also provide some comfort through techniques such as stress testing to see where their particular company may be vulnerable. Those vulnerabilities can then be addressed by putting contingency plans and risk management in place. The treasurer may need some outside help and expertise on these issues.

The Middle East is changing. Recent events have refocused concerns on issues such as transparency and the desire to know your business partners and counterparties, including financial institutions. This challenge for the organisation continuing to do business in the Middle East presents a great opportunity for the treasury profession to use its skills and knowledge for both the physical and financial supply chain. This will go a long way to overcoming these newly identified problems and drive a long-term profitable relationship.

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