HEAD FOR THE HUB

IT MAKES BUSINESS SENSE FOR MANY COMPANIES TO CREATE A REGIONAL TREASURY CENTRE THAT CONNECTS AFRICA AND THE MIDDLE EAST. HAYTHAM ELMAAYERGI EXPLAINS

By 2050, the Middle East and Africa's share of global GDP is expected to reach 17%, according to the World Trade Organization (WTO). This makes it the fastest-growing region in the world. Meanwhile, overall inter-regional trade is expected to grow at a compound annual growth rate of 10% from 2010 to 2030, says the WTO. Consequently, Middle Eastern companies are looking to ride the huge wave of trade that will come from the south and take full advantage of the attractive opportunities set to come with it. They often see having a regional treasury centre as a good way to support their growth.

Some companies in the Middle East have managed to set up a regional treasury centre with ease and others have found it immensely difficult. Let me share some of their experiences by compiling them into a case study concerning a fictitious company named DMEA.

Meet DMEA

DMEA operates more than 20 entities in the Middle East and Africa. It is also part of a larger conglomerate with interests in a range of industries headquartered in Europe. The group has a decentralised

IMAGE: SHUTTERSTOCK/NAUFAL MQ

organisational structure in these regions, with limited visibility, control and unreliable reporting. As a result of increased business activity in the two regions, a number of challenges have arisen for DMEA and its European HQ.

For starters, DMEA recognises that it deals with too many banking partners, both locally and globally. Working with a large number of banks leads to counterparty risk issues, idle funds sitting in accounts in different regions, asset erosion (especially of African investments), mismanagement of FX, commodity and interest risk, inefficient financial processes, and limited visibility and control.

In an increasingly tough market, DMEA understands that in order to stay competitive and manage risk, it needs to increase the efficiency of treasury and better manage its exposures. So it concludes that it needs a regional treasury centre with close links to the business in order to cover the two regions of the Middle East and Africa, and it builds a business case accordingly.

Location, location, location

Selecting a location is a daunting task. After all, the location must fill several key criteria, including having an attractive regulatory environment, efficient markets, a suitable taxation regime, a detailed financial market development plan with easy access to banks and other financial services, high-quality and modern infrastructure, and ample professional local talent.

Since DMEA manages a considerable amount of its business from the Middle East, it narrows down its choices to Dubai. Dubai offers unlimited access to the region and DMEA can set up its regional treasury centre in a tax-free and liberal environment. In terms of infrastructure, Dubai currently ranks among the top five cities worldwide and it is home to a number of free zones.

The Dubai International Financial Centre (DIFC) is the right fit for DMEA's regional treasury centre. DIFC offers unparalleled financial services, 100% ownership (ie there is no requirement for a company to have a local partner in order to operate there), and flexibility in labour law. Furthermore, it operates in an international standard regulatory jurisdiction and is open seven days a week.

The right partners

Like most companies, DMEA needs to employ an experienced law firm to establish a legal framework for its operations. Once it is legally established and resourced, DMEA can now conduct basic treasury operations with appropriate procedures and policies firmly in place.

DMEA needs to appoint a primary banking partner that can provide it with the banking services and products it needs in both regions today and in the future. Additionally, the right bank will need to deliver consistent local and regional support.

There is a wide range of banks available in Dubai, so DMEA must look closely at the services and products on offer. Cash and liquidity-management offerings are important since it needs access to cash pooling, cash flow forecasting, yield protection and e-banking systems. Furthermore, trade finance solutions, bank credit facilities and similar products and services will be essential.

In more volatile countries, interest rate risk, market risk and country risk will need to be taken into account alongside FX risk, commodity risk and counterparty risk. Meanwhile, reporting and analysis with cash flow forecasting, cash balance reporting, external bank credit facilities and treasury activity reporting are also vital to the company's growth.

The chosen banking partner will be expected to provide expert advice and a full set of banking products. Efficiency is a constant concern. DMEA wants a connection to process transactions; online platforms to initiate, confirm and settle FX; and availability to money market and trade transactions. Automated reconciliation, virtual accounts, automated liquidity and integration with treasury management systems are also important to efficiency as a whole.

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DMEA needs its bank to have technology that supports industry-standard connections, such as SWIFT and ISO 20022XML. It also requires global payments, collection channels and liquidity portals that support global and regional billing. The right bank will act as a single point of contact for DMEA, provide local support seven days a week, and offer guidance on market regulatory restrictions and structuring solutions. It will be able to offer customised products, remote cheque printing and multi-bank collections, and be willing to partner local banks when appropriate.

Internal reporting has been inconsistent to date. So DMEA starts to collect balance and transaction reporting using MT940 messages from its banks. These are fed into the electronic banking platform of its primary relationship bank and through an enhanced reporting system in order to gain visibility and control.

The enhanced reporting system helps DMEA to rationalise banking partners and bank accounts. It also supports it in moving funds from low-rated banks to highly rated ones in order to reduce counterparty risk and comply with established treasury policies.

Onboarding

DMEA is now ready to onboard its entities to its regional treasury centre. In order to deal with entities and joint ventures in regulated markets, the regional treasury centre operates as an in-house bank through which majority-owned entities in less regulated markets will process deposits, FX and funding. As a treasury service provider, the regional treasury centre acts on behalf of an entity, with local settlement being in that entity's books.

Before DMEA can start onboarding entities, it must consider the challenges presented by the markets in which the entity operates. These include issues related to tax, regulation and the banking landscaping. Furthermore, DMEA needs to gain an understanding of the regulations surrounding FX and intercompany lending in each market. It must also fully master account structure restrictions associated with tax issues, such as withholding tax on intercompany interest and dividends. Finally, it must understand the local banking and clearing market to fully exploit banking products and adhere to local cut-off times.

To achieve early successes when onboarding entities, DMEA looks first at easier markets before moving on to more complex ones. Onboarding new entities is an ongoing process as the business expands into new markets.

Ultimately, DMEA's regional treasury centre onboards the majority of entities and assumes responsibility for their FX, funding, deposit taking, risk management and occasional liquidity management, among other functions. The ability to run these activities has transformed DMEA's regional treasury into a transactional one.

Overload

With entities in various countries in both regions onboarded successfully, DMEA's regional treasury is overloaded and looks for solutions. Its options include hiring more staff or automating more of its treasury processes, which are still inefficient. So DMEA looks into automating liquidity management by implementing regional pooling and/or sweeping structures that are dependent on regulatory limitations. This simplifies processes, but also optimises the availability of internal funds for self-funding purposes by reducing current cash buffers held by the entities.

The need for automation and the rise in the use of risk management products, such as structured derivatives for FX, interest and commodities, encourage DMEA to acquire a treasury management system. The company invests in a real-time data terminal for instant price information and trading capabilities. Trading of vanilla products is done through a multi-bank trading portal. Its confirmation matching is done through dedicated software. The use of technology reduces the need to expand its teams on the ground and gives DMEA the opportunity to use complex risk management products with enhanced reporting and control.

At this point, DMEA raises concerns as to how the accounts payable (AP) and accounts receivable (AR) processes are dispersed locally. These are generating operational risks, delays and inaccurate forecasts, and causing the company to incur unnecessary costs due to ineffective processes and bank connectivity issues. DMEA therefore decides to create a shared service centre based out of Dubai, which will handle the company's AP/AR in the region as well as its HR and IT. The shared service centre also takes on the handling of letters, bills of exchange and guarantees.

The creation of the shared service centre enables the regional treasury to establish payment factory solutions with connections to each bank for payments and reporting. It also allows DMEA to look into payables on behalf of and receivables on behalf of structures that will transform the regional treasury centre into an in-house bank and enable it to join the global in-house bank structure operating at HQ level.

Through its strategic banking partnership, DMEA becomes aware of the treasury-related benefits of creating a centralised procurement hub where most FX, working capital and commodity transactions would be processed. It also allows DMEA to use internal invoices as a tool to finance entities and extract cash in regulated markets by delaying payments or making them early. DMEA is now a process efficiency treasury and operates as a provider to group subsidiaries. It delivers a service proposition based on efficient execution, lower costs, attractive service levels and strong advisory capabilities.

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Strategic treasury

Next, DMEA's regional treasury centre focuses its efforts on becoming a strategic treasury and adding value, instead of just providing an internal service function. This means getting involved with M&A and investment at an early stage.

The regional treasury centre actively reviews funding and capital structures, and ensures treasury policy and procedure compliance centrally as well as locally (including for potential new entities within the regions). It conducts regular bank reviews and advises on supplier and buyer contracts with regards to currency, terms and settlement instruments. Furthermore, it reviews contracts for embedded derivatives such as rental contracts linked to prevailing interest rates and supplier or buyer contracts linked to commodity prices. DMEA's regional treasury emerges as a strategic treasury and is core to the group's success in the region.

Benefits

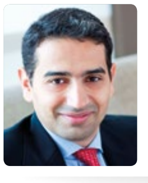
Organisations such as DMEA that take the plunge and create regional treasury centres clearly achieve substantial benefits. Fifteen years ago, the technology and know-how needed to set up a regional treasury centre was exhaustive. Since it meant having access to extensive resources, more often than not, it was usually only large multinationals that possessed the capabilities to create them.

These days, of course, technology is much easier to implement and considerably more affordable. Thus it is far simpler and more cost-effective to set up a regional treasury centre.

Dubai's friendly business environment, together with the strategic location of the United Arab Emirates, clearly makes Dubai and the rest of the Emirates an attractive option for businesses.

As companies seek cross-border growth and to make better use of all of their resources, regional treasury centres not only make good business sense, they are rapidly becoming a necessity. The rationale for regional treasury centres is pretty straightforward: they can help to improve risk and liquidity management while reducing costs efficiently.

So, the next time someone asks if you should set up a regional treasury centre in Dubai, the answer should be quite obvious. You cannot afford not to.



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