Cash management in the Middle East

Adapting to the changing financial climate is crucial for Middle Eastern companies if they are to survive in the region, says Sunil Veetil of HSBC Bank.

If you ran a search of the myriad of press and periodical articles that began with the words "the recovery of oil prices..." you might perhaps reach a conclusion that the subject was cut and dried, and that the financial future of the Middle East was assured. But the economics – and politics – of oil is a vivid reminder that nothing can be taken at face value.

The rather rosier prospects for Middle East economies, particularly oil-rich ones, because of increasing oil revenues over the past 18 months are clouded by many challenges on the horizon. Achieving – sometimes over-ambitious – development targets, balancing of budgets, the cost of creating and maintaining modern infrastructure, the social dimensions of growing populations, and the looming spectre of international competition take much of the lustre away from what should be a haven of financial security for these countries in the future.

TABLE 1

GCC: Ratings of economic freedom ratings 2001

	Bahrain	Kuwait	Oman	Saudi Arabia	UAE
World ranking	9	42	48	75	14
Score (highest = 1)	1.9	2.55	2.7	3	2.05
Level of trade protectionism	Moderate	Low	Low	High	Low
Average trade rate	4.80%	3.20%	2.80%	12.00%	1.00%
Fiscal burden of government	Low	Moderate	Moderate	Moderate	Low
Top income tax rate	0%	0%	0%	30%	0%
Top marginal corporate tax rate	0%	55% (on foreign firms only)	12%	45%	0% (except 20% on banks)
Government expenditure as a percentage of GDP	28%	43%	33%	34%	17%
Government intervention in the economy	Moderate	High	High	Moderate	Moderate
Government consumption as of percentage of GDP	21%	31%	26%	24%	14%
Rate of inflation	Very low	Very low	Very low	Very low	Very low
Average inflation rate	0%	1%	–1%	–1%	3%
Barriers to capital flow and foreign investment	Low	High	High	High	Moderate
Protection of property rights	Very high	Very high	Moderate	Moderate	Very high

GCC = Gulf Co-Operation Council. *Source: Heritage Foundation, US Department of State and WTO*

The Middle East economy

While Middle East governments have understood the need to overcome fluctuations in economic conditions and dependence on oil revenues, their choices are limited. They need to invest heavily in new projects and to attract foreign investors to do the same and to become partners with them.

The upshot of this trend is the realisation by countries, which have for so long carefully protected themselves against the threat of foreign investors, that they should actually embrace foreign investment. Some states have gradually extended their investment and ownership rights to certain other nationalities. For example, initially the Gulf Co-Operation Council (GCC) states of Kuwait, Oman, Qatar and United Arab Emirates (UAE) among themselves, but latterly by Bahrain and Saudi Arabia (also GCC states) which have played to a wider audience. Free trade zones, pioneered by the UAE, and now a common feature of all GCC states, has been instrumental in providing ownership and control to foreign investors, which is the kind of reassurance they seek to make the initial step. Apart from minimised registration and licensing procedures, free trade zones offer tax holidays, world-class infrastructure facilities, warehousing facilities and other incentives to attract new investors. But these benefits notwithstanding, investment of the type and scale needed to meet the development programmes of Middle Eastern countries overall requires liberalisation of quite another order of magnitude.

Business outlook

According to the economic freedom indicator developed by the Fraser Institute of Canada, Gulf countries do reasonably well. Bahrain leads the region, ranked at ninth in the world, with UAE not far behind, in 14th place. Kuwait (42nd), Oman (48th) and Saudi Arabia (75th) are also featured in the rankings. All these countries score highly on currency and monetary stability, as well as on inflation control. Although a majority of the countries still require local equity participation, they have steadily shown their commitment towards free enterprise and private ownership. Dubai's recent decision to open general trading to GCC nationals is a step in this direction.

The financial markets

The result of these developments is that companies operating in the Middle East, whether headquartered locally or elsewhere, cannot rest on their laurels or neglect ways of making their operations as efficient as they can be.

The role and position of banks is critical. Whether domestic or international, small or large, they have some reputation reinforcement to do. They are no longer the paragons of virtue or the fortresses perceived by depositors in the past.

They now have to compete fiercely with each other, across the local/international divide and lock horns on the battleground of customer loyalty (now not a given) innovation and service. They no longer have an unblemished record and, partly as a result, are seeing market share go to service providers outside of the banking sector.

Cash management environment

The Middle East offers one of the most favourable environments anywhere in the world in terms of cash management. Fully convertible currencies, stable exchange rates, minimal foreign exchange controls and favourable tax regimes all work to companies' advantage in setting up an efficient cash management system.

Many multinationals which have structured their cash management operations in the US and Europe have viewed the Middle East as not having sufficient turnover to warrant the implementation of efficient, integrated cash management systems. However, volumes are now growing conspicuously, and the need to introduce better liquidity management, reduce costs and improve controls has compelled treasurers in the region to look again at how cash management can help.

Cash management trends

Companies are increasingly looking to the internet to access banking information, make payments and initiate trade instructions in real-time. Another key priority is to link their back office system with their bank. By centralising and getting rid of all the local interfaces, a single electronic platform, with one sales and support contact, leads to a seamless implementation where speed is always of the essence.

Many Middle Eastern companies are adopting enterprise resource planning (ERP) systems which interface with their banks. Outsourcing payments and collections is increasingly being seen as a boon to companies wherever there are constraints on expatriate manpower.

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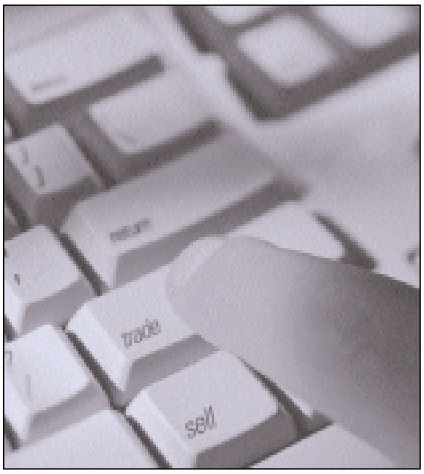
Businesses are establishing regional transaction centres in the Gulf and implementing electronic banking systems that permit multiple bank reporting and initiation.

Impact of new technology

Like oil prices, the internet attracts acres of column inches. Behind the euphoria and hype, however, lurks a deeper truth. The internet, as with many inventions before it, will not necessarily replace what went before. HSBC's ethos that what the customer wants and needs drives the business particularly shapes its attitude towards the internet. Though there is little doubt that it is a godsend to banks and other financial services providers in terms of how it can drive down transaction costs, there are other routes that have been satisfying customer needs for many years which will not radically change in the near term.

This means that potential, as many are now realising, can only become reality by combining a conventional business mindset with new information technology strategies. The relationship has to be symbiotic. The Middle East is uniquely placed to take advantage of the internet revolution, in the same way as it has forged a successful role for itself as a bridge in terms of trade between East and West.



Although the Middle East has lagged in terms of full connectivity in the past, it is now well placed to leapfrog developments in Europe and the US. It is changing fast, thanks to new infrastructure, higher education and IT investment, and internet connections have blossomed. According to Pyramid Research, part of the Economist Intelligence Unit, the number of Arab internet users will soar from four million this year to about 34 million by 2005.

The region now conducts about $250m worth of business online. As Arab businesses go, digital providers of e-commerce tools, applications and services will encounter a market with exceptional opportunities in the Middle East. E-commerce growth in the region is expected to reach up to $3bn by the year 2003. This makes the Middle East one of the world's fastest growing e-commerce centres.

To date, countries have been slow to enact cyber laws. Mechanisms providing full legal security for internet payments are not widely available. But these are expected to become more widespread this year as the internet takes its place as more than simply an additional distribution channel.

The quest for business

The economic climate for domestic and multinational companies operating in the Middle East is radically and rapidly changing. The reforms sweeping the Middle East will not only stimulate growth and modernisation, but if they are successful will also encourage many more foreign multinationals to open up there. The determination of governments to attract investment for future infrastructural and other development needs and the changing financial climate means that efficiency will become ever more important to companies in their quest for business in the region, and will make the difference between their success or survival. In reality, this exciting process has only just begun. ■

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