Local problems global solutions

ECONOMIC ACTIVITY IN THE MIDDLE EAST MAY BE SLOWING, BUT THERE IS STILL GROWTH AND RECESSION SEEMS UNLIKELY. CORPORATE TREASURERS OF MULTINATIONALS OPERATING IN THE REGION FACE A NUMBER OF CASH MANAGEMENT CHALLENGES, AS **SURENDRA BARDIA** EXPLAINS.

Executive summary

Corporate treasurers in the Middle East need banks to help support their business operations, especially in cash and risk management. Global banks that partner with local providers can act as intermediaries to deliver the local capabilities that multinationals require.

The countries of the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE) – have not been affected as badly as many parts of the world by the economic downturn. GCC economies have enjoyed years of strong growth, due to high energy prices, and diversification into sectors such as infrastructure, financial services and tourism. Although forecast to have a lower annual rate of GDP growth this year than in recent years, GCC countries will probably avoid recession as long as oil prices remain above $45 a barrel.

The business climate remains resilient. The regulatory environment is still largely benign with few restrictions on moving capital within the region. Several GCC governments, with the UAE taking the lead, have attracted investment from international corporations to take advantage of the modern infrastructure, liberal environment and business opportunities.

BANKING CHALLENGES FOR TREASURERS Despite the obvious benefits of doing business in the Middle East, corporate treasurers face a number of challenges. The rapid economic growth of the past few years as well as the recent market turmoil has increased the focus on issues around the management of liquidity and working capital. The mix of businesses and jurisdictions to be financed has become more complex because of both organic and inorganic growth. Many operations require dealing with not only OECD markets but also different, often tighter, regulatory regimes in north and central Africa, and parts of Asia.

Corporate treasurers in the Middle East need banks to help support their business operations, especially in cash and risk management. For global cash management they have the choice of a handful of major banks; in countries where those global banks are not present or do not have a relationship with a local bank, treasurers have to go directly to local providers.

But using a multitude of local banks can present problems for multinational corporations because they are used to dealing with their core banks in a certain manner, with established account structures, processes, platforms and liquidity management solutions in place. Having multiple banking relationships forces companies to adapt to new payment methods, technologies and markets.

The solution is for multinationals to use a global bank that has partnership arrangements with local providers in the Middle East and Africa. Such a bank can act as an intermediary to bring the local capabilities multinationals require.

Treasurers will also want to partner with a global bank that can provide diagnostics and advice on areas of improvement, such as access to liquidity and rationalisation of account structures. They can also help identify the tools needed to provide visibility over working capital positions and help map cashflows effectively, ensuring the right investment and borrowing decisions are made. With the shift from traditional to internal funding, treasurers will also want their bank to help them create structures that minimise idle money and

Case study: TAQA's liquidity management lift

Abu Dhabi National Energy Company (TAQA) is a leading UAE company, with revenues of $4.5bn in 2008. It has a portfolio of businesses in the Middle East, North America, Europe and India, in upstream oil and gas, pipelines, gas storage, power generation and water desalination.

Rapid expansion abroad had placed new demands on TAQA's treasury team. The treasury organisation was decentralised, with insufficient liquidity and visibility of funds; there was not enough delegation of authority to improve cash management and liquidity efficiency; new systems and processes were needed to support multinational operations; and it had to handle new injections of capital to reduce leverage and support growth. A restructuring of the treasury management function was essential.

TAQA appointed PwC to help create a global treasury centre at its Abu Dhabi head office in 2008 to meet its needs in all countries and currencies. A separate treasury office was set up in Amsterdam to handle operations, such as cash payments and receipts.

The global treasury centre appointed Citi's Global Transaction Services its single global banking service provider. The arrangement, implemented in early 2009, involves a number of best practice and cutting-edge solutions, including:

- domestic cash management services for 30 legal entities in North America, Europe and the Middle East;
- a global liquidity structure with a multi-currency notional pool in London;
- daily sweeping of cash balances;
- host-to-host payment and reconciliation connectivity to TAQA's SunGard treasury workstation; and
- the CitiDirect online banking platform.

Doug Fraser, TAQA chief financial officer, says: "By choosing Citi, we are gaining access to its high-calibre expertise, global footprint and local knowledge. Citi was able to provide us with a solution that was flexible and matched the needs of our company."

move cash swiftly from subsidiaries to the parent.

Foreign companies setting up in the Middle East can choose from several types of legal structure – from a branch or representative office, to a limited liability company or a free zone entity with 100% ownership. However, if a joint venture with a local company is chosen, repatriating funds can cause tax problems. Legal complications can arise in other areas, too, such as interest reallocation. Treasurers must evaluate the legal implications of cross-entity cash movements, and how to integrate joint ventures into the overall treasury structure.

CURRENCY CONUNDRUMS The currencies of five GCC countries are pegged to the dollar, while Kuwait's is pegged to a weighted currency basket. Most local companies conduct business in both dollars and the local currency, although some prefer the latter, which can be a challenge for multinationals as taking cash out of a country requires expensive and often cumbersome foreign exchange (FX) conversions.

In 2008, the declining dollar and falling US interest rates forced the GCC states to track the US Federal Reserve's monetary policy and reduce interest rates. Deteriorating local market conditions meant the GCC central banks had to continue taking measures to ease liquidity and spur economic recovery. Record inflation rates have since subsided in line with the two main drivers – oil and property prices.

The GCC created a common market in January 2008, and the agreed next step is a common currency. Economic and monetary union would enable access to a larger market, freer movement of labour and capital, and lower transaction costs. However, the 2010 deadline for a single currency is likely to be extended given other pressing priorities for the central banks.

Although monetary union would be easier by the dollar pegging of five of the six GCC currencies, other aspects would be more complicated. A dedicated GCC monetary council is planned to ensure that the monetary, financial and banking policies of the GCC members are aligned; detailed work would be required in areas such as payment systems.

If a common GCC currency does become a reality, it will be the world's third largest behind the euro and the dollar, and other countries in the region may decide to use it as their reserve currency. For companies operating cross-border in the region, this would lead to a convergence of cash, liquidity, trade and investment flows, which in turn would accelerate the trend towards regional treasury centres and shared service centres. They would have to work closely with their banks to develop integrated and consistent solutions.

AVENUES OF GROWTH Once the global economy revives, which is expected to be next year, multinational companies in the GCC will once again start looking for avenues of growth, not just through organic development but acquisitions too. They are already taking a more sophisticated approach to treasury and cash management and as a result have become more competitive in their outlook, and are on top of the changes in the macro-economic and regulatory landscape. As a consequence, they want their banks to be oriented towards solutions rather than products, and expect them to become more active partners in their regional and global strategies.

Surendra Bardia is cash management head UAE at Global Transaction Services, Citi.
surendra.bardia@citi.com
transactionservices.citi.com

Update: UAE out of monetary union

The United Arab Emirates (UAE) is joining Oman in withdrawing from plans for Gulf monetary union, dealing a blow to further economic integration in the region. The state said it would keep its own currency, the dirham, which would remain pegged to the dollar. No explanation was given, but the UAE has expressed reservations about the choice of the Saudi capital, Riyadh, as home for the union's central bank. Four states – Saudi Arabia, Kuwait, Qatar and Bahrain – remain committed to the plan.