Searching for standards

PETER MATZA REPORTS THE DEBATE ON WORKING CAPITAL, TRADE FINANCE AND FINANCIAL REPORTING AT THE ACT MIDDLE EAST TALKINGTREASURY EVENT HELD IN DUBAI.

The increasing influence of the ACT Middle East was clear at the most recent talkingtreasury event held in September at Raffles Dubai. More than 60 delegates participated in a series of lively, informative debates and continued their discussions during the various networking breaks.

The opening speech was a keynote address by Khatija Haque, senior economist GCC at event sponsor Emirates NBD. The bank's view is that growth across the world will falter in 2012, with wide discrepancies between OECD and developing economies. GCC growth, however, will remain stable based on carbon pricing although output will need to remain high to generate income flows as budget needs especially in Saudi Arabia will require sustained high oil prices above $80 per barrel. Despite this, there are plenty of Western governments that would envy Saudi Arabia's policy of keeping the equivalent of one year's GDP as reserves. Regional infrastructure spending in Saudi Arabia and Qatar (and to a lesser extent in Kuwait and the UAE) as well as increases in social spending (Oman, Bahrain) will be the drivers of GDP growth.

CONSTRAINED PRIVATE SECTOR GROWTH Private sector growth will be constrained, however, because of global economic issues. The volume of trade passing through Dubai is flat even where pricing shows growth of 10–15%. However, the trade in precious metals and jewellery (which has experienced inflation in the past 12 to 18 months) reduces this figure. Tourism, which is an important sector in Dubai, has seen positive growth in the UAE; Dubai may have benefited from regional political unrest although the longer-term impact is uncertain. Regional domestic inflation remains subdued, particularly in housing and commercial property, offsetting food price rises.

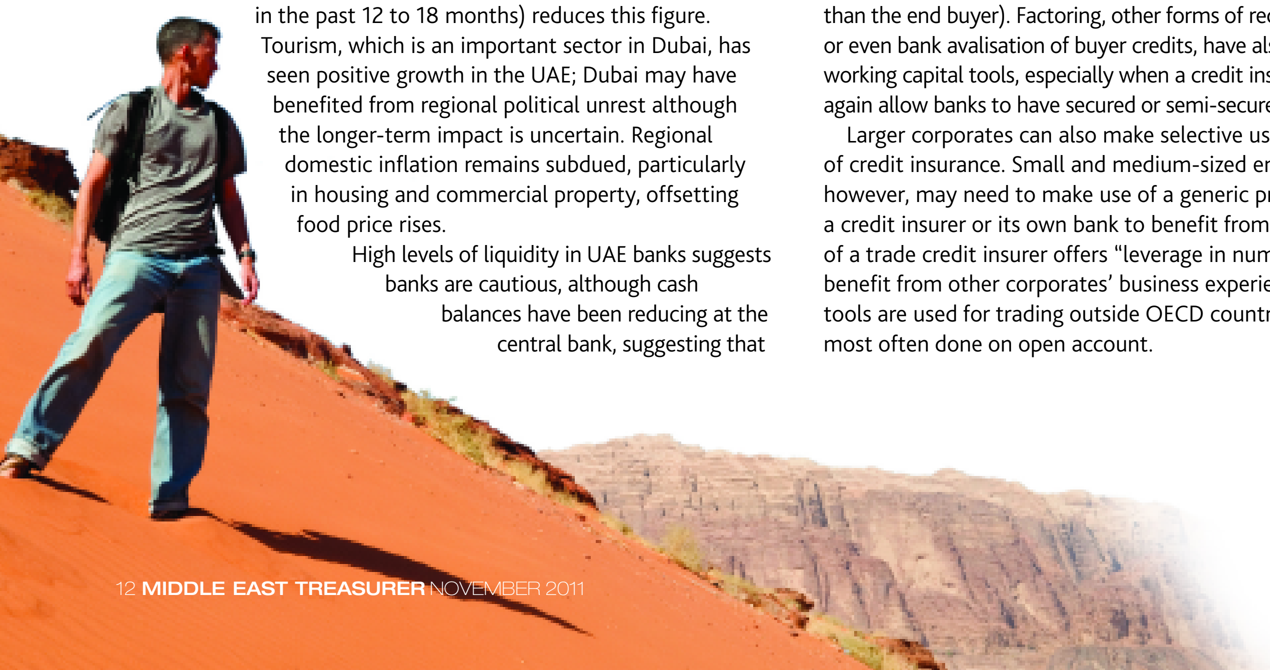
High levels of liquidity in UAE banks suggests banks are cautious, although cash balances have been reducing at the central bank, suggesting that banks need cash funding. UAE credit growth is slow and public sector growth is displacing private borrowers, although unsurprisingly neither Saudi Arabia nor Qatar appear to have difficulties in private sector lending. The first half of the year saw corporate borrowers quite active in bond and loan markets but recent rises in credit default swap (CDS) spreads in Dubai have slowed the private borrowers. Debt maturities are also overhanging Dubai corporates. Equity markets remain subdued in the GCC as a consequence of risk aversion and public sector funding preferences of investors.

The panels that followed this economic overview focused on practical corporate experiences and saw some lively and challenging debate.

TRADING RELATIONSHIPS The first panel on trade finance and best practice in working capital options highlighted the trading relationships for the GCC and the issues that treasurers need to consider when looking at effective trade management. Trade with developing markets such as Brazil and East Africa has increased considerably over the past few years – and not solely in oil and gas – especially as the European market has slowed. Regional trade has been disrupted by political uncertainty but remains important. China is the proverbial 800-pound gorilla in everyone's room.

There was agreement that recent growth in the use of letters of credit (LoCs) helps the banking system provide funding. LoCs offer security for lenders provided the bank issuing the letter is creditworthy (or more so than the end buyer). Factoring, other forms of receivables management or even bank avalisation of buyer credits, have also become popular working capital tools, especially when a credit insurer is involved. This again allow banks to have secured or semi-secured lending.

Larger corporates can also make selective use of direct purchasing of credit insurance. Small and medium-sized enterprises (SMEs), however, may need to make use of a generic programme provided by a credit insurer or its own bank to benefit from any cost savings. Use of a trade credit insurer offers "leverage in numbers" to suppliers to benefit from other corporates' business experience. Generally these tools are used for trading outside OECD countries; OECD trading is most often done on open account.



COMPETITIVE POSITION Corporates need to consider their competitive position when looking at their debtor management policy – will my competitors provide more attractive terms to my customer? The treasurer needs to consider growth versus risk in determining what trading terms to offer. A lack of formal credit information in developing regional markets such as Kenya makes a credit decision on a buyer more complex. To address this, some credit insurers are beginning to offer individual buyer ratings but it is some way from being comprehensive across the region.

Regional treasurers are also beginning to look at the whole process of supply chain management – not solely credit, but logistics and commodity risks too. Some larger corporates can also offer supplier finance via their banks to smaller suppliers to improve certainty of supply, standardise terms and conditions, and better manage credit exposure. However, this requires investment in better internal accounting and financial systems and the training and development of staff. The whole panel agreed that companies had to develop a culture where credit and cashflow are part of the whole business and not solely the responsibility of the treasury or credit teams.

In terms of bank services, by definition international banks clearly offer advantages in terms of networks but regional banks are improving their trade service offering by increasing branch networks selectively, partnering with international banks or banks from other regions (eg. in Thailand) and developing web-based services (eg. automated LoC issuance). Payment processes are also being improved.

DOWNGRADE IMPACT ON THE PEG The discussion on trade finance was followed by a ratings panel which picked up the theme of credit and credit management. The panel started its discussion considering the impact of the US dollar downgrade on the GCC and the UAE dirham's peg to the US dollar. The panel considered that the peg would not be affected in the short term unless there are longer-term problems with the US economy. Indeed, the US currency retains its reserve status and remains the base currency for oil and gas globally. The general view was that treasurers need to be concerned with sovereign ratings because of their impact on domestic banking ratings.

The basic principle underlying ratings is that the agency rating is independent (albeit on an issuer-pays model), consistent and standardised. Corporates need to make a strategic decision to seek a rating driven by their need to broaden investor and funding bases, especially with bank capital likely to be more constrained by Basel III and its focus on capital allocation.

Ratings agencies do allow for regional differentiation in ratings opinions but the primary analysis is generic. Regional scales may be a first step for a corporate; much depends on the use of the rating for the corporate (eg. demand for new capital, trade finance, supply chain finance issues).

Corporates were reminded to be aware that the process is a qualitative exercise that will involve not just financial numbers but risk factors, management structure and so on. The critical issue for the corporate treasurer is ensuring the whole business commits to the need for transparency – not a traditional feature of GCC business and commercial life.

STRATEGIC MANAGEMENT PROCESS The panel on upcoming changes in financial reporting and accounting was concerned to stress that accounting is just about keeping score and should be a reflection of economic activity rather than the driver of business decisions. The panel generally felt that the International Accounting Standards Board (IASB) was trying to create standardisation in accounting although unable to influence the pace of adoption across regions. While there was some criticism of the way in which the IASB recognised and addressed failures in any given standard, it would be unfair to suggest that corporate needs were sidelined. There remains some uncertainty as to whether external analysts or investors fully understand what the accounts tell them –or even if they read them at all – but that's an issue of communication that treasurers should address in their investor relations programmes.

The panel urged treasurers to view implementing standards as part of a strategic management process and incorporate adherence to International Financial Reporting Standards (IFRS) into corporate governance policies and procedures. Indeed, there was a suggestion that doing so would be part of a wider upgrade process that many GCC corporates could benefit from in terms of market transparency. The value of standardised IFRS accounts when accessing credit (including trade credit), or public market investors was also emphasised. In particular, one panellist suggested that it was another way in which companies could differentiate themselves from their competitors, or at least keep pace with them.

The day's debates showed that the region's treasurers and finance managers are as concerned as any that they remain updated and informed of the latest trends in treasury and business management.

The panels

Trade finance and best practice in working capital options
Facilitator: **Lakshman Ranganathan**, head of operations, factoring and escrow services, trade advisory, Emirates NBD
■ **Johnson Mani**, assistant treasurer, Dubai Aluminium
■ **Tumuluru Sri Ramchander**, CFO, Strategic Food International
■ **David Venediger**, managing director, Coface Emirates Services

Ratings in the Middle East
Facilitator: **Harshit H Jain**, CEO, innoVention Solutions
■ **Tommy Trask**, director, corporate ratings, Standard & Poor's
■ **Daniele Vecchi,** senior vice president, group treasury, Majid Al Futtaim
■ **Vaidyanathan Ramanathan**, executive vice president, Oman Insurance Company

Upcoming changes in financial reporting
Facilitator : **Peter Matza**, head of publishing, ACT
■ **Yusuf Hassan**, head of department of professional practice MESA, IFRS services, KPMG
■ **Wali Muhammed**, system group unit controller of substation, ABB Industries
■ **Paul Wagstaff**, vice president government services, Inchcape Shipping Services

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