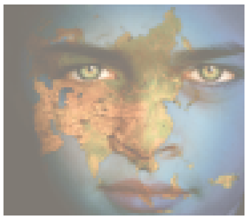


A treasurer's perspective

ANDREW MCMICHAEL DISCUSSES THE CHALLENGES OF CASH MANAGEMENT IN THE MIDDLE EAST.

Executive summary

- Cash management is growing more sophisticated as the Middle East develops, although different countries are moving at significantly different speeds.
- The disparate payments environment is challenging, but the move to greater standardisation and electronic clearing will eventually create market efficiencies; the introduction of a single currency, if adopted, will also act as a driver towards standardisation and modernisation.
- For an effective regional cash management strategy, corporate treasurers should undertake a thorough review of their practices within each country along with the implementation of an overlay solution.

If, as has been said many times, cash is the oxygen that enables a business to survive and prosper, then proper management of liquidity – the process by which a company can quickly turn its assets into cash – is crucial in keeping the oxygen flowing smoothly. Although a company can survive temporarily without either sales or profit, the absence of cash means it will inevitably die. The collection, expenditure and control of cash must be monitored and managed vigilantly.

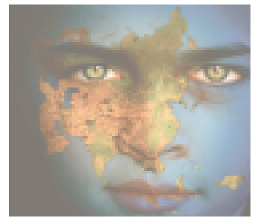
In the Middle East cash management can be challenging given the varying jurisdictions and diverging levels of technological development across borders. Not long ago a company treasurer could simply deal with the day's cash, often in a single currency, but today the role has changed tremendously as the region slowly begins to integrate economically and most companies are operating not only regionally, but in many instances internationally too.

On some matters, the region is right up at the forefront, and in others it seems perhaps a decade or so behind what is expected in most developed markets. While some of the larger regional banking players say they look forward to a regional cash management position, there has been only modest progress so far. The global banks are developing their abilities in this region and solutions do exist, but are not yet approaching standard turnkey solutions as in Europe or the US.

For Agility, the region's largest logistics company, keeping control of cashflow is crucial. With a focus on developing emerging market business, the basic priorities of cash collection are key. However, where an overlay liquidity solution can be employed together with well-managed local relationships, there are obvious advantages of improved processes, tariffs, cash collection times and cash concentration, leading to cost savings from a well-implemented regional solution.

With global recession looking more and more likely, the collection of receivables and the leveraging of liquidity resources to the maximum extent are more vital than ever. Turning receivables into cash as quickly and effectively as possible and moving dead cash from the business units to accounts where it is easily accessible to the corporate treasury operations are more relevant and important than they have been in a long time. It is perhaps not a surprise therefore that one of the areas in which banks are still doing very well is that of cash management solutions. This focus will be ever more important as we take steps into the new financial and business world we will all have to operate in for 2009 and beyond.

CHALLENGES IN THE MIDDLE EAST In the Middle East there are disparities in accounts keeping, taxation, financial regulation, auditing procedures and other issues. The region is less developed than Europe or the US, broadly on a par with Asia, and significantly ahead of Africa. However, the drive to solutions and moves towards a single currency suggest the region will move ahead in this area relatively quickly. This will be further facilitated with more international banks having a pan-regional presence in the Middle East and seeking to develop solutions. Payment infrastructure varies, with some countries near the global forefront of electronic sophistication and others where paper-based payments and clearing still dominate. Although real-time gross settlement systems in operation are not common, more and more countries are



adopting them, while an automated clearing-house is in place in some locations.

Nonetheless, banks are becoming more sophisticated in creating funding arrangements, and automation is being developed. The members of the Gulf Cooperation Council (GCC) have agreed to establish a common currency by 2010, although that timetable is viewed as optimistic by the International Monetary Fund (IMF) and others. Certainly, monetary union would help to promote trade and investment. For company treasurers, it would make it easier to administer cashflow across GCC borders, allow the rationalisation of operating accounts and improve the management of liquidity. Its very introduction is likely to be a catalyst for new standard payment processes, just as the euro was for Europe.

Currently, regulations in most locations allow cross-border sweeps of cash, so concentrating regional cash is now possible. There are challenges of currency mix, but the usual techniques of managing a multi-currency pool are available and, while there are some inefficiencies in these markets (wide spreads, central bank trading limitations and occasionally illiquid market conditions), successful outcomes should be available.

ISLAMIC BANKING CONSIDERATIONS Islamic finance is a significant consideration for any company doing business in the Middle East. However, most global companies do not find it a burden to conform to its principles. In the area of daily liquidity management, the impact is generally minimal, so Islamic finance is not covered in any great detail here.

Some complications may arise, for instance, in a joint venture where one party applies the principles of Islamic finance to all transactions. In the event of commingled funds, it is important to ensure that cash from partners outside the Islamic sphere is either not commingled or is invested in Shariah-compliant investment vehicles. There are plenty of such vehicles available so this is not a significant limitation.

DESIGNING A REGIONAL SOLUTION Multinational companies flooding into the Middle East are establishing their own regional treasuries and the financial infrastructure in the region is becoming more sophisticated. This is making it easier for companies to operate both on the ground and financially. Businesses are growing across locales, countries and even continents, raising questions not only about the management corporate cash but also in determining how and when to collect accounts receivables, where and how to deploy cash and cash equivalents, the risk-return ratio, and how to balance between liquidity, safety and returns on investment.

Given the different stages of financial development in each country the treasurer of a global company needs to take into consideration the domestic practices in each market before being able to apply a regional cash management strategy.

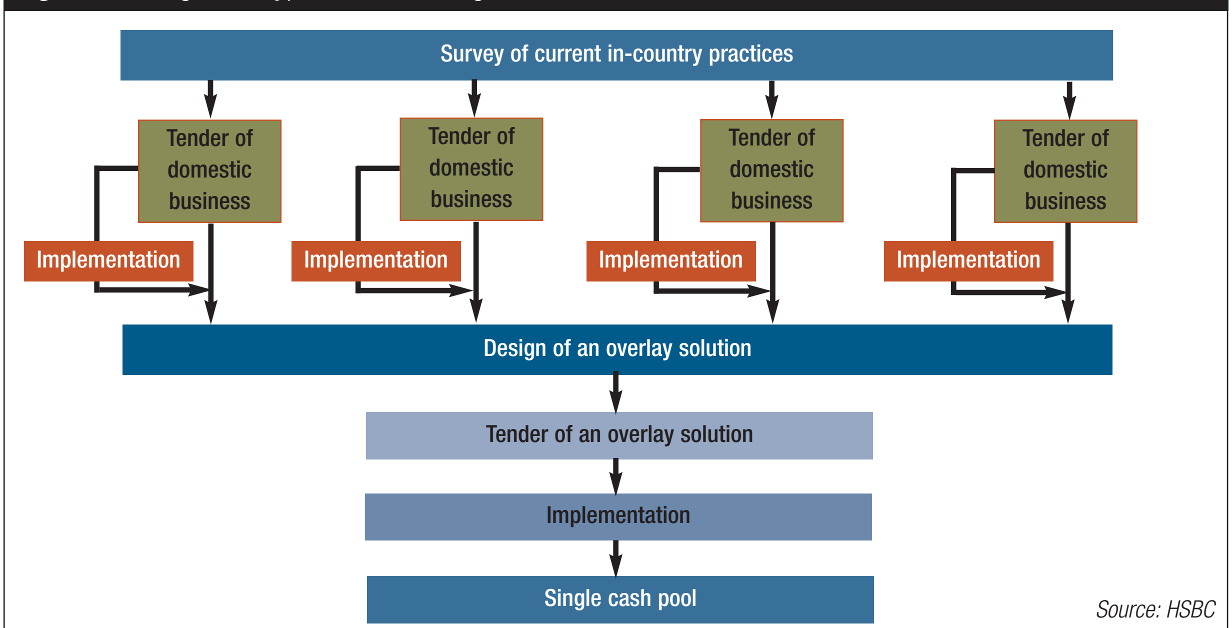
Issues for consideration include:

- the local domestic clearing arrangements involved;
- local bank practices and the general regulatory environment of each market;
- how to manage a regional overlay; and
- how to dovetail the management of existing internal arrangements with all the above.

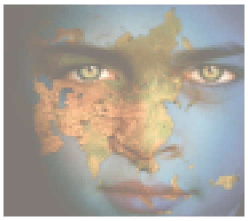
Figure 1 illustrates how a typical regional cash management solution is designed, from review through to implementation.

At the very foundation of efficient cash management is a complete review of existing practices and arrangements that

Figure 1: Design of a typical cash management solution



Source: HSBC



are in place in a company, with an eye to consolidating the banking arrangements. It is advisable for the treasurer to start by tidying up the local business and adding an overlay arrangement with a single bank with a regional presence. This may ultimately lead to a national or international tender of the company's banking business to organise cashflow operations to achieve that overlay solution. This will often involve an international bank that is able to manage liquidity across borders.

However, local bank practices depend very much on the strength of relationships. How a relationship is managed in the Middle East is very important. When deciding on a tender, the impact of moving corporate banking business to another vendor can be higher than in the EU or the US, where banks are used to the practice.

Currently, banks in the Middle East capable of managing liquidity across borders (as an overlay bank) are limited to a small number of global players, although at least one of the larger regional players has launch plans for 2009. Local banks currently lack the systems and the infrastructure to do so. Some have branch networks that cover parts of the region but their systems are unable to manage cash across borders. International banks are generally more experienced and able to leverage their global systems and connections and experience in other markets.

For the domestic portion of company operations, practices are relatively simple and straightforward and resemble those across the globe. Obviously, companies should seize the opportunity to move to electronic banking where possible and should be prepared to leave their current banking relationships if they are inefficient in order to partner with one or two key players in each country. Candidates would include banks that are contenders to become the company's regional overlay bank, depending on their ability to service needs in-country while conforming with local banking practices.

With some countries in the region still wedded to paper payment transactions, a wide branch network is important in these locations to give clients relatively easy access to cashing facilities. Kuwait, where banking partners take delivery of funds on paper, is a prime example of this, although change to electronic payments is coming. Paper-based banking also means that higher floats have to be considered as businesses may keep cheques for some time before they cash them.

JOINT VENTURE COMPLICATIONS Across the Middle East multinationals often become involved in joint ventures, which may complicate the cash and liquidity management process. If, for instance, a company has some form of cash call, whether notional pooling or regional zero-balancing, effectively the cash from one legal entity will be commingled with that of another legal entity. Joint ventures may not be prepared to allow such commingling and corporate arrangements for cash pooling must take that into account.

A 100%-owned company can be flexible on where cash is held. Daily needs may require a domestic player that can sweep the cash to a regional player, but that is not yet as common in the Middle East as in Europe or even Asia. Caution is required. Joint venture partners may object if cash from operations is swept into the company's own cash pool, making it necessary to manage that part of the equation as well.

Also, a company may be involved in a joint venture with an entity that, in turn, is in partnership with a bank. If the company decides to terminate its relationship with the bank, it may have consequences on its relationship within the joint venture. It is necessary to know these relationships and to be sensitive to the implications.

For many, the biggest issue is maximising returns in a situation where Islamic management of returns is involved. It may be necessary to keep excess cash in some sort of an investment vehicle, but there is no reason why this should not be an Islamic one. Certainly, more global banks have indicated that they are willing and prepared to offer treasury solutions to meet this requirement.

GROWING SOPHISTICATION It is only a matter of time before the Middle East's payment systems rival those in developed markets. Across the region, the ability of a corporate cash manager to operate has improved markedly in recent years as the infrastructure grows more sophisticated, bankers become more professional, and both corporations and banks adopt a growing number of best practices. A major structural change is taking place due to the enormous amounts of funds that have moved into the region because of oil revenues. This is extremely favourable for the strategic management of cash and treasury functions. In fact, this will become necessary if the Middle East is to gain the primacy it deserves.

The Middle East is certainly a long way from being immune from the global financial crisis that we face in 2009 but current indications are that the region should fare better than others. As cash resources are scaled back significantly this situation may be an additional driver in improving cash management processes in the region.

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