Cash management in the Middle East

The Middle East is becoming increasingly attractive for cash management. Sunil Veetil of HSBC looks at the opportunities in the region.

Middle Eastern economies are in the process of significant transformation. The region's oil producing countries started the year with tight fiscal policies underpinned by expectations of continuing low oil prices. But they are continuing to diversify their economies and to cut government spending while seeking to raise non-oil revenues through foreign investment in a wide range of enterprises. There are also plans to privatise large areas of state enterprise.

Middle Eastern benefits

The Middle East has a number of attributes that would be beneficial to foreign investors:

- heavy investment in infrastructure over the past 15 years. This has in many cases created a base for the private sector companies that meets world standards;
- proximity to the fastest-growing regions in the world, such as the Indian sub-Continent, East Asia, and Eastern Europe, makes the Middle East an ideal location for value added export manufacturing, which has been changed;
- despite the fluctuation in oil prices, oil-producing countries compare favourably with the world's most advanced countries in terms of per capita income. Saudi Arabia, which has the largest population in the region, is considered to have the greatest economic potential, closely followed by the United Arab Emirates (the UAE);
- low political risk, favourable financial regulations, minimal or no corporate and personal tax and duty requirements in several countries offer good investment opportunities; and
- increased participation by the private sector has been encouraged by means of the construction of high-standard industrial parks. The Jebel Ali Free Zone in the UAE is a strong leader in this respect.

The financial environment

Middle Eastern countries have made great efforts to strengthen and diversify financial sectors. Enormous sums have been spent on recapitalising the domestic banks. Minimum capital requirements have been raised to international standards. There have been mergers among smaller banks and some governments have encouraged growth of their domestic capital markets, allowing access to foreign investors.

Bank reforms have allowed banks to take greater advantage of other vibrant economies and to increase their investment in both infrastructure and technology. This has resulted in a sharp increase in aggregate growth of profits and assets, according to results posted by banks in 1998.

Recently, the Gulf Co-operation Council (GCC), an economic grouping of Saudi Arabia, Kuwait, THE UAE, Qatar, Oman and Bahrain, has begun stimulating co-operation among banks in its member countries. The aim is to allow GCC-owned banks to conduct commercial activities in each others' territories, which would help them to become more competitive and give them access to unexplored markets, such as Kuwait, where non-Kuwaiti banks are not allowed to operate.

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Cash management practices

The need to contain cost and the increasing importance of risk management are the principal drivers of change in cash management in the region. While multinationals are more proactive towards cash management practices, large professionally managed domestic companies with well-diversified portfolios are increasingly interested in maximising benefits this way.

The cash management products required by these corporates, apart from seeking online account information, generally range from account management products, such as call and deposit accounts, non-resident accounts, import and export accounts to liquidity management products, such as cross-border cash concentration and notional pooling. Corporates with clearly defined collection and payment systems perceive accounts payable as a non-core business activity and have started seeking ways to outsource them.

The large middle-market segment generally has a reactive approach to cash management. Resistance to change and lack of confidence in electronic banking have been among the reasons for this. However, more and more middle-market companies are moving towards automating their back office systems. This, coupled with the need to contain cost, has created an interest in cash management among these companies.

Banks offer varied cash management services and product ranges, and international banks tend to have better regional networks. With their extensive product ranges, and normally international banks, such as HSBC, Citigroup and SCB have better global technology and electronic banking systems. Local knowledge and regional networks are obvious strengths in this context. These strengths have been recognised by a number of international corporates who have used HSBC for instance as their cash management bank in the Middle East. Domestic banks may have extensive in-country networks, but they lack regional networks and comprehensive electronic banking services. Some of the large domestic banks with very high capitalisation have the capability to expand in the region once the Middle Eastern countries open up the banking sector.

Foreign exchange controls

The Middle East offers one of the most conducive environments for foreign exchange (FX) control. Middle Eastern countries have minimal FX controls, and in some case none at all. For example, Saudi Arabia, the UAE, Lebanon, Qatar, Oman, Bahrain and Kuwait have no FX controls, nor restrictions on the movement and transfer of funds to and from their respective countries. Egypt allows investors to retain their FX earnings, to participate in the FX market, maintain bank accounts and repatriate all their net profits. With just one annual approval, investors are able to import and export as necessary.

In addition to being fully convertible, most Middle Eastern currencies now offer a fairly stable exchange rate. Many of these Middle Eastern currencies maintain a fixed parity against either the USD or the IMF Special Drawing Rights (SDRs). This has particularly eased the pressure on most of the corporates that have receivables in local currency and payables in USD.

Account services

Most domestic and foreign banks have the capability to offer a variety of account types which are tailored to meet the needs of the corporates. On the regulatory front, countries, such as the UAE, do not allow non-residents to open current accounts, although it does allow them to open deposit accounts. Qatar and Oman do not permit non-resident accounts. Bahrain, Egypt, Lebanon and Jordan, on the other hand, do allow accounts to be opened by residents and non-residents alike. In Qatar and Oman, banks do not pay any interest on local currency current accounts. The majority of countries allow residents to have overseas bank accounts.

Clearing and settlement

Central banks in each of the Middle Eastern countries maintain control over the domestic clearing houses. Most countries except for Saudi Arabia conduct the clearing process manually. Consequently, corporates in the region still rely to a large extent on cheques. The Saudi Arabia Monetary Authority has established a real-time settlement system in that country called the Saudi Riyal Interbank Express (SARIE). SARIE is capable of interfacing with electronic banking platforms for the settlement of interbank transactions.

With the exception of Saudi Arabia, the number of settlement days depends on local practice and the level of sophistication in each country. The average number of days to clear cheques ranges from one to three working days in the major cities and between five and ten days for cheques outside the central clearing system. Foreign currency cheques can take anywhere between five and 15 days to clear.

Lack of a sophisticated settlement system has limited the capability of some cash management services, such as payment outsourcing, especially high-volume low-value payments. Some foreign banks accept instructions for payments electronically, but the service is more like a cheque printing outsourcing mechanism for corporate clients rather than to facilitate electronic settlements.

Electronic banking

Electronic banking awareness among corporates in the Middle East is growing. Large corporates and MNCs are the most extensive users. They normally look at an electronic banking package that can offer comprehensive cash management solutions, including solutions for integrating back office systems.

For the middle market corporates, security and price is of primary importance in choosing an electronic banking package. Lack of confidence and unwillingness to issue electronic authority has limited the use of electronic banking to viewing information only.

Banks offer a variety of electronic banking solutions. A number of domestic banks, being recent entrants in this field, have been able to offer browser-based electronic banking platforms. Though most of these packages have limited functions and cater mainly to individuals, it will not be long before they offer comprehensive services to corporates via the internet. Although foreign banks have a longer time to market sophisticated electronic banking platforms, they are usually comprehensive, secure and have the ability to offer a complete range of services.

Cash management regulations in the Middle East

Country	Foreign currency a/cs	Non-resident current a/cs	Notional pooling	Sweeping	Interest on current a/cs	Interest on foreign currency a/cs	Withholding tax for non-residents	Overseas a/c by resident
Bahrain	Yes	Yes	Yes	Yes	Yes	Yes	Nil	Yes
Egypt	Yes	Yes	Yes	Yes	Yes	Yes	Nil *	Yes
Jordan	Yes	Yes	Yes	Yes	Yes	Yes	10%	Yes
Lebanon	Yes	Yes	Yes *	Yes *	Yes	Yes	Nil	Yes
Oman	Yes	No	Yes	Yes	No	Yes	Nil	Yes
Qatar	Yes	No	Yes	Yes	Yes*	Yes	Nil	Yes
Saudi Arabia	Yes	No	Yes *	Yes *	Yes*	Yes	Yes #	Yes
UAE	Yes	No	Yes	Yes	Yes*	Yes	Nil	Yes

* Subject to local restrictions
# 15% of the eligible income is considered as deemed income for withholding tax purposes. Tax rates ranges from 5% to 30%.

Liquidity management

Treasurers in the region are increasingly selective about how their funds are used. Interest maximisation has taken priority, with the majority of corporates increasingly looking at liquidity management products offered by the banks. While most of the banks will be able to offer balance sweeps and other concentration products, it is only those foreign banks with extensive networks that will be in a position to offer sophisticated pooling techniques and cross-border liquidity management products.

On the regulatory front, most countries in the region permit cash concentration and notional pooling. In Saudi Arabia there are no laws on liquidity management techniques. Egypt permits pooling and cash concentration between resident and non-resident accounts and between two different legal entities. The UAE and Bahrain permit pooling and cash concentration among different legal entities.

Cash management banks

Choosing a cash management bank depends on how well the bank suits the physical and psychological profile of the company in question. The most important physical criteria is the regional network and global connectivity of the bank, the products available and the technological capability of the bank. The most important psychological requirement is how much local expertise the bank can offer the company in each location, the service culture and the ability of the bank to understand and act according to company objectives.

Opportunities

There are clear opportunities in the region for treasury centralisation. While some of the multinationals have set up a regional treasury centre (RTC) in the Middle East, the majority there have been slow to respond to the benefits of treasury centralisation. Compared with the operating environment of Asia and Europe, the Middle East offers a fairly transparent environment, strong communication and banking infrastructure, minimal political and regulatory intervention, stable exchange rates and zero-taxation policies.

Lack of sophisticated clearing systems together with past RTC experience are likely to be forgotten as more countries invest in technology and develop an enabling financial environment. Hence, the advantages of centralising cash and treasury management will be the way forward for MNCs and for large domestic businesses in the region.

Long-term potential

Although the Middle East has seen many changes over the past few years, the proliferation of technology has taken the region a long way forward in a short time. Both domestic and multinational corporates in the region have been quick to adopt the new technologies and are increasingly seeking a banking partner that can offer cost-effective solutions. This, combined with economic reforms, could be the catalyst that invigorates change and compels the corporates to implement further cost restructuring over time. Considering this long-term potential, it is a safe bet that cash management will gain further currency in the Middle East. ■

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