STARTING FROM SCRATCH

How can a family business in the Middle East build its own treasury team? Arun Singh explains

Family businesses account for 80% of all businesses in the Middle East and 90% of those in the Gulf region. This is not a unique situation since a third of all companies in the S&P 500 index and over 70% of companies in the EU are also family-owned.

What sets Middle Eastern businesses apart, however, is the fact that the number of family shareholders increases exponentially from generation to generation. This wide shareholding puts pressure on family businesses to grow as quickly as possible to maintain the wealth of individual family members. A study by strategy consultancy Booz & Co estimates that at least 18% growth per year is necessary to maintain the same level of wealth across generations. Meanwhile, family businesses in the region are undergoing a change of guard, with businesses estimated to be worth more than $1 trillion due to be handed over to the next generation within the next five to 10 years. These businesses face the dual challenges of operating in a difficult economic environment and managing the transition of the business to the third generation. A staggering trend is that less than 30% of family businesses survive into the third generation, according to research by strategy consultancy McKinsey.

One area that family businesses have traditionally devoted less time to is defining fiscal and financial policies, mainly with respect to dividends, capital structure and capital reinvestment policies. Furthermore, private businesses in the Middle East have not been subject to the same level of financial scrutiny and strict corporate governance as their Western counterparts. The trend is starting to change as an increasing number of family businesses tap international markets for initial public offerings to fund future growth through acquisitions. Potential investors demand a high level of risk management and optimum return on investments, which, in turn, require businesses to have a sophisticated treasury function.

The treasury function should be a core part of the finance function. Its principal activities are managing bank relationships as well as cash and financial risks, including FX and interest rates. It should be a strategic partner to the business, supporting key decisions in areas that include financial planning, acquisitions and use of cash.

Creating a treasury function

The first step towards creating a treasury function is to present the business case to key stakeholders in order to get their

TMS AND OTHER TREASURY TECHNOLOGY

◆ With businesses increasing in size by the day, leading to a high volume of transactions, start-up treasury functions tend to be inefficient and rely heavily on manual processes. This can give rise to increased risk of fraud or error. In today's fast-paced economy, an automated TMS plays an important role, not only through meeting reporting requirements, but also by maintaining a real-time position of all transactions, balances and exposures. A TMS provides an additional control mechanism because, when properly configured, it helps with the segregation of duties and minimisation of risks, perhaps by preventing them.

◆ When selecting a TMS, it is important to understand your business's current and future requirements. Choose a system that can support your growth ambitions, is future-proof and does not become quickly outdated. Factors to keep in mind are service, support and the vendor's ability to constantly develop its product. Systems should be carefully implemented and used to full capacity.

◆ Other technology, such as an electronic dealing platform, a confirmation matching system and market data source portals, can be integrated with the TMS.

buy-in. The business case should demonstrate the value that a treasury function will add so that top management is willing to implement it. Keep stakeholders engaged and obtain their approval where appropriate throughout the life of the project.

It is important to assess the availability and skills of in-house resources to determine whether external support is needed to create a treasury function. Once resources are on board, a target operating model should be developed and the remit of treasury worked out. When developing the target operating model, the limiting factors associated with the business need to be considered carefully. These include a complex organisational structure; decentralised management; differing legal and tax regimes; a large number of bank accounts, bank relationships and banking systems; and minimal or no use of treasury-related technology. This model should answer questions such as the size of the treasury team, the quality and level of people required, IT infrastructure, controls, etc.

Ask the business what it wants from its treasury function. One answer may be to increase visibility of all bank account details and balances on a daily basis in order to improve risk management, taking account of counterparty, liquidity and FX risk, across the organisation.

The aim of creating a treasury function is for a business to achieve visibility, centralisation, automation, optimisation and control over all treasury activities. Building a treasury function is a journey that should see treasury evolve from being a cost centre that needs board approval into a business partner that adds value by contributing to important financial decisions while underpinning a significant risk management framework.

Cash management

The main aim of cash management is to maximise liquidity and maintain control over cash flows. This forms part of the business's overall strategy to make the most of the value of available funds and minimise the cost of borrowing. To achieve this, it is necessary to manage cash effectively by focusing on planning, improving visibility of cash positions, enhancing control over cash and optimising the overall cash position. The importance of cash flow forecasting as a tool for an effective cash management process cannot be emphasised enough. It is crucial to develop a culture where cash flows are an important indicator for the group and borrowing is not the main source of funding.

The first step towards achieving effective cash management goals is the review of existing bank accounts and usage; bank account structure; and bank relationships. Next comes the selection of the right banking partner(s) that can support the business's current and future requirements, from both an operational and a strategic perspective. This can help to concentrate banking relationships. Banks in the Middle East are at different stages of technological advancement and have varied commercial offerings. Therefore, it is always a good idea to consider their proposals in detail.

The next step is to adopt a bank account structure that is adapted to the requirements of the business. This includes the creation of an efficient pooling and sweeping arrangement, coupled with a solid and practical bank account structure.

Once the banking partner(s) and account structure have been finalised and adopted, visibility and control can be achieved through a combination of bank technology, treasury management system (TMS) and SWIFT messaging (which acts as the transmission channel). This can provide businesses with real-time information that will enable them to determine the level of cash needed as a liquidity and working capital buffer.

Setting up a treasury function can be a career-defining moment for those involved and can contribute to their professional success. The creation of a treasury function is one of the most important steps that a business can take in the direction of having a more sophisticated financial operation.

POLICIES AND PROCEDURES

It is important to establish a policy framework covering all the key risks such as counterparty credit, covenant, FX, funding and liquidity, interest rate and system risk. This will set the parameters within which the financial risks of the business are managed.

It is important that the true requirements, structure, limitations and challenges of the business are clearly understood. After careful consideration of these factors, and in consultation with the key stakeholders and senior management, policies should be created. These should develop a coherent and robust framework that supports the business objectives while acting as the guiding principle to minimise the risks. Once agreed, they should be followed by document procedures for the new treasury department that also encompass controls. It is important that the whole controls framework is considered, not just the bottom-level operational controls. A treasury function should always have a strong control environment with preventative controls.

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