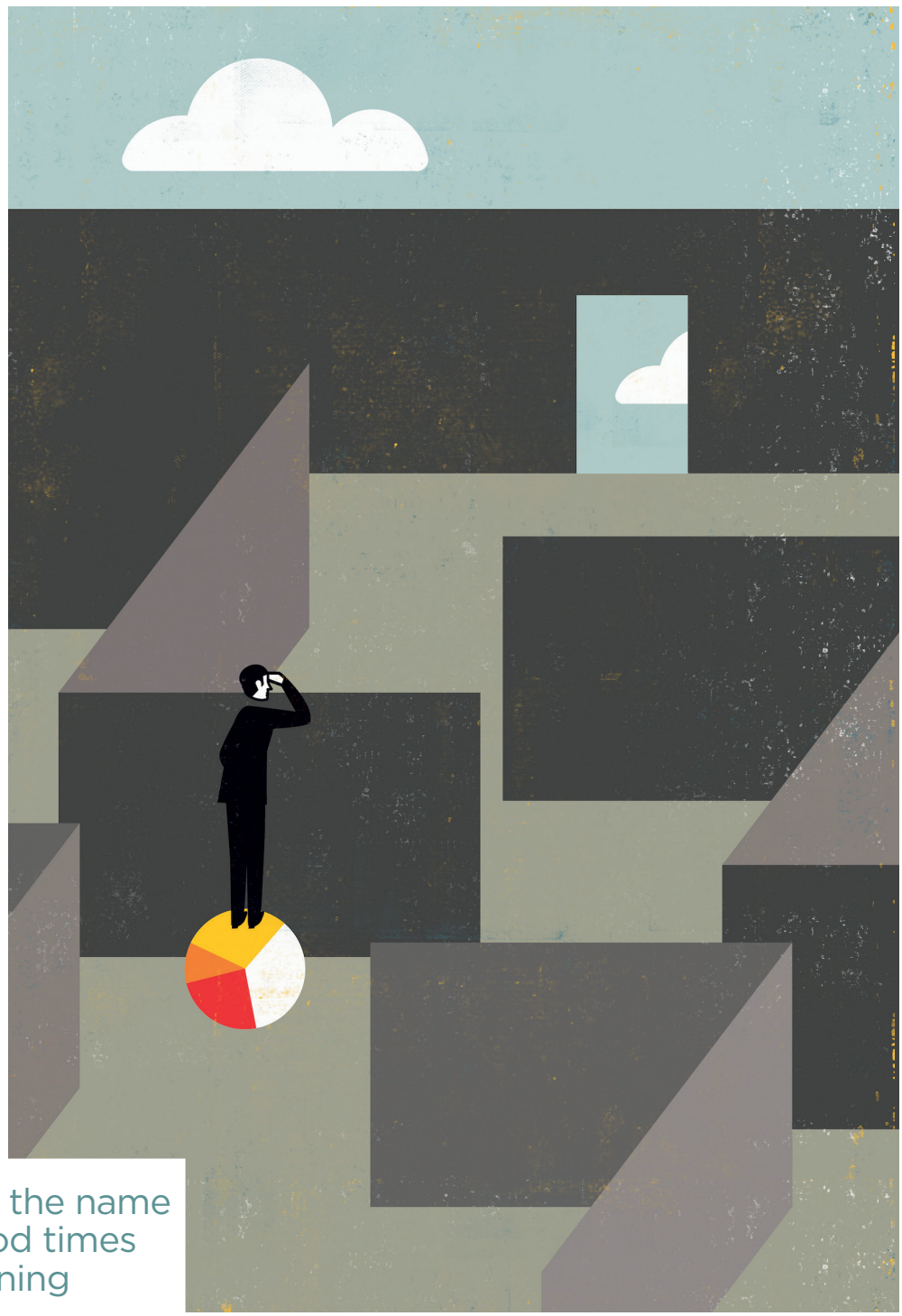
A BIRD'S-EYE VIEW

AS GLOBAL CURRENCY AND COMMODITY MARKET VOLATILITY SHOW NO SIGN OF EASING, MARK O'TOOLE EXPLAINS WHY NOW IS THE TIME FOR CFOs ACROSS THE MIDDLE EAST TO ATTAIN THAT ALL-IMPORTANT HOLISTIC APPROACH TO RISK

From one extreme to the other – this is perhaps the best way to sum up the economic climate across the Middle East in recent times. In the good years, you could not move for corporates splashing the cash on the latest technology to advance their businesses. Cash-rich, better margins and a lower cost base – the life of a CFO was almost 'comfortable'. But how times have changed. From big reductions in liquidity to increased credit risk and far greater exposures to volatile currencies, the CFO now lives in an entirely different world.

This wider geopolitical and macroeconomic volatility has, as you might expect, had a significant part to play in all this. Over the past six months, Middle Eastern currencies, many of which are pegged to the dollar, have seen dramatic swings. The challenge is that for corporates, particularly those transporting high volumes of products from the region, these swings have increased the level of risk, which then feeds into their day-to-day operations. On top of this, vast swathes of the United Arab Emirates have had educational grants removed – which has driven expats to leave the country for pastures new. In turn, this has reduced the number of skilled workers and, ultimately, hit the CFO, who now has to factor in managing operational risk as a fundamental part of the decision-making process.

All in all, volatility appears to be the name of the game, as the good times show little sign of returning. So, with this in mind, what does this macro uncertainty mean for Middle Eastern CFOs and group treasurers, and how exactly do they go about managing commodity and currency risk across the business?



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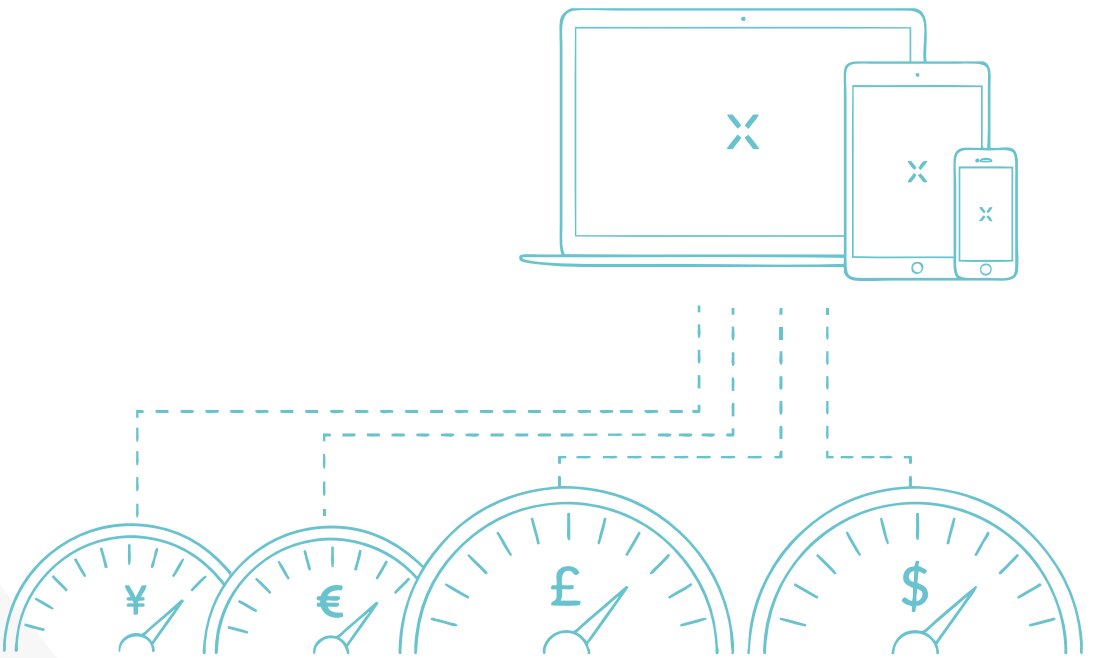

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The need for a bird's-eye view of the world

Just as markets are getting more volatile, globalisation continues apace. We live in an ever smaller, more interconnected world. The proportion of corporates that are exposed to significant levels of commodity and currency risk across their businesses is far higher than it used to be.

The challenge also applies to a broader number of sectors than before. Certain sectors have always had to deal with large levels of commodity and currency risk – think airlines and their exposure to fluctuations in the price of fuel. But there are now few industries around where medium-to-large businesses within that sector – and even many small businesses – are not exposed to significant commodity and currency risk somewhere in their organisation.

Manufacturers and food and drinks companies, for instance, are growing increasingly aware of the impact of commodity volatility on their input costs. Retailers, increasingly dependent on imports and also doing far more international business thanks to the rise of the online consumer culture, are also waking up to smell the coffee. Sectors that didn't have to worry about this risk so much in the past are now having to change their view as supply and distribution chains become increasingly complex and multinational.

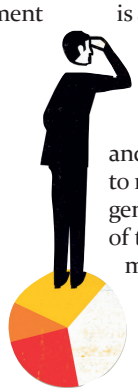
Historically, management of these twin risks has fallen on a spectrum from less to more sophisticated. Firstly, there are now Middle Eastern companies on the extreme unsophisticated end of the spectrum that don't do anything to manage the risk at all. Secondly, there are companies that rely on

The CFO needs to have a bird's-eye view of commodity and currency risk

often disparate, often manual, and somewhat ad hoc systems, usually based around a bit of spreadsheet wizardry. A lot of corporates out there fall into these two categories, especially those in sectors that haven't had to worry too much about this risk historically. Over on the more sophisticated end of the spectrum are companies where the group treasurer handles currency risk via financial hedging on central treasury management systems, and procurement handles commodity risk, generally through the brute method of locking in volumes and prices over long-term horizons.

What road should the CFO go down?

This mix of approaches may have worked for various companies in the more predictable, less globalised climes of the past. But the current environment – marked by intense volatility – is pushing these old approaches, even the more sophisticated ones, to the limit. The level of risk is now such that this is no longer just a challenge for the group treasurer – it is a problem to be managed at CFO level. Wild price fluctuations can create real accounting and forecasting difficulties, and hamper the CFO's ability to manage business risk more generally. Better management of these risks is becoming ever more crucial to the age-old chief mission of the CFO: to reduce bottom-line costs and increase top-line returns. There is also, of course, the fact that price fluctuations of this sort, poorly managed, can cause swings in a corporate's share price – something that is bound to get the board's attention.



The fact that this is now very much a CFO-level challenge highlights the fundamental problem with all of the traditional approaches. It goes without saying that many companies relying on a maze of error-prone spreadsheets (or nothing at all) should consider the benefits of moving to an automated system, both to better manage risk and also save money and resources.

But even the companies with sophisticated group treasury teams out there that are using central systems tend to deal with commodity and currency risk separately and in a siloed fashion, via different departments. Treasury does currency, procurement takes commodities, and never the twain shall meet. In an environment where commodity *and* currency risk are not only heightened, but more interwoven than ever before, this cannot suffice.

The CFO needs to have a bird's-eye view of commodity and currency risk: a single, holistic, transparent approach to commodity and currency risk across the whole of the business. After all, currency risk can be embedded into a physical commodity risk, exposing the balance sheet and income statement at any time. If the currency and commodity risks are being calculated alone and never put together, how is a CFO going to know with accuracy if a business is over- or under-hedged at any given time? This also fits with a major pressure facing CFOs at the moment more generally – the need to reduce capital expenditure and rationalise systems as far as possible.

Luckily, given the volatile times we live in, technology has developed to a point where there are sophisticated, cost-effective systems out there that can achieve precisely this single, enterprise-wide view of currency and commodity risk, and in real time. In addition to all the logistical and vendor-cost-related savings that come from having a single system (as well as the reduction in man-hours and error rates for those relying on spreadsheets), these platforms allow treasury and procurement teams to communicate and share information seamlessly and automatically. They support and provide help with financial hedging, should that be appropriate for the business, and provide the CFO with enough joined-up data to be able to make better decisions faster, in response to market volatility.

Once upon a time, such a system would be a nice-to-have for many CFOs across the Middle East. But today, a CFO without full insight into their company's exposure to volatile markets is putting its value and reputation at risk. In times such as these, investing in such a system can be a powerful way to make a dent in costs, improve margins and gain an edge over competitors. In the volatile world of the blind, the one-eyed CFO is king.

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