



# Do perception and reality align?

The global financial crisis has left no market or region untouched. Some observe that emerging and developing economies have endured the worst consequences. The question now is how closely do perceptions align with reality on the ground in the region? **Alexander Malaket** explores current developments in the MENA trade and supply chain space.

Some regions could initially claim to be shielded from the financial crisis: Canada as a result of a well-regulated financial sector, and the Middle East & North Africa (MENA) region partly as a result of the disciplines inherent in *shariah*-compliant financial practices, and partly due to limited integration with – and exposure to – the international financial system. In the end however, the economic crisis has raced across the globe like wildfire. Kersi Patel, regional head of trade and supply chain for Middle East at HSBC, provides a perspective based upon the bank's extensive on the ground presence of over 450 trade experts in 10 countries across the MENA region. Observes Patel: "There is no doubt that the global crisis has been severe and remains serious. The reality is however that

there still are many good opportunities and positive dynamics in key markets within the MENA region. Dubai, for example, is a fantastic locale for multinationals and regional business houses wishing to establish a trading presence from where they can easily reach over half of the global population within four hours of flying distance, including many young and prosperous citizens of dynamic countries and emerging offshoring powers."

While optics and perception have been central to the global crisis – contributing to its downward spiral, but now also a critical element in the restoration of confidence and eventual return to some variation of 'normal', the relationship of perception to reality is fundamental in the MENA region.

There has been much press about the influx of investment into Africa, particularly funds flowing into Sub-Saharan Africa from China, and less prominently, funds flowing into East and North Africa from Saudi Arabia and other investors in the Middle East.

At the same time, the striking growth and development in the UAE had been the subject of much attention in pre-crisis times. Increases in the price of oil and commodities more broadly, were a key feature of the pre-crisis global economy, generating wealth and suggesting long-term benefits in several regions. Real estate development in the UAE – particularly Dubai and Abu Dhabi – had been in high gear for some time, and the innovative, eye-catching architecture attracted attention from every corner of the globe.

Since the crisis exploded however, the optimism and sense of limitless potential has been significantly muted, partly as a result of realities in every part of the MENA region, and partly as a result of press reports from external observers, pointing to indicators of stalled progress or outright reversals of the

successes achieved to that point. Stories of idle cranes and ghost-town construction sites, empty properties, real estate bubbles and thousands of cars abandoned at Dubai airport have coloured perceptions about the region; some are symptomatic of a substantive underlying problem, while others are perhaps misrepresented and misinterpreted. Patel notes, "The real estate market has had a lot of attention over the past months, in UAE and elsewhere, although this sector is smaller in comparison to trade and logistics activities of UAE and across the region. Dubai now

While Europe and the Americas contemplate a return to fundamentals (and attention to underlying assets), the MENA region has remained consistent in its focus on the flow of goods and the relationship between an asset and its financing. Local knowledge remains a critical dimension in the business of trade finance in the MENA region. Local partners and sponsors are required in any venture involving an international organisation, and bankers must understand, and properly interpret, the financial state of their client organisations, despite the fact that financials

based upon cost-of-funds as opposed to Libor or Euribor-based pricing, is one indication of the refinements in this area." As with other parts of the globe, pricing has been impacted, with spreads reportedly increasing from typical ranges of 50 to 60 basis points, to 150bp or more. The cost of insurance, including accounts receivable insurance, have increased, and export credit agency (ECA)-supported activity has gained some momentum in a region that has not historically sought agency support in the conduct of trade.

Expectations are the spreads will start to normalise in the next quarter. The secondary market for trade finance had evaporated in late 2008, and remains limited, but is beginning to show signs of a return to normal – a return which some project for late 2009. In-market specialists are careful to point out that the circumstances vary by nation, but general observations are offered. By some assessments, Saudi Arabia and the UAE are showing the greatest effects of the crisis, with less impact visible in North Africa and the Levant.

In Africa, the central role, and pace, of Chinese investment has been reduced as a consequence of the crisis, while inflows from the Middle East have shown some upward momentum, driven by the desire to secure dependable sources of supplies of various imports, including wheat, and various commodities.

### A trading region copes with crisis

Trade is central to many economies in the MENA region, and skills in international commerce are well developed, whether they involve the re-export model of Dubai or the commodities trade or investment acumen demonstrated by businesses and government entities such as the cash-rich sovereign wealth funds in the region.

With the US still reeling from the crisis, China heavily impacted by the contraction in demand for its now formidable manufacturing capability, and Europe arguably about six months behind in feeling the effects of the crisis, one important trend emerging is the increase in regional trade, within the Middle East, within Africa and within the MENA region.

Proximity of sources is increasingly important – both from the perspective of cost-control, and from the perspective of minimising the need to hold inventory as a result of timely access to new stock.

Evolving trade between Turkey and Russia is illustrative – driven as much by the shift in favour of proximity, as by a desire to reduce dependence upon – and exposure to – the cost volatility of the primary international currencies. The exchange rate between the rouble and Turkish lira has proven to be more

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Krishnakumar Duraiswamy, Standard Chartered

ranks third globally after Hong Kong and Singapore in re-export activities, and re-exports from Dubai to the region have held up exceptionally well throughout this year. "The other key dimension in the MENA region involves import of sustenance goods, which are again also fairly stable despite the crisis. Additionally, firm and publicly reinforced commitments by governments, particularly in the UAE, Qatar and Saudi Arabia, to see major infrastructure projects to completion, have been very helpful in mitigating the impact of the crisis to an extent."

### Above all, know your customer

Financing in the MENA region remains heavily influenced by the historical practice of name-lending – the extension of facilities based on relationships – which has defined the commercial landscape since the earliest days. In trade finance, a similar link to historical practices is evident in the continuing pre-crisis robustness of letter of credit business, contrasting sharply with the otherwise global shift to open account terms.

While there is some movement to more objective principles and practices in lending, the reality of name-lending – even in the context of the current crisis – preserves the central role of local financial institutions, and keeps the issue of financial transparency at the centre of concerns for international institutions, foreign investors and prospective business partners.

At the same time, the trade finance business in the MENA region remains linked to the movement of goods – underlying assets – guided by the requirements of *shariah* law, and local banking practice. This approach contrasts with other markets, where a shift to financial engineering and balance sheet machinations has had adverse effects on trade and trade finance.

at the operating company level are nearly meaningless, and those related to the holding companies, which provide the aggregate view, are rarely made available.

Recent high-profile defaults and large-scale fraud have been a shock to the financial and business environment, and will doubtless add further impetus to the implementation of stricter risk management practices and credit disciplines – a shift which banks will demand, and one which corporates will be more likely to support and respect.

By most accounts, there has been a tightening of credit in the region as a result of the global crisis. At the same time however, preliminary steps are evident in the evolution of the financial sector beyond pure relationship-based lending, to what would be considered more objective practices in financial and credit management.

While some bank executives describe a halt in the movement from traditional trade finance products to supply chain and open account finance models, others indicate that some momentum persists, noting there is appetite among local providers to develop capabilities in factoring. More advanced supply chain finance programmes will eventually become readily available.

Krishnakumar Duraiswamy, regional trade product manager, open account and supply chain finance at Standard Chartered in Dubai observes: "The region, in particular the UAE and GCC, has been quite resilient in the face of the global crisis. While there has been a shift back to traditional trade finance techniques, we continue to advocate in support of innovation in the space of supply chain and open account finance. We see the dialogue around supply chain finance and working capital optimisation evolving, both with local banks and corporates. Current attention risk-based pricing, and pricing



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stable and less threatening to margins. Maninder Bhandari, managing director - Middle East & Africa, treasury services, at Bank of New York Mellon, notes: “We have seen an increase in intra-regional trade in Africa and the Middle East over the course of the global crisis. While there is a return to traditional trade finance products, particularly the risk mitigation elements, and developments in supply chain finance are in a holding pattern, there are preliminary indications of a reversal in crisis conditions. “Capital preservation and tight credit remain a reality of the landscape, however, early positive signs combined with a return in confidence will be important first steps toward normalisation. At the same time, a partnership approach between banks and corporates will be critical to the restoration of trade flows – this will require some creative risk-sharing arrangements over the medium term.” Patel at HSBC also notes an increased focus on intra-MENA trade, commenting: “The shift back to traditional well-structured trade finance solutions, widely reported across the globe, is visible to us in the MENA region, even considering the wider use of those instruments during the pre-crisis period. Risk aversion among international traders is motivating more importers and exporters to seek end-to-end involvement in a trade transaction by one bank, partly to mitigate risks related to raising of frivolous disputes/ discrepancies by buyers under documentary credits.

“Even with increased focus on credit, operational and fraud risk, it must be noted that banks in the region seem to have been open for trade business, and there is a cautious sense that the worst is perhaps behind us. In a six-month period ending June 2009, AED1.5bn-worth of new trade facilities were granted by HSBC in the UAE alone.” In addition to changing trade flows,

the interventions of governments and government entities have been, by several accounts, effective and well-received. From interventions in the real estate market, to active engagement in offsetting constriction in the credit market, to the initiation of large infrastructure projects in markets such as Egypt, Saudi Arabia and the GCC, the role of government has been vital, and will remain central to a recovery process in the MENA region.

The completion of the Burj Dubai, and the opening of the long anticipated Dubai metro (referred to locally as 9-9-9: nine stations online in the ninth month of 2009) will both be important to the UAE.

Asif Raza, head of treasury and securities services-MENA for JP Morgan, notes: “There have been impacts and changes in the region as a result of the global crisis, however, several mitigating factors have helped cushion leading economies. Infrastructure development and finance remains active, particularly in Saudi Arabia, in the GCC and in parts of North Africa.

“At the same time, the principles and disciplines of *shariah*-based finance have been very effective, as have the well-considered interventions of sovereign wealth funds in the region. The activities of the Islamic Development Bank, including its trade finance team at the ITFC, have been effective and welcome.”

The current crisis has sparked interest in barter as a potential solution to several of the challenges facing businesses. Serious discussions are underway in this space, and the development of an effective model targeted at selected client segments merits attention.

Non-bank providers have been active globally in trying to develop several niches in trade finance. TradeCard Holdings CY, is one such example. The company, licensed by New York-

based TradeCard to represent this pioneer of technology-enabled trade finance in 23 countries in the MENA region, plus Cyprus, is working to position itself as a complement to bank-provided trade finance.

Hisham Nourin, chief operating officer, TradeCard Holdings CY, based in Bahrain, observes: “The TradeCard value proposition is still new to the MENA region; the financial crisis has motivated banks and corporates to look more closely at operational and transactional efficiencies, including process redesign and margins.

“Once we raise further awareness among top executives in the area, the power of the TradeCard model can enhance operational efficiency, increase much-needed transactional transparency, and favourably impact both the cost and revenue sides of the financial equation.”

### Fundamental issues

Even as international banks exert additional influence in the region, and non-bank service providers work to extend the options around trade finance, certain fundamentals remain critical to trade in the MENA region.

The importance of evolving credit and financial management practices is a recurring theme, as is the importance of *shariah*-based disciplines, and the ongoing efforts to diversify beyond oil-based economic growth. The question of transparency is also central to conversations in the region.

In the shorter term, effective risk management and mitigation will be central to the region’s ability to move beyond the current crisis.

Corporates will need to raise awareness of the variety of effective business solutions accessible through trade finance, and financial institutions – local and international – will need to resist the urge to assume the worse about the MENA region, basing decisions instead on an informed, ideally first-hand view

From left to right: Maninder Bhandari, Kersi Patel, Lakshmanan Sankaran, Asif Raza

of the situation on the ground.

Diversification, from industry to technology to financing options and sources, will be important to the MENA region over the long term, and efforts in this regard are continuing. Perhaps more importantly on many levels, the challenge of transparency is one which leaders in the MENA region – both political leaders and business leaders – ought to better appreciate.

Talk of depegging the UAE dirham from the US dollar (in favour of a basket of international currencies) had developed momentum for some time – with the effect of attracting an inflow of billions of dirhams chasing a projected 15% appreciation in the value of the UAE's currency.

This notion has been derailed and funds have since retreated from the market.

Banks lent significant funds against the monies that had been deposited with them in anticipation of the depegging; as the monies were repatriated by investors, banks were left with loan-to-deposit ratios in the 150-to-175% range, adding a further level of risk to the financial markets.

The loan-to-deposit ratios are returning to levels in the 100-110% range, a further indication that the markets possess an ability to rebound. For some local observers, an undervalued asset in the key economies of the region is the wealth of the ruling families, and the extent to which they will go, to protect the financial and economic health of the area. Continuing (if now slightly muted) discussion around an integrated currency in the GCC is noted as one illustration of the level of commitment to long-term economic health and continued prosperity.

### MENA: WYSIWYG?

Does the MENA region approach the idea of WYSIWYG – 'what you see is what you get'? At the moment, perception and reality in the MENA region appear to be out of alignment – at least in part because of a lack of communication and transparency around the region's health and the effectiveness of its responses to the global economic crisis. The nature of that misalignment is not one-sided, however: the external view of the state of the MENA region seems skewed toward the negative, while some of the upbeat observations expressed locally may be a bit optimistic – if for no other reason than the continuing challenges and the persisting crisis of confidence faced by important business partners outside the MENA region. The double-edged sword of interdependence has demonstrated, convincingly, that both edges are very sharp.

While the most optimistic local voices speak of a long-expected and welcome market correction, the most concerned external observers point to recent events in Saudi Arabia – family default, bank failure and fraud,

along with the as-yet unclear ripple effects of these developments, as symptomatic of a dangerous underlying problem.

Financial experts also point to deteriorations in investment and loan portfolio quality as indicators of a systemic challenge that has yet to fully surface.

One way or the other, a story will be told about the state of, and prospects for, the MENA region.

The question is, will the story that is communicated globally be based upon perceptions generated by external observers, filling an information vacuum, or will the story be influenced by in-market experts who can combine context with first-hand observation? Barry Lites, managing director, MENA Distribution Partners, headquartered in New York, observes: "Our focus on facilitating business between US-based exporters and buyers in the MENA region provides an interesting perspective on the global crisis. US businesses are well-advised to seek new markets, and parts of the Middle East and North Africa offer opportunity, particularly in the areas of technology and knowledge transfer.

"Our view is that the press coverage about the region, particularly Saudi Arabia and the GCC, fails to reflect the relative strength of the fundamentals, and underestimates the potential of the region, where leading economies remain committed to diversification beyond oil and carbon-based resources."

A number of senior executives have, in various ways, commented on the issues of transparency and perception. Leading institutions, governments and various experts are working to respond to the need for information.

In the first survey of its kind, the HSBC Trade Confidence Index asked 2,100 trade-oriented SMEs and MMEs in 24 cities across seven countries about their three-month outlook on various factors, including: trade volume; buyer and supplier risks; the need for trade finance; access to trade finance; and the impact of foreign exchange and government regulation on their businesses. Several observations emerged, that will assist in better aligning perception and reality relative to the UAE and more broadly, the MENA region.

The UAE's small and mid-market businesses (SMEs and MMEs) that engage in export and import have identified the Middle East as the most promising region for growth in the near future, according to the HSBC Trade Confidence Index.

Some 57% of survey respondents in the UAE cite the Middle East as the region with the best growth prospects, compared to only 7% and 6% of UAE respondents respectively who expect growth from Greater China and Western Europe (including UK).

The index also shows that amongst the top

three re-export centres of the world, traders in the UAE are more confident of trade business growth over the next three months as compared to traders in Singapore and Hong Kong, the latter being most bearish (source: HSBC press release, June 2009). Lakshmanan Sankaran, head of trade finance, Commercial Bank of Dubai, observes: "Banks specialising in corporate and trade finance need to listen to their customers more; factor in customer expectations like cutting edge technology, innovative products, combined cash and trade solutions, better pricing and easier access to meet cyclical needs for finance, and above all, responsive, knowledgeable, and relationship focused staff at the bank.

"This will help customers conduct cross-border trade efficiently by combining the bank's ability to provide end-to-end supply chain financing options and global reach. Traditional ways of conducting trade finance business are no longer viable and may seriously jeopardise the bank's share of business over time.

"Small and mid-sized trade finance banks will find it increasingly difficult to invest large amounts to get access to the latest technology and qualified resources, on an ongoing basis. These banks will sooner or later realise the need to partner with global banks to cover the foreign leg and make new (ongoing) investments to stay in the business as a full service provider."

The importance of the banks and the need for a revised approach is echoed by Zahoor Dattu, formerly a senior banker at ANZ Grindlays Bank, Mashreqbank and Abu Dhabi Commercial Bank, now principal consultant of Bastaki Management Consultancy in Dubai. Dattu notes: "Banks should be more transparent in their disclosure of bad debt. Financial institutions engaged in trade finance must have respect for each others' reputations and financial standing, improve their reciprocity business and provide services – such as letter of credit confirmations – at a price that is affordable for traders.

"Trade finance is important to the MENA region, and it offers a largely secure and steady flow of income for banks." While there are legitimate – at the very least, understandable – points of variance among local and international observers of the MENA region, there appears to be a significant misalignment of perception and reality. Local leaders and experts must actively work to shape the perceptions of the broader international community about the state of business in the region, and follow that communication with substantive action to capitalise on regional strengths while reinforcing areas of weakness or concern. Perception is reality? Only if it is allowed to be.

MENA