Back to basics? Nothing new to the Middle East...

Alexander R. Malaket considers how one of the 'fundamental' lessons of the global financial crisis has played out in the Middle East.

Trade finance has enjoyed an unprecedented profile over the last year. Transaction banking – a business of which trade finance is now a part in many financial institutions – has regained favour as an important, sustainable and dependable line of business.

Both realities are a direct result of the global economic crisis, as is a near worldwide 'back-to-basics' mantra among banking and financial services providers. Even trade finance, a mature business with a limited history of innovation, has been drawn into the current of 'focus on the fundamentals', though it has, in many ways, always been about those fundamentals: a business grounded in the flow of goods across borders, using established instruments and broadly accepted practices.

Despite this solid history – reflected in relatively low loan-loss experience across the industry – there had been a clear trend, pre-crisis, for trade financiers to innovate in the face of potential disintermediation, given a global shift to open account trade. One consequence of that innovation effort appears to have been a loss of focus on the importance of risk mitigation in the trade finance value proposition: a focus which has now undeniably returned.

The Middle East has offered an intriguing contrast to market conditions prevailing in markets from the Americas to Europe, Asia and beyond.

Observers of the business of trade finance at the transactional level have noted that markets in the Middle East and North Africa have consistently demonstrated a preference for transacting on the basis of traditional instruments, notably the much-maligned, yet enduring, documentary letter of credit.

Leading markets across the region have a long history of engaging in international commerce, and this history, coupled in many key markets with the influences of Shari'a law, has created a set of conditions and expectations that all but assured an uninterrupted 'focus on fundamentals' – including the requirement that trade finance business be linked directly to the underlying flow of goods, and the expectation that business be conducted on the basis of familiar and trusted instruments.

'Back to basics' may be a realisation of sorts among financial services providers in many markets, but not in the Middle East, where the basics have always been an element of the commercial and financial compass guiding trade financiers.

Bankers and financiers across the region speak of fundamentals in banking, and communicate a desire to balance commercial success with good sound stewardship. One senior executive, based in Bahrain, noted that business objectives are often tempered by other considerations in the context of Shari'a law: it is, for example, considered inappropriate, he observed, 'to take the bread from the table of a man and his family', and as such, the financial institution had never let go an employee, preferring rather to re-deploy them to better suited functions. In that same spirit, the acceptance of undue risk, or engagement in transactions that are poorly understood, would be frowned upon among bankers and financiers guided by the fundamentals.

Philosophical argument aside, it is a reality that some combination of factors – including the influence of Shari'a, and the focus on fundamentals, has allowed the Middle East to emerge from the global crisis in better circumstances than many leading economies on the globe.

A knock-on effect of the crisis has been a shift in focus to intra-regional trade, together with a decided shift East, including significant efforts to develop trade with China, and to expand commercial relationships with India. ➤

➤Leading economies from Saudi Arabia to the UAE and beyond, are certainly looking to capital projects and stimulus spending as elements of a recovery strategy; at the same time, sovereign wealth funds are looking outward to investment opportunities and strategies for diversification beyond petroleum-based production. These are all important activities in ensuring sustainable recovery and steady growth. Estimates suggesting the potential for trillion-dollar trade flows between China and the Middle East are not uncommon, and the markets of Dubai reflect an inward flow of goods from new trading partners, just as business executives from the Middle East are collecting more and more frequent flier mileage with trips to China and Asia.

The global crisis did, however, illustrate the importance of certain other fundamentals that will require greater focus among business executives and bankers in the Middle East and North Africa: the importance of transparency and adequate financial reporting, as a direct outcome of the increasingly integrated nature of global financial markets.

Fully appreciating the historical importance of name lending in the region, and commercial practices related to the confidentiality of family businesses and the role of holding companies in aggregating revenues from operating units, it is increasingly a reality that certain local practices will need to better align with internationally accepted practice, if business executives in the region wish to access international capital markets, or the services of global or quasi-global financial institutions.

This does not imply anything about engaging in unacceptably risky financial transactions, or buying in to opaque financial structures marketed by overzealous foreign bankers: a trap that was successfully avoided by financiers across the region. It does, however, suggest that some common and trusted reference points (such as financial statements and credit reports) will facilitate a more efficient functioning of commercial and financial transactions – supporting the objectives of sustainable growth across the region. This is particularly noteworthy, in light of the significant role of foreign-headquartered financial sector providers across the Middle East, and the reality – acknowledged by senior bankers from Lebanon to the UAE to Saudi Arabia – that mega-projects in the region are of such a scale that they cannot be funded solely by local financial institutions, despite the wealth in several of the leading markets in the region.

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The same parallel arguments apply directly to the business of trade finance: trade flows are critical elements of industrial development strategies in numerous markets across the MENA region – intimately connected to the diversification strategies of those same markets. Just as there are lessons in the broader context of financial reporting, the region is being well served by a momentum of innovation around trade finance. Balancing a focus on fundamentals, and continued leverage of traditional trade finance instruments, leading providers are exploring solutions in supply chain finance, and looking at opportunities to better leverage technology in the delivery of trade financing solutions.

Back to basics? In the Middle East, bankers and trade financiers never lost their 'focus on the fundamentals', and are now well-placed to advance financial practices and the development of leading-edge trade financing solutions – on the basis of sound fundamentals. ■