Courting Arabia

Clarissa Dann reconvenes with the Falcon Group community in Dubai as it reflects on how plunging oil prices have affected consumer demand in the Middle East, but there is no shortage of trade finance demand

Six years ago in 2010, Falcon Group's Will Nagle and Kamel Alzarka held their first non-bank financing forum at the One&Only Royal Mirage hotel in Dubai – specialist financing was not addressed in mainstream events and was rather a too well-kept secret. Not any more – it's all out in the open now.

In his welcome address to the 2016 gathering in the very same hotel on 17 April 2016, Nagle reflected that the global economy had not really changed that much, "We still have an unstable market and with global banks' shrinking balance sheets, we do believe there is a greater awareness of the non-bank financing world now than there was then," he said to around 100 delegates. With insufficient supply of credit and more demand than ever as global trade surges past the US$20trn mark, this hardly comes as a surprise.

Entitled "Specialist lending for challenging times – an exploration of the non-bank financing industry", the event was moderated by Greg Fairlie, a broadcast journalist from Dubai One. He set the scene by reminding delegates that the "trends of business funding are changing" and that "the very term alternative finance becomes redundant". "Driven by technology, an increasing number of businesses and start-ups are accessing finance through alternative sources", he commented, referring to a World Bank prediction that crowdfunding would be hitting US$96bn by 2020.[1]

The transaction finance market is in a different place than it was 18 months ago, and the fact that Falcon is the first non-bank institution to join the ICC Banking Commission and that the UK export credit agency, UKEF, has signed a cooperation agreement with the group says something about the scale of what Falcon has become since it was a gleam of an idea in Alzarka's eye.[2] What makes it work in a market where banks are struggling is that the fees are not wiped out by compliance costs – it can cost as much as US$50,000 to onboard a new client and a further US$50,000 to maintain the relationship. "Banks are challenged by lower returns because of regulations brought in after the 2008 recession. They are weary of credit losses on bad assets," said Fairlie.

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Emma Clark, Falcon's head of business development for the UK and Europe, developed this point in her introduction to examples of specialist finance in action. "Banks have less money to lend. Where does that leave the mid-caps and SMEs?" She called it "the perfect storm of uncertainty", and reminded delegates that reaching for equity solutions or pushing out payment terms to suppliers simply introduced gearing, reputation and supply chain problems.

Non-bank and alternative finance, she commented, covers a huge landscape that now includes: crowd funding, peer to peer lending, fintech, hedge funds and securitisation. This is all very different, said Clark, from "specialist finance that is tailored to specific business requirements or project type, and is flexible around tenor, documentation and how you treat it in your books".

The Midcom Group, present in 17 countries across East Africa, West Africa and the Middle East, operates across six different industries including mobile phone distribution and dairy products. Supplier relationships were precious and many had been in place for decades and more working capital was needed to protect them. While the corporate had good banking relationships, specialist trade finance was a pivotal diversified source of liquidity.

Clark cited an example of this, "There are some interesting players in the market and non-bank finance is a multi-trillion dollar industry. And it is not retrenching," she concluded.

> "The fastest growing deposit taking institution in the world is Ant Financial, the financial arm of Alibaba. It took US$100bn of deposits in the past 18 months"

Left to right: David Smith, Greg Fairlie, Gurpreet Singh, Will Nagle, Nam Sahasra, Emma Clark and V Shankar

The global economy, trade and finance

Although oil prices have recovered to the mid-forties, and the supply/demand imbalance in the oil market is starting to correct itself, "we are a long way from the US$110/bbl we were in 2014, there has been a big correction in the oil price", according to David Smith, the economics editor of the Sunday Times (who last spoke at the event in 2013). He explained how a fall in the oil price usually boosts real incomes in consuming countries, reduces costs for oil importing countries, and produces stronger economic growth. But this has not happened.

The negative impact of cheap oil felt by the oil exporting countries is greater than any of the positive effects felt by the oil importing ones, although more benefits might be felt, said Smith, "after three or four years".

China's 6% to 7% new normal economy is not, he added, "a temporary period of weakness" and while he admitted that the timing of China's "growing up and slowing down" could not have been more inconvenient alongside the glut in oil, even at 6% China's sheer size now adds more to the global economy than it did when it was growing at 10% ten years ago.

"The weakness of world trade worries me quite a lot," said Smith. Apart from the post-global financial crisis bounce-back in 2010, trade has struggled to keep up with world GDP. Why? "Protectionism and the lack of trade credit, as well as what has happened to commodity prices," explained Smith. And the big hope of intra-regional trade hasn't really materialised either.

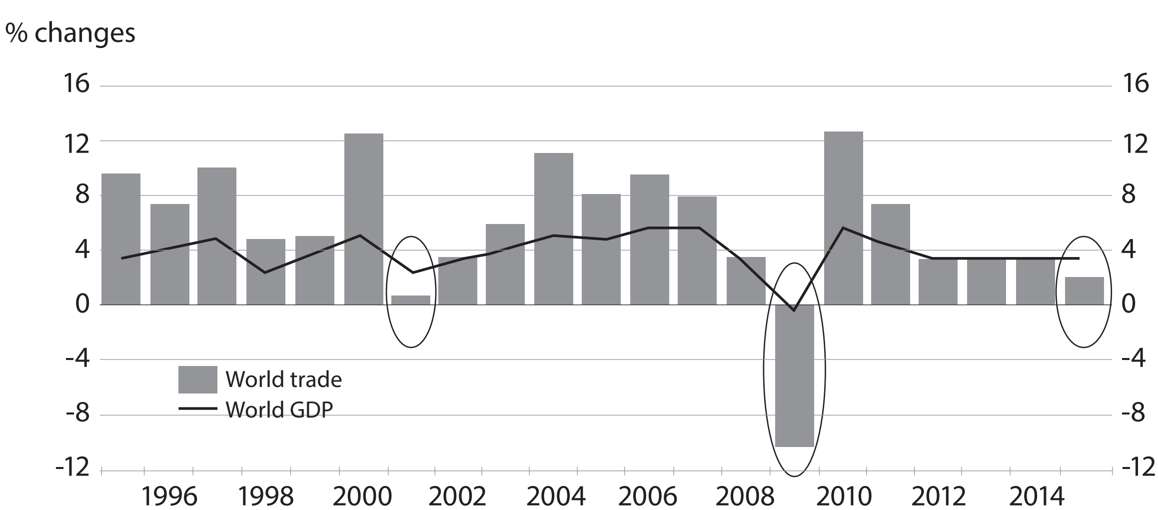
Banks are doing much less cross-border lending than they were, particularly those now largely in public ownership that have readjusted their priorities to their domestic markets, he reflected, citing the divestment by Barclays of its Africa operations as just one example of this. "Credit is the oxygen of the modern economy," he concluded, and unless non-bank finance can step in to fill the gap left by the banks, trade will continue in the doldrums.

In the driving seat

Jaguar Land Rover's head of fleet and corporate sales MENAP, Gurpreet Singh, was next up on the podium to share the corporate experience of how a falling oil price is affecting demand. While one would expect cheap fuel to encourage more purchases of big brand vehicles like these, it doesn't when that oil is the main source of this MENA market's earnings. "Oil is the primary trigger that leads to the fall in spending", said Singh. And the assumption that the region is a tax-free environment is no longer accurate. "Taxes are coming to the Middle East," said Singh – mainly in the form of VAT and corporation taxes. While some corporates have responded to lower returns with deep cost cutting, this was, he said "short sighted" as the region moves into a demand and consumer driven market.

On the bright side, GCC nations sit on vast reserves in of huge sovereign funds with the UAE leading the diversification from hydrocarbons agenda. "Saudi has US$700bn and Kuwait US$500bn but the governments are not ready to part with these reserves in the current situation."

Figure 1: Weak world trade is the real worry
Note: World trade is goods plus services trades volumes. World GDP growth is measured at purchasing power parties.
Source: OECD Economic Outlook database



The deceleration of bank lending growth has hit the MENA region as well, and as opportunities present themselves to build customer bases in non-oil dependent countries such as the UAE, Morocco and Egypt, bespoke financing solutions are, he said, increasingly important now that the banks are so cautious. The Dubai leasing and finance industry is very much still in its infancy he said, and there is a lot of untapped potential. Financing needs "quick decision-making, needs to be flexible and to be willing to take on some risk", said Singh.

Opportunities to grow lie in taking the long-term view, and being able to close gaps in sales, marketing, government relations, maximise local presence, capabilities and competencies. Supply chains must also be accelerated – hence the need for specialist finance, he reflected.

Delegates at the Falcon Group specialist lending forum

The White Rabbit

Former Standard Chartered board member V Shankar termed the changed economic landscape as "an Alice in Wonderland situation". Based in Dubai and Singapore, he left StanChart in 2015 and is now with a start-up private equity firm focused on growth opportunities across Africa, Asia, and the Middle East: Gateway Partners. "Who would have thought in our lifetime we would see negative interest rates?" he exclaimed. China produced and consumed 800 million tonnes of steel in 2015. The US, at its peak, consumed around 100 million tonnes. However, he warned, a China moving from investment to consumption is "no longer going to be building bridges and skyscrapers" and will use less steel. What does this mean? The Chinese could dump their unused steel on global markets and let steel prices collapse, or they could cut back on production and iron ore prices would tumble. The repercussions would be felt as far away as Brazil and Canada, he said.

Turning to the Middle East, tourist spending is down – in the UAE credit card spending usually grows at 7% to 9% but in the last 12 months it only grew 1%. The spending of Chinese tourists has fallen 18% and of Russian tourists by 52%. So the China contagion is already far-reaching.

"We are in for a structural change in how the banking system works. What do banks do?" asked Shankar. He continued, "They take deposits, they lend money, they move money from one place to another in payments, and they provide hedging and risk management funds." He pointed out that the fastest growing deposit taking institution in the world is Ant Financial, the financial arm of Alibaba. It took US$100bn of deposits in the past 18 months and the China Daily reported that it is seeking overseas business partners.[3] "No bank has ever raised deposits as fast", said Shankar.

"Digitisation is going to change the game, we are in the zone of the unknown", he concluded, and alluded to the music industry transformation where technology now allows the content creator to connect with the ultimate consumer without an intermediary. "Access to finance will be important" but large international banks may not be there for the small and medium-sized companies. I see a large gap developing in SME financing, not just in emerging markets – just look at Italy. Specialist finance will become a go-to player in this space, as will local and regional banks. It is their time to shine. Ten years ago only two banks outside Northern Europe, US and Japan were in the top 50. Now that two has become 24. That does not mean international banking is dead, they are just playing in a different zone. The challenge for fintech companies is that they will be in eye of the regulators. So far it is has been light-touch but that may change.

When the speakers lined up to take panel questions, Kamel Alzarka pointed out that much of the prudential regulation issuance in Europe and the US is because of the scale of deposit taking. "Nobody wants to see more bail-outs and if institutions such as Alibaba go on taking huge deposits, surely they will face the same regulation?" Shankar followed this with a reminder that it is the objective of every central banker "to make the financial system both open and safe". "It is not a binary choice," he said. It's not "either/or", but "and". All forms of finance have a role to play.

But will it be enough to plug the financing gap and help improve world trade growth rates? Time will tell, but the overall takeaway from the Dubai gathering was that there is no shortage of determination to make this happen.

Clarissa Dann is the editor-in-chief of TFR

References

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2. See TFR profile of Kamel Alzarka: http://bit.ly/294xTOI
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