Business Conditions in the Arabian Gulf

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The economies in the Arabian Gulf continue to grow rapidly, despite instability and unrest afflicting their neighbouring countries in the Middle East. The Arabian Gulf countries are the members of the Gulf Cooperation Council ("the GCC") namely Saudi Arabia, the United Arab Emirates, Kuwait, Qatar, Bahrain and Oman. These GCC countries are collectively important for any business with global aspirations and ambitions.

According to the International Monetary Fund ("IMF"), in the five year period following the financial crisis of 2008, the real gross domestic product of the GCC countries grew by 24 per cent – a stark contrast to negative growth experienced over the same period in the UK and in the Eurozone countries.

Growth Drivers in the Arabian Gulf

This impressive growth in the Gulf was made possible by high oil and gas reserves and prices over most of the period since 2008, coupled with a willingness on the part of governments in the region to increase spending and to move aggressively to diversify their economies away from energy production. High rates of government expenditure continue in most GCC countries, as governments invest these significant oil and gas reserves to boost social services and infrastructure. At the time of writing the outlook for oil prices was uncertain, but the major producers have built significant reserves from big surpluses over recent years, so in the short-term public spending should not be affected.

Aside from these advantages, all GCC countries have rapidly increasing populations. The IMF also reported that between 2008 and 2013 the population of the GCC countries grew by a staggering 18.9 per cent, emphasising the youthful demographic.

Importantly, most of the Gulf countries are zero tax or low tax jurisdictions. Labour markets are flexible, and local businesses import and deploy expatriate workers across a wide spectrum of skilled and unskilled occupations (literally from labourers to rocket scientists). Under the GCC legal systems, residency visas are linked to employment contacts and are generally weighted in favour of employers.

Despite the political unrest across the wider Middle East, all the GCC countries seem politically stable at present, with only Bahrain having a recent history of civil disorder and sectarian political issues.

What are the Critical Issues for Foreign Investors in the GCC?

All GCC countries impose restrictions on the level of foreign ownership and control in local businesses. These restrictive rules often pose a challenge for foreign investors when setting up companies or businesses in the GCC; or when investing in established GCC companies.

The foreign investment rules are intended to protect national entrepreneurs and to limit foreigners to minority ownership positions. Foreign investors usually have two options.

- pursue the path of joint venture – the investor identifies a local company which will contribute to the business, share any financial risk and facilitate business development and operations on the ground; or
- conclude arrangements with a local businessman (or company) who will become a partner in name only; even where such a local partner owns 51% of the company, the foreign investor will put in place side agreements which allow the foreign partner to retain almost all the profit, carry all the risk and exercise full control over the business.

Both types of arrangements are extremely common throughout the region.

The restrictions on foreign ownership go hand in hand with a prescriptive business licensing regime which prevails in all the GCC countries. Any business must obtain a "*gateway*" licence to carry on business from the government authorities. This is a substantive approval process and applicants must demonstrate that they have employed staff with appropriate skills and experience and track record to operate the business. Highly regulated types of business (e.g. healthcare and education) also require further regulatory approvals and licences to be obtained, in addition to basic "*gateway*" licences.

What is the best way to conduct due diligence on potential investment targets?

Foreign investors find it difficult to identify targets for acquisition or partnership in the Middle East, let alone conduct detailed due diligence on their targets. In Western countries it is normal to elicit considerable background information about target companies from corporate registers, real estate registers, court registers, credit checks and other public sources. However, in the GCC countries, not much information is recorded on public registers, there is no accessible credit reporting system (except in Bahrain) and most of the information maintained is not available is not available to the public or to any third party.

This lack of publicly available records makes it difficult to source or corroborate reliable information from public sources to verify basic facts about the target. It is usually necessary to rely wholly on information and documents furnished by the prospective seller.

SAUDI ARABIA

Deals in Saudi Arabia – Mixed Messages

Saudi Arabia is the biggest economy and market in the GCC. So it offers the greatest rewards but also presents significant challenges in making investments. Politically, Saudi Arabia is stable at present and business activity is strong, although a major crackdown on expatriate workers without proper visas has led to labour shortages in some sectors, particularly in the building industry.

The gateway to foreign investments is the Saudi Arabian General Investment Authority ("**SAGIA**"), a regulatory body which must approve any foreign investment application from outside the GCC countries.

SAGIA was established in 2000. It administers a foreign investment regime dependent on the issue of foreign investment licences by SAGIA.

For those foreign businesses wanting to carry on a business activity in Saudi Arabia, they can only do so if they have a legal presence in Saudi Arabia and they have a foreign investment licence which authorises that activity to be conducted.

Foreign investors may acquire ownership of business in all sectors of the economy subject to two broad qualifications:

- Foreign investment is not allowed in oil exploration, drilling and production (although there is no

prohibition on foreign investment in refining and petrochemical development).
- The Foreign Investment Law identifies a number of business activities reserved for Saudi owners. This is referred to as the “Negative List”.

After a liberal beginning to the SAGIA administration about three years ago there was a change in leadership at SAGIA which led to a tightening of foreign investment rules. SAGIA is now selective about the applications it approves. Nevertheless, for many business activities it is feasible to achieve foreign ownership up to 75%. Foreign investors may be allowed to own up to 100% of the capital of the enterprise. However, there are some business activities where at least some level of Saudi ownership would be required.

But it is easier to secure approval if your investment is large; or is viewed as bringing new technology or significant job creation to Saudi Arabia.

Foreign players can often gain access to the Saudi market without carrying on a business in Saudi Arabia. In many cases, the restrictions on foreign ownership encourage companies to enter into distribution, commercial agency and franchise arrangements with parties allowed to carry on those businesses in Saudi Arabia. The foreign company will not need a foreign investment licence to enter into these arrangements and won’t need to establish a legal presence in Saudi Arabia.

THE UNITED ARAB EMIRATES

Deals in the United Arab Emirates (Dubai and Abu Dhabi) – Business is Brisk

Business in the UAE is extremely positive. Dubai in particular has reinforced its position as the leading financial centre in the region as a result of its superior lifestyle and infrastructure, coupled with its unequalled air transport connections with the region and the rest of the world. Dubai is a major beneficiary of the difficulties elsewhere in the Middle East. It is now the major tourist destination and focus for property investment in the region.

Abu Dhabi is likewise constructing the first offshoot of the iconic Louvre Museum and a new Guggenheim Museum, has built theme parks and significantly upgraded its hospitality and transport infrastructure (including the beginning of a trans-Arabian railway network). There is also a major port and industrial zone being developed in Abu Dhabi near the main freeway between Abu Dhabi and Dubai.

The UAE has pioneered the development of economic free zones, which are designated areas within urban or industrial precincts where foreign investors are permitted to set up 100 per cent owned companies and businesses. UAE free zones, particularly those in Dubai and Ras Al Khaimah, have been very successful and a staggering array of businesses operates from the free zones, ranging from manufacturers to banks and consulting firms. However, there are strict limitations on the types of business activities which can be conducted from free zones. Also, to set up in a free zone, it is necessary to buy or lease premises in the free zone areas.

One sector that is currently seeing exceptional growth in the UAE, particularly in Abu Dhabi, is the healthcare industry. It is forecast that over the next few years, due to factors such as the rapidly expanding population, greater public awareness of medical conditions and treatment available, higher incidence of lifestyle diseases and deeper insurance penetration, this sector will continue to grow exponentially (becoming a $12bn industry by 2015 according to the Dubai Chamber of Commerce & Industry).

The UAE seeks to promote itself through the development of healthcare tourism, attracting patients to its premium facilities from around the region. The Government and the government-subsidized insurance schemes also recognize the opportunity to save costs by treating the national population at home, rather than paying for expensive treatment abroad as has been common previously. This forecast growth has fuelled a significant increase in both public and private sector investment in healthcare facilities with highprofile names, such as Cleveland Clinic, John Hopkins and Mayo Clinic now operating in the UAE.

The UAE's non-oil sectors expect continued growth in 2015, driven by strong real estate development activity, tourism, leisure and retailing buoyancy and a continuation of major infrastructure projects.

KUWAIT

Deals in Kuwait – Building Infrastructure is the Key

Of all the GCC countries, Kuwait is closest geographically to the serious ongoing violence in the region, as it has a long land border with Iraq. However, the GCC's only parliamentary democracy remains relatively stable and prosperous. It retains significant oil reserves.

The government of Kuwait has vast foreign assets, but much of the local infrastructure is overdue for overhaul and enhancement. However, it continues to take time for the political processes to work through how Kuwaiti's plentiful sovereign resources will be spent. This long-delayed "*makeover*" of Kuwait and its infrastructure will act as a major stimulus as it emerges over time.

In response to its growing need for robust local infrastructure projects, the Kuwait government passed the country's first PPP (Public Private Partnership) and IWPP (Independent Water Power Plant) laws in 2008 and 2010 respectively. On the heels of the passing these laws, Kuwait embarked on a mission to procure numerous midsize and large infrastructure projects under a PPP regime. The PPP projects anticipated by the issuance of these laws cross a business areas that include (but are not limited to) electricity and power, waste water management, transportation, communications, hospitality, healthcare and land development within the State of Kuwait.

The aim of the PPP Law is to create wider ownership in larger projects (i.e. to shift the development cost burden away from the government and toward private investors), while giving the investor management control of the joint stock company and the project. Since the PPP Law was passed in 2008, over $25 billion worth of projects have been announced and significantly more are expected to be announced over the next few years as Kuwait sets out to expand and diversify its economy.

In January 2014, Kuwait reached financial close on the Az Zour North Independent Water & Power Project, Kuwait's groundbreaking PPP/IWPP project. Considered as Kuwait's flagship infrastructure project under the PPP and IWPP laws, the $1.8 billion project will result in the construction of combined cycle power plant and associated water desalination plant.

To improve upon gaps in the PPP regime and lessons learned following the success of the Az Zour North project, Kuwait recently passed a new PPP law, which is more flexible and conducive to attracting foreign private investment. As such, Kuwait believes large infrastructure projects to gain momentum, including projects such as the Umm Al Hayman Wastewater Treatment Plant, Az Zour North Phase 2 IWPP, Al Abdaliyah Integrated Solar Combined Cycle Plant and Al Khiran IWPP amongst many others in the pipeline.

QATAR

Deals in Qatar – Countdown to the World Cup

Qatar is the wealthiest country in the GCC per capita and enjoys vast gas reserves. There have been major new developments in Doha and important cultural attractions established (such as the magnificent Islamic Art Museum). However the real stimulus to activity in Qatar is expected to be the major infrastructure which must be built to permit the staging of the 2022 World Cup.

The country's economic progress has slowed following a change in leadership in 2013 (the old Emir stepped down in favour of his son) as the government and the publicly owned businesses continue to digest the implications of the change. However, the World Cup infrastructure has an implacable deadline for completion, so significantly increased activity is expected in the near future.

The Qatar railway project is also underway with contracts now filtering downstream. The Msheireb “Heart of Doha” project re-vamping the old central business district is making significant progress; and development of the new Doha satellite city of Lusail is expected to move up a gear during the next 12 months.

Whilst infrastructure works are proceeding, the policy of attracting industrial activity to the country has not achieved significant success. Difficulties with registration of businesses with over 49% foreign-ownership and slow paced industrial licensing are proving to be significant hurdles and the under-developed state of Qatar’s industrial zones are hampering efforts to attract the larger players in the manufacturing industry.

Significant mergers and joint ventures in Qatar are still largely driven by governmental initiatives. The Qatar Exchange is now wholly-owned by the sovereign wealth fund entity – Qatar Holding. There are still proposed mergers and strategic consolidations being considered by government entities and Qatar Petroleum and its subsidiary organisations are involved in joint ventures with a number of global companies. Despite encouragement from various sources, new listings on the Qatar Exchange are few and far between and the capital markets lag behind largely more buoyant regional financial markets such as the UAE and Saudi Arabia.

BAHRAIN

Deals in Bahrain – All Investors Welcome

Bahrain has long established roots in international trade and in 1932 it was the first GCC country to discover significant oil reserves. Over the past 40 years Bahrain has put in the place foundations for a modern economy. As Bahrain no longer has significant oil reserves like some of its GCC neighbours, is has moved away from dependence on oil, diversifying into other sectors. During the 1980s and 90s, it was seen as the banking hub of the GCC.

Bahrain has close ties with the US and is the first and only GCC state to have a bilateral Free Trade Agreement with the US, which came into force in 2006. As a result, there are few restrictions for US individuals and companies wanting to do business in Bahrain. Bahrain is also home to the US Navy’s Fifth Fleet.

There are many advantages to doing business in Bahrain. It has a relatively liberal lifestyle compared to some other countries in the GCC, e.g. Saudi Arabia and Kuwait. It is strategically positioned between Saudi Arabia (to which it is connected to by a causeway), Qatar and Kuwait. It has a well developed legal system with relatively advanced companies law, financial services laws and even a trust law. It has well developed sectors in financial services, manufacturing, professional services, logistics and ICT. It has a relatively liberal foreign investment ownership regime with no restrictions on foreign investors in certain sectors and no restrictions on US investors at all. Bahrain also has an educated and diversified work force comprising both expatriates and Bahrainis. Like all other GCC states, Bahrain is tax free in most sectors of industry.

Bahrain’s Economic Development Board is responsible for attracting inward investment into Bahrain and is charged with leading implementation of the Government’s 2030 Economic Vision.

Bahrain was affected adversely by the Arab Spring and in 2011 an attempted uprising took place as a result of a latent sectarian divide between the Shia majority and the Sunni monarchy. The uprising expressed in some civil disorder and a degree of political violence. The situation has however stabilised in recent months. Bahrain is acutely aware of the loss of business and investor interest which has been a side effect of the recent disorder and as a result it has become increasingly investor and business friendly, whilst also trying to address its political issues.

OMAN

Deals in Oman – An Oasis of Stability

The Sultanate of Oman has a long record of political stability under the dynasty of Sultan Qaboos and continues to be on good terms with all its neighbours. Major industrial development is occurring at Sohar, whilst near the capital Muscat there is outstanding hospitality infrastructure on the coast, catering to travellers who prefer five star resorts.

The legal infrastructure is likewise good and the Government has made a comprehensive assessment of the investment sector to define the obstacles and challenges faced by the existing legal framework. Oman offers attractive investment concessions to US nationals and US companies under treaty arrangements designed to create a more market friendly environment for US investors.

Oman was ranked above Saudi Arabia, Bahrain and the United States of America in the 2014 Global Peace Index put together by the Institute of Economics and Peace, ranking 59th out of a total of 162 countries. The Index of Economic Freedom 2014, an indicator of ease of doing business, ranked Oman 48th out of 178 countries. Moody's and Standard and Poor's both view Oman's investment outlook as stable and have reaffirmed Oman's A1 and A/A1 sovereign credit rating respectively.

Oil exports remain the major source of foreign earnings and significant revenue earnersfor the Sultanate; the impact of depressed oil prices towards the end of 2014 on the economic health of the Sultanate is yet to be seen. It is likely that marginal infrastructure projects will re-evaluate or postponed whilst the oil price continues to fluctuate.

The Sultanate's finite oil resources have propelled the Government of Oman to embark on a strategy of economic diversification to lead the Sultanate away from an economy driven by oil to one more reliant on tourism, real estate and trade (through better utilisation of its geographic positioning as the gateway to Asia). World Bank projections indicate growth in GDP of 5% during 2015, making the Sultanate an attractive market for investment.

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