THE RISKS AND OPPORTUNITIES OF DOING BUSINESS IN THE MIDDLE EAST

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INTRODUCTION

For every company considering market opportunities in the Middle East and North Africa (MENA), the region’s political and economic stability is of great concern.

A broad geographic expanse that is home to more than 350 million people, the region faces an increasing threat of violence and unrest from civil wars in Libya, Yemen, Iraq and Syria, and continuing clashes between Israelis and Palestinians. Add to this the rise of terrorist groups like ISIS, an erupting migration crisis as millions of refugees have been displaced and declining oil prices that have resulted in tighter fiscal policies, and political tensions are high throughout the region.

In addition, many MENA nations face pervasive problems with corruption, payment obligations, currency risks and physical security threats. Companies must deal with bureaucratic minefields and an uncertain, ever-changing regulatory and tax climate. As a result, although not every MENA country presents the same challenges, companies looking to enter the region must conduct a careful risk analysis before expanding into this market.

But the rewards of doing business in MENA cannot be ignored. Organizations that pursue and adhere to strict principles of risk management can generate very profitable business growth. This report is a roadmap of what to expect and where to exercise caution.
COUNTRIES IN THE MENA REGION

According to the World Bank, the following 20 countries make up the MENA region

(some definitions expand the list to include Somalia, Sudan, Turkey and others)

IS MENA WORTH THE RISK?

The political and economic climate varies between MENA nations. The risks of doing business in war-torn Syria or Yemen may be too great to invest capital in a local venture, but what about the rest of the region? Several business and risk management experts who regularly advise clients on the practicality of doing business in the region believe that the reward of investment are worth the challenges.

“Absolutely there are business opportunities,” said Sorana Parvulescu, director of political risk at strategic risk consulting firm Control Risks. “We are working on a daily basis with international clients looking to invest or operate in the Middle East.”

She pointed out that many of the MENA countries are among the largest oil-producing nations in the world, and have some of the planet’s largest petroleum reserves. Big Oil has traditionally driven the region’s growth, which has trickled down into other sectors like construction and infrastructure-building that in turn generate other business prospects.

Other experts agreed. “One must consider the region less as a whole and more as a lot of different risk profiles, with some countries stable and others with war-related issues,” said Sofia Tozy, MENA economist with Coface, a provider of credit insurance.

She explained that the Gulf Cooperation Council (GCC) countries of Bahrain, Oman, Qatar, Kuwait, Saudi Arabia and the United Arab Emirates are relatively stable from a political and violence standpoint, even with reduced revenues from lower oil pricing. “There’s a lot of buffer for companies investing in these regions,” Tozy said, adding that other regions like Syria, Libya and Yemen require far more careful consideration of the risks and rewards.

Yet, even perceived stable countries like Turkey are not immune to crisis, as underscored by the
October 2015 twin bombing at a pro-Kurdish peace rally in the Turkish capital of Ankara that killed 86 people and injured hundreds of others. Alexander Kramer, senior counsel at Washington-based law firm Foley & Lardner, was in Istanbul the day the bombs exploded.

“Turkey is a much safer place than it was 10 years ago, as are other formerly violent places as Lebanon and Jordan,” said Kramer, who specializes in international investing and anti-bribery work. “But, then something happens like the Turkish bombing and it sets off a potential cascade of business risks.”

He noted that in the wake of the bombing, many workers stayed at home out of fear for their safety. “When civil unrest arises and employees don’t go to work at the plant you just built, it disrupts the normal progression of work, and things simply worsen from there,” Kramer said. “No matter how stable a country in the region appears today, you still have to put in place contingency plans if the picture changes.”

Stephen Kay, executive vice president for political risk insurance at Marsh, shares this view. “One cannot oversimplify the wide-ranging business and security threats that exist across the region,” he said. “You’ve got oil prices that have cratered and affected major exporters in countries like Saudi Arabia, revolutions across Northern Africa, wars in Yemen and Syria, ongoing conflicts in Iraq, simmering tensions between Israelis and Palestinians, and the terror tactics of the rapidly expanding Islamic State movement.”

All this would seem to suggest that it would be a mistake for multinationals and regional companies to risk their capital in the region. Yet, Kay believes otherwise. “Yes, you’re analyzing risks that are inherently unpredictable, with not many beacons of stability,” he said. “But, this doesn’t mean you shouldn’t try.”

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- Alexander Kramer, Foley & Lardner

As assessed risks and rewards

For companies that proactively identify, manage and mitigate the various threats to generating profitable business, there are significant market opportunities in MENA. The most recent statistics released by the International Monetary Fund (IMF) through its World Economic Outlook Database put the export value of the Middle East at $1.13 trillion at the end of 2012, a figure that represents 6.2% of the total worth of global exports, while the combined GDP of all Middle Eastern nations was $3.96 trillion.

The report precedes the precipitous decline in oil prices, however, which has caused export earnings to fall by hundreds of billions of dollars in the GCC countries alone. This has been difficult for major oil producers in the region that have had to optimize expenditures, lay off non-essential employees and reduce employee benefits provisions.

Despite the challenges, however, overall economic growth in these oil-exporting countries has remained steady at 2.4%. The IMF predicts a substantial rise in the price of oil from less than $50 per barrel in 2015 to $74 per barrel by 2020, which bodes well for the future.

Although the economies of some MENA countries have been devastated by wars and political unrest, many others are emerging markets that offer profitable opportunities for a wide swath of foreign businesses. According to Nielson’s Internet Usage and World Population Statistics report, Internet usage across the Middle East is up more than 2,500% in the past decade, Saudi Arabia is now the world’s largest consumer of videos on YouTube, and mobile phone ownership across the Middle East is 19% higher than the world average.

Furthermore, some countries are expected to see significant economic gains. Now that the U.S.-imposed economic sanctions against Iraq have been lifted, a recent report by BMI Research pegs the nation’s economic growth at 4% through the next few years, driven primarily by foreign investment and domestic exports. The report further projects that the economies of Iran and Egypt will grow significantly throughout the remainder of the decade, given their rising populations of young people, the presence of highly skilled workers and pent-up demand.
DUE DILIGENCE

Assuming a company’s due diligence indicates a sufficient economic return on investment in the MENA region, the next step is to identify the threats to achieving this return. These run the gamut and include strategic and operational risks (asset expropriation and regulatory and tax impositions); financial risks (currency exchange fluctuations, contract repudiation and non-payment of monies owed); cultural risks (the failure to negotiate the ways in which foreign business partners expect to negotiate); and reputational (the disclosure that the company paid a bribe or provided a kickback).

The first step in determining the efficacy of conducting business in the Middle East is undertaking a market analysis. Traditional industries like oil and gas, pharmaceutical, automotive, defense, banking, chemical, agriculture and construction have enjoyed profitable engagements throughout the region for decades. Mobile communications, data analytics and information technology are now gaining ground, as are a variety of export industries.

The primary risks have been and will remain geopolitical and macroeconomic variability. “These are the two big risks that you generally cannot do much about, as you have very little control over them,” Parvulescu said. “Nevertheless, there are ways of mitigating their impact.”

Other MENA experts agreed. “The Middle East is a case study in how to expect the unexpected,” said Daniel Wagner, CEO of Country Risk Solutions, a global risk management consultancy specializing in political risk, and author of the book *Global Risk Agility and Decision Making*. “Anyone who thinks they know what the future holds in the region is misguided.”

Wagner explained that there are countless variables to doing business in MENA, which can change quickly to influence the perception of risk. “It’s a fool’s errand to think you can apply a cookie cutter approach to identifying risk across the region,” he said. “You need to laser in on one country, do your homework, put your boots on the ground, get a feel for the culture, and partner with an outside firm to assist you along the way.”

He added, “In almost all ways, despite governments and regulators trying to do the right things, this is and will remain an evolving landscape.”

FINANCIAL EXPOSURES

To outsiders, MENA is known as a landscape rife with civil and international conflicts, social unrest and the growing presence of extremists. Such pernicious dangers increase the risk of asset expropriation, currency manipulation and contract repudiation, while increasing threats to personnel security.

“If you’re working for a government or on a public-private infrastructure-type project, the economic slowdown caused by low oil prices means that national coffers are depleting, pressuring governments to slash costs, causing potential civil unrest,” Parvulescu explained. “This also can result in a slowdown of a project that is currently underway to spread out the costs. Or it could result in a call to revise the contract midway through it.”

Economic problems also can affect the timing of anticipated payments for products or services already rendered. Since international investments are essential to a country’s economic development, multinational companies do have leverage to pressure payments on a timely basis. But this will not always be effective. “At the end of the day, it often boils down to a single risk—will I be paid or not?” Wagner said.

Fluctuations in foreign currency exchange rates have a different effect on payments, creating a higher risk of capital loss or gain. Currency devaluation will make exports cheaper and imports more expensive, while currency appreciation will raise the price of exports at the expense of import costs. In addition, foreign companies that sell their products or services on credit could face a loss if the exchange rate has moved in a disadvantageous direction during the time period between invoicing and payment.

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CORRUPTION AND COMPLIANCE

Corrupt public officials are another risk of doing business in the Middle East. It is not uncommon for government contracts to contain imbedded “commissions” and “surcharges” that are effectively bribes and kickbacks. According to Transparency International’s 2014 Corruption Perceptions Index, more than half of the MENA nations were perceived to be more corrupt than the global average, with three nations ranking in the bottom 10.

Other reports affirm this perception. A 2014 survey by accounting firm Ernst & Young characterizes corruption as “widespread, tolerated and sophisticated” throughout the region. More than one-fifth of survey respondents stated that it was not possible to conduct business competitively in the Middle East “without committing fraud.” Despite anti-bribery laws enacted in many MENA countries and the broad reach of the U.S. Foreign Corrupt Practices Act (FCPA), one-third of the respondents to the survey say the rules will make “no difference” to corporate business practices in the region.

“People in the Middle East are part of what we call an honor culture. In such cultures, a person’s worth is a function of their reputation, and their reputation is a function of what they do and what others think of what they do.”

- Jeanne M. Brett, Kellogg School of Management

CULTURAL DIFFERENCES

Another risk companies face is underappreciating the social and cultural norms of doing business in the Middle East. Companies must endeavor to build an authentic personal relationship with their business partners. “Take the time to study Middle Eastern cultures, particularly as this relates to business comportment and conduct,” said psychologist Jeanne M. Brett, DeWitt W. Buchanan, Jr. Professor of Dispute Resolution and Negotiations at Northwestern University’s Kellogg School of Management. “People in the Middle East are part of what we call an honor culture,” she explained. “In such cultures, a person’s worth is a function of their reputation, and their reputation is a function of what they do and what others think of what they do.”

Consequently, it can take quite a bit of time for Middle Easterners to build trust in the other party. “In the Middle East, business and personal relationships are the same thing,” Brett said. “Expect to develop a true bond.”

This process contributes to the protracted amount of time it generally takes to conduct negotiations and make business decisions. Westerners tend to work on “thought time,” acting upon their thoughts regardless of the time of day, whereas people in the Middle East work more on “event time,” she explained. “Ramadan moves around the Western calendar at different points of the year, and the call to prayer moves with the sunrise and the sunset, which is not the same every month,” Brett said. “This is ‘event time’ and it drives Americans crazy because we want to close the deal.”

The bottom line is to respect these cultural differences and have patience throughout the negotiations. “Rushing the discussion will affect the quality of the relationship you must develop,” she said.

Even with several governments in the region stepping up their enforcement of existing anti-bribery laws, the situation remains murky. Nevertheless, foreign entities caught engaging in such crimes can suffer reputational damage affecting their business across the globe.
MANAGING THE RISKS

As more multinational corporations and regional companies engage in business ventures in the MENA region, risk management professionals will play increasingly strategic roles. In some cases, risk managers will be called upon to help determine the viability of doing business in the region, based on an in-depth analysis of risk and reward.

The principles of risk management apply in MENA just as they do in other regions. Company risk professionals undertake an identification of strategic and operational risks, assess these threats in terms of frequency of loss and overall financial severity, and where possible quantify these risks for comparison purposes. Plotting each risk on a matrix, for instance, can help prioritize the exposures insofar as their financial impact. Once prioritized, resources can be allocated based on the risks that pose the biggest threats.

LOCAL PARTNERS REQUIRED

Given the breadth of financial exposures in MENA, it is considered a best practice to partner with a local company that understands the evolving political, cultural and economic dynamics of the region (in some countries, partnering with a local company is mandatory). Keep in mind, however, that these partnerships also create risk if both parties’ roles and responsibilities are not clearly defined and delineated. Given the concern about corruption, it is important to vet the local partner for evidence of past criminal behavior. Experts recommend having the partner submit to a background screening and provide their books of business for assessment.

Ongoing monitoring of risks is absolutely essential, as the political and economic situation in MENA can change quickly. In many cases, it is necessary to have people on the ground to provide intelligence on the emergent political climate, a service that the local partner can provide. Information on brewing political conflicts that may pose an adverse market impact in future also can be obtained from research and consulting firms that specialize in the region.

Kay agreed such reports are useful to make insightful decisions, but advised caution. “You’ll get a nice glossy report from an analyst saying everything is good politically in a country going forward, but you need to broaden your vision and take into account the outlier, non-consensus opinions, as well,” he said.

Under the surface, there may be dissidents unhappy with the current regime, which is the case now in Saudi Arabia, for example. “Such things have a way of boiling over at some point,” Kay said.

POLITICAL RISK INSURANCE

Some threats to business caused by political factors can be insured. Political risk insurance is available from commercial insurance companies and governments (the Overseas Private Investment Corporation, or OPIC, in the United States is an example of the latter) to absorb business-related losses due to war, civil strife, terrorism, government asset expropriation or confiscation, government contract repudiation, restrictions on the conversion and transfer of local currency revenues, and other risks.

Political risk insurance is not a panacea, however. “If you are booted out of a country that has experienced a coup and your assets are left there, you can claim the losses on your policy, but it will take a long time to get your money,” Parvulescu said.

Companies must be proactive about managing the political risks to a business venture, monitoring the environment on an ongoing basis to “see the red flags before they raise,” she added.

MITIGATING FINANCIAL RISKS

With regard to contract repudiation risks, the experts recommend structuring company payments to correspond to different phases of the business venture, rather than providing lump sums in advance. A similar structure is advisable to assure more timely payments. “If you’re delivering a piece of machinery to a company, map out the revenue-and-cost curve for the buyer,” Kay said.

He explained that the buyer of the machinery will expect cash flow from this equipment over a period of time in which it will also be dealing with labor and other expenses. “It’s in the best interests of companies to help their MENA business partners be cash flow positive, rather than putting them and you in a difficult financial situation,” Kay said.

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- Sorana Parvulescu, Control Risks
Contracts need to be worded carefully to further address these risks. Consider inserting clauses requiring force majeure to remove liability for unavoidable catastrophes that restrict the contracted parties from fulfilling obligations. To reduce these risks further, companies can purchase business credit insurance from private insurance companies or governmental export credit agencies. The coverage protects international accounts receivables from losses due to non-payment.

Currency risks can be hedged to offset any currency-related gains or losses. “You need to make projections on where you think the currency appears to be headed, while also considering what the currency has been doing in the past,” Kramer said. This will affect whether or not the company wants to enter into a long-term contract in a region, because of the possibility the currency value will be adversely affected over the longer period of time.

**PROCEED WITH CAUTION**

Overall, many experts advise outside companies to proceed slowly, starting with a small deal to discern if the transacting party is serious about the viability of the business relationship. Once a more meaningful relationship blossoms, this can be the cue to expand the business activity. Again, a local business partner can guide the company toward smaller ventures at first and then gradually toward the bigger deals.

**CONCLUSION**

Business opportunities in MENA countries must be weighed against the various risks. The same principles that apply in managing risk in other regions of the world apply in the Middle East, although given the volatility of the region, risk monitoring must be more stringent. Therefore, it is important for both multinational corporations and regional companies doing business in MENA countries to have a human presence on their side. By dispatching its own personnel in the region or retaining a local partner that understands the risks of doing business in a particular country, businesses can monitor changes to their risk profile and better take advantage of the investment opportunities the region has to offer.