Where capital flows

HOW PREPARED ARE MIDDLE EAST COMPANIES FOR MAKING THEIR PRESENCE FELT IN THE WIDER GLOBAL ECONOMY. **PETER WILLIAMS** REVIEWS ONE SURVEY WHICH SUGGESTS SOUND PROGRESS.

Executive summary

Traditionally the Middle East has been seen as a magnet for inward investment. Foreign corporations have invested substantial capital and human resources over decades in a bid to develop the potential of the region's energy wealth.

While capital continues to flow into the region it is no longer a one way street. Investment and capital is now moving out the region as Middle Eastern companies are leveraging the resources of the region to establish themselves as key players in the emergence of an increasingly globalised economy.

A series of surveys conducted during 2008 by KPMG International investigated the future direction of capital flows both globally and in specific regions around the world. The results from the survey covering 15 countries around the world suggested that investment was moving away from the US and into Europe, India and China. The survey results suggest the emergence of "a three-bloc world" comprising the Americas, Europe and Asia Pacific. KPMG also produced a report focused on the investment intentions among a group of large companies based in the Middle East and North Africa. In a bid to discover where companies expect to go in the next phase of their expansion, 50 senior corporate investment strategists in seven countries in the region were asked which countries (other than their own) they plan to invest in during 2008/09 and where they are looking to invest in five years time.

Countries included in the study were Saudi Arabia and Kuwait (over half the interviews took place in those two countries) as well as UAE, Oman, Qatar, Bahrain and Egypt. The results showed that companies were focusing on investments in countries within the region in the immediate future. However over the next five years it is clear that Middle Eastern companies will be taking steps to expand into foreign markets.

CHANGING ORDER In the next year the countries set to receive the most investment were UAE, India, Qatar, China, Bahrain and Saudi Arabia. In five years time the order is expected to be India, UAE, China, US and Saudi Arabia. In terms of change in percentage of corporates planning a significant investment between 2008/09 and 2013/14, the KPMG survey suggests that India makes the most significant gain followed by the US, Yemen, Brazil and Thailand. Middle Eastern investors are showing relatively low interest in Europe with the exception of the UK whose share of investment remained steady at 8%. See box on infrastructure investment.

In the longer term KPMG paints a picture of companies showing increasing interest in investment outside the region, especially in India and the US. The report says: "If Middle East investors are indeed widening the range of companies they are willing to invest in, then this may increase the level of competition that companies within the region could encounter if they are looking to investment from a neighbouring country. But this doesn't mean that regional support disappears."

Indeed Gulf Co-operation Council (GCC) states are expected to continue to pour significant shares of Middle

East investment into neighbouring economies. In the near future the survey found that the most influential country aggregated across all sectors is Saudi Arabia, driven mainly by its very strong showing as the most influential country in services. Second in terms of influence is the UAE, again largely through its presence in service industries. Looking ahead five years those two are still expected to dominate with Qatar still seen as significant. However the near-term position of the US and the UK is expected to wane in favour of the emerging economies of China and India.

It is clear from the KPMG survey that the primary focus for GCC business over this period is likely to remain within their

Infrastructure capital demand

PUSH TO DIVERSIFY ECONOMIES IN THE MIDDLE EAST CREATES HUGE NEED FOR INFRASTRUCTURE CAPITAL

In order to meet capital demands driven by strong population and economic growth, more than $100bn of public-private partnership (PPP) investments in the Middle East and North Africa region will be required over the next five years to supplement government funding, says a report by Ernst & Young.

According to *Bridging the Gap: Private Investment in Middle East Infrastructure*, current and active civil engineering projects in the six nations of the GCC have a total value of $1.3 trillion. But with construction costs rising and dramatic economic growth, infrastructure needs are rapidly outstripping the region's public resources despite record exports of oil in recent years. For example, despite the Middle East boasting two-thirds of the world's desalination plants, the World Bank has predicted that the amount of water available per person in the region will halve by 2050 as a result of population and economic growth and climate change. This suggests that a significant capital investment will soon be needed to meet demand and private sources will be increasingly looked to for a portion of this investment.

EVEN WITH THE LARGE AMOUNT OF REVENUE GENERATED FROM OIL EXPORTS IN THE REGION, GOVERNMENTS ARE HAVING TO FIND ALTERNATE MEANS OF FUNDING THE EXPANSIVE INFRASTRUCTURE DEVELOPMENT PLANS REQUIRED TO MEET RAPIDLY GROWING DEMAND

"Even with the large amount of revenue generated from oil exports in the region, governments are having to find alternate means of funding the expansive infrastructure development plans required to meet rapidly growing demand," said Abraham Akkawi, Middle East Leader of Infrastructure, Ernst & Young.

Despite oil revenues increasing to an estimated $381bn in 2007, countries in the region have decreased their public spending by 5% since 2002, according to the Institute of International Finance.

"In the long term, we expect the current trend towards continued greater private sector participation in infrastructure in the Middle East to continue. Investors looking to compete for the lucrative contracts are going to have to cultivate relationships through consultants or other intermediaries already well versed in Middle Eastern business practices," said Mike Lucki, global leader of infrastructure, Ernst & Young.

In the Middle East governments traditionally have contracted with regional or international companies to design and build infrastructure such as airports, ports or roads and government agencies have usually operated the infrastructure. While that is still true today, governments are increasingly forming PPPs with the private sector to build and operate projects. Such partnerships provide private investors and contractors with new business opportunities in the Middle East, and enable governments to share the risks of project development, draw on the knowledge and experience of the private sector and leverage public investment in infrastructure with private capital. "No doubt the global credit crisis will have some effect on regional project finance pricing, terms and time to close, but it is too early to determine the magnitude. There are billions of dollars of announced infrastructure projects in the pipeline which have been planned on the assumption of varying levels of private sector participation. These projects are critical to the economic growth of the countries in the region, especially GCC countries," said Phil Gandier, Middle East Leader, Transaction Advisory Services, Ernst & Young.

region. However at the same time, the mixture of foreign partners taking an interest in the region looks set to change in a way that reflects the wider changes that are likely to take place in the global economy.

The KPMG survey looked at the factors that were important for companies that were looking to invest. The survey found some key differences between what is important for GC companies and those in the rest of the world. Respondents were asked to rate 12 country attributes by the influence they have on decisions to invest in a particular country. Globally the more important attribute was access to new customers, followed by political stability. In contrast for GCC companies political stability was paramount, especially for manufacturers which presumably are concerned over the effects of instability on their factories or supply chains. GCC showed more agreement with other respondents for factors such as impartial rule of law and good infrastructure. However priorities diverged again over the relative importance of high quality labour forces and the tax regime.

KPMG suggests that the relaxed view of the impact of tax on foreign investment may be due to some GCC unfamiliarity with more complex tax regimes found in other parts of the world.

EMERGING PICTURE According to KPMG, the picture that emerges from this study is of a group of companies part way through a process of establishing their presence outside their region and doing so in a cautious and careful fashion. The report states: “They are not new to the idea of overseas investments: over half (54%) have already put money into the countries they plan to invest in over the next five years and 70% plan to use the profits from these investments to build their presence in their chosen countries.” But investors from other countries are further down the track of building a presence cross-border and are, according to KPMG, more comfortable taking the risks associated with bringing in new money rather than relying on generated profits.

MIDDLE EAST CORPORATE INVESTORS ARE AHEAD OF THEIR GLOBAL COUNTERPARTS. THE CHALLENGE REMAINS FOR GCC INVESTORS TO ESTABLISH A LASTING MIDDLE EASTERN PRESENCE IN THE WIDER GLOBAL ECONOMY. AND IT SEEMS THEY ARE WELL-PLACED TO MEET THE CHALLENGE.

One notable difference between GCC and other investors is that GCC investors are less concerned than their global counterparts about the influence of private equity in their sectors. The report suggests that 60% of GCC investors are most likely to find themselves bidding against private equity investors or portfolio/strategic investors when making overseas acquisitions. That compares with 36% in the global study. Moreover 61% of GCC investors welcome private equity investors in their sector as a good source of capital and long-term supportive shareholders (58% globally). The contrast in attitudes to sovereign wealth funds is even more marked.

Nearly a quarter (24%) of global investors said they would not welcome an investment from a sovereign wealth funds, only 4% of GCC investors agreed. The survey suggests Middle East corporate investors are ahead of their global counterparts thanks to their familiarity with sovereign wealth funds which look certain to become more important in the years ahead. The challenge remains for GCC investors to establish a lasting Middle Eastern presence in the wider global economy. And it seems they are well-placed to meet the challenge.

See www.kpmg.com/Global/IssuesAndInsights/ArticlesAndPublications/Pages/Middle-East-capital-flows-survey-2008.aspx

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