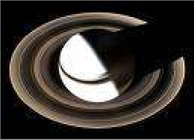

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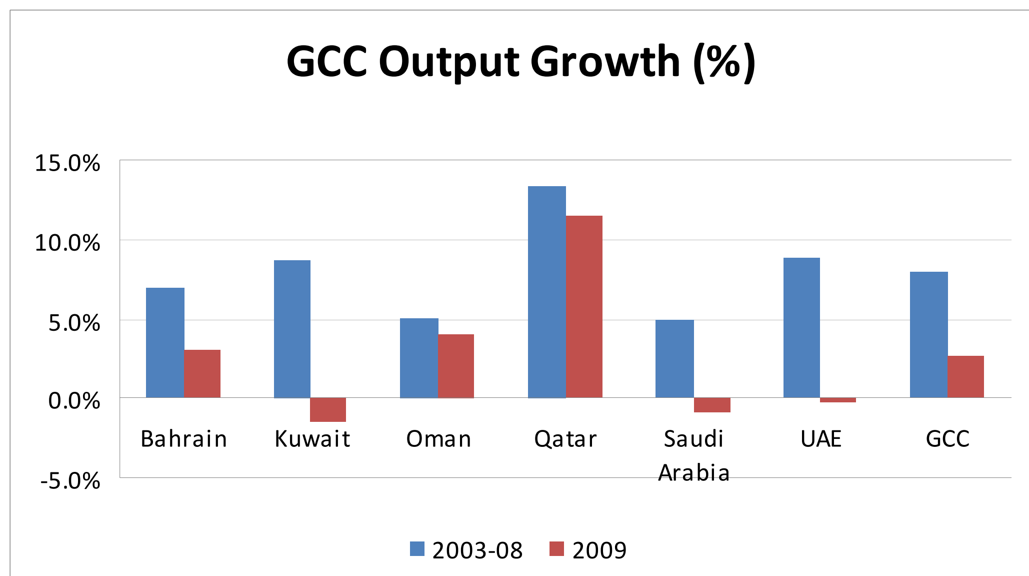
Graph of the Month



The GCC- the end of a commodity cycle

EDITOR'S NOTE:
The Gulf Cooperation Council-Feeling the Cold Winds of the Global Financial Crisis

The Gulf Cooperation Council (GCC) is a regional organization grouping six Arab oil producers of the Persian Gulf (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates). While oil is the common thread of their economies, these countries, with a collective GDP of about $1.1 trillion constitute a diverse group. Saudi Arabia accounts for 65% of the population of about 38 million, while Bahrain and Qatar have each less than one million people. Average income per capita reached $28,500 in 2008, ranging from about $19,000 for Saudi Arabia to $93,000 for Qatar. Saudi Arabia leads oil production with the world's largest oil reserves and production capacity, while Qatar possesses the world's third largest natural gas reserves (after Russia and Iran). Bahrain, on the other hand, with scant hydrocarbon resources, has developed as a regional banking, tourism and services center. Dubai, the UAE's second largest emirate, has also diversified its economy away from oil and has become a major regional hub for trade, finance, services, tourism and transportation.

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The global economic boom and surging oil prices in the first half of the "noughties" underwrote a period of spectacular growth for the GCC. Regional GDP growth averaged 8% a year between 2003 and 2008, regional GDP tripled between 2001 and 2008, reaching $1.073 trillion, and GDP per capita rose by 160%. The GCC's current account surplus rose from $31 billion to $282 billion over the same period, (totaling over $1 trillion over 2001-2008) and the countries accumulated significant foreign assets (both official and private) in the process. Aggregate GCC foreign exchange reserves are estimated at $200 billion at the end of 2009. In addition, it is estimated that regional sovereign wealth funds hold $1 trillion dollars in assets. Inevitably, the surge of oil income, rapid fiscal expansion and global easy money gave rise to regional asset bubbles, both real estate and financial. At the same time, structural reforms and lessons learned have led the governments to use the rising oil and gas revenues more prudently, building up strong fiscal positions

The region did not escape the global financial and economic shock of 2008-2009. Despite some degree of diversification, oil has remained the economic basis of the GCC economy. Oil prices peaked at about $140/bbl in July 2008, and fell sharply in the aftermath of the Lehman Bros collapse, dropping by almost 80% between July 2008 and the end of February 2009 to a low of $30/bbl. Since then, they have recovered, reaching a range of $75-80 per barrel in recent weeks. Regional asset prices also fell sharply as credit dried. The MSCI-GCC equity index fell by 80% between its peak on 1/31/2006 and its trough of 2/27/2009, recovered by 53% by the end of September, but has fallen since as the result of further regional shocks, including the $56 billion default by Dubai World at the end of 2009. Aggregate GCC economic growth fell sharply as a result to 2.7% in 2009.

The oil and global economic and financial shock have been recently compounded by the Dubai World financial crisis, which is a microcosm of the global financial one, involving weakening credit standards, over-leveraging and more generally a high degree of financial hubris by Dubai World and its creditors alike. In the sort term, the Emirate of Dubai has been rescued by its oil-rich brethren, Abu Dhabi, which provided a $10 billion line of credit to avoid default on a major sukkuk (Islamic bond) in December, but both the Dubai government and Dubai World face a long negotiation on the restructuring of tens of billion of debt owed to domestic, regional and international financial creditors.

The region's economic fortunes have been tied to oil and therefore have been subject to repeated economic cycles in the past three decades. However, lessons have been learned and the GCC countries have entered the global crisis in a strong fiscal and external position. Governments are using their reserves to provide significant fiscal stimulus, cushioning the impact of the global slowdown.

Oil prices are expected to remain in the $75-85 range in the foreseeable future, providing a floor for economic activity, which should revive by 2011. In the longer-term, however, the region needs to address its unresolved structural issues, in particular providing jobs for a rapidly rising, young and educated labor force and diversifying their economies away from oil and government-directed economic growth.

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The Changing Dynamic of Family Business in the Middle East and the Gulf: M&A a Potential Scenario for Future Survival

By: Faisal Alsayrafi, ASA, CM&AA, Financial Transaction House

The problems faced by any organization and company; developing successful leaders, mitigating decision-making hierarchies and consolidating company tradition with new generational ideas, are undoubtedly issues that can be magnified in the setting of the family business.

More than 80 percent of businesses in the Middle East are family-run or family-owned, with an estimated USD 1 trillion expected to be handed down to the next generation within the upcoming 5 – 10 years, and with family businesses controlling over 90 percent of commercial activity in the region, as opposed to 65 – 80 percent in other parts of the world, the dynamic and effect of their progression and development is huge. However with studies showing that historically, family businesses are eventually run down after three generations, we may be at a point where many family businesses will need to start looking around for exit strategies or even welcome new turnaround ideas to keep them afloat.

Developing new ways of doing business may be easier said than done for an organization which not only is deeply rooted in tradition, but also in culture and personal values. Over 40 percent of the current family businesses in the Gulf were established in the 1960s or before, with almost all the major employers (5,000 people or more) were founded during that time, thus highlighting both the huge potential, and with it the responsibility, of family businesses to generate employment wealth and welfare. Yet when a recent Ernst &

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Young survey showed that only 16 percent of companies have admitted to having a well defined succession and clear ownership transition plan, it may show that family businesses may soon be looking to restructure or consider alternative routes.

With around 50 percent of family businesses drawing in annual revenues above USD 100 million, and over 15 percent showing annual revenues of over USD 500 million, going public would be the next logical step in the development of the organization, yet only 8 percent of family business are publicly traded. Further, E&Y's survey also highlighted a critical point whereby only 20 percent of companies were planning to stage an IPO in the foreseeable future.

The pressures of changing social values, new technologies and essentially a very young population, whereby 40% of the population is between the ages of 15 – 35 years, make the challenges facing the development of the family business in the Gulf a unique case. However companies are not oblivious to the trend and many have taken the initiative to expand, as 60 percent of family owned businesses have shown a propensity to diversify into new sectors and regions, both in the Middle East and internationally, essentially marking the way into a family conglomerate.

As to whether the family owned organizations in the Middle East have strayed far enough away from the traditionalist managerial styles in order to be able to make a break in Western markets is supported by the finding that 68 percent of regional family businesses select their management team purely based on competence and talent, regardless of family relationship, making it clear that the majority of business have been able to adapt to a point of maturity that is able to separate family relationships from business relationships in a professional manner. Adopting global as well as Western traits into the organizational structure, with many family businesses now inviting non-family members to serve on their boards, shows the willingness to adapt and adopt new perspectives that are ultimately helping to prolong the lifespan of the company beyond the traditional '3 generational limit' as well as amplify the value of the company in the long-term.

Actually, due to their strength and values, many family businesses in the region have shown that they are susceptible to adapting successfully, with various potential scenarios currently being developed at management levels, including cross-border acquisitions and alliances. Expected M&A opportunities are a driver behind the renewed interest in the region, which was temporarily put on hold last year amid the credit crunch on Wall Street, with M&A fees from the region accounting for almost 50% of fees brought in by bankers for the first three quarters of 2009. Growth plans that were put on hold have now appeared to have resumed, and with it family businesses have shown an inclination to start looking abroad, with Germany appearing to be the most targeted country, and the UAE housing the highest number of international acquirers.

A few years ago, although M&A activity in the region saw incredible year-on-year growth, with an increase of 106 percent in deals as recent as 2006, the activity was considered minimal in global terms, with one of the sited blockades being the saturation of the market by family owned businesses. Today, we already see the paradigm shift from hindrance to opportunity, where it is exactly these family-run companies that have become both the targets and initiators in acquisition and alliance deals. Family businesses owners have begun to realize the importance this opportunity presents them, and are heading advice to implement clear and fixed management strategies within the organizations, as many predict they represent the growth drivers for the future.

Based on the above, it is clear to see that the family business model has developed, and is still developing, as it continues to meet various challenges. The internal problems of succession and decision making hierarchy are similar to those seen by family businesses in the US in the 1930s, however the solutions need to be different amongst new management perspectives and technological advances. Family businesses in the Gulf will need to become more aware of the options of M&A and IPOs, and start by building strong corporate governance, that will help it survive, and be effective for future generations in order to establish continued presence and growth.

Financial Transaction House

FTH was the 3rd Corporate Finance firm to be licensed by the CMA in Saudi Arabia. FTH has over 15 years of experience in Arranging and Advisory Services, including IPOs, Rights Issues and M&A. FTH is also a member of Global M&A, widely recognized as one of the world's leading partnership of independent merger and acquisition houses, where we are the exclusive partner for the Gulf Region and Yemen.

FTH was founded by Faisal Alsayrafi in 1994. Among many other designations, Faisal has also recently earned the prestigious ASA designation conferred by the American Society of Appraisers and is an Accredited Senior Appraiser (ASA). Mr. Alsayrafi is the first and only Arab investment banker to complete and pass the ASA's stringent experience and examination requirements.

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