The Economist INTELLIGENCE UNIT

A report by The Economist Intelligence Unit

LEADERSHIP AMID TRANSFORMATION:
Business opportunities and risks in the Middle East

Sponsored by:

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Executive summary

Operating a business in the Middle East requires executives to navigate an exceptionally challenging geopolitical and macroeconomic environment while dealing with unique labour and technological considerations on the ground. This often requires managing expectations against reality. The aim of this report is to dispel regional business myths and take an evidence-based approach to assessing business opportunities and risks. We have identified these through a survey of business executives in the Middle East, complemented with in-depth interviews. This report presents these findings, along with strategies businesses are adopting to navigate these unchartered waters.

Business leadership in the Middle East

- Not swayed by short- and medium-term geopolitical risk factors
- Recognise changes to long-term oil market dynamics and strongly advocate for economic diversification
- Expect positive economic spillovers from mega events such as Dubai's Expo 2020 and Qatar's FIFA World Cup 2022
- Plan to capitalise on the digital transformation under way in their countries:
    - Designing trials to deploy advanced technologies, such as artificial intelligence and blockchain, in key areas of their business
    - Creating new job opportunities by upskilling employees and hiring new talent for implementation of advanced technologies

Priorities for the future:

- Participate in economic initiatives
- Explore markets for expansion in the Middle East and beyond
- Identify evolving consumer preferences of digital natives
- Accelerate adoption of advanced technologies
- Create opportunities for a virtual workforce
- Understand and respond to climate change risk

Key findings include:

- **The region's business executives appear not to be swayed by short- and medium-term international and regional geopolitical risk factors.** Respondents were more concerned about short-term macroeconomic risks such as oil price volatility (61% of respondents), changes to domestic tax structures (55%) and exchange-rate volatility (52%). Although Gulf Co-operation Council (GCC) tensions with Qatar were cited by 47% of respondents, it was only perceived as a lower level risk. The Economist Intelligence Unit believes that the boycott of Qatar by Saudi Arabia, Bahrain, the UAE and Egypt will continue over the medium term, as close ties with Iran are unlikely to be radically reformed over the next five years, a major point of contention. Furthermore, as the oil and gas industry in Qatar has largely been unaffected and they have taken steps towards self-sufficiency, the economic pressures of the boycott have been limited. Longer-term geopolitical events such as the ongoing conflicts within Yemen and Syria as well as the US withdrawing from the Iran nuclear deal were cited as having no direct impact on their business by a majority of respondents. However, respondents were concerned by the risk posed by civil unrest in the country they are located in (45%).

- **Executives recognise the longer-term shifts in oil demand and supply and the risk of continued reliance on oil for economic growth. They strongly advocated for economic diversification to reduce the region's exposure to oil price volatility.** With the exception of the infrastructure and energy sectors, all other sectors broadly support continued reform with between 40% and 56% of respondents in each sector viewing a slowdown in economic diversification as a risk.
- **Short-term mega events in the region (Expo 2020 and the World Cup in 2022) are perceived to bring positive spillovers.** Respondents believe the economic benefits of Dubai's hosting of Expo 2020 will be felt beyond the UAE's borders—the event was cited as an opportunity by more than 60% of respondents in Saudi Arabia, Kuwait, Jordan, Egypt and Oman and Bahrain. Larger companies responded more positively to these mega events than smaller companies.
- **The UAE, Saudi Arabia and Egypt continue to be sweet spots for business operations in the Middle East.** Market size and level of political stability are the key factors facilitating business expansion in the region. A key impediment to expansion in the Middle East is fierce competition from domestic players, as business is still highly driven by personal networks and implicit state support in some cases. Beyond the Middle East, executives prefer expansion into Asian markets (particularly India and China) over East Africa.
- **The vast majority of respondents believed that advanced technologies such as artificial intelligence (AI), the Internet of Things (IoT), robotics and blockchain will have a positive impact on business operations.** Building on digital transformations under way in their countries, survey respondents expect to see these implemented across the region in three to five years, and some are already taking steps to prepare for their adoption. Over 55% of respondents have taken five or more steps to prepare for the adoption of advanced technologies. Upskilling employees (71% of respondents) and hiring new talent (66%) were prioritised over investments and redesigning business practices.
- **Region-wide interviews indicate that more needs to be done to accelerate the pace of adoption of advanced technologies.** Interviewees attribute the slow adoption to limited understanding among senior management of advanced technologies, although the survey identified high capital investment, cyber-security risks and the skills shortage as greater impediments. Our survey revealed that non-C-suite respondents are more likely to recognise that advanced technologies will increasingly disrupt their business than the C-suite.
- **Financing instruments remain focused on traditional and Islamic bank financing mechanisms, according to 93% of respondents.** Alternative funding mechanisms like peer-to-peer, crowdfunding, private equity, private debt and venture capital are largely underdeveloped in the region.

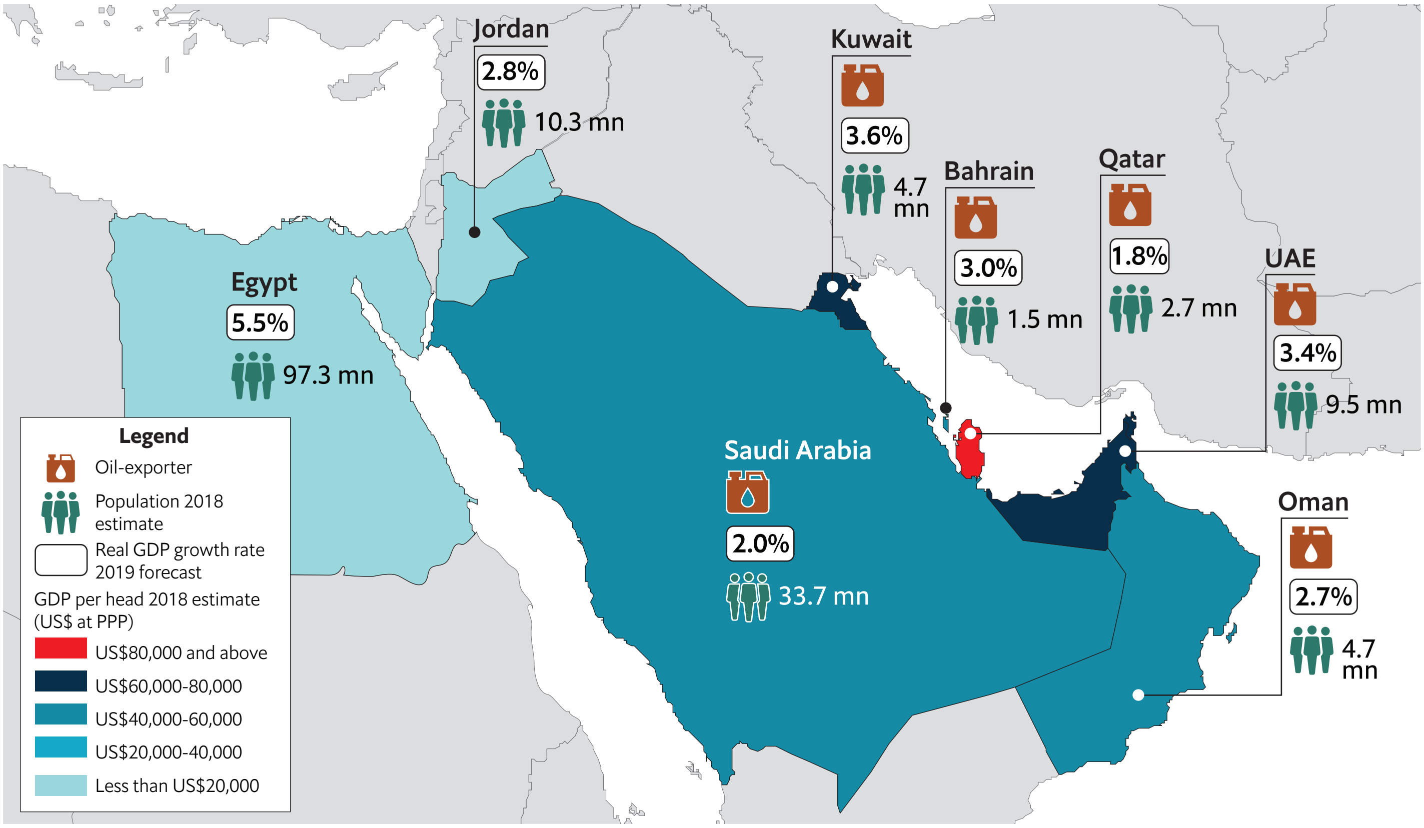
Chapter 1: Macroeconomic and geopolitical frameworks

According to Economist Intelligence Unit forecasts, global economic growth will decelerate from an estimated 3% this year to 2.7% and 2.5% in 2019 and 2020 respectively. This is due to a number of factors: tighter credit conditions due to monetary policy normalisation in developed markets, an economic slowdown in China and the US, commodity price volatility, rising protectionism and threats of full-fledged trade wars, and rising geopolitical risks. Globally record-high levels of corporate and sovereign debt (as of the first quarter of 2018),[1] have also raised concerns about a market correction.

These factors have contributed to significant capital outflows from emerging markets, weakening emerging market currencies.

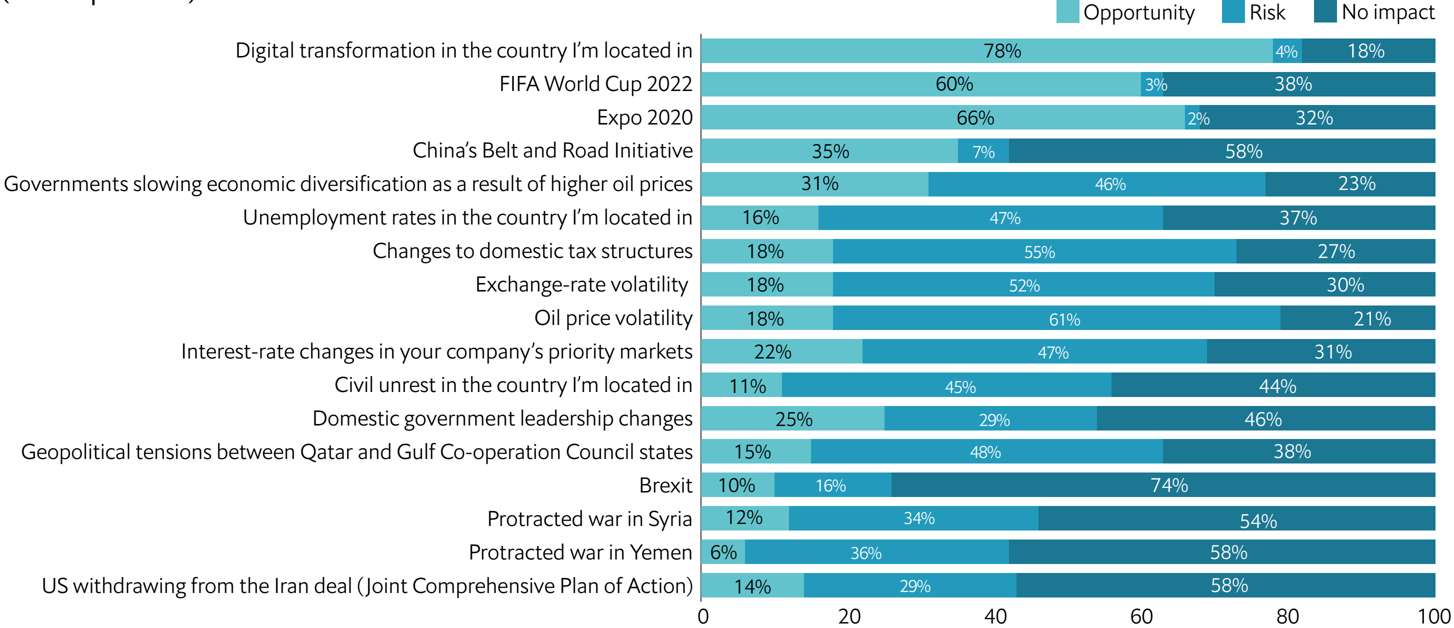
In the Middle East, global macroeconomic risks are compounded by an additional set of challenges. The region's diverse political dynamics and dependence on natural resources, as importers and exporters, has resulted in the countries of the region being at very different stages of development and with varying economic performance. The divergence is represented in the Economist Intelligence Unit's

Figure 1: Vital stats: Key economic indicators for select countries in the Middle East



Source: The Economist Intelligence Unit

Figure 2: Macroeconomic and geopolitical opportunities and risks in the Middle East
(% of respondents)



Source: EIU survey.

Business Environment Rankings 2019-23: the UAE (ranked 25th out of 82 economies) and Qatar (34th) are among the most attractive Middle East investment destinations; Egypt, ranked 65th, continues to be dragged down by poor governance and a poor regulatory environment. Intensifying geopolitical risks, including the ongoing conflict in Yemen and regional tensions with Qatar and Iran, are additional challenges that investors and business executives in the Middle East are expected to factor in.

Although geopolitical tensions affect regional governments through the economic opportunity cost associated with disruptions and wars, it appears for many executives simply to be a case of business as usual.

The region's business executives appear not to be swayed by short- and medium-term international and regional geopolitical risk factors. Although such events negatively affect regional governments through the economic opportunity cost associated with regional disruptions and wars, it appears for many simply to be a case of business as usual. More than half of the executives we surveyed see broad international and regional geopolitical risk factors, particularly unresolved conflicts in Yemen and Syria, as well as the US withdrawing from the Iran deal, as having no direct impact on their business. A senior executive at a Saudi conglomerate says, "for a long time, I don't think we're surprised by what's happening. There's always been some form of geopolitical tension or war."

Regional executives are much more concerned with shorter term macroeconomic risks:

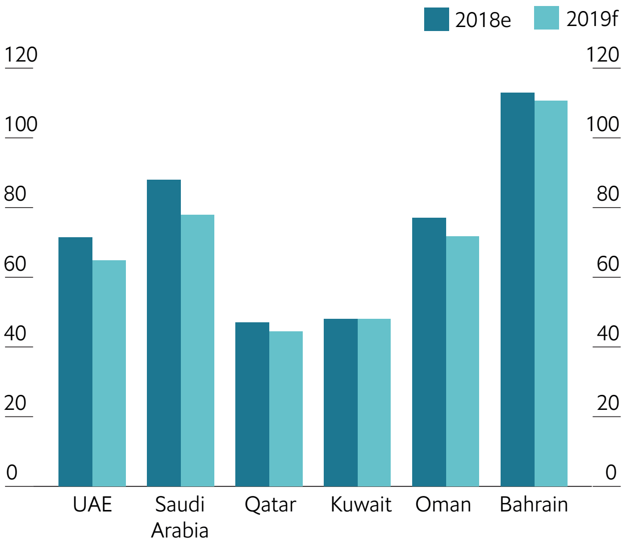
Oil price volatility

Exchange-rates volatility

Interest-rate changes in company's priority markets

However, executives were much more concerned with shorter term macroeconomic risks. Exchange-rate volatility and interest-rate changes were among the chief concerns. US monetary policy tightening and the rise in the dollar have been

Figure 3: Breakeven oil price for oil-exporting countries in the Middle East (US$ per barrel)



e = estimate
f = forecast
Source: International Monetary Fund. https://www.imf.org/~/media/Files/Publications/REO/MCD-CCA/2018/May/English/mreo0518-statistical

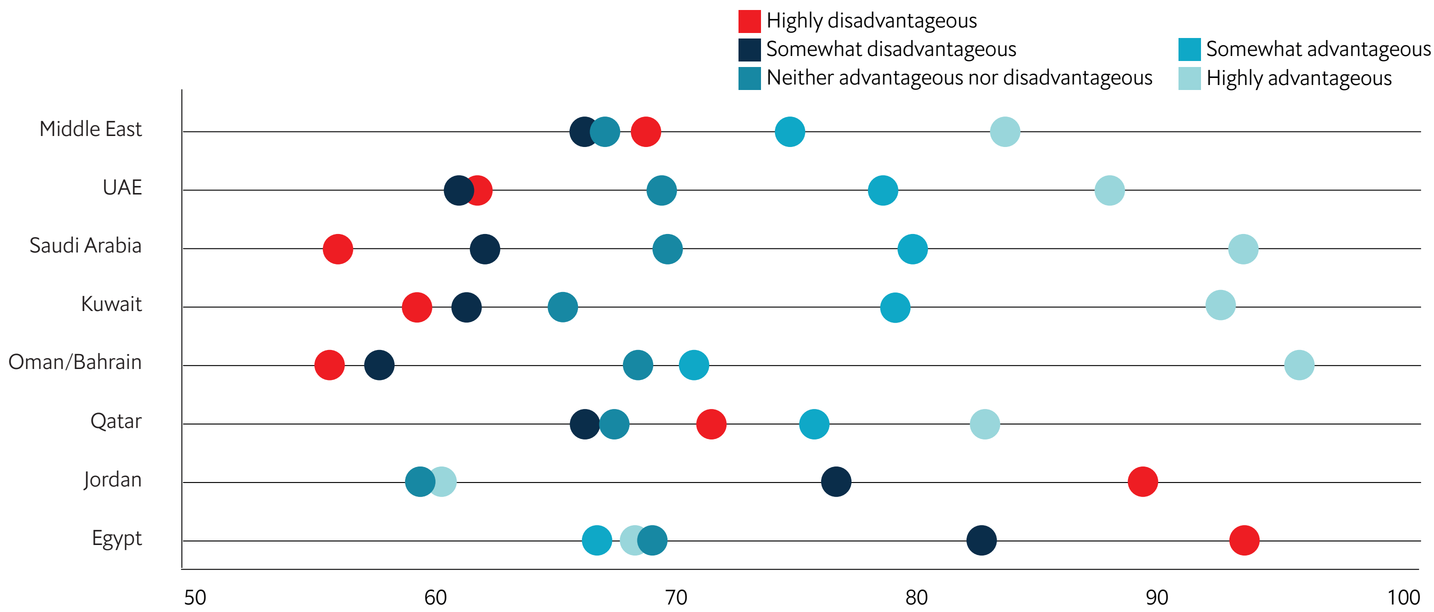
associated with a tightening in financial conditions in many emerging-market economies. It is a particular problem for countries with pegs to the US dollar (UAE, Saudi Arabia, Oman and Bahrain), as it means that the cost of capital must go up in these countries, therefore weighing negatively on their growth outlook.

Another notable concern for regional executives is changes to domestic tax structures, with 27% citing this as their primary concern in the short term (ie, 12 months or less). This view may be influenced by the introduction in 2018 of the 5% value-added tax (VAT) in the UAE and Saudi Arabia and the expected introduction of a VAT in Oman and Bahrain in 2019 and in Kuwait in 2021. If this tax is deemed successful, it opens up the possibility of regional governments increasing VAT rates or even introducing new forms of taxation. These countries have largely been considered low-tax environments, and such fiscal policy measures may reduce their attractiveness as investment destinations. It is therefore important for governments in the region to weigh this potential loss in investment and associated activities against the benefits of diversifying revenue sources.

The carbon conundrum

Oil price volatility remains the top concern for regional executives (cited by 61% of respondents) signifying the region's continued reliance on oil revenue. Among the oil-exporting countries, nearly half of respondents in Oman and Bahrain considered oil price volatility a "significant risk" while the response in the UAE, a more diversified economy, was somewhat more muted, with 57% of respondents considering it "somewhat of a risk".

Figure 4: Oil price threshold for Middle East businesses



Source: EIU survey.

Executives in oil-exporting countries are looking for prices above US$66 a barrel, with prices above US$75 a barrel seen as most advantageous. Across the Middle East, there are variations across sectors: respondents from the infrastructure/energy and financial services sectors are the most likely to believe that higher oil prices are better, given that governments still remain the primary source for industrial and infrastructure spending, whereas those in tourism tend to prefer lower oil prices. These prices reflect the continuing high break-even price, as government budgets and economic activity remain directly and linearly dependent on oil prices. Such dependence will make fiscal and structural reforms harder as social pressures build; respondents cite civil unrest in their own countries as a risk.

Interestingly, the highly advantageous oil price for oil-importing Jordan and Egypt was slightly higher than the somewhat advantageous price, which points to possible expectations of financial support from Gulf states, higher remittances from workers in those countries, and greater capital repatriation from domestic businesses operating in those states.

However, given that oil prices are likely to continue to experience sharp volatility in the longer term due to global shifts in demand (eg, due to the growth in renewables and materiality risks forcing global investors and banks to reduce their exposure to carbon-producing industries) and in supply (eg, US supplies), regional governments will need to focus on diversification for longer-term growth. The experience of 2014-2016, when the oil price dropped by 70%,[2] has driven efforts to try to diversify away from oil, including the simplification of rules for foreign direct investment (FDI) and a substantial reduction in the state's role in the economy, for instance in infrastructure spending. However, given the subdued long-term prospects for oil, the policy response needs to be strengthened in oil-exporting countries if they are to attract private-sector financing to ensure economic sustainability.

Foot on the accelerator

The need for diversification becomes clearer when societal impact is taken into consideration. Respondents are concerned by the potential for domestic civil unrest, with 26% seeing this as a significant risk. Particularly in Saudi Arabia, the ambitious plans for economic diversification outlined in the original National Transformation Program published in 2016 have recently been scaled back, lowering targets for unemployment and backtracking on cuts to public-sector salaries.[3] Oil-importing countries have also been negatively affected by the oil price shock, given their dependence on remittances, investment and aid from the Gulf countries. With the exception of the infrastructure and energy sectors, all other sectors broadly support continued reform, with between 40% and 56% of respondents in each sector viewing a slowdown in economic diversification as risk.

Stergios Voskopoulos, general manager and head of investment at Kanoo Capital, the investment arm of the Bahrain-headquartered conglomerate YBA Kanoo Group, highlights that timely execution is critical and advocates for governments to keep forging ahead: "If it's successful, then the future is very bright for the region. Even where unemployment rates are high, like Egypt and Saudi Arabia, supported with the right level of training and education, this might actually turn to be very positive because both countries have very young populations."

Sources of short-term opportunity may arise from mega events like **Expo 2020** in Dubai (cited by 66% of respondents) and the **FIFA World Cup 2022** in Qatar (60%). Of the two upcoming mega events, the former was viewed more favourably—a higher share of respondents cited Expo 2020 as an opportunity in all countries surveyed apart from Qatar (a likely result of the boycott led by some Gulf states). Businesses perceive that these events will drive activity across multiple sectors—mainly tourism, IT, retail and finance—resulting in a multiplier effect in the host country and a positive spillover effect across the region.

In our survey, larger companies have responded more positively to Expo 2020, but there has been a commitment to support small- and medium-sized enterprises (SMEs)—20% of the project budget AED25bn (US$6.8bn) is to be spent on SME vendors, and of the 2,400 contracts awarded up to November 2017, 50% have been awarded to SMEs.[4] "[And so] anything that promotes SMEs and entrepreneurship in the region is impactful and will be viewed positively," says Jennifer Warren, founder and managing partner of AtlasX Ventures, an investment advisory company in the UAE.

However, regional businesses do not appear to be thinking about the longer-term impact of mega projects like **China's Belt and Road Initiative** (BRI) on economic and business growth in their countries—58% of respondents stated that it would have no impact on their business. Just over a third cited it as an opportunity, with executives in Jordan, Egypt and Qatar showing the least interest. Particularly surprising was the short-term focus of infrastructure/energy companies; a higher proportion cited Expo 2020 and the World Cup as opportunities compared with the BRI (49% and 44% versus 34%, respectively).

This could largely be attributed to limited knowledge of the project, particularly relative to other opportunities in neighbouring markets. More information on specific opportunities for local business may change opinion on this. Efforts to develop stronger ties with China are under way in countries like the UAE, where the recent visit of the Chinese president, Xi Jinping, was well-received across a range of sectors.

In the long-run, executives are most optimistic about the digital transformation under way in their countries. Sources of short-term opportunity may arise from mega events like Expo 2020 in Dubai and the FIFA World Cup 2022 in Qatar.

In the long-run, executives are most optimistic about the **digital transformation** under way in their countries. Governments in the region are taking efforts to improve the digital infrastructure and services in their countries, with some working towards building 5G networks, setting up open data platforms and offering online government services, among others. To capitalise on this, companies need to look closely at their own digital transformation strategies, explored in more depth in Chapter 3 of this report.

Diversification is a long-term strategy; the effects on the economy will not be instantaneous. Governments in the region are becoming more creative by implementing measures for alternative sources of revenue (such as VAT and taxes on sugary drinks). But funds raised through these means, some executives say, have yet to translate into increased government spending.

From our survey results and in-depth conversations with senior executives, we see how the geopolitical and macroeconomic landscape is defining business expectations and operational strategies. Risks at this level have a direct impact on the level of FDI as well as the access and cost of finance for expansion. In the next chapter, we will focus on how geopolitical tensions and political stability have a bearing on the choice of markets to expand into.

In the third chapter, we shift our focus to the internal business environment. Changes to the regulatory environment are at the forefront in the short term, but the advent of advanced technologies and its impact on the business seem to be concerns for the medium to long term.

Chapter 2: Market expansion: Across the Middle East and beyond

More than half the respondents currently operate in two key markets in the Middle East—the UAE and Saudi Arabia—followed by Kuwait and Egypt (about 40% of respondents). Executives were most interested in accessing the markets of Kuwait and Oman, with a slightly lower share interested in Qatar and Bahrain.

Two factors underpin this interest in the UAE, Saudi Arabia and even Egypt. Saudi Arabia and Egypt are among the two most populous states, with about 34m and 97m people respectively, providing businesses with economies of scale and scope in retail, financial services and healthcare in particular. In Saudi Arabia, changes to social norms—from allowing women to drive to the recent reopening of cinemas after decades—are creating more opportunities for businesses in the automotive, retail and leisure industries.

Ms Warren explains (in an interview conducted prior to the current diplomatic fallout between Saudi Arabia and Western governments over the murder of a Saudi journalist, Jamal Khashoggi, the impact on business of which The Economist Intelligence Unit predicts will be short-lived): "Saudi Arabia is a key market with untapped potential in the Gulf region, particularly for consumer-driven businesses. This means that investors largely prefer businesses that can achieve scale in Saudi, either with an existing footprint or plans to expand." The second factor is high levels of disposable income—the UAE, Saudi Arabia, Kuwait and Qatar are among the wealthier states in the Middle East.

Despite the attractions of growing populations and disposable income, regional executives take a cautious approach to these markets. Mr Voskopoulos explains their approach to Egypt: "It's over 90m people and so we keep an eye on Egypt, even though political instability in the past ten years also hurt us a bit. We want to be very, very careful calculating well all risks we take." Political instability and the risk of social unrest (cited in particular by executives in Egypt, Oman and Bahrain) is thus a key consideration.

Geopolitical tensions and ongoing conflicts have ruled out some markets for executives. Over 70% of respondents indicated that they were not interested in accessing Syria or Yemen. More than two-thirds of respondents put Iran on that list too. Although 52% of respondents felt that US withdrawal from the Iran deal had no impact on their business, their lack of interest in the Iranian market likely stems from regional rivalries between Saudi Arabia and Iran, the most prominent manifestation of which is the proxy war in Yemen.

While the strategy with some markets is clear, opinions over Qatar are mixed. Many companies across the Middle East had well-established operations in Qatar (close to 40% of respondents currently operate there). The diplomatic crisis between some of the GCC states and Qatar have meant that, in many cases, operations are on hold in the hopes of a speedy resolution. However, The Economist Intelligence Unit expects this boycott to continue to 2023 and beyond, as Qatar's close ties with Iran—the main point of contention—are unlikely to be radically reformed in the medium term. In addition, Qatar's critical oil and gas industry has been largely unaffected and the country has taken many steps towards self-sufficiency, encouraging local and international companies to invest in production facilities in the food and commodities sectors especially. Combined, these limit the economic pressures of the boycott.

While across the region a little less than half have cited geopolitical tensions with Qatar as a risk, the percentage for the UAE is much higher at 75% (although two-thirds of the 75% described it only as "somewhat of a risk"). One example of the impact on UAE businesses is that shipping trade to Qatar that used to be routed through the UAE is now routed through Oman.[5] The concern among UAE-based executives was far higher than any other country (less than half the respondents in other countries cited this as a risk), including those in Qatar (58%).

The muted concern expressed over Qatar reflects the regional approach to long-standing geopolitical tensions—that this should just be approached as business as usual. A senior executive from Saudi Arabia explains: "we have [always] been navigating through such [geopolitically risky] situations; this is our turf, so we have to adapt and figure out [the right direction for the business]."

Nearly two in five respondents expressed no interest in expanding into Turkey, attributable to the recent currency and debt crisis, as well as tense political relations with Saudi Arabia and Egypt. But just over a quarter of respondents see an opportunity: to buy it cheap and "hold" for the long-term. This is supported by The Economist Intelligence Unit's long-term positive economic growth outlook for Turkey, which is expected to be above that of other emerging markets such as Brazil, Russia and China between 2018 and 2050.

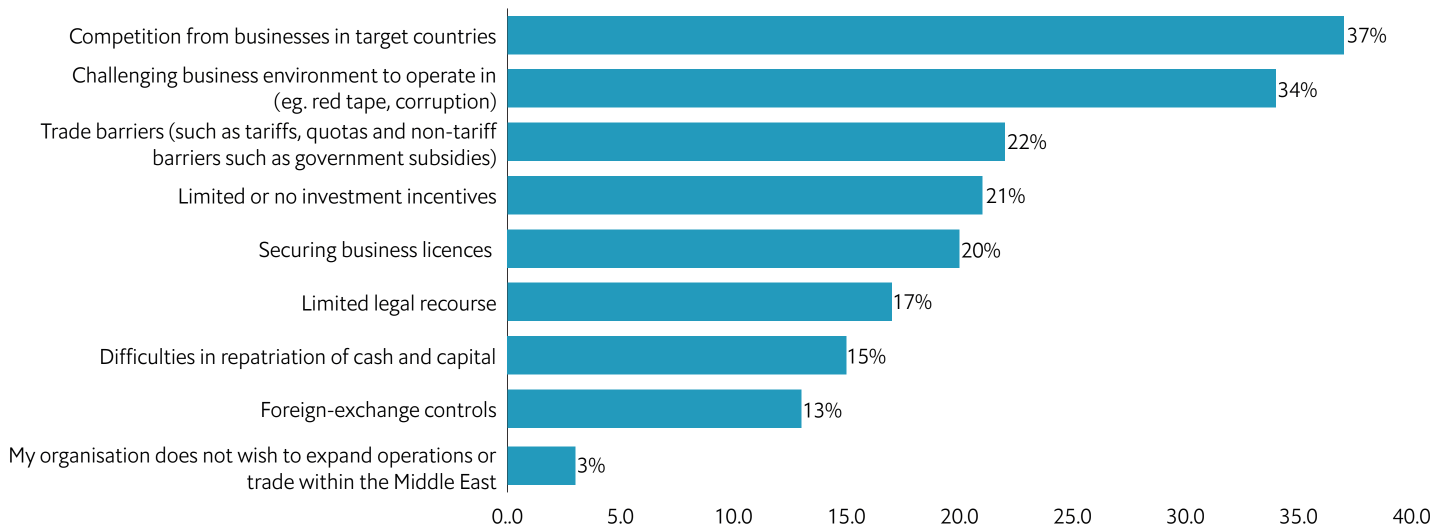
Similarly, interest in Lebanon was mixed: nearly half of respondents indicated no interest in accessing the market, probably due to the current political quagmire and spillover effects of the war in Syria. But the presence of a skilled workforce and lower costs compared with the GCC markets, experts believe, make it an attractive market for 22% of respondents.

Hurdles to overcome

Despite a clear desire for scale, there are a few key impediments keeping ambition in check. The greatest impediments were **competition from local businesses** (cited by 37% of respondents) and a **challenging business environment** (34%). These were the top two challenges cited by executives in all countries, except for Qatar, where the top concern was trade barriers, likely those put in place following the diplomatic crisis with Saudi Arabia, the UAE, Egypt and Bahrain.

Taken together, these heavily restrict a business's ability to access new markets and drive business growth. A challenging business environment is not only limited to long delays in securing business licences and setting up offices to start operations, but extends to limited information on market demand, key vendors and upcoming regulatory changes to compete effectively. The nature of competition in the region explains why it is the top impediment—business is highly reliant on personal networks, and, to an extent, implicit government support behind certain players across sectors

Figure 5: Impediments to business expansion within the region



Source: EIU survey.

in each market such as construction, finance, healthcare, infrastructure and energy. Competing in this environment requires a different strategy.

Dilshaad Ali, group CEO of AVIVO Group, a healthcare company headquartered in the UAE, shares two ways in which his company was able to clear these hurdles. In Saudi Arabia's crowded healthcare sector, the is to go in offering premium, niche services. They are offering high-end aesthetic surgery and dental practices rather than primary healthcare services for the masses. "This fills those gaps in the middle where there is a high demand and decentralises healthcare to a certain extent, which is normally hospital-dependent," says Dr Ali.

Domestic investors with strong internal networks and local knowledge can also play a vital role in the level of access a company may achieve. AVIVO's investors include sovereign wealth funds in the GCC, which reduces barriers says Dr Ali. "[In addition] we have partners [and investors] who are on the ground who are more familiar with the situation and can advise us," he says. These networks can have a bearing on how quickly paperwork is processed as well as their ability to secure prime locations for their facilities.

Financing business expansion

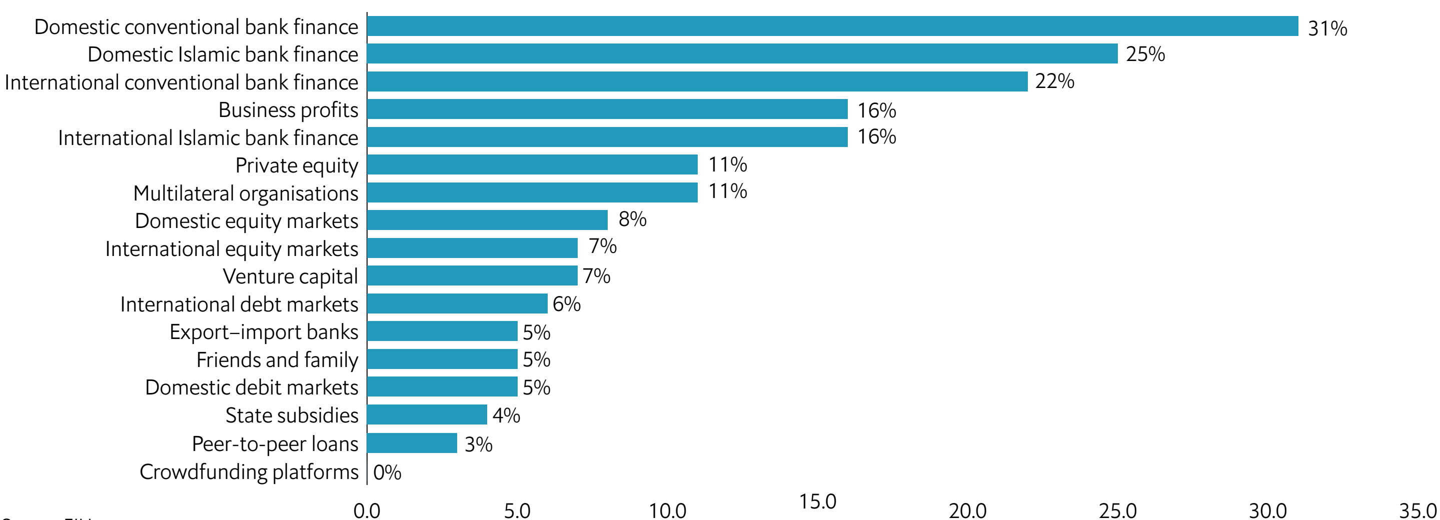
Part of the struggle that businesses face in accessing new markets and growing their business is the limited number of financing options. The vast majority of businesses turn to conventional and Islamic bank finance (93%), with Islamic finance being prevalent in Saudi Arabia and limited in other parts of the region.

The reliance on bank finance, says Vijay Raghavan, group finance director of ARENCO, is due to the "availability of cheap and easy financing for big groups in this market and the comfort of working with the local bank. So there is no real need for us to scrounge around for other options."

Both large and small companies rely upon domestic bank finance—65% of companies with annual revenue under US$500m selected domestic bank finance compared with 45% of companies with annual revenue above US$500m. Larger companies have more varied sources of funding, including greater access to international banks and multilateral organisations, than smaller firms do.

Financial market development remains limited in the region. **Equity markets** are fragmented and often illiquid. The reluctance to use equity financing may be due to many businesses in the region being family-owned, averse to diluting ownership or publishing their financials as required by listed firms. Home-grown businesses often use profits to support expansion plans, cited third in the region in "accessible funds for expansion" (16%).

Figure 6: Sources of finance most accessible for expansion



Source: EIU survey.

Corporate debt is used only by a small minority of respondents (12%). Non-sovereign debt capital markets represent the smallest proportion of financial markets in the Middle East. According to Maher Hammoud, the head of private equity at Olayan Financing Company in Riyadh, "the regional institutional buyer base is relatively small, regional sovereign funds tend to invest abroad to diversify their exposure and international investors' appetite for regional debt instruments is subdued. Demand from regional institutional investors, such as insurance companies and pension funds, will eventually become bigger but it will take time." Development of deep, liquid and broad local currency debt markets would enable more diversified funding structures, especially beneficial for firms undertaking long-term projects (like infrastructure).

Alternative finance vehicles like **private equity** (PE) were more accessible for those in Egypt (19%) and Oman/Bahrain (17%) than those in other countries. Experts we spoke with consider private equity to be underdeveloped, although there are issues around measuring the scale of private equity. Private equity investments are driven largely by family offices, especially in the GCC, which are often not included in formal statistics.[6] **Venture capital** (VC) was only cited by 7% on average.

According to the MENA Private Equity Association, though VC and PE have been evolving as a popular asset class among regional investors, fundraising has been a major challenge—it was estimated to have fallen below US$500m in 2017 after an already low US$582m total in 2016. Ms Warren believes that local investors are "looking for Silicon Valley type unicorns and there is not yet enough depth in local markets for many businesses to reach that scale".

The regional economic slowdown, external views on geopolitics and the inability of some players to exit and recognise profits on vintage funds[7] act as major drawbacks.[8] Furthermore, the region's PE sector is still suffering from reputational damage following the Abraaj Capital scandal; the region's largest private equity firm filed for provisional liquidation after it emerged that money from a healthcare investment fund had been used for corporate purposes.[9]

Despite a positive view of digital transformation and fintech development in the Middle East, **peer-to-peer lending and crowdfunding platforms** have not yet taken off as major new financial resources. This may be less about accessibility and more to do with the size[10] of firms surveyed—these tools are largely considered solutions for start-ups that are unable to access more formal sources of finance (such as bank financing or venture capital). Supportive government policy that fosters an innovation-friendly ecosystem, a favourable regulatory environment and a growing appetite for fintech products will probably increase interest in this financing mechanism. But the limited interest in these tools may also be a reflection of companies' reluctance to move out of their comfort zone, preferring bank finance or institutional investors, says Dr Ali. "[Institutional investors] usually bring larger [investments] and you have a smaller cadre of shareholders that you need to manage," says Dr Ali.

Beyond our shores

When it comes to expanding overseas operations or increasing non-Middle Eastern trade, businesses are considering Asia over East Africa. India and China were cited as countries of interest by 40% and 32% of respondents, respectively, followed by East Africa with 28%. Interest in India is strongest in Kuwait and Oman/Bahrain, and weakest in Jordan and Egypt. Interest in China is strongest in Jordan, followed by Oman/Bahrain (nearly a third ranked China as the first priority market, significantly higher than other countries).

Proximity to African markets helped the Middle East position itself as a hub for doing business there. However, the fact that East Africa was not viewed as favourably as India and China is indicative of the challenges on the continent. As Ms Warren noted, African countries are largely disjointed when it comes to their local requirements, infrastructure capabilities and regulatory frameworks, making it more challenging for businesses to scale as rapidly as they could in more sophisticated markets. But East Africa remains a priority over more distant emerging markets such as West Africa and Latin America, with about only one in ten interested in those regions. Efforts to improve market knowledge may help promote expansion into these regions.

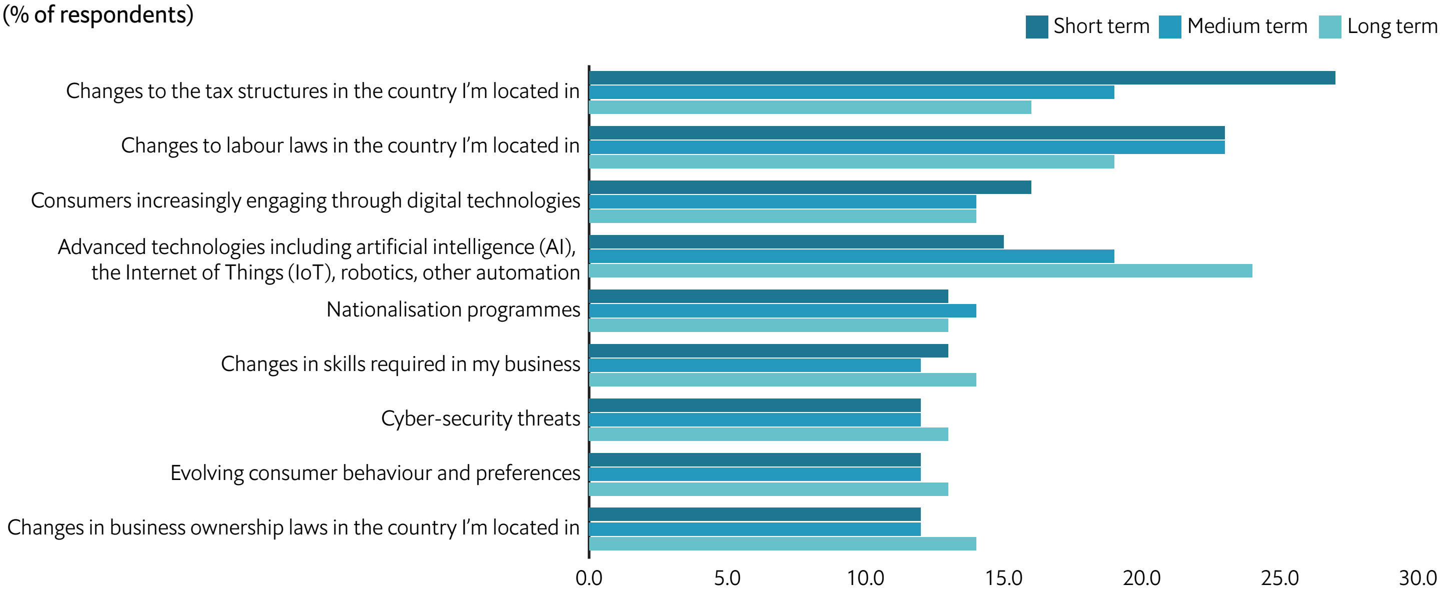
Chapter 3: Success amid disruption

As business executives in the Middle East navigate through a complex external environment, internal business operations are also under pressure as a result of industry-wide disruption. Globally, businesses are preparing for a wave of technology-driven disruption, which is changing the very nature of their industries—from ride-hailing companies competing with public transport to e-commerce platforms competing with food retail and cloud computing. "There could be challenges [with changes in technology] because people are used to the current business model, which has been the same for the past 50 to 60 years," says a senior executive in Saudi Arabia. "When you change it, there could be risks that we need to manage."

But this is not the sole concern for executives in the Middle East. Survey respondents selected a mix of technological and regulatory factors that they believe will most disrupt business operations and their industry over the short, medium and long term. Over the short term, executives are most concerned with changes to tax structures (27%), changes to labour laws (23%) and consumers increasingly engaging through digital technologies (16%).

The concern around possible **changes in tax structures** seems to reflect an understanding that as governments in oil-exporting nations reduce their reliance on oil revenue as the primary budget source, they are more likely to consider introducing a range of taxes (such as VAT and taxes on sugary goods and tobacco). However, concerns around tax dissipate over time. This may be due to the belief that as these economies diversify, governments will have new sources of revenue and may not necessarily have to look to further tax expansion. Recent **changes to labour laws**, such as the change to employee guarantees in the UAE and programmes to hire nationals over expatriates in Saudi Arabia and Oman, are changing labour market dynamics in the region. The need for structural reforms will also influence the development of future labour market policies.

Figure 7: Top factors executives believe will most disrupt their business in the short term, medium term and long term
(% of respondents)



Source: EIU survey.

Consumer engagement via digital technologies is more of a short-term concern. This may reflect the fast pace of changing consumer behaviours and expectations. Executives we interviewed emphasised the importance of **engaging with the millennial consumer** through digital technologies. In our survey, this was cited by a higher percentage than the regional average in the IT, tourism and retail sectors. This is becoming important in business planning too. "[Consumer] habits are easier to track with the recent technology advances," explains Abdulla Aujan, the executive chairman of Aujan Coca Cola Beverage Company. "Online shopping and other digital interactions have been very interesting in terms of allowing us to find ways to sell our products to the consumer." Surprisingly, only 12% of those in the financial services industry cited this as an immediate concern, but this grew to 16-18% in the medium to long term, as the adoption of more advanced technologies, such as robo-advisers, once again change the way the industry interacts with consumers.

It appears that executives in the region have not yet come to terms with the impact of **climate change risk** to their businesses. While about 11% acknowledged climate change as a risk to their business in the medium and long term, the prospect of any climate change regulation in the short term was not perceived as a disruption (cited by less than 5%). However, as governments, regulators, and companies around the world set sustainability targets and are forced to respond to more economic disruption due to growing incidences of severe weather-related events, it is essential for the region to follow suit. This goes beyond just renewable energy production and includes targets for energy and water conservation, adoption of sustainable production practices and better waste management, among others. Businesses need to account for the physical and transition risks stemming from climate change and what it means for the sustainability of their business, particularly if there are significant material risks to their operations, including possible stranded assets. Governments across the region need to realise that to be able to achieve national development plan targets, participation from the private sector is imperative.

The **emergence of advanced technologies** (including AI, the IoT, blockchain and robotics, among others) grew in importance in the medium to long term (selected by 19% of respondents as a disruptor in the next 1-3 years and 24% in the next 3-5 years). The increase in importance over the long term was more pronounced in the manufacturing and infrastructure/energy sectors, given that these technologies may be adopted on a larger scale in capital-intensive factories and energy production than in other labour-intensive industries. The percentage of respondents citing advanced technologies as a disruptor more than doubled in Kuwait between the short-term and the long-term and doubled in Saudi Arabia and Oman/Bahrain.

Although some organisations have deployed advanced technologies, these are mainly limited to government entities and multinationals. Prominent examples include Dubai Healthcare Authority trialling AI to detect diabetic retinopathy[11] and S&P Global Platts using blockchain for collation of Fujairah oil inventory data.[12] Some senior executives interviewed are keen to "wait and see" and advocate keeping a close eye on more advanced markets where these technologies are being rolled out. But others are more proactive. Dr Ali of AVIVO Group described a blockchain trial under way to bring patient medical information available in different parts of the business onto a single platform.

Proof of concept exercises are important because, although advanced technologies were cited as disruptors, executives perceive these to have a positive impact across all aspects of their business. Three areas where they expect significant benefits from the adoption of these technologies are technology infrastructure management (83%), sales and marketing (81%), and developing products or services (81%). Overall, this paints a picture of businesses that are excited about the potential positive impact of digital transformation but still consider it an abstract concept likely to materialise only in the medium to long term.

Preparing for the Fourth Industrial Revolution

Many executives interviewed advocated for a more proactive approach to technology adoption. "Technology doesn't wait," says Mr Voskopoulos. "Technology changes every minute, so you have to be really determined to drive things through a new era where change is exponential."

A big part of this is educating senior management. **Better understanding of advanced technologies among senior management** was the top choice for factors required to ensure business success amid industry disruption in the next five years. Although high capital investment and cyber-security risks were cited as top impediments to the adoption of advanced technologies, some experts disagreed. "It's not cost related," says Mr Voskopoulos. "It's more about the mentality because most people resist change, especially if you are from an older generation and have learned how to operate in a certain way." Results from our survey reinforce this: non-C-suite respondents are more likely to recognise that advanced technologies will increasingly disrupt their business than the C-suite.

The impact of the adoption of advanced technologies on jobs is an important consideration though, with some experts around the world predicting mass unemployment as a result. But Mr Voskopoulos dispels concerns about the loss of jobs: "Technology is a tool. Technology will not take jobs from people. Technology is not something that we should be scared of. It's a tool, it's a means to progress. Seeing as that it's a trend globally, we cannot look to [a] different direction; we have to also do it in this part of the world if we want to be competitive."

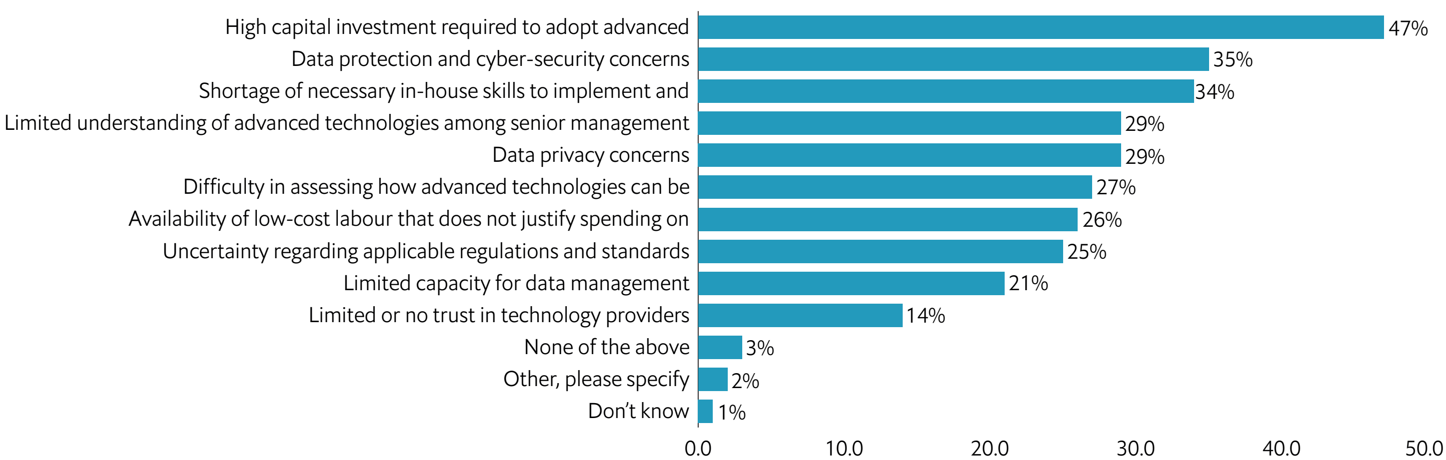
Beyond the adoption of technologies available in other parts of the world, there is potential for home-grown technologies to provide local solutions. "There is definitely opportunity for home-grown technologies to rapidly develop local markets by addressing the bespoke needs of those markets," claims Ms Warren. "Retail is one sector where there have been positive strides made in areas like e-commerce, such as the growth of Souq.com and Noon, but there is a long way to go."

To improve understanding among senior leadership, she recommends, businesses need to draw on the expertise and guidance of experts in this space: start small with a talk or seminar to ensure that the top management and board members are aware of the upcoming technological changes in the business sector.

Access to the right talent and skills is another immediate concern to ensure business success amid industry disruption, although it becomes less important over time (falling to 15% within five years from close to 20% in the short-term).

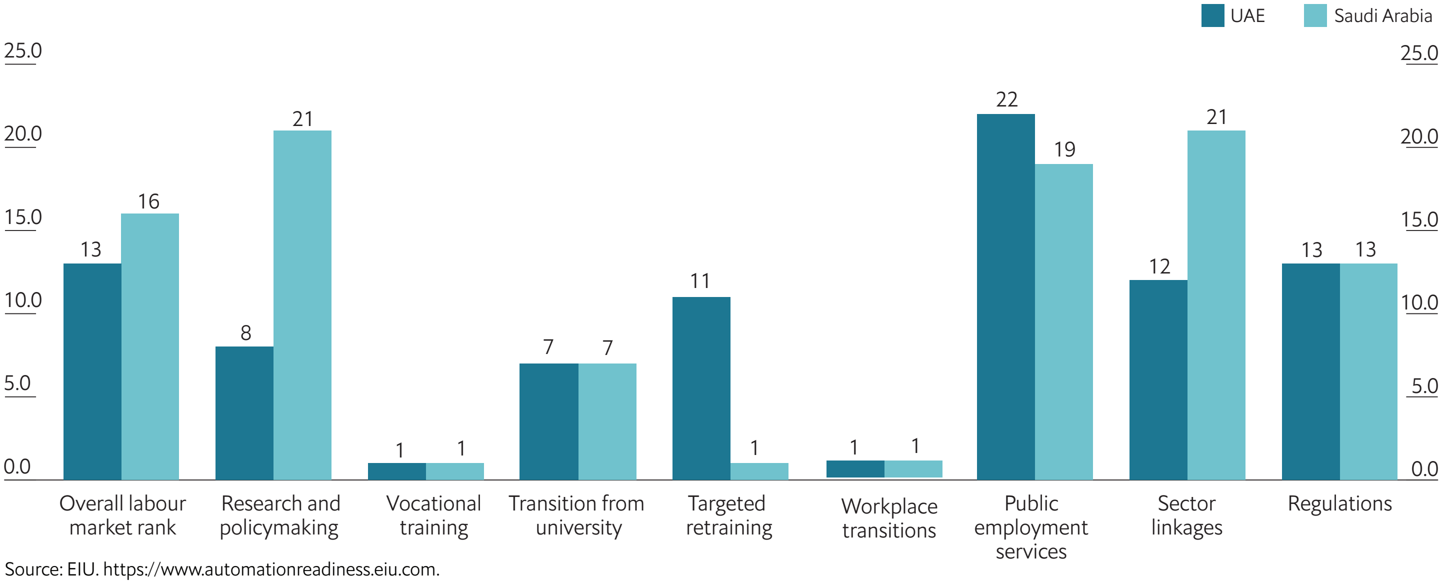
Our survey results reinforce the idea that highly skilled talent will be key to businesses successfully disrupting their markets: human capital development strategies were among the top two measures taken to prepare for digital transformation in respondents' businesses. Upskilling employees (71% of respondents) and hiring new talent (66%) were among the low-hanging fruit, prioritised over investments and redesigning business practices. This is especially important in Middle Eastern markets with large, foreign-educated, expatriate populations (more than half the population in the

Figure 8: Biggest impediments to adopting more advanced technologies (including AI, IoT, robotics, other automation)



Source: EIU survey

Figure 9: Rank out of 25 countries for sub-categories of the labour market pillar in The EIU's Automation Readiness Index



Source: EIU. https://www.automationreadiness.eiu.com.

GCC, closer to 80-85% in the UAE and Qatar). Significant discrepancies in the educational background of the domestic workforce was the second biggest human resource challenge, cited by close to a third of respondents.

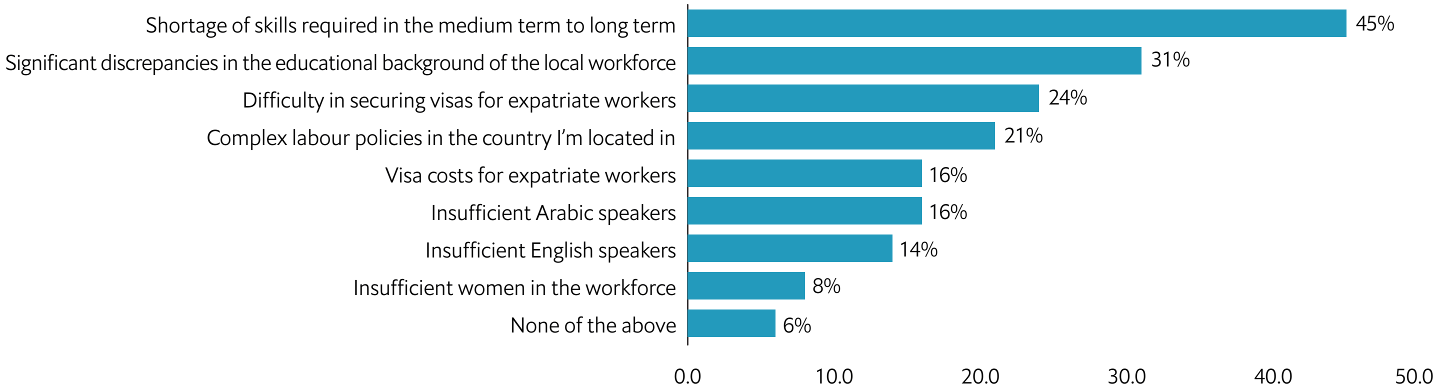
Over the longer term, businesses expect reform of existing labour laws. Mr Voskopoulos underscores the need for labour market reforms: "For sustainability, the region needs to attract the right people, the right human capital while at the same time educating and training adequately its own people". With a large expatriate population, which is often transient in nature given their reliance on work visas to stay in the country, this puts a significant cost on businesses that spent time and money to relocate and train such employees. Recently, more structural reforms are being introduced to attract and retain high-skilled professionals and improve labour mobility: Qatar promised permanent residency while the UAE has become the latest to announce a ten-year visa to foreigners in specific professional fields and even a five-year retirement visa. Clarity from policymakers as to how existing and upcoming regulations will be implemented is critical to the success of businesses in
the region.

As technology plays a bigger role in how people and businesses work, it would also be beneficial for businesses (and policymakers) to adjust to a "virtual workforce", which allows for remote and virtual work. This would not only increase workforce participation, but also improve productivity and growth. It could also allow businesses to work around labour force targets for nationals (often a percentage of the total full-time workforce).

This may also encourage more women in the workforce, although "insufficient women in the workforce" was selected as the least significant human resource challenge by survey respondents. Women in the region are three times less likely than men to be in the labour force, as they continue to face cultural, legal and social barriers to working. Even when they do look for work, women are nearly twice as likely to not get a job. Ms Warren, a strong supporter of enabling women to join the workforce, believes that "initiatives launched in the region to promote women as leaders and entrepreneurs are driving increased diversity and inclusion at the government and private sector levels", although she also notes that there is "still a long way to go". The IMF estimates that, in the UAE, if the number of women workers matched that of men, GDP would expand by 12%; Egypt loses 34% in annual GDP due to the economic gender gap.

Despite some short-term hesitancy, businesses have been active in taking steps to prepare for the adoption of advanced

Figure 10: Human resource challenges facing businesses in the Middle East



Source: EIU survey.

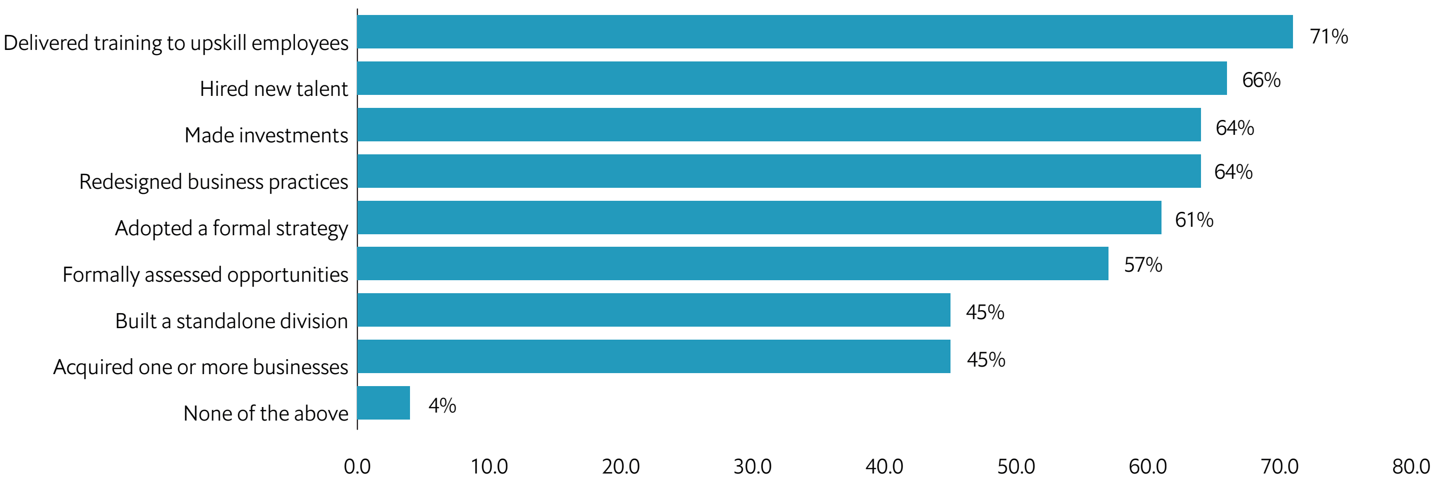
technologies. Over 55% of respondents have taken five or more of the steps listed in figure 11. But this must be viewed with some caution, as Ms Warren explains: "While traditional businesses may want to adopt advanced technologies or implement a next-gen tech strategy, the necessary know-how to set the strategy and availability of skilled talent to implement the strategy is not typically at a level where adoption can happen quickly." Executives we interviewed emphasised the need to be more proactive, best articulated by Mr Hammoud, who described emerging technologies as a "risk to those that oppose it and an opportunityfor those that will do something about it." Mr Voskopoulos echoes this: "We want to make sure that we are ready for the next phase of growth that is going to be exponential."

55%

Of regioinal executives surveyed have taken five or more steps to prepare for the adoption of advanced technologies

Emerging technologies are a "risk to those that oppose it and an opportunity for those that will do something about it."
- Maher Hammoud, head of private equity, Olayan Financing Company

Figure 11: Measures undertaken to prepare for the adoption of advanced technologies



Source: EIU survey.

Conclusion: Riding the fourth wave

The Middle East region is often discussed primarily in the context of its associated geopolitical risks. But our research finds that businesses, while not entirely immune to the issues that surround them, have developed a longer-term view on these risks and learned to navigate and succeed in this complex environment. However, they do see the possibility of civil unrest in their domestic market as a risk to their organisations. Such threats simultaneously reduce the likelihood of quick structural reforms in the region and reduce attractiveness to investors outside the region.

Businesses acknowledged their exposure to oil price volatility, mainly through the impact on government spending in the economy. However, regional governments must acknowledge changes to long-term demand and supply patterns to effectively forge ahead with economic diversification plans.

Macroeconomic risks and geopolitical tensions have a strong bearing on companies' market expansion strategies, but access to finance has an important role to play too—support from large institutional investors enabled better market access, giving companies an edge in markets where they face stiff competition from incumbents. Broadening the financial sector, to develop debt and equity markets as well as private equity and venture capital, will better enable businesses to scale up, but local businesses, often family-owned, must also be willing to relinquish ownership to a certain extent.

Businesses in the region are conscious of industry-wide changes driven by advanced technologies and the evolving consumer preferences of digital natives. While over half of respondents have taken five or more steps to prepare for the adoption of advanced technologies, some experts we interviewed described a reluctance to embrace these technologies. Ensuring that senior leadership is better informed of rapid changes in this space is critical.

While being mindful of cyber-security risks, embracing technological change presents many opportunities across the business, particularly job creation. Virtual roles may also present opportunities to involve more women in the workplace. To prepare, many companies have picked the low-hanging fruit of upskilling workers and hiring new talent, over making investments and redesigning business practices. Through this, they acknowledge the importance of having the right skillset in place to support continued competitiveness. While the skills gap can be partially solved by improving levels of technical and vocational education and training, it requires a significant policy change. Investing in curricula that support job-readiness, early exposure to the workplace (such as through summer internships), and promoting STEM (science, technology, engineering and maths), digital and ICT skills are a few of the policies that could create a stronger education system. This, coupled with continued global geopolitical and economic uncertainties, highlights the need for the region to progress on structural reforms and economic diversification.

Ensuring sustainable growth across the region will require "stronger corporate governance requirements, enhanced financial auditing and reporting standards, mature insolvency frameworks, further adoption of technology, and greater access to banking products and services," summarises Ms Warren. Executives across the region will need to advocate more strongly for economic diversification if the region is to reduce its unsustainable reliance on oil. This diversification should allow for a reduced dependence on traditional and Islamic bank financing and regulators across the region, encouraging the use of more alternative funding mechanisms like private equity, peer-to-peer lending, and crowdfunding to help grow the SME sector. More needs to be done to accelerate the pace of adoption of digital technologies like AI, the IoT, robotics and blockchain, all of which can act as catalysts to productivity and economic growth. As these efforts accelerate, businesses in the Middle East need to be ready and, more importantly, willing to adapt.

About this research

Leadership amid transformation: Business opportunities and risks in the Middle East is an Economist Intelligence Unit report sponsored by Emirates NBD. The report assesses the most important geopolitical and macroeconomic risks facing senior executives in the Middle East, how these are shaping market expansion strategies and how businesses are adapting amid industry disruption led by advanced technologies.

The analysis is based on a survey of 405 senior executives (conducted between July and September 2018) from companies with headquarters in the Middle East. Of these, 200 represent companies with annual revenue of at least US$500m. Respondents were drawn from eight countries in the Middle East, with 55 each from Egypt, Jordan and the six Gulf Co-operation Council (GCC) countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. Respondents were drawn from a range of sectors, with 50 each from manufacturing, retail, infrastructure (including energy), tourism, financial services and IT/technology. In addition, The Economist Intelligence Unit conducted a series of in-depth interviews between September and October 2018 with senior executives at companies in the Middle East. We would like to thank the following individuals (listed alphabetically) for sharing their insight and experience:

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