How Gulf companies can build global businesses

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When, in 2006, DP World acquired the British port and ferry operator P&O, in a deal valued at $7.1 billion, political debate over the company's ownership of US port assets dominated the headlines. What was not in dispute was the transaction's significance for the industry—the deal catapulted DP World to the position of the world's third-largest container terminal operator.

Lying behind that massive acquisition, moreover, is a growing trend for companies from across the Gulf Cooperation Council (GCC) states—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE)—to use the petrodollars flooding into the region to finance strategic investments abroad. Even if oil prices declined modestly over the next few years, these states would likely accumulate $2.4 trillion in windfall revenues through 2014. While much of this money is headed toward domestic investments in health care, education, and infrastructure, a significant portion of it is financing overseas investments. But today's moves, unlike those of earlier oil booms (when much of the surplus was funneled into passive portfolio investments), are likely to be strategic.

What's more, since today's investments do not focus exclusively on Europe and North America but also include assets in Asia—another change from the pattern during the last oil boom—they are likely to accelerate the shift of global economic power from West to East. The first moves in this new strategic direction are already apparent in telecommunications, logistics, and petrochemicals, among other sectors.

Growing liquidity in the GCC region is providing a strong impetus for international expansion. Many companies have built successful businesses at home, capturing substantial profits in markets that are often protected from competition. Starved of sufficiently large-scale opportunities in the domestic base, these companies are expanding beyond national borders.

Deep pockets alone, however, will not buy GCC companies a seat at the global economy's head table. If they are to become global leaders in their industries—and insulate the region more effectively from the consequences of lower oil revenues in the future—they will have to master capabilities that would equip them to face global competition. By and large, they have not had to develop these capabilities in their home markets.

Companies of all stripes are active in this transformation. The petro-chemical giant Saudi Basic Industries (Sabic) was among the early movers, acquiring the petrochemical division of the Dutch chemicals and pharmaceuticals group DSM in 2002 for $2 billion—at the time, the largest takeover of a European company by a Middle Eastern investor. The deal helped Sabic become the world's tenth-largest chemical company, with revenues of $20.9 billion in 2005. A year later, Sabic announced that it would invest up to $5 billion in a Chinese joint venture. Other state-controlled businesses have also been active. In late 2006, for instance, a consortium led by the UAE's Dubai Aerospace Enterprise (DAE) paid $1.3 billion for the Swiss company SR Technics, the leading independent supplier of aircraft maintenance, repair, and overhaul services.

Private companies are also fueling the trend. In 2005 the Kuwaiti logistics group Agility (formerly PWC Logistics) bought companies in Singapore and the United States as part of a drive to become one of the world's top logistics groups. Smaller, family-owned businesses, such as the Saudi independent car distributor Abdul Latif Jameel (ALJ) and the Kuwaiti retailer M. H. Alshaya, are rapidly venturing into Europe, Russia, and elsewhere.

In general, two factors motivate such expansionist ambitions. The first is the need to find new growth opportunities as domestic markets become saturated. Many GCC companies are larger and more advanced than their counterparts in neighboring North Africa and the countries bordering the eastern Mediterranean.

Although these regional markets could provide a significant growth opportunity for any company—in mobile telecommunications, for example—the inherent risks and relatively small size of the markets have kept them off the agenda for many large multinationals.

It is this situation that faces the GCC's telecom companies as they have moved aggressively into Africa and South Asia in recent years (see "Gulf telcos: Managing expansion better"). The UAE's Emirates Telecommunications (Etisalat), for instance, has acquired strategic stakes in Pakistan Telecommunication and in Atlantique Telecom (in West Africa), as well as mobile licenses in Egypt and Saudi Arabia. Strong earnings at home give Etisalat the luxury of being able to wait for its overseas investments to pay off. By late 2006, it was operating in 12 countries, with a customer base of more than ten million.

The second motive for expansion is a desire to acquire particular skills or capabilities. Acquisitions in Europe and North America, especially, are typically part of a broader strategy to gain rapid access to Western management know-how and technology; they allow Gulf companies to short-circuit the laborious task of building such capabilities internally. In 2006, for example, the Dubai property group Emaar Properties acquired both the second-largest private home builder in the United States, John Laing Homes (for $1 billion), and the UK realtor Hamptons International (for $154 million). Besides gaining access to the British and US markets, Emaar can now draw on John Laing's vast experience in real-estate development and Hamptons' expertise in marketing. The latter skills, in particular, will be critical for Emaar as it expands into overseas markets, where, contrary to the situation at home, supply of real estate greatly outstrips demand.

Strong cash positions have not only opened the door for aggressive takeover strategies but also given GCC companies time to learn about new markets and to absorb the skills they need. Relying solely on their experience in lucrative home markets, by contrast, would ultimately doom their expansion strategies. The advantages that drive margins at home—high-income customer pools, cheap labor, and low energy costs—can't be transferred to external markets, and Gulf companies will need to become more efficient abroad to be profitable there. The acquiring companies must out of necessity bring in (or quickly develop) special capabilities that foster competitive advantages.1

Acquisitions inspired by growth will probably have to be underpinned by a strong customer service ethos, while integration skills will be especially important when an acquirer buys a company to gain its capabilities. Other factors also come into play: for example, customers will span a broader range of incomes, including a large segment of the poor and "near poor." Segmentation, pricing, and cost-efficiency skills will be crucial in these cases. In addition, companies will have to transform their organizations to manage operations across a number of countries, and finding and retaining managerial talent will require more attention as the need for it develops.

These are the core challenges facing most companies that enter emerging markets. The long-term success of expanding GCC companies may also rest on something more nebulous—a change in corporate culture. In the GCC and throughout the Arab world, relationships between people and social structures have traditionally carried great weight in every aspect of life: social, business, and public. In corporate life, these relationships can determine whether someone is hired, promoted, transferred, or fired. What in the West would be criticized as nepotism or cronyism is still widely accepted in the GCC as a way of reinforcing cultural bonds.

Yet as Gulf companies expand into other cultures and compete to hire top global talent, they will need to find a balance between their own established cultural mores and the expectations of the global corporate environment. As they grow in scale, scope, and complexity, they will also find it increasingly difficult to manage an organization based on personal relationships. Inevitably, such relationships will become less important and individual performance more so, forcing companies to maneuver their way through a very difficult corporate transformation.

This challenge will extend to the boardrooms of the acquired companies: GCC acquirers must understand and work within the governance structures of other business environments, which may be quite different from the GCC norm. The board of the acquired company must be active and aggressive in setting performance targets for it and not allow it to drift without direction after the takeover.

Despite these challenges, we expect GCC companies to go on expanding into international markets. In the near term, a steady diet of petrodollars will fuel this trend. But over the longer term, larger servings of distinctive capabilities and skills must balance the diet.

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