

Chazen International Study Tour Report

Continuity and Change: The Business of Business in the Middle East

TAO TAN MBA '11

Outstanding Study Tour Report Award

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Chazen International Study Tours

Designed to enhance the classroom curriculum, Chazen International Study Tours offer students and their faculty adviser an intense, firsthand experience of the business culture of their chosen country or region. Study tours are initiated by students and organized with the help of the Jerome A. Chazen Institute of International Business. During study tours students meet with leading executives and government officials while visiting businesses, factories and cultural sites. Destinations change yearly, as study tours are student-initiated. Recent destinations include Brazil, China, Dubai, India, Japan, Mexico, Romania and South Korea.

Introduction

In January 2011, seventeen Columbia Business School students visited the cities of Cairo, Egypt and Dubai, United Arab Emirates—one civilization that erected pyramids 2,500 years before the birth of Christ, and the other that came into existence within the lifetimes of most Columbia faculty, yet both cities navigating challenges of engaging modernity in commerce while respecting their oft distinct, sometimes familial, but always rich cultural heritage. We visited companies that are well known to see how they adapted to their surroundings, as well as a slate of no-less-remarkable homegrown enterprises. In all, the themes of continuity and change became apparent in our hosts' remarks.

As with many things in the Middle East, even our terminology can contain many layers of meaning. Change can mean changes of political governance (the governments of Lebanon and Tunisia collapsed during the trip), changes in economic balance as the region shifts away from oil, and changes of social attitudes towards commerce. Continuity, likewise, can mean continuity of religious attitudes like the Islamic forbiddance on interest, continuity of family-owned enterprises, and a continuity of the general values that govern social and commercial intercourse.

In our trip, we found extensive, genuine, and ingenious efforts at navigating within and bridging across these oft-conflicting themes. Our company visits provided further opportunities to probe how different sectors and industries addressed these themes. Despite these efforts and the commonalities therein, I have concluded that a distinct model of “Middle Eastern capitalism” across the areas of entrepreneurship, access to capital, management, and governance may never emerge; rather, the unique efforts across the region will continue to—as they have for thousands of years—supplement and complement each other.

Economic and Social Framework

Our first meeting in Dubai was hosted by Philippe Dauba-Pantanacce, SIPA '07, senior economist at Standard Chartered Bank. Dauba-Pantanacce provided a framework of the Middle East that would prove invaluable for contextualizing our meetings.

First and foremost, it is a fallacy to think of the Middle East as a monolithic economic entity—rather, they can be divided into three supra-national regions with distinct economic identities.

The Levant countries — Turkey, Syria, Lebanon, the Palestinian territories, and Egypt — are distinguished by a relatively progressive political structure, moderate socio-religious climate, and economic diversification. Levant countries are relatively poor in oil and rely on trade and other

diversified industries to fuel their economy. Notably, Israel is not considered part of the region, as it is a developed country with strong political and cultural ties to the United States.¹

The Maghreb countries — Algeria, Mauritania, Morocco, and Tunisia — are concentrated on the northwest coast of Africa and are trade-oriented economies at a lower stage of development following the loosening of central economic planning. Maghreb countries, like Levant countries, are moderate in terms of socio-religious climate, but tend to be more politically authoritarian.

Finally, the Gulf Cooperation Council (GCC) countries — Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates — are those most synonymous with the Middle East in the popular mindset. All are oil-rich and oil-dominated economies. None are democracies, and although there are degrees of variation, all are more socially and religiously conservative.

There are further divisions within the GCC itself: Saudi Arabia forms one socioeconomic extreme, while Bahrain, Kuwait, Oman, Qatar, and the UAE take the other. The Saudi royal family, which owes its legitimacy to the ultraconservative Wahhabi clerics, conducts an extremely repressive government, notwithstanding the reigning King Abdullah's liberalizing reform efforts. (Dauba-Pantanacce told us a story of two of his colleagues on a business trip to Saudi Arabia, one male and one female, who were thrown into jail for getting coffee together.) Large sectors of the economy remain closed, and conducting business in the country is decidedly difficult. The other GCC states, while authoritarian, are far more business-friendly. Although Saudi Arabia dominates the region, it does so on the basis of its sheer size, public profile, and custodianship of two of Islam's holiest sites, Mecca and Medina. Surprising to many is the fact that the per-capita GDP of Saudi Arabia is less than one-third that of the UAE.

A social and economic dichotomy is slowly forming in the Middle East, driven largely, but not completely, by the location of oil. Egypt's economy has never been dependent on oil; its economic difficulties stem from population growth and the legacy of socialism. Facing the near-exhaustion of its oil reserves, Dubai has been positioning itself as a tourist and business hub. While still having laws in the books that prohibit premarital sex, purchase and consumption of liquor without a license, and the well-reported debtors' prisons, the authorities have often cast a blind eye. As Dauba-Pantanacce pointed out, other GCC countries, and even other Emirates, are more than happy to cede to Dubai the reputation as a country where traditionally conservative

¹ Aside from Israel, three other countries, Iraq, Iran, and Libya, are excluded from this framework of the Middle East. Their political instability and security situation restricts investment and renders their economies distinctively business-unfriendly.

attitudes are relaxed, where “every type of entertainment can be found,” and where in certain “free zones,” foreign companies can wholly own local subsidiaries and expatriate all profits, a compelling draw which results in over 90 percent of the population being expatriate workers.

The framework of the Middle Eastern economies traced by Dauba-Pantanacce only begins to illustrate the complex geopolitical and economic superstructure of the region. What is clear is that every region, every country, and indeed even subnational entity (such as Dubai) are handling continuity and change in different ways. Whither will this lead? Will, for example, Saudi Arabia trend more socially and economically liberal, and Dubai more conservative? Will attitudes shift in the traditionally more moderate Levant and Maghreb countries? Or will the socioeconomic polarization become permanent? Dauba-Pantanacce introduced this framework by saying that we shouldn’t think of the Middle East as a single entity—what we took from it was the insight that the countries of Middle East were in no hurry to become one.

Entrepreneurship and Capital

Two of the organizations we met with—the Egyptian Ministry of Finance and the Advanced Technology Investment Company (ATIC) of Abu Dhabi—provided a fascinating glimpse at how Middle Eastern economies, with deeply entrenched economic actors, deal with encouraging the growth and development of new companies and new industries. Fostering change is usually never a strong suit of entrenched interests, yet both Egyptian and Emirati entities were making sincere efforts.

We were hosted by the now-former Egyptian Deputy Minister of Finance, Hany Kadry Dimian, SIPA ’96. Dimian, refreshingly frank and open, did not shy away from tough questions or from acknowledging the difficulties faced by aspiring entrepreneurs in Egypt. He began by telling us a story of a personal acquaintance, an Egyptian inventor, who developed a revolutionary new syringe system for administering medication. Unable to find any seed capital to develop his invention into a viable company that could create value for the Egyptian economy and jobs for Egyptian people, he ended up selling his invention to Pfizer, which promptly announced plans to manufacture the syringe in another country. Stories like these, he explained, were all too common in a country that first, had no venture capital industry of note to provide a platform to launch new industries, and second, had a deep-seated cultural attitude that associated prestige with jobs in civil service.

Dimian also told the story of his cousin, a distinguished lawyer, who aspired to a career on the bench. Unable to secure a position as a judge, his cousin took a temporary job as an English-

speaking tour guide, where he ended up in a high-ranking position making ten times the salary of Egypt's judges. Still, he persisted in classifying himself as "unemployed/looking for work" because he could not contemplate such a position as a career.

Our questions then turned to a topic that has become especially relevant in light of recent events. Could entrepreneurship be an answer to Egypt's massive problem of youth unemployment, with 700,000 graduates entering the workplace annually, with job creation nowhere near keeping pace, and with a highly technocratic education system that did not emphasize transferable skills? Dimian emphasized, quite forcefully, that a cultural shift had to take place before entrepreneurship on the scale that could resolve the youth unemployment problem could be possible. Egypt's young people, he opined, "had to accept jobs and roles that they might not want or might not like."

ATIC, on the other hand, is a government entity that is actively trying to engineer just such a change. Seeded by the government of Abu Dhabi, ATIC presented itself as "patient capital"—there to generate social as well as economic returns, and with the funding base to wait decades if necessary. At ATIC, we were hosted by Reem Mobassaleh '09, who gave us an overview of ATIC's investment philosophy and mandate. Currently, Abu Dhabi derives 70 percent of its GDP from oil, and 30 percent from other sources. ATIC is part of the Abu Dhabi's government plan to invert that ratio — that is, 30 percent from oil, and 70 percent from non-oil sources — by 2030.

ATIC's signature transaction is the 2008 acquisition of a 20 percent stake of AMD. ATIC then spun off AMD's manufacturing operations into a new entity, GlobalFoundries, with facilities in New York, Singapore, Germany, and crucially, Abu Dhabi. ATIC took the risk of "buying into" the semiconductor field, in which it had no competitive expertise or advantage, to start a native semiconductor industry in Abu Dhabi that would provide jobs for local citizens as a sustainable economic entity in the years ahead.

As one might imagine, questions came thick and fast. Could Abu Dhabi become a genuine player in the semiconductor space when it had, again, no competitive advantage or history? Would Emirati citizens, overwhelmingly employed by the high-paying civil service, agree to take jobs in manufacturing? How would one control labor costs in a very cost-conscious industry located in a region with one of the highest living standards in the world?

There were no easy answers to such questions. ATIC has been taking proactive steps—setting up partnerships with leading universities in technical fields to train future semiconductor

engineers and setting up a global rotation and scholarship program to attract young people to the field. Beyond that, there was only the reassurance and emphasis on “patient capital.” Most tellingly, the investment professionals of ATIC spoke not of whether Abu Dhabi *could* change, but rather that it *must*, in order to remain a relevant economic player when the oil runs out.

Management and Governance

We met with three companies that gave us a comprehensive overview of how Middle Eastern companies strive to foster continuity, usually in family ownership, while balancing the demand for transparent and high-quality management and governance. At the Egyptian Stock Exchange, Mohamed Farid Saleh, vice chairman, described the development of the Egyptian securities industry in the early 1990s. At the first stage, merely to encourage listings, the Egyptian government issued a tax break for listed companies. The result was a flood of thousands of companies rushing to list solely for the tax break. Liquidity was a major concern — the sole motivator was the tax break rather than an intention to trade or the need to raise capital—and a subsequent requirement that a company’s security had to trade twice per year resulted in hundreds being delisted.

The government experimented with further regulation in the 1990s, often with many unintended consequences, but stabilized listings at just under 300 companies by the mid-2000s. Crucially, steadily increasing liquidity requirements, capital requirements, and most of all, disclosure requirements whittled down the eligibility and willingness of companies to list. Yet, in early 2011, not a single one of the companies listed on the Egyptian Exchange was majority-floated. In all cases, family interests were the dominant shareholders. There is no such thing as an “activist shareholder” and hostile takeover bids and tender offers are unheard of. Still, the mechanism of a public equity market for the purpose of raising capital was at last accepted — while keeping intact long-entrenched family interests.

We also had the chance to visit one of the listed companies, Egypt’s Orascom Construction Industries, where we were hosted by Hassan Badrawi, Director of Investor Relations. The Orascom group of companies, founded by serial entrepreneur Onsi Sawiris in 1950, is a multi-sector industrial conglomerate and one of Egypt’s leading industrial concerns. Keeping family ownership, and maintaining a semblance of fairness between Sawiris’s three sons, over an increasingly diverse and multinational company was a challenge that the Orascom group addressed in an innovative manner.

In 1997, the Orascom group split itself into three companies, Orascom Developments, Orascom Telecom, and Orascom Construction, each headed by one of the three sons. The commitment to transparency of a company with such overwhelming family ownership was impressive. All three Orascom companies are publicly listed and make clear that aside from a common name, history, and participation of a limited number of non-executive directors, all three companies operate completely separately. There are no commingling of assets, no cross-participation of management, and although the companies do cooperate, they often do so in the context of a competitive bidding process.

In Dubai, we met with the Al-Tayer Group, a family conglomerate with interests in the retail, fashion, luxury, and automotive sectors. Like Orascom, the Al-Tayer family is also undergoing generational succession from the founding entrepreneur to his sons. Unlike Orascom, the Al-Tayer group is unlisted, has no plans to list, primarily because they do not feel the need for capital.

Representatives of the Al-Tayer family were very open about their initiatives to ensure a balance between family ownership and maintaining the highest standards of corporate governance. Family members are not guaranteed management positions with the group. Rather, they are pushed to explore opportunities elsewhere, in consulting or banking, often overseas, before they are considered for positions with the family business. Second, they must prove themselves by leading initiatives in business development. They are encouraged to seek postings to nonprofit and governmental bodies — such as the board of the Central Bank of the United Arab Emirates — to further their knowledge of the area and the industry, and only then, with the approval and ongoing mentorship of senior non-family executives, are they considered for management positions within the family business itself. At these family-owned companies, still the dominant business form of the Middle East, we observed the careful balancing act of developing talent and ensuring top quality management with the need to maintain family interests.

Conclusion: “Middle Eastern capitalism”?

The forces of continuity and change are, and continue to be, the dominant undertone of business in the Middle East. In our visits, we saw many different attempts in different geographies and industries to address the two, but few commonalities therein. Culturally, politically, socially, and economically, the Middle Eastern economies have different priorities, and the few similarities, such as a preference for family ownership, are not sufficient to shift the region toward a common

model of “Middle Eastern capitalism”. As the region shifts away from oil (or, as in the case of Egypt, already has shifted away from oil), change in its various forms, distinct to each country and economy, will continue to accelerate and manifest itself.

Our delegation was in Cairo when the government of Tunisia fell and left just as small groups began congregating in Tahrir Square. We followed the events with fascination and sympathy as we traveled to Dubai and then back to New York. We look back on the time we spent there, including our final afternoon at the Egyptian Museum and in Tahrir Square, with newfound appreciation.

Yet, as I watched the protests unfold with little certainty of what was next, I was left with a certain conviction that when the events are over, when the new government is seated, whatever form it takes, the great markets and bazaars of Cairo will once again open for business—as they have since the days of the Pharaohs. Notwithstanding the violent change gripping the region, the fundamental continuity of business itself will remain part and parcel of the Middle East, as it has for thousands of years and will for thousands more.