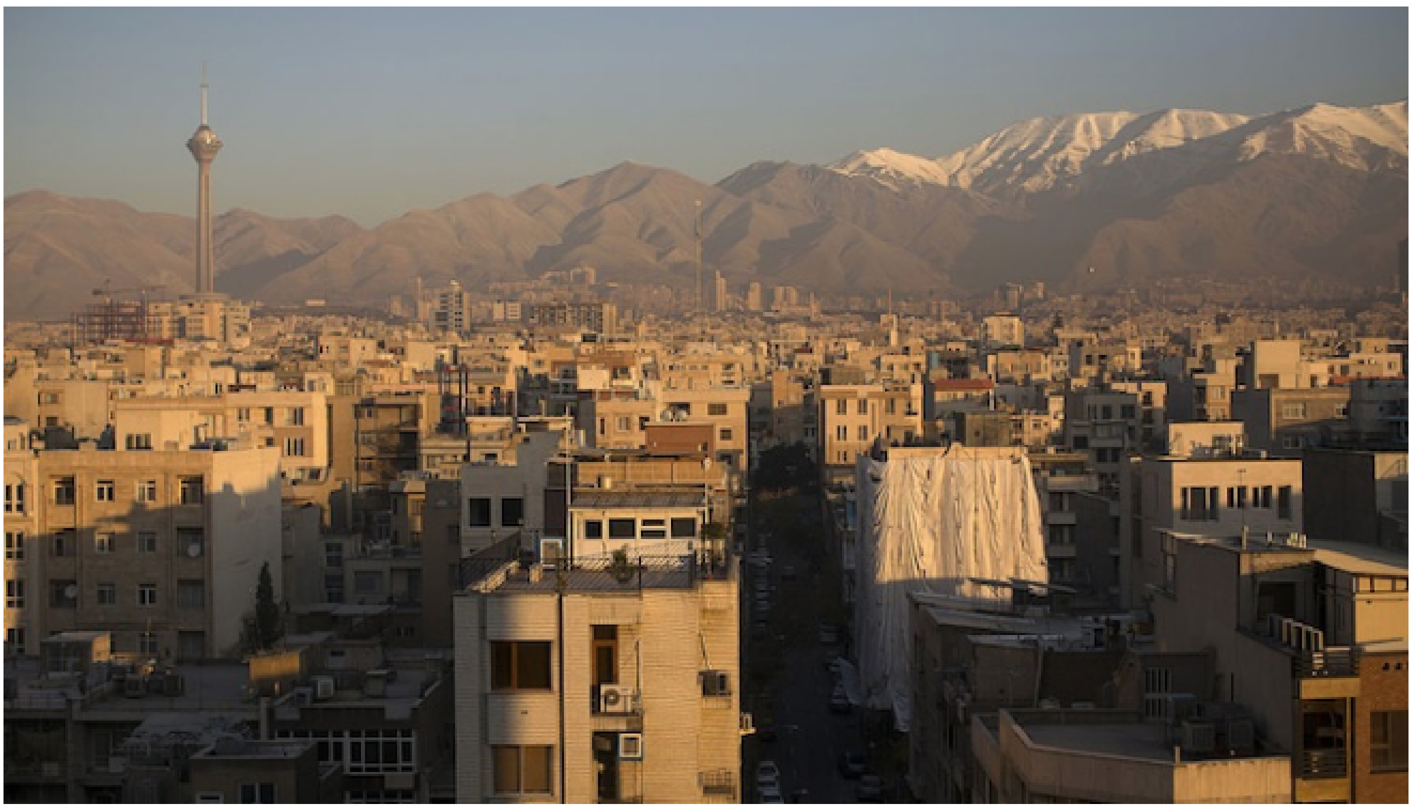
Iran is open for business, but what does it mean for GCC companies?

Erika Masako Welch, business development director for the Middle East at Solidiance, examines the opportunities and challenges for business as Iran opens up



In January this year, senior diplomats from around the world formally announced the lifting of sanctions against Iran. In principle this put a definitive end to 37 years of various degrees of sanctions imposed on the country.

Boardrooms of global Fortune 500 companies and regional conglomerates alike have been lit up with debate on what this means for their business over the past 10 months, but two things are certain. First, Iran opening up to the world is arguably one of the most prolific global business opportunities of our generation. Second, the answer to the above question depends heavily on your company's origin, DNA and risk appetite.

For the majority of the largest European and Asian companies (excluding China), this marks a much-awaited opportunity to return to Iran, where many had investments, manufacturing facilities and large-scale operations prior to the financial sanctions made against Iran in 2011.

Chinese and American companies view the current situation as more of a threat, and for different reasons.

Chinese firms have greatly benefitted from the international sanctions on Iran over the past few years, which provided a window where an inflow of Chinese products flooded the market without much foreign competition. The lifting of sanctions will see an inevitable curtailing of Chinese dominance in this market.

For American companies, the situation is more complicated.

Although US companies' foreign subsidiaries are technically allowed to engage with Iran, there is still a minefield of regulatory, transparency and legal challenges that have left many hesitant to take even preparatory steps. Furthermore, the fact that 2016 is a US Presidential election year, and the mounting layers of uncertainty of the future government's policies towards Iran have left the majority of American companies unable to decide.

But what does Iran opening up mean for GCC players? There are both significant opportunities and many challenges, and to understand the complex nature of GCC-Iran ties we must first understand how Iran fits into the macro-economic fabric of the Middle East.

Iran: what's the big deal?

The excitement felt by foreign companies can be understood when you look at Iran's economic indicators.

Iran isn't a stereotypical sanctioned economy, which might be perceived to be underdeveloped. On the contrary, the economy is more diversified than most emerging economies today, and is substantial in size across various indicators.
Despite the sanctions, Iran has maintained the 26th largest GDP in the world at $425bn, between Saudi Arabia (20th at $646bn) and the United Arab Emirates (31st at $370bn). It generates 1.5 per cent of global GDP and is the only country that exported in every single category of exports (as defined by the IMF) in 2012-2013.

Iran also boasts a population of nearly 80 million inhabitants, which is equivalent to the population of all six GCC countries combined. With a burgeoning middle class, Iranian consumers increasingly have disposable incomes. Moreover, Iran's predominantly young population is amongst the most highly educated in the region, with 13.3 per cent of the working population having graduated from university. The country has the highest literacy rates in the region and is the fifth largest producer of engineers worldwide.

Like some of its GCC neighbours, Iran is blessed with natural resources, and in abundance. Iran has the world's fourth largest proven oil reserves (4 per cent global share) and the world's second-largest proven natural gas reserves (17.5 per cent global share). Iran remains the world's 12th largest oil exporter, as of 2015, and is expected to climb as it increases production.

But unlike its GCC neighbours, Iran has managed to build a diversified economy that does not rely solely on its oil and gas industry. Though oil-based revenues still provide a quarter of the country's GDP, the automotive, mining and manufacturing, and agriculture sectors each also command 10 per cent of the economy.

As the national GDP breakdown infers, Iran is blessed with many natural resources besides oil and gas; the country holds over 7 per cent of the world's total minerals. Iran has the largest global zinc reserves and the largest copper deposits and is a large global supplier of iron ore and chromite.

Iran is currently home to the 20th largest automotive manufacturing hub in the world, having produced approximately 1.4 million units in 2015. Iran is also expected to become the biggest market for new car sales in all of the Middle East and North Africa (MENA) by 2020. This translates into big opportunity for automotive manufacturing and automotive aftermarket players in the region.

Elsewhere, the country's construction sector is still expected to continue at a relatively strong and steady growth rate of 6.1 per cent CAGR from 2016 to 2020.

Driven primarily by residential construction projects, Iran's construction market is expected to reach $196bn by 2020. Iran is the 13th largest steel producer in the world – far ahead of any other GCC country – and is also the fourth largest cement producer, behind China, India and the USA.

Beyond Iran's impressive industries, the country's strategic geographic positioning between Europe, the Middle East, South Asia, and the Far East also works in its favour. And it seems this is more relevant than ever before, as talks of reviving and modernising the old 'Silk Road' trade routes between Asia and Europe have intensified in recent months.

Business opportunities

Iran's large market spells big opportunity for GCC businesses, which have a number of advantages over global competitors.

The first of these advantages is geography. It comes as no surprise that most Fortune 500 companies that are entering Iran are predominantly doing so via the UAE or Turkey – primarily due to proximity and logistical ease, as well as ease of communication, travel and management of business operations.

Secondly, the GCC has already established grey channels into Iran. Many foreign companies are surprised when they first visit Iran and realise the market is flush with their products and the products of all their competitors. The UAE and the wider GCC have acted as Iran's unofficial backdoor during the sanctions, and distribution and supply chain channels are already carved out in these markets. The challenge will be to keep these channels open once official channels are developed.

Third and perhaps most importantly, companies in the Gulf know how to operate in volatile and high-risk emerging markets. This is why many GCC companies have done well in emerging Asia and Africa. Due to the ability of GCC companies to take these risks, regional companies have an opportunity to enter Iran faster than their foreign rivals.

Finally, there are a number of sectors where GCC companies are primed to flourish. For starters, the bank and financial sectors in the GCC are expected to witness an increase in longer-term business opportunities. The region's top construction players – which may be suffering from the contraction of the sector at home – might also find a welcome respite in Iran.

Construction growth in the country is primarily driven by the residential segment – accounting for 45 per cent of the market – due to a severe shortage of housing stock. The demand stands at 1.5 million housing units per year, of which Iran is able to provide less than half. Infrastructure projects and construction of manufacturing plants are also expected to see sharp growth rates that cannot be met with local capacity alone. Thus, all adjacent industries, from the excavators and heavy machinery sector to the construction materials sector, will be prime growth segments.

Potential risks

Opportunities outweigh the risks in most instances for GCC companies, but there are still risks and restrictions to be aware of.

First and foremost, opening Iran to the world will mean that Iranian industries will begin to compete more fiercely with Gulf businesses. Major industries where Iran and the GCC will compete include oil and gas, petrochemicals, aluminum, machines, engines, pumps, and dairy products.

In oil and gas exports, for example, Iran will directly compete with Saudi Arabia, the UAE and Qatar to become the energy importer of choice with lucrative oil-importing nations such as China, Japan, South Korea and India, as well as Europe. This will be an ever-growing challenge, as Iran is the only country in the world as cost-effective as Saudi Arabia in oil and gas production.

Secondly, Iran will bring fierce competition for foreign direct investment. As the Iranian government continues to develop policies that deter foreign entities from becoming an import-only partner to Iran, many large multinationals may decide to build local manufacturing facilities for their regional operations, instead of bringing this investment to the GCC.

Another challenge facing Gulf companies planning to operate in Iran has to relate to the marketing and origins of their products. Though Iranians have a strong demand for European, North American and Japanese products, there is little to no consumer affinity towards products produced in the Gulf or products with Arabic content. This may require many Gulf companies to invest in rebranding their products entirely to enter this promising neighbouring market.

Iran's regional gateway

The UAE has the highest trade exchange with Iran amongst its GCC peers, earning over $32bn in export value in 2014, and over $8.7bn in the first quarter of 2015 alone. The emirates accounts for more than 80 per cent of Iran's trade with the whole of the GCC. Oman is the second major GCC trade partner.

Many analysts suggest that the removal of sanctions on Iran will have a positive effect on the UAE economy over time, with trade between the countries likely to increase between 15-20 per cent. The International Monetary Fund (IMF) forecasts that $13bn will be added to the UAE's economy as trade between the two countries steps up between now and 2018.

Some have argued that Iran opening up could see jobs move from the UAE directly to Iran, but the majority of Iran's imports are likely to continue to go through Dubai's Jebal Ali Free Zone Port.

Furthermore, Iranian businesses have a major presence in the UAE, with around 8,000 Iranian traders and trading firms registered in the emirates, according to the Iranian Business Council. Ethnic Persians are estimated to account for roughly 10 per cent of Dubai's population of two million. The UAE also has a strong commercial presence in Iran, with leading companies such as RAK Ceramics, Majid Al Futtaim Group and Mammut Building Systems operating there.

Diplomatic and commercial relations

Iran and the GCC countries have economic incentives to expand their trade relations, but diplomatic and geo-political concerns are likely to play an important role as well.

Looking specifically at relations between Iran and the UAE, there exists one major unresolved conflict between the two countries. The UAE has challenged Iran's sovereignty over three islands in the Arabian Gulf. In addition, the UAE's close economic and political ties with Saudi Arabia led to the emirates downgrading diplomatic ties with Iran following the storming of the Saudi Arabian embassy in Tehran in January of this year.

Oman and Iran share close diplomatic, economic and military ties, upholding a tradition of cooperation that dates back to the Shah of Iran's regime. The sultanate played a key role in the 2013 secret talks between the US and Iran, which paved the way to the current removal of sanctions. Oman also signed an accord with Iran in early 2014 to construct a $1bn natural gas pipeline from Iran to Oman.

Qatar and Kuwait also have close relations with Iran; all three are members of OPEC, the Non-Aligned Movement, and the Organisation of the Islamic Conference. The two countries also generally refrain from criticising Iran's domestic and foreign activities.

Bahrain and Saudi Arabia are the two GCC states that have the most strained relationship with Iran. Bahrain-Iran relations have been under pressure since the Iranian Revolution and the 1981 discovery of a planned Iran-sponsored coup. However, in recent years, Bahrain has begun taking steps to improve relations.

Saudi Arabia's relations with Iran have been troubled to say the least, as both countries aspire for a leadership role in the Islamic world. The political differences between Riyadh and Tehran are stark, with little sign of rapprochement in the near future.

That said, there has been some economic activity between the two rival countries. Trade stood at a mere $215m in 2015, mainly comprised of Iranian exports, but look closely and you can find a small number of notable Saudi businesses either directly or indirectly established in Iran via official distribution channels.

These include strategic investment holding group Savola Group, SABTEC – a subsidiary of Saudi Arabia's largest public company SABIC, fast food chain Al-Baik, Saudi Ceramics Company, and Al Abdulatif Carpets.

In summary, while entering Iran might not necessarily be straight-forward, right or possible for every business in the GCC, its opening up to the world is one of the most signifcant global business opportunities of our generation – one many businesses in the Gulf should at least consider.

Comments

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