

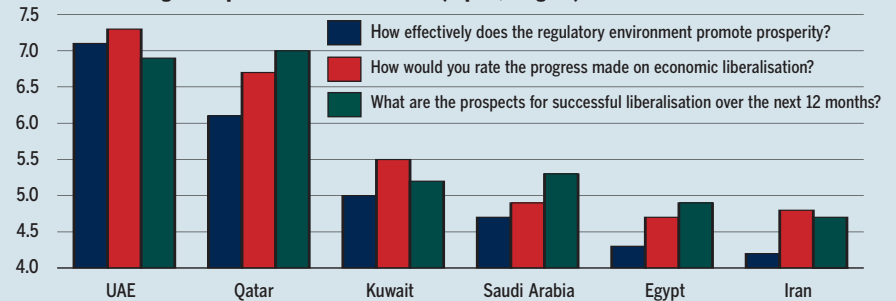
Glass more than half full

The first full-scale business confidence survey ever conducted across the Middle East casts a new light on government progress with economic liberalisation. It also shows the region's business community is optimistic about opportunities over the next 12 months

Tom Everett-Heath reports

1. ECONOMIC LIBERALISATION

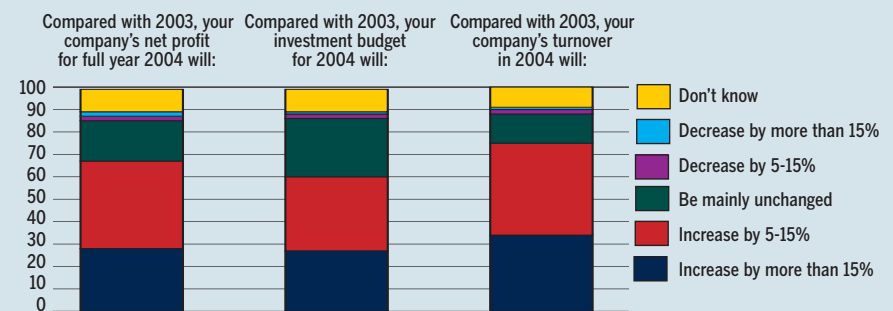
Panellists were asked which Middle East market they did the most business in and, with that country in mind, to answer the following three questions on a scale of 1-10 (1=poor, 10=good)



Source: YouGov

2. CORPORATE EXPECTATIONS FOR 2004

(%)



Source: YouGov

The Middle East's share of headlines in the international media has grown exponentially of late. Two years of the before, during and after of the US-led invasion of Iraq; repetitive false dawns in the search for peace in Palestine; terrorist attacks in Saudi Arabia; the mood swings of Muammar Qaddafi; upheaval in Iran – both political and geological. The list goes on. At a cursory glance the region looks one of the most hazardous on earth.

Perhaps only the frequent references to the high price of oil – lazily blamed on Arab producers – might give pause for thought. The less reported story is that the Middle East is enjoying a substantial and sustained economic surge. Robust oil revenues since the 1998 crash have provided the fuel, but significant structural development by a number of governments combined with focused infrastructure investment and legislative reform have laid the foundations for a lengthy boom.

The Middle East business community has repeatedly demonstrated its capacity to compartmentalise economic opportunity and political risk, as the results of the inaugural HSBC-MEED Middle East Business Confidence Survey (MEBCS), conducted in May by London-based YouGov, unequivocally show. Asked to score the region's political prospects over the next 12 months on a scale of 1-10, with 10 being the highest, the 786 respondents generated a

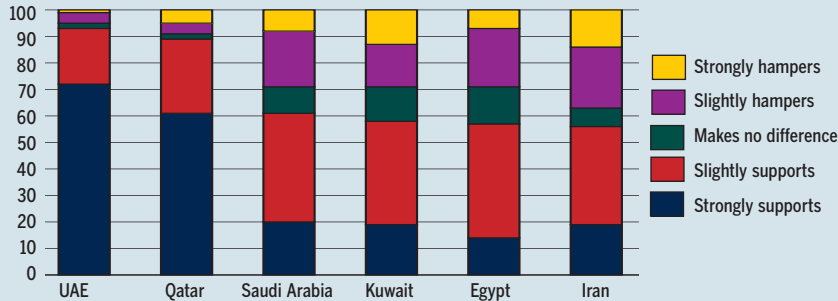
mean score of 5.2 (see page 6 for a full explanation of YouGov's methodology and the composition of the survey's respondents). In comparison, when asked their view of economic prospects over the same time-frame, the mean score was 6.8. The enthusiasm is clear.

Segmentation of the respondents throws up significant variations. Participants in the construction sector are the most optimistic – clearly the anonymous nature of the survey allowed the habitual grumblers room for honesty – followed, unsurprisingly, by the oil, gas and petrochemicals sectors. Significantly, size brings comfort. Participants from the biggest companies – those with more than 1,000 employees – are considerably more bullish than executives from the small and medium-sized enterprises. Perhaps most importantly, location matters: the 61 per cent of respondents who actually live in the region are the most enthusiastic; the 6 per cent who do business in the region but are based in the US are the least. Perhaps there are lessons about the benefits of local knowledge and the power of the media contained there within.

However, while there is substantially greater confidence in business prospects over the next 12 months than in the region's political stability, the latter remains the most important factor driving change in the economic climate (see figure 6). Progress with economic liberalisation and the potential for falling oil prices are the next two most popular choices.

3. GOVERNMENT POLICY

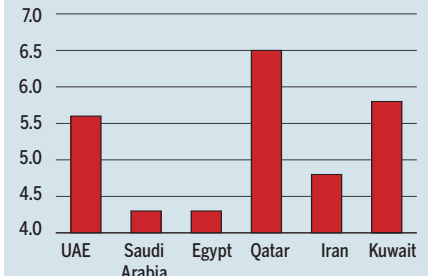
Panelists were asked which Middle East market they did the most business in and, with that country in mind, to assess government support for business



Source: YouGov

4. JOB CREATION POLICY

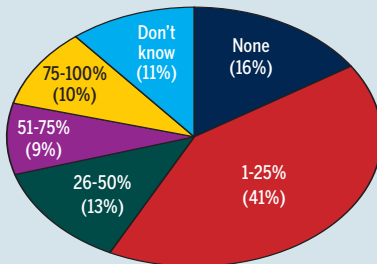
On a scale of 1-10 (1=poor, 10=good), how effective are government policies for job creation for the indigenous workforce?



Source: YouGov

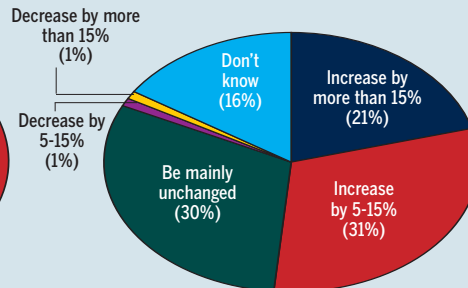
5. CROSS-BORDER TRADING PATTERNS

What proportion of your company's turnover comes from cross-border trading?



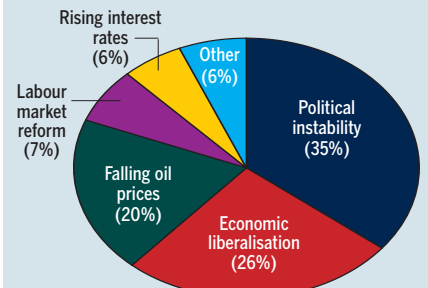
Source: YouGov

Over the next 12 months, do you expect your company's cross-border trading to:



6. CHANGING LANDSCAPE

What will be the key drivers of change in the regional economic climate?



Source: YouGov

BENCHMARK = 100

HSBC-MEED Middle East Business Confidence Index

In addition to the survey, the HSBC-MEED Middle East Business Confidence Index (MEBCI) has also been built. Starting from a base of 100, the MEBCI will, three times a year, provide a leading indication of the region's business climate.

Half of the index is generated by the responses given to a string of key questions in the survey on the expectations of future corporate performance and the outlook for the regional economies. The same questions will be asked in each survey, allowing for the construction of comparative data series.

The other half of the MEBCI is constructed from hard data relating to gross domestic product (GDP), oil prices and production, money supply, interest rates, credit volumes, inflation, government budgets, capital expenditure, stock market performances and exchange rates.

By fusing the expectations of almost 800 business leaders with a data-driven, weighted model of regional economic health, a unique index has been created that will provide an independent and anticipatory indicator of the future health of the business environment. HSBC and MEED hope it will become a benchmark for the region.

The survey, which is to be repeated three times a year so as to create a moving, three-dimensional picture of the region's business climate, asked questions loosely divided into two sections. First came the subject of economic liberalisation and the success regional governments have had in developing attractive operating environments. The answers to those questions chart the trajectory of reform, from an assessment of the current regulatory regimes, to a view on how much progress this represents and the expectation of further progress over the next 12 months. Figure 1 breaks down the responses geographically – the six countries included accounted for 76 per cent of respondents – and the variations are compelling. Unsurprisingly, the UAE is regarded as having the most benign regulatory environment, with Qatar also scoring highly. In contrast, Saudi Arabia, Egypt and Iran attract lower scores.

However, the expectations of future progress tell a different story. The prospects are best in Qatar, robust in the UAE and positive in Kuwait. For those respondents most active in Saudi Arabia, there is confidence that the pace of reform is accelerating.

Such sentiments are further sketched out in the answers to questions on whether government policy supports business, or not. Again, the governments of the UAE and Qatar attract the most praise. But Saudi Arabia outperforms the rest, while Kuwait is second only to Iran in

having 13 per cent of its business community thinking that the government strongly hampers business (figure 3). All governments should take note: the competition for foreign direct investment (FDI) is getting tougher, and perceptions of state support and the ease of operating environments are important.

One area of potential collision between governments and business communities is in the field of job creation. Demographic pressure, and the limited remaining capacity of the state to act as a sponge soaking up each year's new wave of labour market entrants, has forced the issue to the top of the agenda in most Middle East states. More aggressive approaches to nationalisation quotas for the private sector are being introduced – noticeably in Saudi Arabia – and training and salary subsidy schemes are under consideration across the region. However, the survey illustrates doubts over the effectiveness of such moves (see figure 4).

The respondents also showed no reticence in suggesting policy areas worthy of the most urgent reform. For Iran, the *cri de coeur* is for political reform. Cairo is asked to eliminate corruption and bureaucracy and accelerate the privatisation programme. In Kuwait, the desire is to see non-tariff barriers removed and the easing of access for foreign companies. The long list in Saudi Arabia ranges from the implementation of the capital markets law to WTO accession, from educational reform to privatisation.

METHODOLOGY

HSBC-MEED Middle East Business Confidence Survey

Independent and broad-based research underpins the region's first business survey

For this, the first comprehensive business survey conducted across the Middle East, HSBC commissioned London-based YouGov to recruit a panel comprising almost 800 senior business opinion formers. Initial contact was made via 20,000 emails and letters sent to selected MEED readers and business leaders nominated by HSBC.

The interviews were conducted via an online survey platform and, where required, by paper surveys. Responses were gathered from business leaders across the Middle East – the majority live in the UAE, Saudi Arabia, Qatar, Kuwait, Bahrain, Oman, Egypt and Jordan – and those doing business in the Middle East from offices in Europe, North America and the Far East. Of those interviewed, more than a third are of Middle East origin and 61 per cent are resident in the Middle East.

A wide cross-section of sectors are represented including banking and finance (20 per cent), construction (15 per cent), oil, gas and petrochemicals (13 per cent), power and water (9 per cent), IT and telecommunications (7 per cent) and those in direct government employment.

Further segmentation ensured that the views of different-sized companies are heard. Small businesses with fewer than nine employees account for 7 per cent of the respondents, though those with

critical mass provide the base load – respondents from companies with annual turnover greater than \$200 million make up 44 per cent of the panel.

Perhaps most importantly, the construction of the panel was focused on attracting senior decision makers. More than 7 per cent are chairmen of their companies, 14 per cent are managing directors, 16 per cent are directors and a further 25 per cent describe themselves as senior management.

The survey will be conducted three times a year. Some of the questions will be repeated in each survey, so as to create sets of comparable data monitoring changes in attitude and outlook over time. Much of this data is used in the construction of the HSBC-MEED Middle East Business Confidence Index (see page 5). Other sections will be altered with each survey, so as to address topical questions.

Research capabilities

YouGov is a research company using online panels to provide research for public policy, market research and stakeholder consultation. It currently has a panel of about 50,000 members throughout the UK as well as access to a sample of more than 1 million respondents internationally through an online panel partner network. YouGov uses its panel-based sampling techniques to provide

accurate research for a wide range of business, media and public sector clients.

YouGov's predominantly online approach surmounts many of the problems associated with traditional polling methods. The internet offers a freedom and flexibility unavailable to telephone and face-to-face research practitioners. Questionnaires, communicated via email, can be completed at any time, facilitating research operations across time zones. In addition, YouGov works to build relationships with its panel members. Consequently, YouGov experiences higher and faster response rates than the norm in traditional research. The self-completion nature of YouGov's online surveys provides a confidential, low-pressure interview environment that has been shown to enhance the candour of responses entered as well as allowing respondents the time they need to consider their answers fully, providing a greater level of depth and authenticity.

YouGov has aimed to be at the forefront of its field: during the conflict in Iraq, it was commissioned to conduct three tracking surveys a week, for television and print media in the UK. It also conducted the first survey of Iraqi citizens in Baghdad following the 1 May 2003 official declaration of the cessation of the war.

Doha was asked to implement labour market reforms. And in the UAE – where the greatest number of respondents felt there was no need for further reform – a clear demand was made for 100 per cent onshore foreign ownership.

The second half of the survey highlights the expectations of strong corporate performance this year. Of the 351 respondents based in the region, 68 per cent are expecting profit growth in 2004 greater than 5 per cent, against 4 per cent expecting declining returns, and 28 per cent are expecting profits to grow by more than 15 per cent (see figure 2). Investors in regional equities should take note: the bull runs seen on some markets have priced such expectations in, but not on all, and there might be more upward pressure from corporate earnings than the potential short sellers have bargained for.

Significantly, stark variations appear when the responses are subdivided by sector. The banking sector should be throwing the best party: 91 per cent of respondents are expecting profit growth – with 45 per cent expecting increases of greater than 15 per cent this year. And this comes on the back of record profits in 2003: a recent MEED survey established that the aggregate earnings of the top 60 GCC banks rose by 21 per cent in 2003 to more than \$7,000 million.

Also interesting are the views of the construction sector – which in a number of key markets such as Saudi Arabia, Kuwait, Qatar and the

UAE have been enjoying an almost unparalleled boom. The vast majority think the boom will continue – 80 per cent forecast turnover will increase by 5 per cent or more this year – but only 59 per cent are expecting this increase in activity to be converted into rising profits. The surge in the cost of raw materials seems to be trimming margins.

However, on an aggregated basis, the prospects of improved net earnings appear to be based on increasing turnover rather than cost-cutting or rationalisation programmes. Three-quarters of respondents expect trading volumes to increase this year – 34 per cent by more than 15 per cent – and only 3 per cent are anticipating a contraction in turnover.

Growing investment

The high appetite for increased investment reinforces the prospects for strong economic growth. Some 60 per cent of regional respondents see an increase in their investment budgets – 27 per cent see them as more than 15 per cent bigger year on year, and 33 per cent see them 5-15 per cent bigger. The surge of corporate investment – be it in expanding capacity or upgrading front or back-office systems – has been facilitated by a blend of factors including low interest rates and high liquidity, but the underlying force is a robust confidence in trading conditions.

And this confidence is spilling over national boundaries. The renewed emphasis on enforcing GCC-wide tariffs and the efforts made to reduce barriers to inter-regional trade are clearly having some impact. Figure 5 shows the extent of cross-border business activity: significantly, only 16 per cent of respondents said they operated in one market only. However, it also shows there are high expectations that trade flows will grow, with 52 per cent of respondents forecasting increases of more than 5 per cent over the next 12 months. Of these, the banking and finance sector participants are the most aggressive, with 63 per cent of them expecting cross-border activities to increase by more than 5 per cent over the next year.

But which markets will be the most important? The survey threw up a broad spread, but Iraq topped the list, followed by Saudi Arabia, the UAE, the US and China. The respondents demonstrated a clear conviction that there are short-term business opportunities in Iraq. Some 26 per cent are expecting to see activity in Iraq adding between 11-50 per cent to their company's business over the next 12 months.

Whether their optimism here – and elsewhere in the survey – is well placed remains to be seen. When the second survey is conducted in three months' time, it will be interesting to see whether there have been any significant shifts in the mood and outlook.

MIDDLE EAST ECONOMIC DIGEST

MEED

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