Gulf Family Businesses

From traders to protagonists of industrialization

WHAT SHOULD COUNTRIES DO IF THEY DO NOT HAVE OR SOON WILL RUN OUT OF NATURAL RESOURCES? THEY NEED TO REINVENT THEMSELVES BASED ON THEIR STRENGTHS, CAPABILITIES AND COMPARATIVE ADVANTAGES. THE GOAL OF THIS STRATEGY IS TO DEVELOP UNIQUE NICHES AND STRENGTHS PROVIDING THE BASIS FOR FUTURE PROSPERITY – AN IDEA THAT WAS FIRST DEVELOPED BY ADAM SMITH IN "THE WEALTH OF NATIONS" IN 1776.

There are many examples of successful implementation of this strategy: German engineering, IT and software in India, Singapore as a high-tech hub, shipbuilding in Korea, or tourism in Thailand, to name but a few. All these success stories have in common that the countries identified their unique profiles and capabilities and developed productive industries around these strengths.

Fuelled by its rich resources of oil and gas, the Gulf region has witnessed a phenomenal boom in real estate. However, real estate is not a suitable basis for a sustainable economy because it is not a productive asset – you cannot export flats. Even worse, building flats with imported material and labor actually moves value creation out of the country. Therefore, the Gulf countries need to focus on technology-driven industrial activities, in other words industrialization, as the backbone of their economies.

The value chains in the Gulf countries start with the state-owned oil and gas companies that extract natural resources. In a first wave, basic industries such as refineries, the petrochemical industry, aluminum smelters and others were established as large, state-owned companies. At the other end of the value chain many family companies are active in retail and trading on the basis of agencies and dealerships. In between these two ends, there is a sizeable gap in the value chains due to the almost complete absence of manufacturing industries other than basic ones. The key question now is: Who is the ideal protagonist in the Gulf countries to fill this gap?

Government companies, monopolies and central structures are unable to do this – and even if they would be able, the result would be an undesirable and inefficient state capitalism. The stock listed companies from the private sector are caught in the 'rat race' of short-term growth, short-term performance targets and quarterly results. They cannot fill the gap because their planning horizon is too short. Start-ups and entrepreneurs lack the capital and the structures necessary for the task at hand. Only one type of company has the capital, the long-term perspective, the management capability and the business experience to build the economic backbone for sustainable industrialization: small and medium size companies or in other words, the family businesses.

In fact, the competitiveness and strength of the German economy is based on such small and medium size companies, known as Mittelstand, that have filled this gap with engineering-based industrial activities. Today they represent 90 per cent of all companies, 90 per cent of total employment and much of the innovative power of the country.

It seems to be the right time for family businesses in the Gulf to consider giving more importance to industrial activities. For many years the focus has been on trading activities and so far, there has been no necessity or incentive for them to change course. However, family businesses should be spearheading their respective countries' industrialization efforts for four reasons. Firstly, they have a patriotic duty to support job creation for locals and long-term economic sustainability. Secondly, it is in their own interest to create an economy that provides sustainable jobs, and therefore income, to the population in order to secure the spending power of their retail customers. Thirdly, widening the business activities into manufacturing contributes to managing the traders' business risks associated with dependency on foreign product providers. Last but not least, engaging in industrialization creates a wide range of new growth opportunities to produce and export goods with higher added value.

To move ahead, family businesses must identify and consider their existing strengths, capabilities and potentials. These considerations must include regional aspects and advantages that allow them to implement greenfield projects in sectors of

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particular relevance for the Gulf countries such as renewable energy, aerospace or logistics – together with partners from Europe who bring in proven technology. In addition, the companies' status quo is the starting point to assess what is the best option for enlarging their value chains, for example backward integration, up- or downstream developments or even a complete change of focus. In any case, the industrialization requires the appropriate technology as a basis for any further step.

There are two basic options to get hold of such vital technology. Firstly, family businesses can engage in foreign direct investments in European technology companies with the view to tap into their industrial know-how and technological expertise. Secondly, family businesses can implement joint ventures and projects with European technology providers to develop industrial activities on the ground. There are some first examples for both options being executed, albeit on a highly strategic and governmental level. One such example is IPIC's purchase of Daimler shares and another one is the establishment of EADS/Airbus production facilities in the UAE under an agreement between the plane maker and Mubadala. However, these activities are quasi-governmental landmark projects and therefore can only be a first step. They must now be followed up by a broad private movement towards industrialization, spearheaded by the family businesses in the Gulf, together with their European partners.

It is now the ideal time to secure the access to world-class technology through foreign direct investments or via joint venture agreements with appropriate European companies. Many companies from the Mittelstand are facing difficulties in obtaining debt financing from their banks or equity financing from the capital markets in Europe. Therefore they are open to new sources of funding, in particular from abroad. The excellent reputation of being reliable, long-term partners is an important advantage in this context for investors from the Gulf countries, giving them an edge over Chinese or Russian investors both of whom have already started buying into European technology companies for the sole purpose of technology transfer. In addition to the financial dynamics, the MENA region is increasingly becoming a strategic focus area of European small and medium size companies: On one hand they regard the region as a major growth area going forward and have an interest to enter these markets. On the other hand rising costs of production in the East European countries encourage them to relocate production facilities to more attractive regions in other parts of the world.

It is highly encouraging to see that the first family businesses have commenced this transformation from trader to protagonist of industrialization, and we are delighted to further support them in this endeavor. ■

Prof. Dr. Bernd J. Hoefer
Chairman & CEO
A9C Capital - Business Consultants & Technology Advisors WLL