THE BUSINESS ENVIRONMENT

KEY POINTS

- Most Australian companies use commercial agencies to distribute their goods in the Gulf. However, companies need to take great care in choosing agents and drawing up agency agreements. As the long term trend is for agents' legal importance to decline, agents are looking to add more value and be more actively involved in businesses than in the past.

- Arabian Peninsula economies generally have similar, investment grade risk ratings to the Republic of Korea, Malaysia and Thailand, although Iran is rated significantly more risky. Further economic reform and diversification are critical to improve ratings.

- The Gulf region's young population will influence the future regional business environment. Young populations will stimulate demand for snack foods, housing, education, information technology and communication products. On the other hand, pressure to localise employment will grow as the number of local workforce entrants swells.

- Several Gulf jurisdictions' legal frameworks are not as well developed as western economies', so avoiding litigation is important to business success. To avoid litigation, undertake thorough due diligence on potential partners and use all available means of non-legal dispute resolution, such as negotiation and arbitration.

Understanding the Gulf region's unique history, religion and culture significantly improves the business prospects of today's traders and investors. For millennia, these countries have been trade crossroads between Europe, Asia and Africa, actively engaging in and facilitating international trade. The Gulf economies present an array of market types, ranging from extremely poor Yemen and lower middle income Iran, to very wealthy Saudi Arabia, the UAE, Qatar and Kuwait. Unusual demographic, ethnic and cultural diversity also influences commercial opportunities.

This chapter draws out the implications for western businesses of the region's religion, culture and history. It then assesses the regional legal environment and analyses some key business issues, including the role of distribution representatives, market risk, taxation, demographics, bureaucratic culture, the role of chambers of commerce, Arab-Israeli relations, the role of negotiation, marketing issues and visa requirements. Appendices detail taxation, labour and other business environment policies in individual economies.

RELIGION

Islam, the region's dominant religion, permeates policy making and daily life far more than religion does in western economies. For example, while exceptional by regional standards, the Leader of the Islamic Revolution in Iran and conservative Islamic theologians in Saudi Arabia considerably influence law making and economic policy. Islam also guides food and drink consumption, clothing patterns, financial sector activities and products, attitudes to advertising, sayings and phrases, and most of the population's world view.

The primary source for Muslim behaviour and beliefs is the *Koran*, the holy book of Islam, which is complemented by the Prophet Mohamad's sayings recorded by historians or *hadith*, and a large body of Islamic jurisprudence and scholarly analysis. *Sharia*, or traditional Islamic law, underpins the legal systems of all the Gulf states.

All Muslims should adhere to the five basic tenets of Islam:

1. *Al-Shahada* – declaring and living by the statement, 'there is no God but Allah and Mohamad is his Prophet'
2. *Al-Salah* – praying according to the laws of Islam, five times each day (three in the case of the S*hi'a* denomination)
3. *Al-Zakah* – giving alms to the poor (normally 2.5 per cent of income and inheritance each year)
4. *Al-Siyam* – observing the holy month of *Ramadan* (which includes abstaining from eating, drinking, smoking and sexual relations during daylight hours)
5. *Al-Hajj* – undertaking a pilgrimage to Mecca at least once in a lifetime, if affordable.

The Gulf region contains followers of both *Sunni* and *Shi'a* Islam. These two communities dispute the original method of choosing a successor to the Prophet Mohamad, and *Shi'a* followers allow appointed religious leaders, the *Imams* and *Ayatollahs*, to control religious doctrine. These differences do not radically affect the way of life in either community. The *Shi'a* dominate in Iran, form a majority in Bahrain, and account for a sizeable proportion of the Kuwaiti and Saudi populations.

The *Sunni* account for most of the Saudi and lower Gulf populations, and dominate in the rest of the Arab Middle East, except southern Lebanon.

CULTURE AND HISTORY

Understanding how Arab and Persian culture and history are different, and how they influence business practices, is critical to business success in the region.

Culture and History on the Arabian Peninsula

Contemporary Arabian Peninsula culture derives from traditional *bedouin* or nomadic customs, and from being Islam's birthplace. Until oil exploitation in the mid twentieth century, much of the Arabian Peninsula's settled population lived either in small cities in the west of present day Saudi Arabia or in Yemen. The rest of the peninsula was either populated by nomadic tribes, or was virtually uninhabited desert. The borders of twentieth century nation states reflect foreign power demarcations rather than traditional boundaries, and many are disputed.

Persian Culture and History

Iran (formerly Persia) has a long history of settled civilisations and contact with the outside world. The area encompassing modern Iran was a trade crossroads on the ancient Silk Road between Asia and Europe. While outside powers conquered Iran many times, it also controlled a regional empire and was a major centre of cultural, scientific and economic achievement. Consequently, Iranian national identity and pride in past achievements is strong.

ARABS AND PERSIANS

Despite geographical proximity and some cultural similarities, Arabs and Persians are completely separate peoples, often taking offence if misidentified or grouped together.

Arabs are of Semitic background, originally from the Arabian Peninsula and the Levant.[1] Arabic language belongs to the same family as Aramaic and Hebrew. Persians are of Caucasian ethnicity, and *Farsi* or Persian language is of Indo-European origin. Written Arabic and Persian overlap, especially in religious, scientific and political terminology, but common usage and grammar are quite different.

A common issue relating to Arab and Persian terminology is the official term for the Gulf itself. Iranians refer to it as the 'Persian Gulf', which is reflected in reflects the United Nations' and the Australian Government's practice, while Arabs refer to the 'Arabian Gulf'. Using an inappropriate term on official documents, such as export labels or contracts, can cause serious problems for the business involved and local partners or representatives.

[1] Semitic refers to a number of racial groups, including the ancient Phonecians and Assyrians, as well as Jews and Arabs.

Common Cultural Issues Influencing Business

Persian and Arab cultures share many characteristics, including regarding honour, face, modesty, hospitality, patience and trust as important indicators of character. Usually, foreigners' minor, unintentional cultural and social mistakes are forgiven; many business people and senior officials are western educated or experienced in dealing with westerners.[2] Nonetheless, culturally acceptable behaviour greatly assists communication between business people.

Personal Honour

Because personal honour is so important, including maintaining face against comments or actions considered insulting, confrontational behaviour is unlikely to succeed. Honour also applies to the family, where defending family, including extended family members, is extremely important. Behaviour, such as reluctance to bear bad news, is related to the importance of honour.

Modesty in Dress and Behaviour

Modesty is manifested foremost by relatively conservative dress and behaviour, by western standards.[3] While dress standards for westerners generally are more relaxed in the less conservative states of the UAE, Oman, Kuwait, Qatar and Bahrain, 'skimpy' clothing is culturally insensitive.

The traditional greeting between two Arab or Iranian men includes a hug and often a kiss on the cheek, as well as extensive personal inquiries. Most Middle Easterners use a handshake with foreigners and considerable social chat. In more conservative Gulf economies, greetings to foreign women may not include physical contact, as traditional people and religious leaders never physically touch a woman who is not family. However, many younger or more westernised Middle Easterners will shake hands with a woman. Generally, men and women should not publicly display affection; in Saudi Arabia, married couples do not even hold hands. In Bahrain and the UAE, conventions are less strict for foreigners, but behaviour should favour conservatism.

Hospitality

Hospitality is a key characteristic of Arab and Iranian culture. Generosity to guests is a strong tenet of Islam, but also stems from traditional tribal structures, and in the Gulf Arab case, the hardships of the traditional nomadic desert lifestyle where refusing hospitality to visitors could cause their deaths. Hospitality therefore is an integral part of business relationships. Guests should not refuse basic hospitality such as drinks and food, invitations to social functions or small gifts. However, they should treat more valuable gifts cautiously. If a business person accepts an expensive gift, a holiday or anything disproportionate to the business relationship, recipients may be seen as indebted to the provider and their negotiating position weakened (Williams, 1998).

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2 For more background and explanation of the foundations and evolution of Arab business and management culture, see Ali, 1990; and Bakhtari, 1995.

3 Male foreigners should wear a business suit during business hours, and a sports jacket or similar casual clothing on informal occasions (Ghassan, 2000). Female foreigners usually should wear a long sleeved blouse, long skirt or dress or loose-fitting trousers. In Saudi Arabia, foreign women must wear a loose-fitting black cloak or *abaya* to completely cover their normal clothing and should carry a large scarf to cover their heads if required. In Iran, all women must wear clothing to cover everything, except the face and hands, including upon arrival in the country.

Attitudes to Time and Meetings

Some Middle Eastern people are not rigidly tied to timing or deadlines; this should not be interpreted as discourtesy or lack of interest (Ghassan, 2000). While some business meetings may not start on time, foreigners should not assume that turning up late for meetings is acceptable. Because people accept invitations to simultaneously held events, last minute cancellations or changes of plan are common. In such situations, Arabs usually attend the more important event without concern for order of acceptance. Family obligations and responsibilities toward government leaders often override other considerations.

Arabs often view agendas as unnecessary, so they are best avoided, apart from providing a general outline of issues for consideration. Agendas including sensitive or uncomfortable issues will be counter-productive; such matters are only discussed when people are comfortable and ready to progress to them. Issues of real sensitivity tend to be canvassed toward the end of discussions, and often are addressed initially in indirect ways. Excessive note taking or verbatim reporting of meetings may be unacceptable and inhibit establishing strong personal rapport (Williams, 1998).

Friendship and Trust in Business Relationships

In both social and business contexts, many Middle Easterners are unwilling to trust people they do not know. Mutual respect and trust is the key protection in a relationship and most effective in ensuring fair treatment for all parties. Hence, while building trust takes time, it is an essential prerequisite for business relationships. An introduction from a trusted third party can slightly speed up this process, but several meetings, including some socialising, is normal before commencing serious business negotiations. Once established, regular visits and contact should nurture a business relationship. One order does not necessarily become several, even if the client is satisfied, unless the relationship is maintained.

Political and Historical Factors

Both Arabs and Iranians attach importance to the widely held perception that Australian business people are honest and reliable business partners. The feeling is widespread that Australians, unlike some other Westerners, do not have political ambitions or negative historical associations with the region. These factors create important advantages for Australians seeking opportunities to do business in both the Arabian Peninsula and Iran.

AWB LIMITED: A SUCCESSFUL LONG TERM STRATEGY

AWB Limited, formerly the Australian Wheat Board, has captured around two thirds of the A$2.4 billion per year Gulf wheat market through a strategy of developing long term partnerships with key regional buyers and governments.

In Abu Dhabi, in the UAE, AWB has been the sole supplier since a flour mill was established in the 1970s. In Iran, a close and longstanding relationship with the monopoly importer, the Government Trading Company, GTC, helps AWB routinely supply up to 60 per cent of Iran's import requirements. GTC greatly values AWB's continued supply, despite the Iran-Iraq war, US trade embargoes and Iranian economic difficulties. AWB has worked closely with Australia's Export Finance Insurance Corporation to extend short term insurance and finance to cover contracts under National Interest provisions, to maintain market competitiveness.

AWB promotes and markets Australian wheat as a distinct, branded product, with reliable quality designed to meet specific customer end use requirements. This strategy differentiates AWB from other bulk wheat suppliers, and meets the demand for quality and service that adds value to customer businesses.

Source: AWB Limited, 2000.

THE LEGAL ENVIRONMENT

The region has a distinct legal environment with *Sharia* law forming a basis for regional constitutions and applying to such civil issues as marriage, divorce and inheritance.[4] *Sharia* law recognises property rights and contractual obligations. However, beyond that, its direct business impact is limited; business law is not usually cited in religious texts and tends to be government legislated. Nonetheless, legal frameworks are not as well developed as in western economies, and avoiding litigation often is critical to business success.

Key legal issues for foreign companies operating in the Gulf include:

- undertaking thorough due diligence on commercial agents or investment sponsors to minimise the chances of costly, time consuming legal action
- complying with the complex foreign ownership laws, where movements above certain thresholds can be illegal or have major tax implications
- minimising the likelihood of paying compensation to agents in the event of non-renewal, or unjustifiable termination of agency agreements
- seeking intellectual property protection.

4 Information on the regional legal environment was kindly provided by UK law firm Trowers & Hamlin, which maintains a network of branch offices and cooperation arrangements with local counsel across the region. (See contact details at the end of the report.)

Courts do not always award interest or costs, and require Arabic documentation. Consequently, using the court system is generally the last resort after exhausting all avenues of negotiation and arbitration. Whenever possible, contracts should specify third country arbitration.

All regional economies anticipate substantial business law reform in the near future, with WTO requirements a major driver. Key priorities include developing competition laws, which currently only exist in Yemen, further improving intellectual property protection and reforming commercial agency laws.

Saudi Arabia

In Saudi Arabia, appeal to the Board of Grievances is an automatic right in commercial disputes, including claims against the government and government agencies. Practitioners regard the board as impartial in deciding between domestic and foreign interests. However, Saudi courts do not award interest or costs, and damages are limited to actual or tangible losses, with no means to recover loss of business reputation or anticipated future profit. Consequently, foreign companies prefer arbitration.

The enactment of the new Foreign Investment Regulation of 10 April 2000 marks the beginning of an extensive reform program of Saudi Arabia’s business laws. Already, laws on taxation of foreign companies and land ownership have changed, although how all the changes will work in practice is unclear.

The UAE

Federal legislation covers most key business areas to some degree. Individual emirates also have their own laws governing land, property, natural resources and taxation. The court system is not necessarily quick or efficient for resolving disputes and costs are not awarded, but frequently courts award simple interest of up to 12 per cent on disputed late payments. Chambers of commerce promote arbitration; however, court involvement is usually required for enforcement. Moreover, foreign arbitral awards and judgements generally are not enforceable without court endorsement.

The United States now considers intellectual property law sufficiently robust for it to remove the UAE from its ‘watch list’. However, as a WTO member, the UAE is likely to come under pressure to address the restrictive nature of its commercial agencies law. Competition and consumer protection laws also are lacking.

Iran

Foreign companies find the current legal situation problematic. Commercial law is codified in overlapping legislation, and the court system is inefficient and arbitrary. Moreover, government regulations constantly change and may override legislation; overlapping municipal, provincial and national legal jurisdictions also make it difficult to determine appropriate jurisdiction.

The strong likelihood of legislative change to business laws under the new, reform minded administration, particularly acceptance of international arbitration, is a positive sign.

Kuwait

Kuwait is undergoing a major reform of business laws, with a new industrial law passed in 1999 and new intellectual property protection law implemented in 2000. Courts are reasonably effective for resolving disputes, but arbitration is an important first step, and formally recognised in law.

Oman

Oman's WTO accession bid has helped business law reform. Oman tightened intellectual property protection in 1999, and should relax foreign investment and taxation laws discriminating against companies with foreign equity in 2000. The court system generally is effective for resolving disputes and becoming more so, as precedents are established. Arbitration is encouraged as the commercial court upholds both the decision to arbitrate and choice of governing law for, and location of, arbitration.

Bahrain

Bahrain's business law is generally well developed and respected. The courts are an effective, albeit time consuming means of resolving disputes. Bahrain has a developed arbitration system, with two commercial arbitration centres, one being the GCC States Centre for Arbitration. The highly regarded Bahrain Monetary Agency regulates banking and finance, and its prudential supervision of banking drives Bahrain's growth as an offshore financial centre.

Yemen

Yemen's business laws are well developed, covering intellectual property protection and competition policy, and equally treating Yemeni and foreign capital. Arbitration also is allowed, and if one party is non-Yemeni, the parties may agree to arbitrate outside Yemen. However, Yemeni courts require further development to support fully Yemen's modern commercial legislation.

Yemen's desire to accede to the WTO by 2005 should drive further legal reform.

KEY REGIONAL BUSINESS ISSUES

Regional business issues important to commercial success include:

- importance of agents and their changing role
- choice of a local investment partner
- degree of market risk
- taxation regimes
- changing demographics
- bureaucratic culture
- key role of chambers of commerce
- Arab-Israeli relations
- importance of negotiation
- need for a different emphasis in marketing
- visa requirements.[5]

[5] Foreign direct investment restrictions also are a critical issue. (These are considered in Chapter 4 - *Foreign Investment*.)

The Importance of Agents

Most Australian companies selling goods on the Arabian Peninsula initially use an agent to market and distribute their products. Generally in Oman, Qatar, Kuwait and Bahrain, by law, foreign companies exporting directly to the region must use local agents to distribute goods locally (Table 5.1). In the UAE, for products with low promotion and after sales service requirements, an exchange of letters between a foreign company and a re-seller can avoid legal problems associated with agency laws (United States Department of State, 2000). Agents are less critical in Iran, as the central bank prioritises all potential imports to determine foreign currency allocation. Instead, most exporters, particularly of basic food, industrial and agricultural items, submit tenders to government trading companies, ministries or merchants with an import licence.

On the Arabian Peninsula, choice of an agent is critical because laws governing agents and their relationship with foreign firms are inflexible, and in legal disputes, courts usually favour local agents. Furthermore, as mass advertising is less prevalent than in the West, agents and distributors are primary marketing tools. Australian companies establishing a presence in the region often engage specialist representatives with regional experience, such as Austrade, state government business offices or export consultants, to help find the right agent or distributor.

Agents' importance and contractual inflexibility increases the importance of drawing up formal agency agreements. Agreements in Arabic or Farsi should not be signed without independent translation (Fisher and Fisher, 1998). Clauses regarding individual responsibilities, performance, expiry and termination are critical.[6] For example, in Oman, local agents must be compensated when terminating an agreement, unless they clearly failed to fulfil prescribed obligations (British Bank of the Middle East, 1997a). The Saudi and Kuwaiti Governments have produced 'model' agency agreements, which can form the basis to negotiate a document both parties accept. In Saudi Arabia, any additions to the agreement cannot conflict with or detract from the model agency agreement. Specific legal advice on any proposed alterations is critical, as infringement of Saudi commercial law results in fines or bans on doing business there (Fisher and Fisher, 1998).

SAN REMO: SUCCESSFULLY EXPORTING TO THE GULF

San Remo Macaroni Company Limited has exported to the Middle East through an Australian manufacturer's representative for the last ten years. San Remo started with a limited range of pasta meals, then diversified into a wider range of pasta products, Asian noodles and snack foods under two brands. Over the decade, sales have fluctuated considerably, but presently exceed A$1 million and are growing strongly; noodles and snack foods presently are doing best. San Remo is implementing a new marketing strategy for pasta products and expects to double its export values over the next two to three years. In addition to the Gulf, San Remo exports to Egypt, Jordan and Lebanon. It has separate distribution arrangements in each economy.

Source: Giller, 2000.

[6] Importantly, an expiry date alone may not be sufficient reason to cancel a registered agency agreement.

DIFFERENT AUSTRALIAN APPROACHES TO EXPORT MARKETING

Current President of the Australia Arab Chamber of Commerce and Industry, Syd Giller, organises importing, marketing and distribution in all Gulf markets through his company, Austanz International. Austanz represents companies such as Berri and San Remo, focusing on accessing the most appropriate representatives to distribute products and developing suitable marketing strategies. Austanz works with local representatives on marketing and with distributors in preparing the initial draft of each annual marketing plan to ensure a consistent focus across regional markets, and to inject appropriate international marketing techniques. Giller maintains that successfully exporting retail ready products to the Middle East through an agent requires a whole hearted market commitment for at least three years. This commitment helped Berri and San Remo to succeed.

The Al Mutawie General Trading Company, managed by Australian, Barrie Harmsworth, also imports and markets Australian products, including metal manufactures and industrial abrasives, as well as construction related products from Europe. This company has a local partner who actively promotes the company's products and provides financial guarantees to obtain bank credit. Harmsworth believes the active participation of a well informed local partner, along with an experienced expatriate manager, can avoid damaging pitfalls in a market where exposure and risk often are difficult to determine accurately.

Source: Giller, 2000; and Harmsworth, 2000.

Future Role of Agents

Over the next five years, the agent's role is likely to change considerably. As elsewhere, e-commerce will reduce dramatically the role of intermediaries in many Gulf industries. For example, already major clients try to do business directly with Johnson and Johnson Medical Middle East (McLaren, 2000). In addition, WTO requirements increase the difficulty of reserving agency roles for nationals and of requiring exclusive agencies. For example, the Saudi Government recently banned the use of agents in bidding for downstream gas developments, while Oman and Bahrain no longer require exclusive agencies. Combined with tariff unification, these reforms will increase the scope to have one distributor for several different Gulf markets, rather than one distributor per market.

Generational change also is important in driving change in agents' roles. In the UAE, higher education levels and recognition that agents increasingly will need to add value means the younger generation are developing their own businesses and becoming more involved in actively running them (Deacon, 2000). This is opening up opportunities for Australian business, as these young entrepreneurs often seek non-traditional suppliers to help establish their businesses (Deacon, 2000).

Choosing a Local Investment Partner

Requirements for majority local ownership are common, particularly in the UAE, Kuwait, Iran and until recently, Saudi Arabia. (See Chapter 4 - *Foreign Investment*.) Even without these requirements, a strong local partner can be an important asset, facilitating prompt payment and market access. Finding the right investment partner often can be time consuming, but Austrade offices in the Gulf, and state government economic development offices in Dubai provide partner matching services for Australian companies. (See contact details at the end of the report.) Consulting and accounting firms like Talal Abu-Ghazaleh also can introduce foreign investors to wealthy local investors looking for joint venture opportunities (Hashem, 2000).

Contacts through other Australian firms and regional clients can be useful. In establishing its business supplying and installing mobile taxi data and communications equipment in Dubai, Raywood Communications found a 51 per cent local partner through the contacts of another Australian company already operating in the Middle East. The Dubai Transport Corporation helped check the partner's credentials, and locally based English solicitors drew up a partnership agreement (Elton, 1999).

Market Risk

Arabian Peninsula economies generally have similar investment grade risk ratings to the Republic of Korea, Malaysia and Thailand (Table 3.1).[7] Iran is rated significantly more risky; however, with most of Iran's foreign debt likely to be retired by 2002, prospects for a ratings upgrade are good.

The main factors positively influencing risk weightings on the Arabian Peninsula are large oil reserves and structural savings surpluses, which strengthen repayment ability. Saudi Arabia's 1998 gross domestic savings rate of 35 per cent compared to its gross domestic investment rate of only 20 per cent, while Kuwait's 1998 gross domestic savings rate of 25 per cent compared to its gross domestic investment rate of only 13 per cent (World Bank, 1999).[8]

Negative factors include weak fiscal and economic management and political and security problems. For example, in 1998 Saudi central government domestic debt reached 116 per cent of GDP, and throughout the region economic reform is progressing slowly and over reliance on oil continues. Internal political problems remain including succession concerns in Saudi Arabia and Kuwait, unresolved demands for democracy in Bahrain, ongoing banditry in Yemen and tensions between moderates and conservatives in Iran.

7 Except Yemen which attracts the most negative sovereign risk rating from Australia's Export Finance Insurance Corporation, and which Moody's and other leading international rating agencies do not rate.

8 Data for other Gulf economies are not available from World Bank, 1999.

Table 3.1

Low, Medium and High Risk Ratings

Moody's and EFIC Risk Assessments for the Arabian Peninsula and Iran

	Moody's long term bonds and notes ratings[a]	EFIC risk ratings[b]
Bahrain	Ba1	2
Qatar	Baa2	2
UAE	A2	3
Saudi Arabia	Baa3	3
Iran	B2	5
Oman	Baa2	3
Kuwait	Baa1	2
Yemen	na	6
Thailand	Baa3	3
Republic of Korea	Baa2	3
Malaysia	Baa3	3

Note: a Moody's investor service ratings: obligations that extend longer than one year are rated using Moody's Aaa-through-C long term rating symbols, with Aaa representing the highest credit quality, meaning that the obligation ranks highest in its margins of investor safety against credit loss, even under severe economic conditions. The lowest rating, C, indicates the lowest level of credit quality, meaning that the obligation has extremely poor chances of attaining any real investment value. In between, obligations rated Baa and above are termed investment grade. Those rated Ba and below are speculative grade. Moody's uses a separate rating system to rate securities that mature in less than one year.

b Export Finance and Insurance Corporation, EFIC, ratings also are by category, with 1 the lowest risk and 6 the highest. Ratings are effective as of August 2000 and may change over time.

na means not available.

Source: Moody's Investor Services, 2000; and Export Finance and Insurance Corporation, 2000.

Iran's higher risk rating stems from the slow pace of economic and political change, high reliance on oil for foreign exchange revenues and absence from international capital markets which gives it little flexibility to borrow new money or refinance existing debt during oil price slumps. Under these pressures, Iran twice rescheduled its bilateral debt in the 1990s. Nonetheless, Iran's higher country risk can be offset by lower buyer risk. For example, the Iranian Government Trading Company is a monopoly purchaser of basic foodstuffs with priority access to foreign currency through central bank letters of credit; Queensland Sugar Corporation and AWB Limited successfully expanded their exports to Iran through this company. (See Chapter 2 - *Australian Opportunities*.)

The Future

With the region's burgeoning infrastructure and project financing requirements, governments increasingly recognise the benefits of investment grade credit ratings. In 2000, strong oil prices should improve domestic fiscal positions. However, to improve their credit ratings, the Gulf economies also need to progress economic reform, further liberalise investment laws and level the playing field between domestic and foreign companies.

Complementing reform efforts with further economic diversification would reduce the risk associated with fluctuating oil prices. The UAE and Bahrain already have developed strong services sectors, while Qatar and Oman are particularly well placed to diversify with major gas projects coming on-stream, although the foreign debt incurred in establishing these projects needs to be reduced.

Taxation Issues

The Arabian Peninsula is unique in having no personal income tax, wholesale or point of sale taxes. Bahrain and the UAE also levy no corporate tax on firms in most sectors.[9] Generally throughout the region, corporate tax rates rise as profits and foreign equity rise (Appendix Table 3.1).

Foreign businesses often are taxed implicitly through higher charges for utilities and health care, and via a range of other charges. For example, according to BDO Hospitality consultants, a Dubai based management consultancy, governments progressively are using trade licences, residence visas and work permits for indirect taxation (Wilkinson, 1998). In addition, Abu Dhabi recently raised utility charges for expatriates by 80 per cent, albeit only to cost recovery levels (*Gulf Business*, 2000). Until revenue bases are broadened, this trend is likely to continue and spread to local citizens.

TAXATION OF AUSTRALIAN NATIONALS

Under Section 23AF of the Australian Income Tax Assessment Act, Australian businesses undertaking specific projects in the Middle East can apply to Austrade, which coordinates applications for the Australian Tax Office, to have the earnings of employees or contractors exempted from Australian taxation. Approval as an eligible project depends on factors including existence of foreign competition, employment of Australians, a net foreign exchange benefit or a goodwill benefit to Australia. Employees or contractors working for an Australian company on an eligible project can claim the salary related components of their remuneration package as tax exempt, thus ensuring a competitive position in the world labour market.[10]

Source: Deacon, 2000; and Moore, 2000.

Demographics

The Gulf region's young population and the importance of non-nationals in many economies have important business implications.

Young Populations

The Gulf Cooperation Council, GCC, economies' populations are very young, with 66 per cent of the population aged under 25 (*Gulf Cooperation Council*, 1999 and Figure 1.9).[11] This is due to the high

9 In the UAE, individual emirates levy corporate taxes in the oil and gas sector, and banking.

10 The Australian Tax Office does take the global earnings of the individual into account in determining the average tax rate. However, this rate only applies to Australian earned income.

11 In Iran, the proportion of the population aged under 25 is even higher, at 70 per cent.

birth rate of nationals, whose per capita incomes surged after the 1970s oil shocks, and to large numbers of young immigrant workers. This young population should stimulate demand for a range of products including education, music products, snack foods, travel, housing, electronics, information technology and communication products and mortgage finance. (See Chapter 2 - *Australian Opportunities*.) Pressures to lift employment growth also should maintain economic reform pressure. (See Chapter 1 - *Economic Prospects*.)

The Importance of Non-nationals

Non-nationals are an important element in all GCC markets, accounting for more than 70 per cent of the population in the UAE and Qatar, and 65 per cent in Kuwait (Figure 3.1). The different income levels and cultural backgrounds of expatriate and local populations in already small markets complicate advertising and marketing.

In many Gulf economies, non-nationals do virtually all menial, dangerous or lowly paid work, and fill many skilled and managerial private sector positions. In many cases, foreign companies will deal with non-nationals, although often a local citizen is still the ultimate decision maker.

Localisation of Staff

Young rapidly growing local populations, large non-national populations and state sectors unable to provide enough quality jobs for citizens drive attempts to increase local citizens' private sector role. The programs, known as Saudiisation, Omanisation, Emiratisation and Qatarisation, direct a range of industries to lift their employment of local citizens.[12] For example, by the end of 1998, 60 per cent of Oman's transport and storage industry workforce was expected to be Omani, as was 35 per cent of manufacturing, 30 per cent of the hotel industry and 20 per cent of the restaurant service workforce (Economist Intelligence Unit, 1999a).

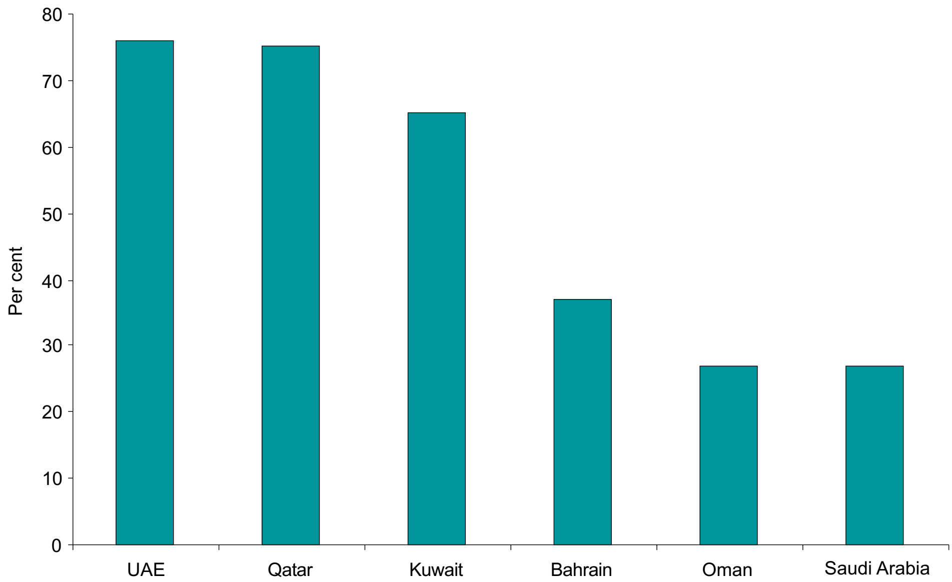
In the UAE, Emiratisation largely applies to banks, which must lift the average proportion of national employees from 12 to 14 per cent in 2000, then to 25 to 40 per cent by 2006; and individual banks must raise their Emirati workforces by 2 percentage points each year (Economist Intelligence Unit, 1999b; and Nangia, 2000).

[12] Employment of nationals is a lesser issue in Bahrain.

Figure 3.1

Non-nationals Most Important in the UAE and Qatar

Non-nationals as a Share of the Total Population, Per cent



Source: Business Monitor International, 2000.

Businesses also face taxes or administrative charges that increase the cost of employing expatriates. For example, in 1995, Oman levied a tax of 7.5 per cent of basic salary on expatriates, while Saudi Arabia recently increased the cost of visas, work and residence permits for expatriates from US$94 to US$427 (Economist Intelligence Unit, 1999a and 1999c).

Some local and foreign businesses are unhappy with this policy trend, claiming local workers cost more, are less motivated and change jobs more frequently than expatriate workers. In Oman, quotas in the hotel and restaurant trade may even restrain foreign participation in developing Oman's considerable tourist potential. Bahrain's approach may be preferable; there, the Government has sought to increase the skills and productivity of locals, and hence their relative attractiveness to employers. To supply staff for the banking sector, the Bahrain Monetary Authority supported developing high quality courses at the well regarded Bahrain Institute of Banking and Finance at Bahrain University. Consequently, while no quotas for Bahraini staff exist, foreign banks located in Bahrain speak highly of their Bahraini employees, and 70 per cent of staff of Bahraini banks are locals (Belooshi et al, 2000; Brodedelet, 2000; and Atkinson and Dixon, 2000).[13]

[13] As Bahrain is running out of oil, locals have no real choice but to find productive employment and cannot demand wages well in excess of their productivity.

Bureaucratic Culture

The Gulf region has a strong bureaucratic culture stemming from state led development and import substitution industrialisation policies pursued between the 1950s and the 1980s. The strong bureaucracy and formalised authority structures mean usually a small number of senior people make decisions. Access to these decision makers can be difficult, but often is vital to obtain an agreement, approval, or firm product order. Moreover, if businesses do not gain appropriate access, getting low level decisions reviewed can be difficult. Often senior officials make consensus decisions, which can slow down the decision making process.

The Greater Role of Chambers of Commerce

Chambers of commerce and industry in the Gulf states are more influential than in Australia, often performing a function closer to a Department of Industry in western economies. Each emirate in the UAE, as well as Bahrain, Kuwait and Qatar has its own chamber of commerce, while Saudi Arabia has a national chamber and a series of subordinate regional chambers. Establishing a business in the Gulf requires membership of the local chamber of commerce; this generates large revenue bases for chambers. These chambers are large employers and have strong relationships with government, which usually appoint chamber executives.[14] Chambers of commerce also help resolve agency disputes and oversee importing. For example, importers to Bahrain must belong to the Bahrain Chamber of Commerce and Industry, and importers to Qatar must register with the Qatar Chamber of Commerce (British Bank of the Middle East, 1997b; and Hong Kong Shanghai Banking Corporation, 2000).

The importance of Gulf chambers of commerce means business partners attach importance to the Australia-Arab Chamber of Commerce and Industry; membership can be an important market entry tool.

Labelling Requirements

The Gulf economies often require Arabic or Farsi labelling of food, medicine and personal care products. Required information is less prescriptive than in Australia, and includes product description, list of ingredients and the supplier's name and address. Even without legal requirements, Arabic or Farsi labelling and advertising is more effective than English only marketing.

Food and medical products also require an expiry date, equivalent to an Australian use by date, and a production date. In Saudi Arabia and the UAE, government regulations specify expiry dates; whereas, in Bahrain and Kuwait, manufacturers decide safe shelf lives for themselves (Giller, 2000).

Arab-Israeli Relations

Iran and all Arabian Peninsula economies, except Oman and Qatar, still boycott trade with Israel. However, since 1994, GCC economies no longer enforce secondary and tertiary boycotts of third parties dealing with or investing in Israel. Hence foreign firms now can maintain links with both Israel

14 Staff also frequently move between the chambers and government.

and most Gulf economies. Nonetheless, travellers to the Gulf region should not use a passport including Israeli entry or exit stamps.

Negotiation

Local Gulf businesses expect long negotiations, partly because they develop mutual confidence at a personal level. Final decisions often come down to price, but discussions often focus on quality and factors differentiating a product. Further, Middle Easterners frequently use diversions and strategic behaviour to gain the upper hand. For example, to gain concessions, local negotiators may express surprise at the price demanded or at a comment made. This should be politely refuted, taking care to avoid loss of face, and not interpreted as a breakdown in discussions (Williams, 1998). Maintaining a sense of humour and equanimity is important, although self deprecating humour may diminish the status of the person using it.

Factors particularly important to negotiating successfully in the Gulf economies include:

- putting proposals to appropriate people with decision making powers, such as heads of sections, vice presidents, and deputy chief executive officers
- being seen as a decision maker with a suitable title. A negotiator continually referring back to head office for authority quickly loses credibility
- pitching the initial offer at the right level, allowing scope for bargaining down but not seeming greedy.

Marketing

For many foreign businesses, commercial agencies remain an important marketing tool. Designing effective advertising is challenging because of the region's diverse populations. However, advertising is increasingly important because of the growing importance of brand identity and capturing market share.

Advertising also must suit local standards. For example, catchy one word slogans are rare in Arabic or Persian, and often cause misunderstandings. Material should be descriptive, 'soft sell', and even 'flowery' or dramatic. Highlighting how a product will help clients or save them money is more effective than telling clients what 'is best' for them. Material that includes an attractive woman, especially a scantily clad one, or an amorous couple, can be culturally insensitive, and is banned in Saudi Arabia and Iran.

VISAS

Obtaining visas is an important, and often time consuming administrative problem for foreign business people travelling to the Gulf region. A guide to visa rules for Australians for each country is:

- Bahrain – visas are available on arrival at Bahrain airport for stays under seven days; such stays require an onward or return ticket. Longer stay visitors require a visa issued in advance by an embassy abroad or arranged through a local sponsor
- Kuwait, Oman and Qatar – business travellers should arrange visas in advance through an in-country sponsor; usually this is the company with which business is being conducted or a top-end hotel. The sponsor deals directly with local authorities and is responsible for the visitor during the stay
- the UAE – the UAE Embassy in Canberra issues visas, usually in a few days. Sponsors also can arrange visas, with hotels again able to act as sponsors
- Iran – the Iranian Embassy in Canberra issues visas. Travellers need a cogent travel purpose; ‘business’ usually is not a satisfactory explanation. Travellers also should have a local contact or sponsor plus pre-arranged travel and accommodation bookings
- Saudi Arabia – business travel visas must be arranged in advance with a sponsor and the Royal Embassy of Saudi Arabia in Canberra issues them after the Ministry of Foreign Affairs in Saudi Arabia instructs them to do so. The sponsor is usually an actual or prospective business partner. Austrade also may be able to assist first time visitors with sponsorship arrangements. Business visa applicants with the requisite letter of sponsorship from a Saudi individual or company normally receive visas in three days; however, to be safe, allow two to three weeks for delays. For Australian citizens, normally domiciled in Australia, visas cannot be obtained outside Australia
- Yemen – business travel visas must be arranged in advance with a sponsor, and a letter from the traveller’s company must indicate the purpose of the visit. The Yemeni Consulate General in Dubai or Yemeni Embassies in Abu Dhabi, Riyadh, Kuwait, Qatar, Bahrain, Tehran or Muscat issue visas. Visas cannot be issued in Australia as Yemen maintains non-resident diplomatic relations with Australia, conducted from the Yemeni Embassy in Tokyo.

Note: These regulations may change without warning, and only indicate visa conditions at the time this report was prepared.
Source: Department of Foreign Affairs and Trade, 2000; and Austrade, 2000.

KEY ISSUES FOR AUSTRALIAN BUSINESS

Markets of the Gulf region present considerable opportunities for Australian companies willing to invest time and money cultivating contacts and searching for niche areas of demand. Key guidelines for doing business in the region include:

- studying the market, being aware of cultural and structural differences and carefully planning market entry
- allowing time for business relationships and agreements to develop
- taking extreme care in selecting agents, distributors and joint venture partners, including thorough due diligence to minimise the possibility of legal action which can be time consuming, expensive and hard to win
- taking a medium term view (two to three years) to initial market entry, and a long term view to servicing clients to maintain markets.

Appendix Table 3.1

Gulf Business Regulations

Saudi Arabia	
Corporate income tax	Sliding scale of 20 to 30 per cent for foreign firms, depending on the level of profit, although tax treatment favours lower foreign equity stakes. Tax holidays from five to ten years, if Saudi equity is greater than 25 per cent. Saudi and GCC firms pay *zakat* (Islamic alms requirement) in lieu of corporate income tax
Capital gains tax	Aggregated and taxed as regular income
Withholding tax	Applies to payments to non-residents, charged at corporate income rates on deemed profit of 15 per cent of the transaction's value
Personal income tax	Nil
Wholesale or point of sale tax	Nil
Social security/payroll tax	Employer pays 8 per cent levy and employee pays 5 per cent. Both Saudi and foreign staff pay a 2 per cent hazard levy
Foreign exchange controls	Nil
Labour supply	With the shortage of skilled workers, guest workers are common. Saudiisation of the workforce is a key priority, and businesses employing foreign nationals must increase Saudi employment by 5 per cent per year
Staff overtime/bonuses	48 hour week. Foreign employees invariably receive housing allowance and annual employer funded home leave
Staff leave	15 day minimum; longer periods common
Staff dismissal	Three month probationary period, severance payment of two weeks' pay for every year of service up to five years, one month thereafter
Employee health cover	8 per cent employer levy, 5 per cent employee levy and 2 per cent accident insurance payable by employee
Labour issues	Unions not permitted and strikes banned
Accounting principles	International standard
Foreign land ownership	Not permitted, but under consideration
Banking services	Small and sophisticated, with foreign banks well represented via joint ventures

The UAE	
Corporate income tax	Nil at federal level (except for oil, gas and banking sectors)
Capital gains tax	Nil at federal level
Withholding tax	Nil at federal level
Personal income tax	Nil
Wholesale or point of sale tax	Dubai municipality levies a 5 per cent tax on rent and leases
Import duties	0 to 5 per cent
Social security/payroll tax	Nil. Mandatory public health care card costs a nominal fee
Foreign exchange controls	Nil
Labour supply	With the shortage of skilled workers, guest workers are common. Visas usually, though not always, are available. Emiratisation of the workforce is a key priority in service sectors
Staff overtime/bonuses	Generally 48 hour week, with set overtime and bonus rates subject to individual workplace agreements
Staff leave	30 working days per year
Staff dismissal	Severance payments of 21 days pay for every year of service up to five years, 30 days thereafter
Employee health cover	Good quality, state provided care for nationals and residents. Employers to supply any additional cover
Labour issues	Unions not permitted and strikes unheard of
Accounting principles	International standard
Foreign land ownership	Not permitted but leasehold arrangements under consideration
Banking services	Quite sophisticated, with foreign banks well represented. The UAE is becoming a regional banking centre
Stock/financial markets	Newly opened stock exchange in Dubai, soon to be extended to Abu Dhabi

Iran	
Corporate income tax	Complex and as deemed by authorities; not based on company records
Capital gains tax	As for corporate income tax
Withholding tax	Varies according to type of payment
Personal income tax	Expatriates pay 50 per cent of deemed income
Wholesale or point of sale tax	Nil
Social security/payroll tax	Employers pay 23 per cent and employees pay 7 per cent
Foreign exchange controls	Strict. Converting local currency to hard currency is complex
Labour supply	Some shortages of local staff in high technology or other skilled areas; otherwise good local labour supply and high unemployment
Staff overtime/bonuses	Yearly bonus of one month's salary
Staff leave	Three weeks per year
Staff dismissal	Theoretically difficult; although foreign companies manage to hire and dismiss staff, they must pay end of service indemnity
Employee health cover	Provided by the state
Labour issues	Unions and legally organised strikes permitted, although uncommon
Accounting principles	Theoretically, international standards apply
Foreign land ownership	Not permitted
Stock/financial markets	Effectively closed to foreigners

Bahrain	
Corporate income tax	Nil
Capital gains tax	Nil
Withholding tax	Nil
Personal income tax	Nil
Wholesale or point of sale tax	10 per cent municipality tax on rent and leases
Social security/payroll tax	For nationals, employers pay 10 per cent, and employees pay 5 per cent. For foreigners, employers pay 3 per cent
Foreign exchange controls	Nil
Labour supply	With some staff shortages in skilled areas, guest workers are common
Staff overtime/bonuses	48 hour week. Severance pay is 15 days' pay for each of the first three years, and one month per year thereafter
Staff leave	21 days after a year's service, and 28 days after five years' service
Staff dismissal	Difficult as employers must give adequate notice and pay end of service indemnity
Employee health cover	State provided
Labour issues	Generally peaceful
Accounting principles	International standard
Banking services	Very sophisticated, with many international banks in the local and offshore markets. Bahrain is a regional banking centre

Oman	
Corporate income tax	Omani firms pay 5 to 7.5 per cent depending on profits. Foreign firms with Omani participation pay 15 to 25 per cent. If Omani equity is less than 10 per cent, firms pay up to 50 per cent tax. Oil exploration and production firms are treated separately
Capital gains tax	Taxed as regular income
Withholding tax	10 per cent levy on firms without a permanent presence in Oman
Personal income tax	Nil
Wholesale or point of sale tax	Nil
Social security/payroll tax	Employers pay 8 per cent, employees pay 5 per cent and government pays 3 per cent
Foreign exchange controls	Nil. Public or limited liability companies must contribute 10 per cent of profits to a statutory reserve, similar to a withholding tax
Labour supply	With some shortage of skilled workers, guest workers are common
Staff overtime/bonuses	45 hour week. Severance pay of 15 days for first three years, one month for each subsequent year
Staff leave	Three to four weeks per year
Staff dismissal	Difficult to dismiss nationals, and strict severance pay requirements exist
Employee health cover	Employer pays 1 per cent levy
Labour issues	Disputes effectively unheard of
Accounting principles	International standard
Foreign land ownership	Not permitted
Banking services	Small and sophisticated, with foreign banks well represented

Kuwait	
Corporate income tax	Kuwaiti and GCC firms pay no tax. Foreign firms pay from 5 to 55 per cent tax, depending on profit levels
Capital gains tax	Nil
Withholding tax	Nil
Personal income tax	Nil
Wholesale or point of sale tax	Nil
Social security/payroll tax	Payable for Kuwaiti employees
Foreign exchange controls	Nil. Public or limited liability companies must contribute 10 per cent of profits to a statutory reserve
Labour supply	With a significant shortage of skilled workers, guest workers are common
Staff overtime/bonuses	Most companies pay annual bonuses, and overtime ranges from 25 to 200 per cent of basic salary
Staff leave	14 days for the first year of service; 21 days after five years' service
Staff dismissal	Must give one month's notice with reasonable cause. No severance pay requirements
Employee health cover	Provided by the state
Labour issues	Unions are legal; membership is optional
Accounting principles	International standard
Foreign land ownership	Not permitted
Banking services	Relatively sophisticated, with many foreign banks operating

Qatar	
Corporate income tax	Foreign company profits and dividends are taxed at 10 to 35 per cent. Tax exemptions are available for significant national development projects, or those involving considerable technology transfer
Capital gains tax	Aggregated and taxed as regular income
Withholding tax	Final payments are withheld, but offshore payments are exempt
Personal income tax	Nil
Wholesale or point of sale tax	Nil
Foreign exchange controls	Nil
Labour supply	With some shortage of skilled workers, guest workers are common
Staff overtime/bonuses	48 hour week. Severance pay is 15 days' pay for the first three years, one month for each subsequent year
Staff leave	Two weeks per year for up to five years' service, four weeks thereafter
Staff dismissal	One month's notice for up to five years' service, four weeks thereafter
Labour issues	Formal arbitration mechanisms exist; strikes are permitted but are uncommon
Accounting principles	International standard. Accrual
Foreign land ownership	Not permitted
Banking services	Small and sophisticated, with foreign banks well represented

Source: Most of the information contained in the above tables came from Ernst and Young's Middle East website, www.eyme.com/section/doing_business/index.htm, accessed on January 14,15 and 16, 2000; additional information was provided by Austrade following interviews with Senior Trade Commissioners in the Gulf region in January 2000.

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