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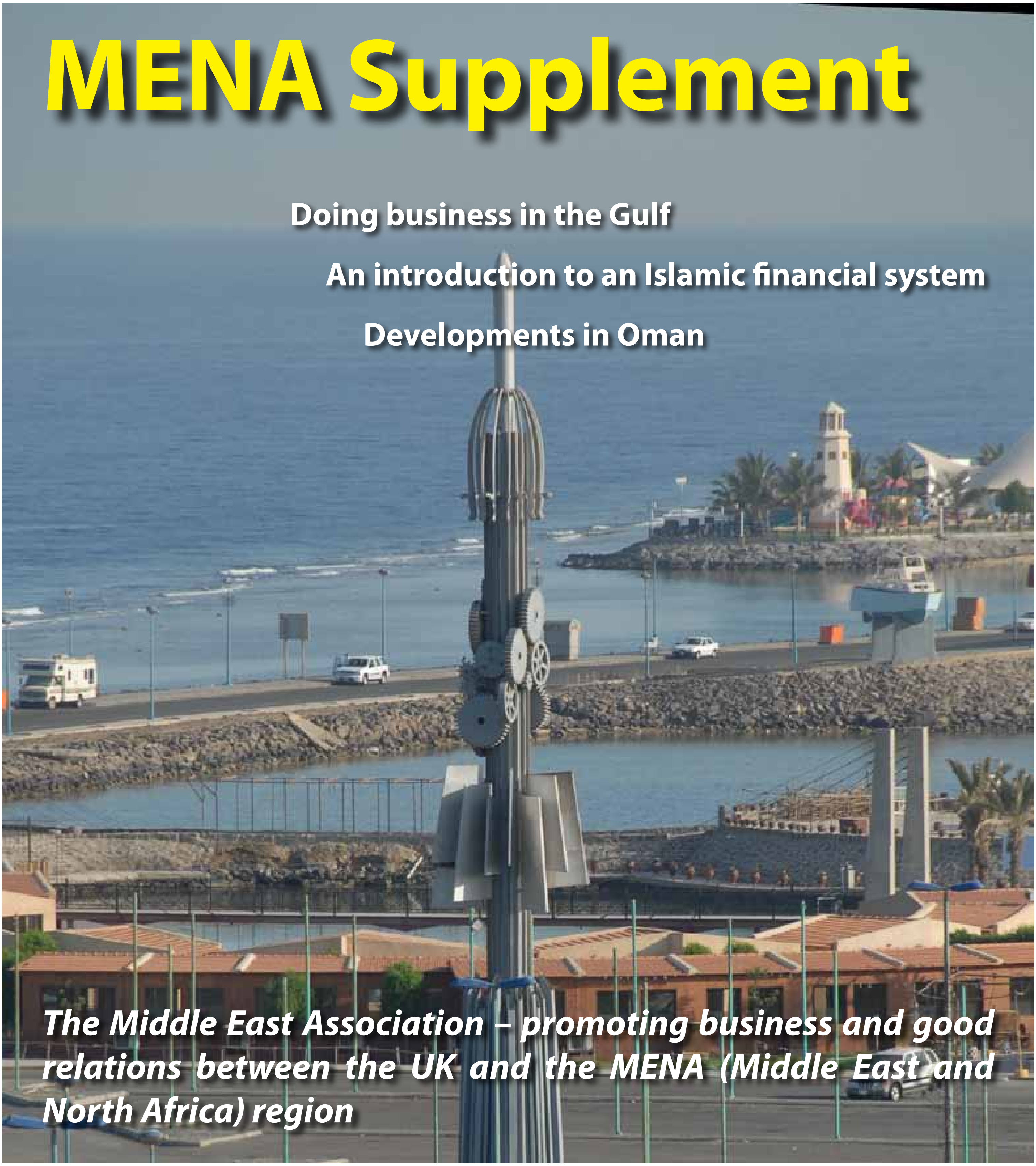

MENA Supplement

Doing business in the Gulf

An introduction to an Islamic financial system

Developments in Oman

The Middle East Association – promoting business and good relations between the UK and the MENA (Middle East and North Africa) region

THE GLOBAL TRADE PLATFORM

Oman Trade & Investment Forum promotes Oman/British business relations

The Middle East Association's Oman Trade & Investment Forum, which took place on 21 October and marked the 40th anniversary of the accession of HM Sultan Qaboos bin Said, was a resounding success. London's prestigious Mansion House was full to bursting for the landmark event, which was attended by over 270 delegates, including around 60 senior Omani government representatives and business leaders accompanying HE Maqbool Ali Sultan, Oman's Minister of Commerce & Industry.

Organised with the full backing of the Oman Centre for Investment Promotion and Export Development (OCIPED), the Embassy of the Sultanate of Oman in London, the Omani British Friendship Association Business Council and UK Trade & Investment, the Forum opened the eyes of British business to the latest developments and opportunities in Oman, highlighting Oman's achievements over the past 40 years and the country's attractions for foreign investors. While the strength of the UK's relationship with Oman was underlined, speakers warned against complacency, with Baroness Symons, Conference Chairman commenting that the relationship *"needs to be refreshed to grow stronger"* and Alan Duncan MP, UK Minister for International Development characterising Oman as a *"loyal and generous ally, but who we must never take for granted".*

"Oman is a high growth, low risk, stable, competitive and resource rich country"

Opening the conference Michael Thomas, former Director General at the Middle East Association, underlined the need for British companies to be *"up to speed with the latest developments in Oman"*, noting the $14.5 billion industrial investments in the Port of Sohar and plans for the development of secondary industries. He spoke of the significance of Salalah, now the port of choice in the region for the four largest container lines in the world and the potential for the establishment of joint ventures in the free zones as a secondary industries centre serving the region. *"Oman's doors are wide open to British business people and it is up to us in the UK to take advantage of this,"* he said.

Steady development

Baroness Symons highlighted Oman's steady development in areas ranging from international relations to infrastructure, national institutions and education as well as the impressive growth in its economy and trade. It is an increasingly attractive investment destination as a result of its tax and other reforms, its diversifying economy and development of tourism, ICT, financial services, water and energy industries. She acknowledged Oman's commitment to its young people and the development of human capital, and the potential for the UK to forge *"important lasting partnerships"* in education and skills development.

Former Lord Mayor of the City of London, Alderman Nick Anstee, commented that in the 40 years since the Sultan came to the throne Oman has been "transformed", noting the Sultanate's progress towards a diversified knowledge based economy with an expansion of education, development of scientific research and IT. *"You are investing in the oil and gas industry, but also in infrastructure development for tourism, in protecting Oman's coasts, and in preparing Omani citizens for a greener future with the development of renewable energy,"* he said. Record budget surpluses are adding impetus to Oman's ongoing infrastructure and industrial development programme. *"It goes without saying that within this new Oman there is a wealth of opportunities for UK firms to work in partnership with Oman."* He highlighted in particular the scope for cooperation in education, training and qualifications, SME development and investment in both directions.

Alan Duncan MP, UK Minister for International Development, highlighted the strong relations between the UK and Oman, The 40th anniversary would soon be celebrated by a State Visit of HM the Queen. *"I am certain that this will help to pull us even closer together and to open up new possibilities for greater partnership,"* he said. He pointed out that the UK was the largest overseas investor in Oman in 2009 and trade with Oman had increased by 60% over the past five years. He noted however that the UK is losing market share, both to established competition and to emerging markets such as India, China and Korea. While British companies continue to win significant levels of new business *"we could and should be doing more"*. He noted the multi-stranded infrastructure development programme underway focused primarily on free-trade zones, industrial hubs, ports, road and core utilities and noted that more than $10 billion of civil, industrial, transport, petrochemicals, oil and gas and tourism projects are planned, as well as $7 billion in power generation and water desalination projects. He also mentioned opportunities in enhanced oil recovery, the development of a new generation of solar and wind projects and the "critical" importance of education, where the UK has an "outstanding reputation". "*Realising those opportunities together would be the best way to celebrate the 40 years of His Majesty's rule and the great association between the Sultanate and the UK,"* he said.

HE Maqbool Ali Sultan, Oman's Minister of Commerce & Industry, addressing the conference

HE Maqbool Ali Sultan, Oman's Minister of Commerce & Industry, highlighted Oman's "remarkable achievements" over the past 40 years in both social and economic development, noting in particular the progress achieved in the empowerment of women. Oman faces two

"We want the UK to be Oman's - and the wider Gulf's - commercial 'partner of choice'. British business and expertise have much to offer the region"

main challenges, he said – further diversification of the economy, and human resources development. Discussing Oman's economic diversification strategy, he noted that Oman has been successful in attracting multinational investors in many industries such as methanol, fertilisers, aluminium and steel and is now diversifying into non-oil and non-gas sectors such as tourism, knowledge economy, fisheries, food, trade, minerals and manufacturing. He called for further British private sector investment in Oman to sustain the strategic relationship between Oman and UK, and to support SME development and employment creation. *"British companies should look at Oman as a strategic location using it as a hub for trade with countries like Yemen, Iran, East Africa, GCC and others, benefiting from Oman's political and economic stability, its excellent relations with all its neighbouring countries and its friendly and flexible laws which welcome foreign investments."*

Business environment

A panel session moderated by Martin Amison, Co-Chairman, OBFA Business Council and Partner and Head of International, Trowers & Hamlins, painted a picture of the excellent business environment in Oman and the Government's focus on encouraging business and investment. Attractions include clear laws, strong regulation, an independent judicial system, low taxes (flat rate of 12% corporate tax, no personal income tax), free trade agreements with various trading partners including India, the USA and Arab countries, the availability of OCIPED as a one stop shop for dealing with Ministries, and investor friendly laws relating to ownership of businesses, land and labour. As Eng Awadh Salim Al-Shanfari, CEO, Salalah Free Zone Company pointed out, *"Oman is a high growth, low risk, stable, competitive and resource rich country."*

In particular discussion focused on the advantages of Oman's Indian Ocean ports and associated free zones, which are successful manufacturing bases for many businesses with the availability of strong local infrastructure, excellent communications, support and incentives from the Government and advantageous geographical location outside the Arabian Gulf. Salalah, with its competitive freight costs, has developed as a major transhipment port, and its free zone has attracted more than $4 billion of international investment over the past two years. Sohar is a major industrial port with hydrocarbons, metals and minerals clusters, and its adjacent free zone is focusing on logistics, downstream industries, manufacturing, services and niche industries. Duqm will develop as a huge port over the next ten years, with the world's largest dry dock.

A panel session on financial services, moderated by Ewan Stirling, CEO of HSBC Oman, discussed Oman's diversified, robust and well regulated financial services sector and the role of this sector in underpinning economic development. It was noted that Oman's banks had survived the financial crisis in good health. Encouraging statistics were provided as to growth, with real GDP growth per capita forecast at 4.5% for 2010. $2.4 billion has been allocated to new infrastructure projects in 2010, including airport projects, petrochemicals, aluminium smelting and the expansion of LNG facilities. The panel felt that considerable advances had been made and would continue to be made in the sophistication of the financial services industry in Oman. It was suggested that corporate bonds, asset management, and insurance would be areas for future development and offer scope for co-operation, while education, training and qualifications, would continue to offer opportunities - there have been significant British successes here, such as the Chartered Institute for Securities & Investment (CISI) agreement with the CMA to develop management programmes for intermediaries in the capital market.

A panel session moderated by Dr Phil Goddard, Director, The Energy Industries Council, discussed power, water and renewable energy. Oman was the first country in the region to implement a privately financed independent power project, and private sector involvement in the power and water sector has grown strongly. There will be huge expansion in the power and water sector over the next five years, focusing on expansion of networks and transmission. Further IPPs will be rolled out on a well established model. There is also currently a focus on the development of renewable energy projects. At the present time, Oman is looking to set up small scale pilot solar and wind projects and policies are being developed to support large scale projects and further research. A feasibility study for a large solar project was initiated in 2009. Oman has good solar and wind resources and it is believed there is great potential for CSP projects in particular. A mix of technologies is being rolled out and there is a supportive regulatory environment.

Strong ties

In a keynote speech Dr Noel Guckian OBE, HM Ambassador to Oman, stressed the strong ties between the UK and Oman, particularly in education, with 37% of Oman's overseas students studying in the UK and all Oman's English teachers having been taught by Leeds University. He referred to the 40/40 scheme that was supported by the British Government through British Scholarships for Oman. Dr Guckian encouraged British educational establishments to establish branches in the Sultanate.

The strong potential for cooperation in education and skills development was further discussed in a panel session moderated by Stephen Thomas OBE, CEO Renaissance Services. Oman's Omanisation programme has been very successful but there is a continuing need to equip Omanis with skills to contribute to Oman's growing and diversifying economy, to develop initiatives to create new jobs, and

Alan Duncan MP, UK Minister for International Development, addressing the conference

to promote SME development. There is tremendous scope for British companies to assist with capacity building to develop a skills base aligned to industry needs, for example in enhanced oil recovery, where new skills and competencies are required, tourism and hospitality, enterprise skills, English language skills and other areas relevant to the Omani economy.

The private sector is playing an increasing role in higher education, and there are opportunities both for the development of affiliations with private higher education institutions, and for the establishment of branches of UK universities, as well as in assessment and accreditation.

A panel session moderated by Alison Cryer, UK Director of Oman Ministry of Tourism Representative Office, discussed tourism and hospitality. Delegates were treated to a slide show illustrating Oman's amazing natural beauty. Tourism currently accounts for 2.9% of GDP and plays a valuable role in employment creation. Current levels are expected to rise, with arrivals growing at an average annual rate of 13%. Oman's commitment to sustainable development through tourism was underlined. A number of new hotels are due to open from 2012 onwards and forts are being renovated into boutique hotels. Oman Air's routes, with a growing fleet of long range planes, will bring tourist trade to Oman from all around the world, and Oman is working to develop markets such as Russia, India and China. The conventions and events side is developing as are cultural and niche tourism, with the Royal Opera House due to open next year and other international attractions being developed.

Making the closing speech, UK Foreign Office Minister for the Middle East, Alistair Burt MP, underlined the priority which the UK Coalition Government attaches to elevating commercial relations with the Gulf, mentioning that the conference fell during a week of Gulf-related activities. He noted that UK trade with Oman continues to rise – up by 46% over the first quarter of this year and by 61% since 2006. *"We want the UK to be Oman's - and the wider Gulf's - commercial 'partner of choice'"* he said. *"British business and expertise have much to offer the region."*

The conference was very well received, serving as an inspiring introduction to British companies new to Oman, while those already involved in the market appreciated the opportunity to meet up with Omani contacts. It was followed on Friday 22 October by business to business meetings at the Middle East Association offices, when members of the Omani delegation met with representatives of Middle East Association companies to explore partnership opportunities. ■

The Middle East Association is taking a trade mission to Oman from 4-8 February 2011. Contact Feride Alp (feride@the-mea.co.uk, tel: 020 7839 2137) for further information.

Middle East Association

Doing business in the Gulf

Alan Wood[1] is a Partner and Head of the Pinsent Masons' Corporate Group

This week I had the pleasure of speaking at the Britain in the Region event in Dubai[2]. The event attracted over 300 British companies and, although hosted in Dubai, allowed delegates access to UK Trade and Investment advisors and private sector experts from across the whole of the Middle East and North Africa region from Egypt in the west to Oman in the east. The event has been mirrored by events organised by other European governments and the US government to promote and assist their companies trading in and with the Gulf region.

The size of the event this year and the number of UK companies attending was a further sign of the growing importance of the Gulf region for many international companies. Indeed, at a time when the economic and business conditions for European businesses in their traditional markets remained extremely challenging, the opportunities for doing business in the Gulf region represent a significant opportunity for many to grow their business internationally and diversify their customer service.

Even a cursory look at the figures in terms of year on year growth in GDP for countries across the region and their respective plans for growth over the next fifteen years reveals the almost mind boggling aspirations they have for their economies. Those aspirations are typically set out in 2020 or 2030 growth plans and include a multitude of projects on the hard and soft infrastructure side, all aimed to enable countries in the region to attract an array of businesses across various sectors and so to reduce their dependence on oil and gas. For some in the region like Abu Dhabi, Qatar and Saudi Arabia this long term aim is being funded by current production, but for others, most notably Dubai, who have only very limited oil and gas reserves, the programme is having to be funded by the trade it intends to generate.

"As well as the opportunities in the Gulf region itself, the regions geographic location means that it is increasingly being seen and used as a hub for, and gateway into, the surrounding markets on the Indian sub continent and Africa"

As well as the opportunities in the Gulf region itself, the regions geographic location means that it is increasingly being seen and used as a hub for, and gateway into, the surrounding markets on the Indian sub continent and Africa. Once again the opportunities those markets provide are staggering and so it is no surprise that the Gulf generally, and the lower Gulf in particular, has come to be known as the new silk road. So what do companies need to think about when considering whether to enter the Gulf region or, for those who are already operating in the region, taking those operations to the next level?

Like any international expansion, the process and pitfalls can appear daunting when encountered for the first time and clearly new entrants need to take their time and seek advice from those in the region to demystify some of the regional peculiarities and explain the process. They also need to recognise that whilst the legal systems adopted across the Gulf States are broadly similar (they are all based on a civil law system of Codes), there are differences between jurisdictions and nuances which need to be taken into account. One area where this is true is in terms of the degree to which Sharia law is applicable to businesses in different Gulf States.

For those completely new to the market there are various options for entering the market.

Agents and distributors

For many foreign companies the preferred way to start trading in the Gulf is to appoint a local agent or distributor to market their products. This approach has the added attraction of allowing foreign companies to draw on their local agent/distributor's connections and relationships in the region, and avoids the need to devote large amounts of their own manpower or capital to support the operation and develop their regional brand. Sectors where agents and distributors are particularly popular include automotive and retailing. For those looking at this option there are nonetheless some pitfalls to watch out for. Those issues include the agent/distributor's ability to deliver what they promise in terms of market penetration and the ability for the foreign company to end the arrangement if things do not work out as planned.

Deliverability

Invariably when talking to local agents/distributors they will promise much in terms of their ability to market and sell products and penetrate the local market. At this level this is no different to appointing agents/distributors anywhere else in the world and, as with all such appointments, that confidence needs to be tested to establish industry sectors and jurisdictions where the agent is particularly strong or weak.

The Gulf generally and indeed even the GCC remains a fragmented series of markets in terms of jurisdictions and so the right choice of agent/distributor for the UAE may not be the best person to market the same product in KSA or Qatar where their relationships and business connections may be less. Indeed, even within the UAE, foreign companies may find that an agent/distributor with strong connections in Dubai is far less well connected in Abu Dhabi.

Termination

What perhaps makes the issue of deliverability more important in the Gulf than in other regions is the fact that anyone looking to appoint an agent/distributor in the Gulf needs to understand their ability to and the cost of ending the arrangement, either after a period agreed at the outset or sooner if the agent/distributor is not delivering what they promised. The issue here is that in many Gulf States the agent/distributor will be a "local" and the laws have been drafted in their favour, either preventing termination or non-renewal or entitling the agent/distributor to compensation and an ability to block imports of a principal's product whilst any dispute is being resolved.

Foreign companies need to be particularly wary of commercial arrangements designed to avoid the protective aspects of agency laws in the region. Often, for example, a franchise arrangement designed to fall outside the ambit of agency laws will be treated as an agency agreement and so it is always advisable to have professional advice before committing to such arrangements.

Establishment

For those looking to go a step further and establish their own presence in the Gulf there are a bewildering number of choices which vary (at least in terms of terminology) between the different Gulf states. Business will be bombarded with references to mainland versus freezone entities, LLCs, WLLs, branches, representative offices and many others.

Again, the key is to take advice to establish what structure will work best for a particular company and to ensure that the proposed vehicle will enable the business to do what they want in the relevant jurisdiction.

A particular mental hurdle for many foreign companies looking to establish a regional company is the restriction on foreign ownership which still exists to differing degrees in different countries and industry sectors in the region. Whilst those restrictions have started to ease and look set to be relaxed further, they still apply in some of the key jurisdictions in the Gulf such as the UAE and are often a deterrent to foreign companies. Like many of the regional issues faced by foreign companies the issue need not, in reality, be as daunting as it first appears. A custom and practice has developed to allow compliance with the legal requirements whilst also accommodating the underlying intention of the foreign investors in terms of entitlement to profit and the management of the local entity.

For many the process of establishing their own entity in the Gulf proves to be somewhat of an endurance test. Certainly, foreign companies need to understand that, relative to the time and process involved with establishing a company in many western countries, the time and process involved in doing so in the Gulf is considerably greater. One particular example of this is the need for documents in relation to foreign companies to go through a process of being notarised and then legalised (both in the home jurisdiction and within the Gulf State where an application is being made), often by three separate government offices, and then having to be translated into Arabic.

"...laws have had to adjust to reflect the dramatic change in the size and nature of business in the region over the past three decades"

A final point to note is in relation to licensing. Typically in the Gulf, not only must a company be properly incorporated as a legal entity but it must also be properly licensed by the relevant government ministries. Licensing will take a considerable amount of effort on the part of a company in dealing with the generally numerous demands from government ministries to file and submit various applications and documents.

Joint ventures

It is certainly true to say that the Gulf retains a very strong relationship culture when it comes to business. This fact and the continued growth of regional companies who have developed a strong position in a number of sectors (for example, construction and telecoms) mean that many foreign companies see the best road to market their products or services to be to joint venture with a local company. Drive around any of the Gulf States and the signage on buildings, shops and showrooms illustrates this. An example is Carillion's joint venture with Al Futtaim in the UAE.

For those looking to joint venture or partner with local companies in the Gulf many of the issues which need to be considered will be the same as those discussed above in relation to the appointment of an agent or distributor in the region. Whilst the phrase is somewhat clichéd, overseas investors need to remember the old adage of "marry in haste, repent at leisure" since like the appointment of an agent or distributor, they are likely to discover that once they have chosen their joint venture partner they will face a number of legal and commercial obstacles if they want to make a change. One particular question to ask is what are the local JV partner's drivers for entering the relationship and what other joint ventures or agency/distributorships are they a party to.

Whilst other interests may demonstrate the strength of their knowledge of and relationship in the sector, foreign companies need to take care to ensure that those other interests will be complementary to and not competitive with the partners or agent/distributor's promotion of their business in the region.

For companies already operating in the Gulf there are other things to be aware of and these will include:

Bribery and corruption

As well as the regional challenges in doing business in the Gulf, companies operating in the region will also need to be aware of and comply with the laws of their home jurisdiction which have extra territorial reach and so which also catch their overseas operations.

In recent years the best example of this has been the impact of "domestic" legislation in relation to the prevention of money laundering and bribery and corruption on international companies operating in the Gulf. Whilst the provisions of the US Foreign Corrupt Practices Act and the UK Bribery Act applicable to those operating in the Gulf are the same as those applicable elsewhere, the application of those provisions raises particular questions in the Gulf where the gift and hospitality culture have long been a feature of the way in which long term relationships are developed and maintained and business undertaken.

Transparency and corporate governance

Perhaps because of the size of their markets and the astonishing growth they have achieved over recent years it is easy to forget that most of the Gulf States are relatively young countries. Whilst all have adopted a codified legal system and all of them also apply, to differing extents, Sharia law, their laws have had to adjust to reflect the dramatic change in the size and nature of business in the region over the past three decades.

In the area of transparency and corporate governance that adjustment is still very much a work in progress and foreign companies looking to enter or do business in the Gulf are often surprised by the paucity of publicly available information accessible to them. This lack of information often makes it harder for foreign companies to gauge the size of the market for their products or services or to undertake due diligence on their prospective local business partners.

In addition, one impact on the region of the global recession has been to highlight the need for countries across the region to impose greater corporate governance obligations. Despite the cultural preference of many regional companies to maintain privacy in relation to their businesses, the need for change is recognised in the region and there are increasing rules for banks. There is also an increased move by many large regional companies to adopt a best practice approach to corporate governance and so to voluntarily adopt UK or US policies and procedures.

Decision makers

Many foreign companies doing business in the Gulf encounter the regional peculiarity of dealing with an undisclosed decision maker to whom the person they have been dealing with, often over the period of a prolonged negotiation, ultimately has to defer to seek final approval before concluding a transaction.

Real estate

Across the Gulf States there is a requirement for foreign companies looking to establish a subsidiary or branch to lease or (where permitted) acquire premises. This is another area where the laws of the different Gulf States have had to adapt to reflect changes in business practices, and where further changes are planned by many states to ensure that they are creating as business friendly an environment for foreign investors as possible.

Getting paid

The issue of getting paid for products sold and services supplied in the Gulf region has been a concern for many foreign companies for a number of years. Whilst the risks of payment default have often been exaggerated and generalised, the global recession has impacted on the liquidity of many regional businesses and so the issue has become a very real one for many companies in a variety of industries. Particularly in the real estate and construction sectors, the lack of attention to this area encouraged by the boom years has left foreign companies unpaid and unprotected over the past two years.

Whilst here again the issue is not specific to the Gulf, there are aspects of it which are particular to the region due in part to the historic approach on name lending and in part to the relatively limited options in terms of security which are available to support loans or trade credit. In the construction sector, for example, it is typical for a sub-contractor to accept a "paid when paid" clause to the recovery of its fees from a main developer. In the good times this was reasonable as the payment was underpinned ultimately by a government-owned sponsor. In today's climate however companies need to be circumspect as the credit worthiness of such sponsors is not to be relied upon and as UK companies embroiled in the Nakheel/Dubai World saga will testify, a government owned company will not always be good for its money.

Those looking to operate in the Gulf need to ensure that they take proper advice on their contractual documents to ensure that it affords them as much protection as possible and to ensure that, if relationships do break down and litigation ensues, that they have a neutral and effective forum for resolving disputes. For many this will mean electing for international arbitration but care needs to be taken to ensure that any award received can then be effectively enforced in the region.

Conclusion

Despite the challenges and regional peculiarities the opportunities for foreign companies who enter the Gulf market are remarkable and, in truth, those challenges are no different to the challenges of establishing international operations in many other parts of the world. Whilst there will be many keys to creating a successful business in the Gulf from a commercial perspective, from a legal one the key is to take advice. That advice will be available from a variety of sources, be it through the foreign companies' own government agencies in the region, national or sector business groups and professional advisers. ■

1. Alan heads up Pinsent Masons' Corporate Group in the UAE. He has extensive experience of advising on a wide variety of corporate finance transactions in both the public and private company arenas and of advising on cross border acquisitions and disposals. Alan also advises on a broad range of joint venture and ancillary commercial arrangements and on cross border corporate restructurings.

2. Britain in the Region 2010, Wednesday 24 November 2010, Dubai

An introduction to an Islamic financial system

M Fahad Mehboob is Relationship Director - Islamic Finance at Europe Arab Bank plc

Introduction

Much has been written about Islamic finance in recent years, and there are detailed books on what is and isn't allowed to qualify as Islamic finance, but what has been missing is a more basic understanding of the objectives of having an Islamic financial system.

Most Islamic finance practitioners, and even people who are merely interested in Islamic finance know that the main concepts in Islamic finance are the prohibition of interest (usury), gharar (uncertainty), maisir (gambling) and investments in a range of prohibited activities such as casinos, gambling, pornography, alcohol related businesses, and interest-based financial services. The current state of the Islamic finance industry revolves around "inventing" (also known as structuring) ways and legal structures that comply with sharia in form, but not entirely in substance. At this point, it is fair to differentiate Islamic finance (the broader industry) from Islamic banks. Unfortunately, most Islamic banks have adopted a debt-based model, which in its form, is completely sharia compliant, but the essence of sharia compliancy is missing. This, among others, remains the primary reason that Islamic banking is labelled as "smoke-and-mirrors" by some experts and purists alike.

"The concept of leveraging is something that is inherently contrary to the risk and reward sharing virtues of Islamic finance"

Money – a sharia perspective

Reading through numerous books on Islamic finance, it is evident that sharia treats money itself as a "means of exchange" and not a product that can be traded. The very essence of conventional banking is that money itself is a product, which you can buy and sell at different rates, and in simple terms, make money from money. Under Islam, money is considered an 'amanah' (trust) from Allah, which implies that it does not belong to the individual who has possession of it. He is merely holding it in trust for future generations and for the betterment of society. Furthermore, the individual is answerable to each and every penny given to him by Allah, and does not have the right to demand a return on the money that does not belong to him in the first place, unless he is willing to take the underlying risk along with it.

Conventional banks operate on the basis of borrowing from their customers and the financial markets at a cheaper rate, and along with their own equity, lending the funds at a higher rate to their borrowers, hence leveraging. The concept of leveraging is something that is inherently contrary to the risk and reward sharing virtues of Islamic finance. However, we see that Islamic banks are no different in terms of their overall leveraging strategy, whereby the Islamic banks will use their cheaper clients' deposits and lend to their customers at a higher rate, albeit all based on sharia compliant underlying structures.

Islamic finance industry – going forward

With all the advancement in Islamic finance, especially in the last 30 odd years, and with all due respect and gratitude to the Islamic banking pioneers, perhaps it is time to move Islamic finance in a direction where it is not about replicating conventional products, but a meaningful effort is made to adhere to the principles of sharia in both form and substance. The changes required will be drastic and substantial.

As a start, the three main products Islamic banks should be offering on the deposit side are:

i) Physical cash deposit facilities

ii) Mudaraba/wakala based deposits

iii) Musharaka based deposits


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i) Physical cash deposit facilities

As the name suggests, this would be a simple cash-deposit safe keeping facility, very much keeping in view the prohibition of riba, but also the practical requirement of keeping one's wealth safe. There will be no "profit" paid on these amounts, and the bank will not be able to utilise the funds for its own business. It will, however, be able to charge the client a fee for safe-keeping the cash deposited with the bank.

This particular facility would go against everything fractional reserve banking teaches us, and without going into too much detail, one of the objectives of an Islamic financial system would be the avoidance of a fractional reserve banking system, ultimately. It would also encourage the banks' customers to utilise more of the musharaka or mudaraba based structures.

ii) Mudaraba/wakala based deposits

These are almost like asset management type structures, where the depositor acknowledges the banks' expertise in investments in certain assets, and would like to appoint the bank to manage his funds by investing in certain sharia compliant assets. Again, given the nature of the current lending practices where most of the assets in Islamic Finance are debt-based, initially these deposits will be utilised to fund debt-based sharia compliant structures (such as current sukuk, ijara and murabaha etc) and later developed into managing equity-type investments.

As in asset management, the depositor will take the underlying risk on the project/investment and will have limited recourse to the mudarib/wakil (asset manager). The client will benefit from all the returns from the underlying investment, subject to a management fee charged by the bank as wakeel, or a profit share as a mudarib. This requires a significant change in the mindset of the current Islamic banks' depositors, but is achievable provided the right asset managers with a proven track record.

iii) Musharaka based deposits

Many will argue that musharaka is the ideal Islamic Finance product, but given the current financial system and the risk mitigating mind-set of investors means that musharaka is only utilised by a very small minority. musharaka, or partnership, in essence, is a direct risk sharing structure where two or more than two musharaka partners share the risk based on their respective investment, but the rewards can be shared in any predetermined manner. A musharaka deposit would allow the banks' clients to enter into a risk-reward sharing agreement individual projects/investments, or more generally, allow the depositor a return based on the profits of the bank, hence making a musharaka deposit akin to an equity investment.

Again, as briefly stated, this would require a very significant change in the mindset of the current Islamic investors, but can be achieved if a musharaka based deposit is compared to equity investments.

Significant work will need to be carried out if any of the above products ever become a reality, but in addition to the current debt-based sharia compliant products, these will be a much needed alternative to the Islamic finance purists, who are not comfortable with the debt-based nature of the current Islamic banks.

On the lending side, again, the Islamic banks currently rely on debt-based structures such as murabaha, ijara and asset-based sukuk. This will also need to change with Islamic banks taking on underlying asset/project risk, and not just relying on the credit worthiness of the borrower. It will also mean that the banks employ people with a completely different skill-set, one which is more suited to a venture-capital or equity-type investments profile.

Conclusion

The Islamic finance industry is fast approaching a $1 trillion in assets, and yet, for all the innovations and sharia compliant structures, the practices of some Islamic banks still get referred to as a "sham" by not only conventional financiers, but by a majority of Muslims. It is high time that we move the Islamic finance industry towards a direction where equal emphasis is given to both form and substance of a transaction. This will require much needed efforts on educating the general public, who currently rely solely on the fatwas issued by the sharia boards of the Islamic banks or Islamic windows of conventional funds. Until the general public de-couples itself from the current conventional financial system and is willing to put "faith" in a riba-free financial system, we will continue to see Islamic banks replicating the conventional riba-based products and we will continue to accept them as "innovation". ■

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Middle East Association

Largest ever UK trade delegation to Iraqi Kurdistan

David Lloyd, Senior Consultant at the Middle East Association (MEA), led a trade mission to Iraqi Kurdistan from 17-21 October, the focus being the Erbil International Trade Fair. Sir Andrew Cahn, Chief Executive of UK Trade and Investment, led a VIP delegation to the event. UK Trade & Investment, British Expertise, exhibitors and the MEA made up the mission which, at full strength, comprised 53 delegates representing 35 British companies, making it the largest British delegation ever to visit Iraqi Kurdistan. Nine companies, including several MEA member companies, exhibited at the Trade Fair, where a UK Pavilion represented the first official British presence at an exhibition event in Iraqi Kurdistan.

The mission was a resounding success, and the Trade Fair was very well attended. JCB had a loader on display and Landrover, which set up an agency in Erbil last April, had models on display and sold half a million dollars worth of vehicles during the Fair. Prime Minister Barham Salih and President Barzani toured the British Pavilion, and Sir Andrew Cahn received the President.

New benchmark

"I would like to think that this mission, which unquestionably had an impact on the Kurdish business community, has set a new benchmark for the presence of British companies in the Kurdistan region," said David Lloyd, who has led several MEA missions to the region over the past two years. *"The majority of mission members were new to the market and all were impressed by the market potential and the ease of doing business in this peaceful and prosperous region of Iraq."* All mission members are planning to return, and some are planning to open offices in Erbil.

The MEA has been at the forefront of British industry's engagement with Iraqi Kurdistan, being the only organisation in the UK to have led twice yearly missions there over the past three years. The presence at the Trade Fair of Sir Andrew Cahn, who undertook a punishing schedule of top level government meetings and site visits, was therefore very gratifying. *"There could not have been a stronger endorsement of British intent to take the Kurdistan market seriously and to send a forceful message to would-be British exporters to get out there fast,"* said David Lloyd.

A number of British companies have made their mark in Iraqi Kurdistan, including TRW; HSBC; Scott Wilson, which designed the new Erbil International Airport; Costain; Parsons Brinckerhoff, which is working on an electricity masterplan; Consultancy for Conservation and Development, which is working on the masterplan for the renovation of the Citadel; and the UK National School of Government, which has been advising the three governorates. UK Filter, which is involved in water management, and MCI International, which had stands at the Fair and have taken part in earlier MEA trade missions to Kurdistan, are now doing serious business there.

Iraqi Kurdistan offers tremendous opportunities to British companies across all sectors of the economy, from oil and gas to education, IT and telecommunications, power, environment and water, agriculture and financial services. Expertise and consultancy are required in all areas. There is a tremendous amount of construction and infrastructure development taking place, with a high level of investment from neighbouring countries. Relatively safe and secure, the Kurdistan region is a gateway for western companies to do business in Iraq. Its investment law, one of the most business-friendly in the region, offers foreign investors a number of incentives, and there is much goodwill towards the UK and a desire to see further British involvement. However our competitors are there in force – Turkey was by far the largest exhibitor at the Trade Fair and most of our leading EU competitors had impressive stands. British companies need to make up for lost time and take advantage of the opportunities offered by this stable, resource rich, emerging market. ■

In partnership with the Kurdistan Regional Government, the Middle East Association is taking its ninth trade mission to Iraqi Kurdistan from February 27th to March 4th 2011, with an opportunity to extend the mission until March 6th to coincide with the Erbil Building Trade Solo Exhibition. For more advice on the Iraqi Kurdistan market and the trade mission, please contact David Lloyd at the MEA (david@the-mea.co.uk or +44 (0)20 7839 2137). For a Mission Prospectus, email mea@ctgrouptravel.co.uk.

Fact and figures

Iraqi Kurdistan is an autonomous region of Iraq.

Population: 4.9 million (2007)
Area: 40,643 sq. km
Capital: Erbil (also known as Hewler)
Languages: Mainly Kurdish, Turkmani, Arabic, Armenian and Assyrian in some areas
Natural resources: Oil and other minerals; agriculture

Website of Kurdistan Regional Government: www.krg.org

David Lloyd (front row, fourth from right, light blue blazer) with mission members

MEA business briefing highlights Turkey's huge business potential

The Middle East Association held a very well attended business briefing on Turkey on Monday 11 October. It began with a video message from Prime Minister David Cameron, who has dubbed Turkey 'Europe's BRIC' and wants to double the level of the UK's bilateral trade with Turkey over the next five years.

Sarah Mooney, Head of UKTI Istanbul, highlighted Turkey's large and young population of over 76 million, its tremendous growth potential, diversifying economy, economic stability and openness to trade and foreign investment (the OECD estimates that it will be third fastest growing country after China and India by 2017). She also highlighted the importance attached to education and the growing skills base, the keenness to embrace the latest technology and the international outlook of its population, and discussed opportunities in a wide range of sectors, from software and construction, to defence, railways and marine and third country projects. She advised companies to be aware of the hierarchical business structure, the importance of identifying key decision makers and the importance of relationship building.

Yuksel Akca, Chief Commercial Counsellor, Turkish Embassy, highlighted Turkey's strategic position with access to a 1.2 billion market and its role as an energy hub, with a number of natural gas projects being developed. He highlighted Turkey's healthy economic position and its industrial strength, its various attractions for investors and its unique business environment as a result of its customs union with the EU and free trade agreements with various European and Middle Eastern trading partners. He gave an analysis of Turkey's trade with the UK.

Fadi Hakura, Turkey specialist at Chatham House, commented on the move from low productivity industries to high productivity industries and predicted that Turkey should enjoy high growth levels at its current rate of economic development, although structural reforms and improvements in the business regulatory environment are still needed.

Mina Toksoz, Head of Country Risk, Standard Chartered, argued that Turkey has weathered the global economic crisis well and is experiencing a strong domestic led recovery in 2010. The outlook for 2011 is broadly positive, although fiscal transparency needs improving and political risk remains an issue. The 2011 election will be critical.

Fact and figures

- Turkey is the 17th largest economy in the world and the sixth largest in Europe, with a GDP of $580 billion
- The OECD estimates that Turkey will be the third fastest growing country in the world after China and India by 2017
- GDP is forecast to rise by 7.5% in 2010
- Turkey is the EU's 5th largest export and 7th largest import partner
- UK-Turkey bilateral trade amounted to £6.6 billion in 2009
- UK exports to Turkey amounted to £2.3 billion in 2009 and increased by 26% in January-May 2010
- Turkey is the third largest exporter and producer of home textiles and the fourth biggest manufacturer of clothing
- Turkey is second ranked country in the top 225 international construction companies list, with 17 companies represented
- 65% of industrial exports from the MENA region originate in Turkey
- Over 2,000 British companies operate in Turkey

Brian Dent, International Trade Adviser, London International Trade Team, outlined the ways in which UKTI can help exporters to Turkey. Alan Stevens, Managing Director, Vector Consultants, which has an operation in Turkey, highlighted some of the diverse opportunities, from competency assessment programmes and HR services, to manufacturing, purchasing and supply chain and using Turkey as a regional hub. He discussed some of the challenges, and some of the factors behind the company's success, which include having a good local partner, a presence on the ground and an awareness of local culture and history, and making a contribution to local society. ■

For further information on Turkey and the Middle East Association's Turkey-related activities, contact Feride Alp, tel: 002 44 (0)207 839 2137, email: feride@the-mea.co.uk.