Investment issues in Kuwait

INTERVIEW WITH DIRAAR Y. ALGHANIM

CHAIRMAN AND MANAGING DIRECTOR OF KUWAIT FINANCIAL CENTRE "MARKAZ"

DIRAAR Y. ALGHANIM has been the Chairman of Kuwait Financial Centre Markaz for over 25 years. In 1978 he established his own company "Alghanim International Corp." (AIC) in Kuwait. He has always served in Banking, Investment, Insurance and varied Commercial enterprises, locally, regionally and internationally. Presently, he is a Board member of the Kuwait Chamber of Commerce & Industry (KCCI) and served as Chairman of The Union of Investment Companies from 2004-2009.

What are the principal advantages and benefits of Kuwait as an investment destination over its regional competitors?

Kuwait enjoys several advantages compared to regional competitors. First and foremost, it has a strategic location advantage, at the north of the Arabian Gulf, that places it closer to large developing markets like Iraq and Iran (combined population of nearly 100 million). The country enjoys a democratic parliamentary system with relatively high per capita income with clarity on ownership rights, established legal system and developed finance and banking sectors. On the social side, it is a fairly open and liberal society with a competitive cost of living. While these advantages are generic, investors would want to assess specific advantages depending on the type of investment.

How would you assess improvements over the last two decades in the investment environment in Kuwait for overseas players?

There have been efforts to create a more attractive environment for foreign investors. In 2001, the Foreign Investor Law was passed in addition to the establishment of the Kuwait Foreign Investment Bureau (KFIB) with the purpose of identifying and promoting investment opportunities in Kuwait to foreign parties; streamlining the registration and project completion process for foreign investors by creating a "One Stop Shop" for foreign investors; identifying joint venture partners or strategic allies for Kuwaiti businesses in addition to advising the Kuwaiti government on investment policy issues.

Since inception, the office has studied 33 projects with a value of KD 1.5 bn of which 14 were approved with a value of KD 600 mn. According to the KFIB, over 90 per cent of the FDI flows to Kuwait go to industry while the remainder goes to services. Additionally, the major FDI contributors are Japan (32 per cent), the Netherlands (30 per cent), and the USA (29 per cent).

The Parliament also approved a measure, a few years back, of cutting corporate income tax on foreign companies from a prohibitive 55 per cent to just 15 per cent in order to encourage foreign corporations to enter the market.

What would you say are the strengths and weaknesses of the Kuwaiti stock market, from a foreign investor's perspective?

The Kuwait stock market is the oldest in the region and contains some of the most robust companies in the region. Although the majority of participants are local, efforts have been made to increase the attractiveness of the market to foreign investors, most notably by abolishing capital gains tax. The newly launched Capital Market Authority (CMA) will go a long way towards strengthening the market, increasing its efficiency and promoting transparency and fairplay.

Which are the best sectors for international investors to consider in Kuwait, in your opinion?

It depends on the investment objective. For investors in the stock market, banks remain a very good play which holds up well no matter the cycle. The same can be said for some mid-cap stocks which tend to perform better than Blue Chips during times of uncertainty.

There are several core investments in the oil and gas services, petrochemicals and financial sector that can be looked at for direct investments. Several services sectors like education, healthcare, etc also offer potential given the high level of fiscal and social focus of the government on these sectors.

What is your assessment of the potential for overseas investors of the oilfield services segment of the economy?

Oil remains the bread and butter of the economy and hence, the Parliament is very protective of its oil and gas resources. Consequently, oil exploration, production and refining, so far, are not open to private or foreign investors. However, as stated before, oil services are open to all investors including foreign investors.

A recent report states that the crisis among Kuwait's investment companies stemmed from a misplaced belief in perpetual growth driven by unlimited access to liquidity. How credible is this assessment ?

The crisis in the Kuwait investment sector was not so much a misplaced belief in perpetual growth as it was a fundamental, structural issue in the sector's business model. The primary issue in the sector was an asset/ liability mismatch whereby liabilities were short-term

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in nature while assets were long-term and illiquid. Additionally, the sector was operating on a model similar to that of private equity firms, i.e. operating on high leverage, and investing capital in illiquid assets such as private companies and real estate. Being a nascent industry, it also had its fair share of corporate governance issues.

Great strides have already been made to safeguard against a reoccurrence of the crisis; most notably the stricter regulations set in place by the Central Bank of Kuwait (CBK), which investment companies must comply with by June 2012. In addition, the launch of Capital Market Authority (CMA) also provides additional layer of regulatory requirement for investment companies.

How concerned are you about the added impact on the Kuwait Stock Exchange of the political protests sweeping the region?

US unemployment and Europe's debt crisis did not directly impact Kuwait. However, the first quarter of the year was a negative one across the region as markets grappled with the intensifying of political turmoil. Kuwait's worst month was in February, where the index lost 5.5%, however as of April the index was back up on healthy 1Q earnings. We believe that the turmoil/unrest has more or less been taken into account by the market at this point and don't see further contagion from the region on the exchange, provided no large-scale shocks occur.

In response to the global downturn, would you agree that in the short term, Kuwaiti investment companies should focus on improving their cash position by rationalizing their portfolios to focus their efforts on fewer companies, and that they should also improve cash management at their holding and investee companies?

Cash management improvement is definitely a must, and conforming to the CBK regulations will go a long way towards achieving that. Additionally, companies have been successful in restructuring their debt privately with creditors rather than reverting to the government for bailout help. We do expect short-term goals to focus on "cleaning up" balance sheets, disposing of impaired assets in addition to attempting to realize value from other assets and portfolios.

In the longer term, how do you see investment companies creating sustainable, profitable growth? Would you agree with some analysts' assessment that an explicit strategy is required to create value, and set long-term targets for their portfolios and align their corporate finance capabilities with these targets?

Yes, that is certainly a path to creating sustainable growth. Also, firms are moving away from the so-called "Private Equity" model of investing in illiquid assets to focusing more on the fee-generating side of business, through advisory and placement services in addition to asset management. These products and services provide the company with a steady stream of revenue which is far less volatile than those generated by investment but they are also intensive in terms of manpower quality.

What are your thoughts regarding proposals to set up an over-the-counter market on the Kuwait Exchange for troubled listed firms that trade below 100 fils per share?

The OTC market idea is an interesting one to be sure as the troubled stocks are creating a drag on the index. There are over 200 listed firms on the Kuwait exchange and about 40 per cent of them currently trade below 100 fils. Moving some of these firms, with exceptions made based on financial results and core business, would take some weight off the Price index and allow it to be more reflective of the market. Fifteen Blue Chips would also trade on the index in order to attract foreign investors.

The OTC market is supposed to be in place by the end of 2011; however, given the current activity surrounding the newly created CMA and its regulations/functions, this initiative might face some delays.

Is GCC monetary union achievable or even desirable in current circumstances?

The issue of monetary union is as much political as economic. Hence, it will be subject to political developments in the region. However, Kuwait is a strong supporter of the GCC monetary union and has been since the idea was first introduced. The monetary union has faced several delays due to various issues, but there has been a concerted effort to resolve these issues in order to create a strong, unified economic bloc. Lessons are being learned from the European Union experiment, especially in light of the recent debt and economic issues that have plagued the union, though we wouldn't expect such a situation to arise in the Gulf as the economies are more or less in the same stages of macroeconomic balance in addition to the area being a solvent one on the whole.

Kuwait de-pegged its currency from the Dollar in 2007 and the remaining GCC countries are slated to follow by 2014 by pegging to a basket of currencies. This will be a significant step forward to the monetary union. There are also plans to have a fully functioning customs union in place by 2015 which will enhance economic integration. F