Opinion: Attitudes to Arab business must change

The role of the private sector has been under appreciated

Clouding the issue: red tape rules stem from the Ottoman and colonial eras

Karim Souaid MARCH 31, 2014

The role of the private sector in spurring economic recovery and securing youth employment for millions of graduates in the Middle East has been both underestimated and misrepresented.

The sector cannot be expected to fill the gap in investment needs and create jobs in the face of outdated corporate and investment regulations.

The traditional role of the state in regional economies, which has been labelled "pro-business", exhibits signs of protective socialism that is in conflict with a free-market economy and hampers investment. The state is not accountable for creating jobs or economic recoveries.

However, it *is* responsible for fostering a regulatory environment – via laws, rules, licensing regimes and taxation – that is conducive to creating business opportunities.

A more proactive, rather than prescriptive, state would spur sustainable economic growth and stable employment levels.

The private sector cannot sustain its drive of investments and growth-orientated strategies without bold, modern and continuous regulatory reforms. However, a shared vision between the state and the private sector remains wanting in many nations of the Middle East and north Africa (Mena).

The state need not invest massive amounts of capital in domestic markets. Rather it needs to regulate and monitor them; the private sector needs no handouts, just pro-investment policies.

Ironically, the necessary reforms would be relatively simple to implement. They require few amendments to existing laws and regulations. The starting point should be to foster an environment for creating, retaining and expanding the private investment base.

Investors – foreign or domestic – are attracted by the availability of opportunities. Their cash would be used to establish businesses, grow them, merge and combine them, and increase their size beyond national boundaries.

Companies hire talent, employ skilled and unskilled labour, buy or rent premises, retain lawyers, auditors, consultants, advertising agencies – and distribute wealth to shareholders after deducting operating expenses.

The opening salvo of the Arab spring in Tunisia was directed at economic injustice, not political reform.

Hence, investment in productive assets – excluding the much-revered but not very productive property sector – are at the heart of any economic activity, and are vital for sustainable employment and wealth creation.

But what attracts investors first and foremost – even before an opportunity's merits – is the rule of law.

For example, Hong Kong is a thriving hub for finance and business in Asia and beyond. Although it has never been a democracy, it has nonetheless attracted – and continues to attract – massive capital inflows, thanks to the rule of law, due process, and fairness in dealings.

The independent judiciary – not an independent parliament – is the main reason for this prized stability. Corporate and securities laws in the Mena region lag behind their counterparts in developed and developing economies, while the judiciary remains, to a large extent, a mere tool of the executive.

Once capital is attracted, it must be welcomed and retained. Here, the hurdles of red tape abound in different forms, many of which linger from the Ottoman and colonial eras. Establishing a company in the Mena region – apart from in specific zones – is a nightmare, because of the paperwork required, from registering a corporate name and logo, to coping with ownership restrictions on foreigners, to complying with labour laws. The list goes on, and fulling its criteria is a waste of time, money and effort.

Not a single country or even a group of nations, such as the Gulf Co-operation Council, have issued legislation under which corporate requirements are streamlined and made easier to apply and follow. Many investors opt to form entities in free enterprise zones, lured by the ease of processes, and rules that are simpler and better suited to the needs of a modern-day company.

Swift formation of onshore companies – with reduced red tape, fewer restrictions on majority foreign ownership, different classes of shares, and relaxed employment rules – would go a long way to attracting direct investment.

Finally, no capital can grow without up-to-date capital market rules. In some Mena countries, a company cannot launch an initial public share offering (IPO) unless its founders relinquish control by selling a majority of the share capital. Meanwhile, the regulators also price the offering. Is that the way things are done in Singapore, Hong Kong and other emerging markets we compare ourselves with? Absolutely not.

Minimum requirements on share sales (for example, 25 per cent) are the norm, not the loss of majority control. And the role of a securities' regulator is to encourage the formation of capital and police transactions, not to price offerings.

Arguments for such anomalies are primitive and unconvincing. Basically, they revolve around an inherent suspicion of issuers in IPOs and a paternalistic sense of protection for small investors.

Answers to both arguments are easily provided.

First, a privately held company that is breaking the rules is more difficult to spot than a publicly listed one, so encouraging IPOs helps catch shady promoters.

Second, the stock market is not for small investors. They can invest through mutual funds, whose mission is to manage, diversify and administer the savings of individuals. Such funds are run by asset management companies that can judge for themselves which offerings to subscribe to and which to avoid.

Streamlining listing rules via a unified model prospectus that, for example, outlines disclosure and compliance rules, requires a minimal percentage of shares for IPOs, and redirecting securities regulators to administer – but not govern and price – IPOs would boost regional capital markets and lead to a deluge of capital raisings.

Stimulating the economy, and creating employment opportunities for millions of young people in the region cannot be secured solely by public works or a spree of public sector hirings in administration and the armed forces. A business culture based on clear, modern and fair regulations needs to be encouraged.

No revolts or riots are necessary to spark long-lasting economic changes; only the will to change the laws of the land.

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