



## GCC CONGLOMERATES: MAKE THE MOST OF THE DOWNTURN

The effects of the global credit crunch are starting to reach the Middle East. Companies seeking growth capital are finding a shortage of credit, an increase in price, or both.

Many conglomerates, both large and small, in the Gulf Cooperation Council (GCC) are currently overleveraged and heavily invested in listed equities. These companies will face significant challenges in maintaining their growth and meeting the expectations of debt and equity holders. Some will likely be forced into fire sales to raise capital. Others will struggle simply to meet their short-term capital needs, mainly related to dividend and interest payments.

However, the problem may be short-lived in the Middle East, given the GCC governments' surpluses from oil revenues. Conglomerates that have traditionally been cautious can use the current slowdown to their advantage to build a more

sustainable competitive position and to become better prepared to ride a new wave of focused growth based on strong fundamentals.

### **Four Strategies to Benefit from the Slowdown**

The major objective of GCC conglomerates in the current economic climate should be to build a long-term sustainable competitive position and prepare themselves for future growth. There are several key ways to do so.

*Rationalize the portfolio to free cash and improve return on capital.* GCC conglomerates have invested in various sectors—often with the simple objective of finding uses for their excess cash. As a result, the portfolios of many conglomerates now contain a large number of poorly performing investments: companies that are earning less than their cost of capital or that are not scalable enough to be worth the conglomerates' human and capital resources.

A first step in rationalizing would be to review the current portfolio and identify potential divestitures. The decision to retain or divest a particular company may be based on whether it is in an attractive industry and whether it can gain a sustainable competitive advantage within that industry. Even if weak investments cannot be divested in the current climate, simply identifying them now allows the conglomerate to strategically place its effort and capital elsewhere in the short term. Divestitures need not be limited to companies; they may include fixed assets such as office buildings that do not earn any returns.

*Consolidate market position in strategic sectors and companies through structural growth.* This is a good time for cash-rich GCC conglomerates to explore opportunities for structural growth, using mergers and acquisitions to consolidate their market position. Many industries that benefit from scale—real estate, infrastructure, and contracting, among others—have

seen significant fragmentation in investments and operations. Attractive smaller players might welcome new equity investors as a means of accessing fresh growth capital if the implied valuation reflects their full potential and hence protects their positions in the market. The GCC conglomerates could benefit from the declining price/earnings ratios to acquire superior assets and build the scale required for long-term sustainable growth.

*Improve the capabilities of human resources.* Many GCC conglomerates have scrambled in the past few years to acquire new talent, a task that proved to be highly challenging and expensive. Often the conglomerates ended up with bloated organizations and inadequate capabilities. Given the current economic slowdown in the West and the increasing attractiveness of the Middle East to international talent, now is the right moment to acquire capabilities that weren't previously available. For instance, the finance departments of some of the leading conglomerates have been mainly focused on accounting and could benefit from the injection of new talent in areas such as cash flow, forecasting, and capital structure/financing strategy. Moreover, GCC conglomerates need to develop strong incentive plans with a long-term perspective to attract, nurture, and retain this new talent—both within their own firms and within the region. Doing so will help

reduce a loss of talent due to job hopping or a drain of talent to the West once the economic situation improves.

*Improve corporate governance.* The Middle East has recently seen a few high-profile cases of corruption, mainly driven by lax corporate governance rules. While rigid corporate governance practices are not always the best answer, a review of current practices is required. Most important, there is a need to clearly define the responsibilities and accountabilities of the board members (who represent shareholders), the holding management team (which manages shareholders' money), and the portfolio company management teams. This delineation will ensure greater accountability on the part of the various entities. It will also allow for faster growth, as it speeds decision making through a higher degree of delegation.

#### **A New Era for Focused Growth**

This economy is a buyer's market. It is clearly an opportunity for GCC conglomerates that have traditionally been cautious to take advantage of their strong positions and find a more progressive way forward. The strategies outlined above are critical to creating long-term competitive advantage in a new era of more focused growth.

#### **Contact Information**

##### **Beirut**

**Ibrahim El-Husseini**

Partner

+961-1-985-655

ibrahim.elhusseini@booz.com

##### **Dubai**

**Ahmed Youssef**

Principal

+971-4-390-0260

ahmed.youssef@booz.com