

MBA Global

Country Risk Assessment for Construction Firms

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1. Introduction

The SME company is specialized in the construction sector in the Gulf region. The company has contracted three projects in Saudi Arabia, Kingdom of Bahrain and United Arab of Emirates.

Analyzing risks related to the construction sector is important, however, risks driven by country is the scope of this report.

The report provides a critical analysis of the risks that the three countries are exposed to, as well as rating those risks. The three main risk categories subject to the analysis are economic, financial and political risks.

2. Country Risk Analysis

2.1 Saudi Arabia CRA

2.1.1 Country Overview

Saudi Arabia's economy is based on oil production with strong controls by the government over the major economic activities. To diversify its economy and employ Saudi nationals, private sector growth is encouraged by the Saudi government (CIA, 2014).

The macroeconomic indicators of Saudi Arabia as summarized in Table 1.

Indicators	2007	2008	2009	2010	2011	2012	2013 ^F
Real GDP growth (%)	2.0	4.2	0.1	4.6	6.8	5.4	4.4
• Hydrocarbon GDP growth (%)	(3.6)	4.2	(7.8)	2.4	4.3	1.8	3.2
• Nonhydrocarbon GDP growth (%)	4.7	4.3	3.5	5.5	7.8	4.7	4.9
Inflation (%)	4.1	9.9	5.1	5.3	5.0	4.8	4.5
Current account balance percentage of GDP (%)	24.2	27.7	5.6	14.9	27.4	25.6	23.7
Fiscal balance percentage of GDP (%)	12.2	32.5	(6.1)	5.2	14.1	14.5	11.4
Public debt as percentage of GDP (%)	18.5	13.2	15.9	9.9	6.1	3.6	3.7
SAMA foreign reserves (\$ billions)	305.6	442.4	409.8	445.7	541.1	747.0	860.0
Per capita income (\$)	15,453	18,470	14,129	16,541	21,046	24,917	24,122
Population (millions)	24.94	25.79	26.66	27.56	28.37	29.2	30.1
Capital expenditure as percentage of total expenditure (%)	25.5	25.2	30.2	30.4	33.4	30.9	34.7
Tadawul share price index (year end)	11,038	4,803	6,121	6,620	6,417	6,801	7,200
Break-even oil price (\$ pb)	55.0	60.8	64.1	71.1	69.0	73.0	75.0
Oil production (mbpd)	8.82	9.20	8.18	8.17	9.31	9.1	9.0

Table 1 Saudi Arabia macroeconomic indicators (*Source: Ramady, 2014*)

2.1.2 Risk Assessment

2.1.2.1 Economic Risk

2.1.2.1.1 Oil Production

Decline in oil prices would pose significant risks to the forecasted Saudi Arabia's fiscal and current account position. However, it remains unlikely that either account will fall into the red in the near future (BMI, 2014).

Accordingly, Saudi Arabia may take some changes in the fiscal policy by introducing either income tax on foreigners or consumption value added tax on domestic products and services in order to increase its fiscal revenue (Ramady, 2014).

2.1.2.1.2 Saudization

In 2012, the Saudi government enforced a nationalization programme known as “Saudisation”, which rewards companies for meeting Saudi citizen employment quotas (Allam, 2012).

BMI (2014) consider the programme as a downside risk to the economic outlook as it adds to the costs for the private sector, leading to an increase in project delays and a more difficult business environment overall.

2.1.2.1.3 Risk Ratings

The Saudi Arabia risk ratings, based on the International Country Risk Guide (ICRG), for the different economic indicators are illustrated in Figure 1.

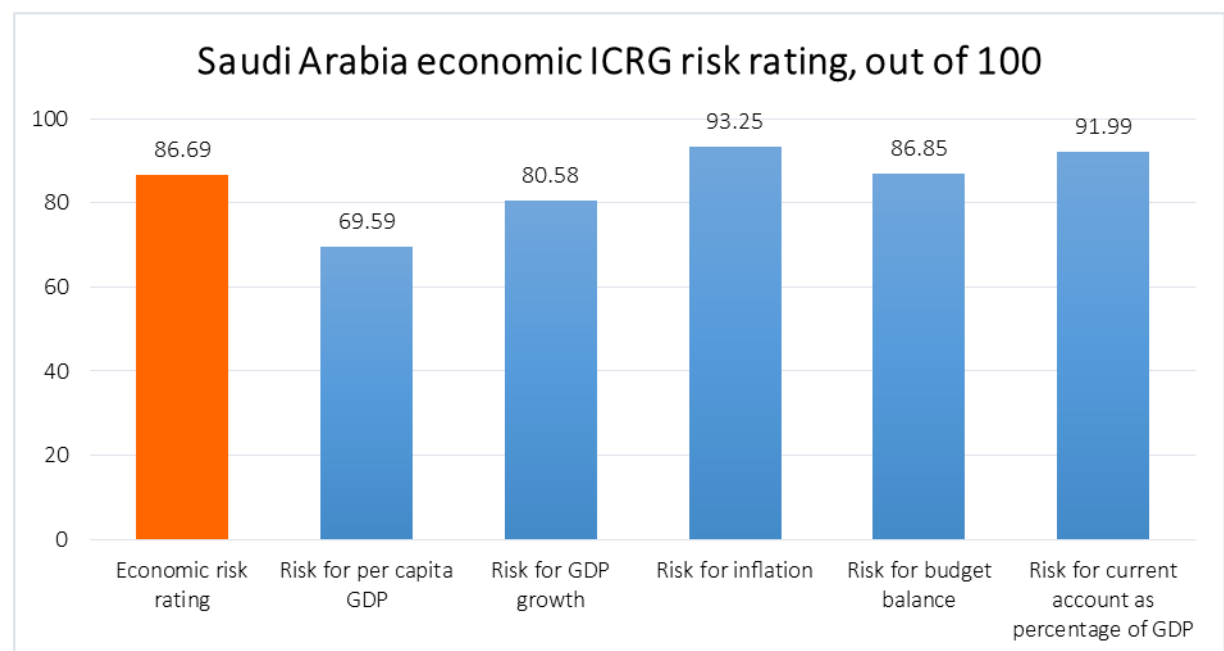


Figure 1 Saudi Arabia economic ICRG risk rating (Source: Ramady, 2014)

2.1.2.2 Financial Risk

2.1.2.2.1 Single Currency

In 2013, Riyadh was officially made capital of the Gulf Monetary Council, with the objective of launching a single GCC currency by 2015 (Arab News, 2013). Only four members of the GCC (Saudi Arabia, Bahrain, Qatar, and Kuwait) are members of the Monetary Council, where two others (UAE and Oman) opting out for the time being. This raises a doubt on the long-term plan for the single GCC currency (Ramady, 2010) and ensures that the dollar peg with the Saudi currency will remain (Ramady, 2014).

2.1.2.2.2 Risk Ratings

The Saudi Arabia risk ratings, based on the International Country Risk Guide (ICRG), for the different financial indicators are illustrated in Figure 2.

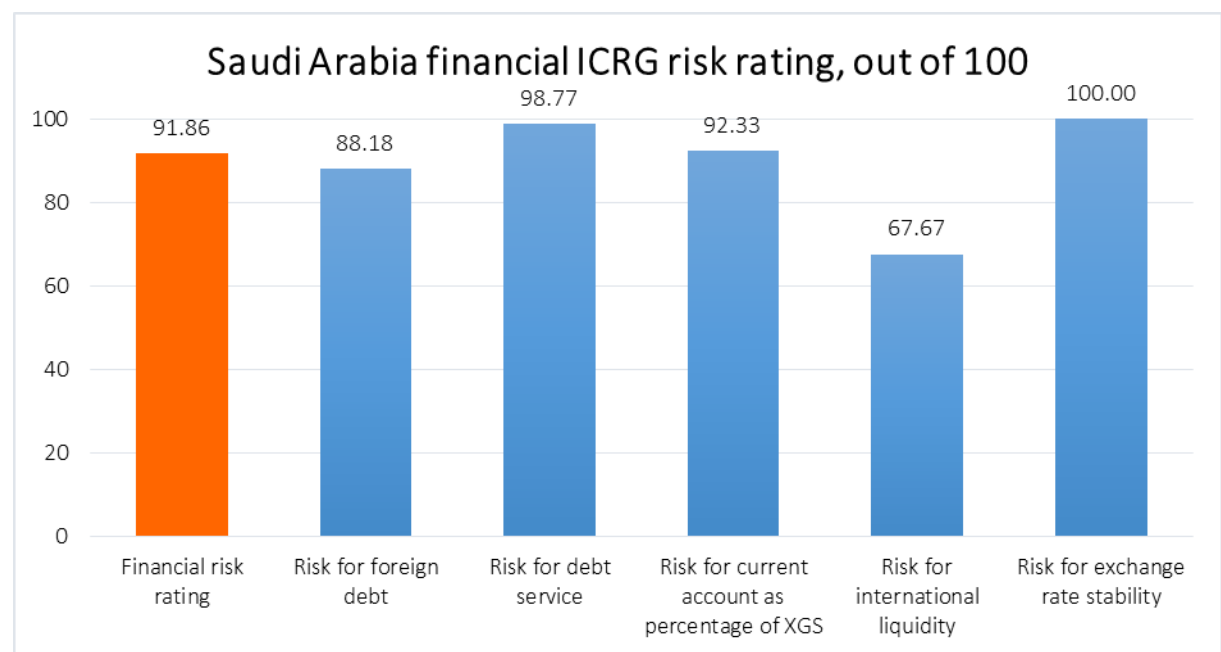


Figure 2 Saudi Arabia financial ICRG risk rating (*Source: Ramady, 2014*)

2.1.2.3 Political Risk

2.1.2.3.1 Ethnic Tension

Arab Spring have raised long-standing tensions in Saudi Arabia's Eastern Province. After the large-scale protests started in Bahrain on February 14, 2011, protests began in the Eastern Province in Saudi Arabia (Matthiesen, 2012).

2.1.2.3.2 Region Tension

Saudi Arabia faces increased security threats following the rapid deterioration of Iraq's political situation. BMI (2014) does not expect direct military actions between the Islamic State and Saudi Arabia. However, the ongoing regional turmoil raises the likelihood of border instability and domestic terrorist attacks.

2.1.2.3.3 Bureaucracy and Corruption

According to the World Bank survey on GCC countries' governance structures Saudi Arabia is places as the lowest ranked GCC country in these categories (Ramady, 2014).

Sophia (2014) has reported that Saudi Arabia's Shoura Council has taken efforts to fight corruption by urging the National Anti-Corruption Commission (Nazaha).

2.1.2.3.4 Risk Ratings

The Saudi Arabia risk ratings, based on the International Country Risk Guide (ICRG), for the different political indicators are illustrated in Figure 3.

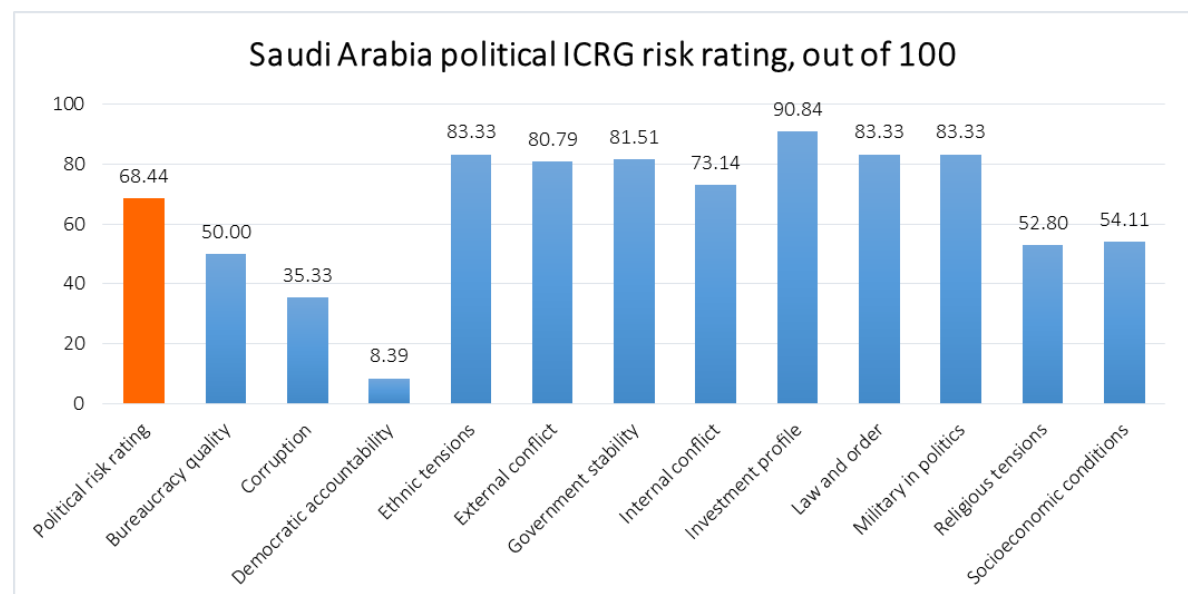


Figure 3 Saudi Arabia political ICRG risk rating (*Source: Ramady, 2014*)

2.2 Bahrain CRA

2.2.1 Country Overview

Bahrain has made significant efforts to diversify its economy in order to attract number of multinational firms with business in the Gulf. However, its economy continues to depend heavily on oil (CIA, 2014).

The macroeconomic indicators of Bahrain as summarized in Table 2.

Macroeconomic indicators	2007	2008	2009	2010	2011	2012	2013 ^F
Real GDP growth (%)	8.4	6.3	3.1	4.1	1.8	3.3	3.8
• Hydrocarbon GDP growth (%)	1.1	0.4	(0.3)	0.1	4.1	2.6	2.5
• Non-hydrocarbon GDP growth (%)	9.6	7.2	3.6	4.6	1.5	3.6	4.0
Inflation (%)	3.3	3.5	2.8	2.0	1.6	1.8	1.9
Current account balance, percentage of GDP (%)	15.7	10.2	4.1	3.4	4.2	11.5	10.1
Fiscal balance, percentage of GDP (%)	1.9	4.9	(6.6)	(6.7)	(2.3)	0.1	(1.9)
Public debt as percentage of GDP (%)	20.4	21.1	31.6	37.0	29.0	36.2	37.5
External debt percentage of GDP ^a (%)	31.4	31.1	36.1	32.4	30.4	37.7	39.6
Foreign reserves (\$ billions) ^a	4	4	4	5	5	5	5
Population (millions)	1.0	1.1	1.2	1.2	1.2	1.3	1.3
GDP per capita (\$)	27,923	31,343	24,382	26,252	27,384	22,915	23,100
Stock market index (year end)	2,755	1,804	1,804	1,432	1,143	1,065	1,100
Oil production ("000" bpd)	39.5	37.5	35.6	35.0	37.0	36.7	36.9
FDI Inflows p.a (\$ billion)	1.8	1.9	0.3	0.2	0.3	0.4	0.5
FDI outflows, p.a. (\$ billion)	1.5	1.8	1.9	0.9	0.4	0.3	0.2
Unemployment rate (%)	18.0	21.0	25.5	27?	N/A	N/A	N/A

Table 2 Bahrain macroeconomic indicators (*Source: Ramady, 2014*)

2.2.2 Risk Assessment

2.2.2.1 Economic Risk

2.2.2.1.1 Financial Services

Due to the 2011 political unrest in Bahrain, some Bahrain based foreign financial institutions relocated to Dubai and Qatar. However, the government's economic policies are now aimed to restore confidence in Bahrain's economy (Ramady, 2014).

2.2.2.1.2 Labor Tax Suspension

One of the economic policies taken by Bahrain's government, which aimed at restoring confidence in Bahrain's economy, is the suspension of an expatriate labor tax. However, this make Bahrain's long-term economic challenges, as youth unemployment and the growth of government debt, more difficult to address (CIA, 2014).

2.2.2.1.3 Risk Ratings

The Bahrain risk ratings, based on the International Country Risk Guide (ICRG), for the different economic indicators are illustrated in Figure 4.

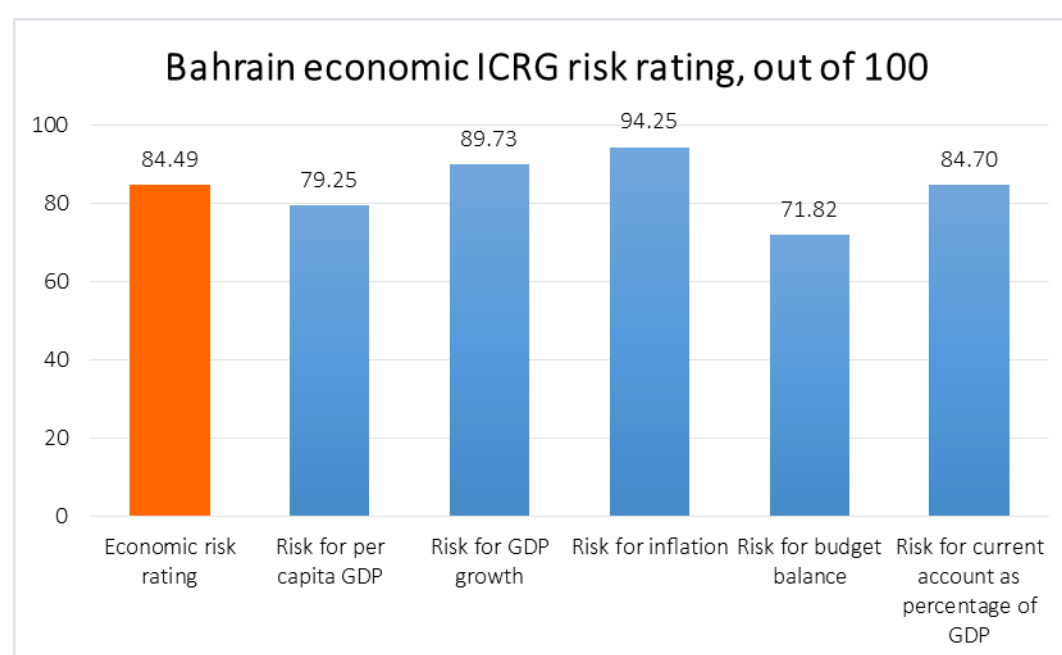


Figure 4 Bahrain economic ICRG risk rating (*Source: Ramady, 2014*)

2.2.2.2 Financial Risk

2.2.2.2.1 Government Bonds

One of the signs of growing investor confidence in Bahrain is the successful placement of a \$1.5 billion 10-year government bond in 2012, which 57% was taken up by investors outside of the Middle East, while Bahraini investors accounted for 14% of the total (Ramady, 2014).

2.2.2.2.2 Risk Ratings

The Bahrain risk ratings, based on the International Country Risk Guide (ICRG), for the different financial indicators are illustrated in Figure 5.

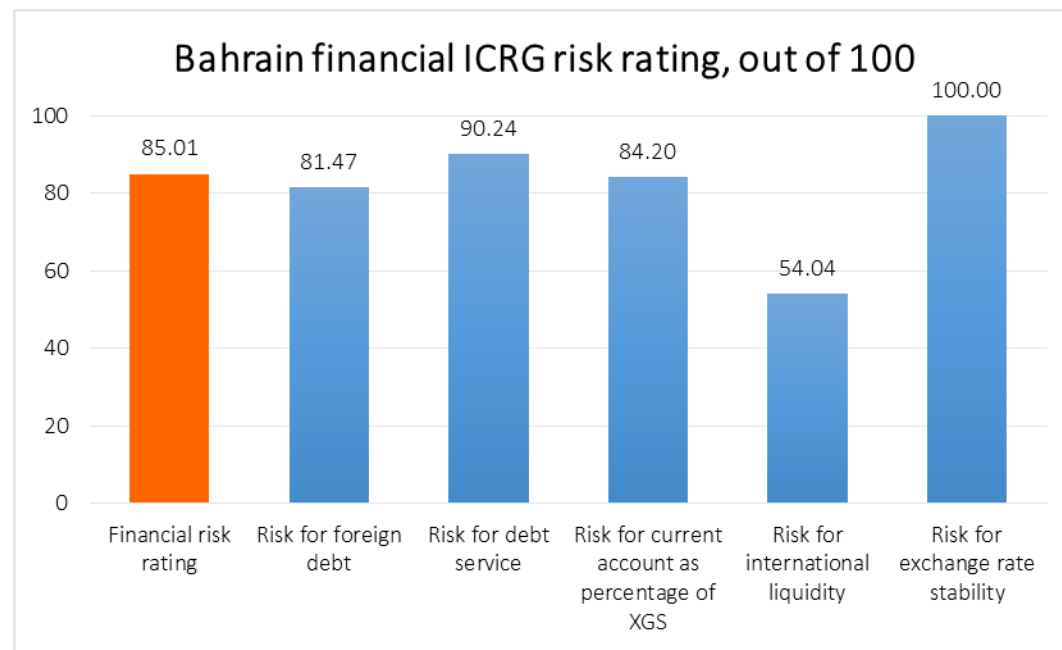


Figure 5 Bahrain financial ICRG risk rating (*Source: Ramady, 2014*)

2.2.2.3 Political Risk

2.2.2.3.1 Political Crisis

One of the main challenges to the Bahrain's government is the continuing of the pro-reform protests by opposition groups (Ramady, 2014). Failure to find a lasting solution to the political crisis could result in Bahrain's 'safe haven' status suffering irreparable damage (BMI, 2014).

2.2.2.3.2 Bureaucracy and Corruption

Bahraini bureaucracy is well regarded, as well as there is little risk of corruption at both lower and higher level of administrators. Accountability and delegation of responsibility, with less bureaucratic decision making at senior levels exists (Ramady, 2014).

2.2.2.3.3 Region Tension

A more pronounced regional crisis between the USA and Iran over the Iranian nuclear program could expose Bahrain to a risk of retaliation especially where Bahrain hosts the USA's naval base in the Arabian Gulf (Ramady, 2014).

2.2.2.3.4 Risk Ratings

The Bahrain risk ratings, based on the International Country Risk Guide (ICRG), for the different political indicators are illustrated in Figure 6.

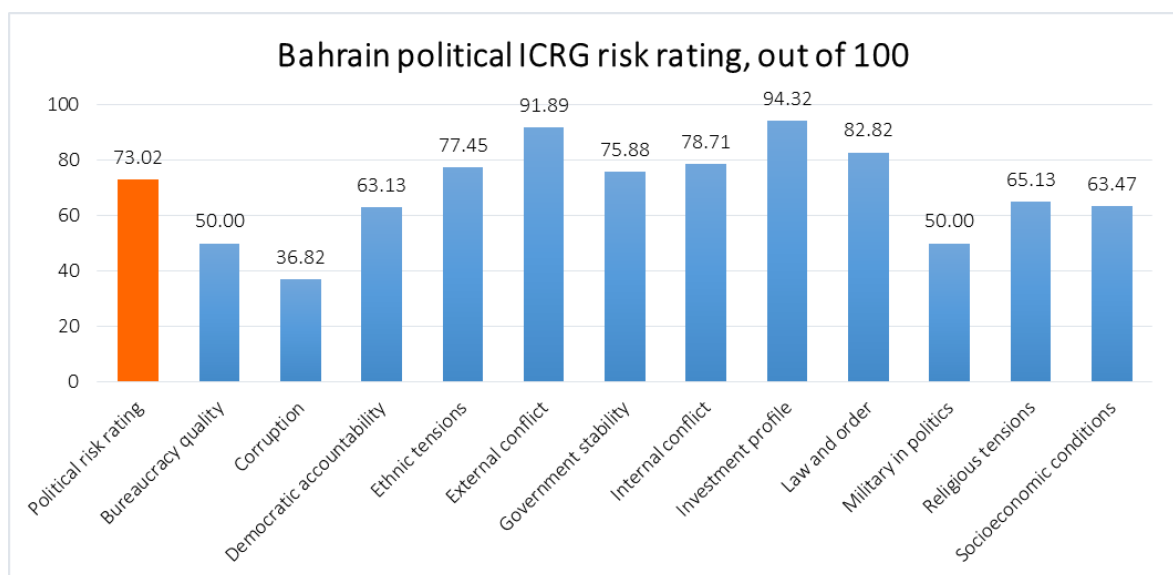


Figure 6 Bahrain political ICRG risk rating (*Source: Ramady, 2014*)

2.3 United Arab of Emirates CRA

2.3.1 Country Overview

According to CIA (2014), the economy of the UAE is open with a high income per capita and annual trade surplus.

To encourage the growth of the private sector investments, the government has increased spending on infrastructure expansion and opening up utilities. The Free Trade Zones, which offers 100% foreign ownership and zero taxes, has been created to attract foreign investors (CIA, 2014).

The macroeconomic indicators of UAE as summarized in Table 3.

Indicators	2007	2008	2009	2010	2011	2012	2013 ^F
Real GDP growth (%)	6.5	5.3	(3.3)	0.9	4.9	4.2	3.3
• Hydrocarbon GDP growth (%)	(2.7)	1.6	(9.9)	(1.5)	9.4	3.6	2.1
• Non-hydrocarbon GDP growth (%)	9.1	6.3	0.6	2.1	2.7	3.5	4.1
Inflation (%)	11.1	12.3	1.6	0.9	0.7	2.0	3.0
Current account balance, percentage of GDP	15.4	7.9	3.4	3.1	10.7	10.5	9.6
Fiscal balance, percentage of GDP	15.3	16.8	(12.3)	(2.1)	3.2	5.4	3.8
Public debt, percentage of GDP	13.2	13.8	22.0	23.3	21.5	21.4	20.2
External debt percentage of GDP	57.8	50.7	63.3	57.4	55.0	54.7	55.4
Foreign reserves (\$ billion)*	77	32	35	37	41	45	51
Population (million)	5.4	5.8	5.7	5.8	6.0	6.1	6.2
GDP per capita (\$)	47,830	54,500	45,935	49,131	56,627	57,436	59,652
Stock market index year end (Abu Dhabi)	4,632	2,106	2,700	2,680	2,530	3,100	3,600
Stock market index year end (Dubai)	5,996	5,400	1,901	1,638	1,353	1,622	2,300
Oil production (mbpd)	2.60	2.65	2.35	2.35	2.55	2.66	2.60
Gas production (billion cubic meter)	50.3	50.2	48.8	51.3	51.7	52.3	N/A
FDI inflows (\$ billion) net p.a.	14.2	13.7	4.0	4.0	2.8	3.2	3.5
FDI outflows (\$ billion) net p.a.	10.6	14.76	22.5	3.5	1.02	N/A	N/A
Unemployment rate (%)	12.0	12.1	13.0	11.0	9.0	8.5	N/A

Table 3 UAE macroeconomic indicators (*Source: Ramady, 2014*)

2.3.2 Risk Assessment

2.3.2.1 Economic Risk

2.3.2.1.1 Labor Market

UAE government has proposed forming of labor organizations that, if implemented, will be restricted in industrial action rights. (Ramady, 2014).

2.3.2.1.2 Emiratization

The UAE “nationalization” policy, known as “Emiratization”, aims to promote employment for nationals. Given the shortage of skilled nationals to achieve the ambitious development projects, there will be a little risk of setting official expatriate labor quotas like the points system “Nitaqat” implemented by Saudi Arabia (Ramady, 2014).

2.3.2.1.3 Inflation Rate

The risk of inflation rising is low where it had eased to around 2% by 2012, although , due to increased economic activity for Dubai and Abu Dhabi projects, a small rise is forecasted in 2013 (Ramady, 2014).

2.3.2.1.4 Risk Ratings

The UAE risk ratings, based on the International Country Risk Guide (ICRG), for the different economic indicators are illustrated in Figure 7.

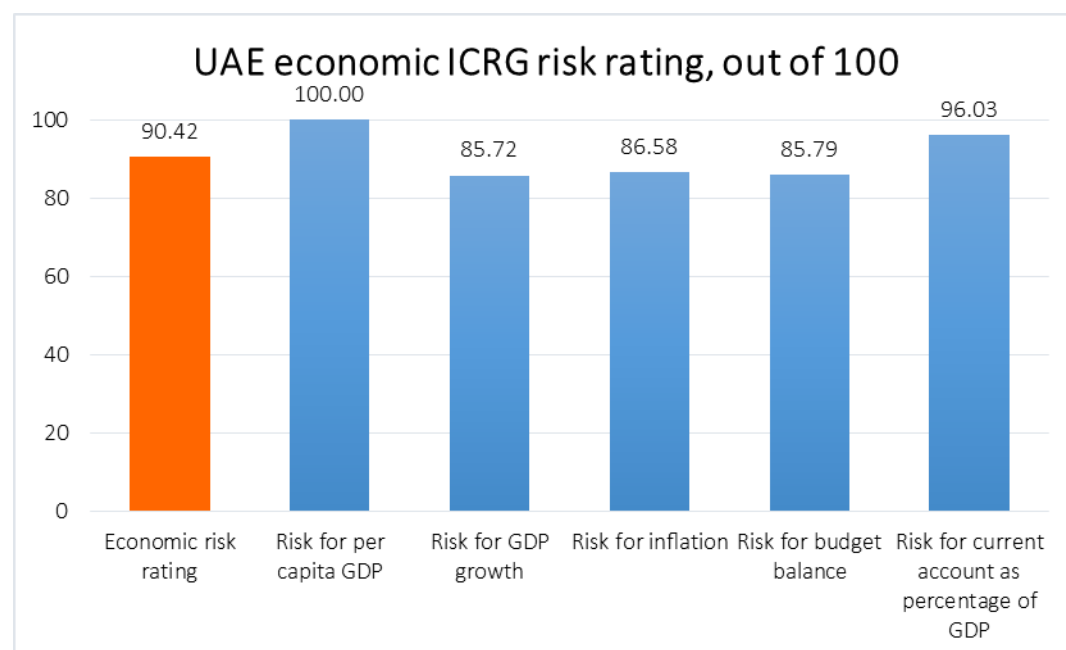


Figure 7 UAE economic ICRG risk rating (Source: Ramady, 2014)

2.3.2.2 Financial Risk

2.3.2.2.1 Current Debit

Although, the UAE has a significant debt level as percentage of its GDP, the probability of a total default is unlikely as the UAE holds the largest combined Sovereign Wealth Funds in the world (Ramady, 2014).

2.3.2.2.2 Currency

The UAE's currency is pegged to the U.S. dollar and there is a very low risk of de-pegging from the dollar. Moreover, the UAE has opted out from joining in a common GCC currency (Ramady, 2014).

2.3.2.2.3 Risk Ratings

The UAE risk ratings, based on the International Country Risk Guide (ICRG), for the different financial indicators are illustrated in Figure 8.

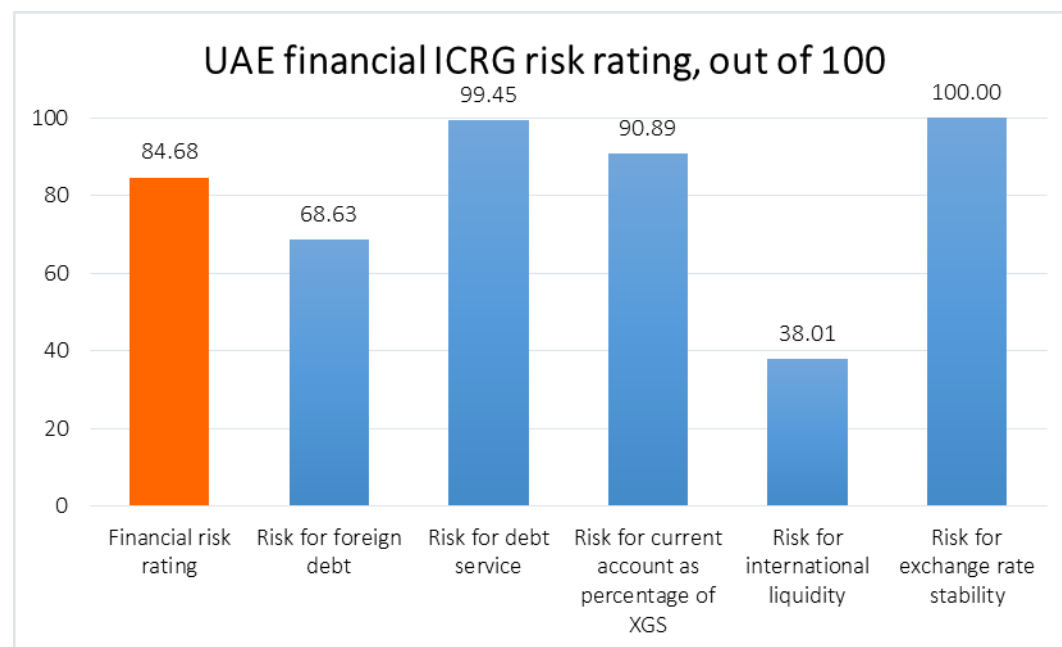


Figure 8 Bahrain financial ICRG risk rating (*Source: Ramady, 2014*)

2.3.2.3 Political Risk

2.3.2.3.1 Government Effectiveness and Corruption

Although, the UAE's government effectiveness is considered high, there are some concerns about limited corruption and "cronyism" between government officials and leading family businesses. However, the government has launched an anticorruption campaign that, accordingly, will raise the level of bureaucratic efficiency (Ramady, 2014).

2.3.2.3.2 Region Tension

According to BMI (2014), any Islamist militants attack would reappraise the UAE's risk profile. Moreover, tensions between the West and Iran could result in a deterioration in its risk profile.

2.3.2.3.3 Political Disturbances

Although, the UAE does not allow political parties, there was a rising of the Muslim Brotherhood in the UAE. However, the risk of major political disturbances following the arrests and imprisonment of Al Islah, the arm of the Muslim Brotherhood in UAE, members is deemed very low, as the government has restricted any political movements.

2.3.2.3.4 Risk Ratings

The UAE risk ratings, based on the International Country Risk Guide (ICRG), for the different political indicators are illustrated in Figure 9.

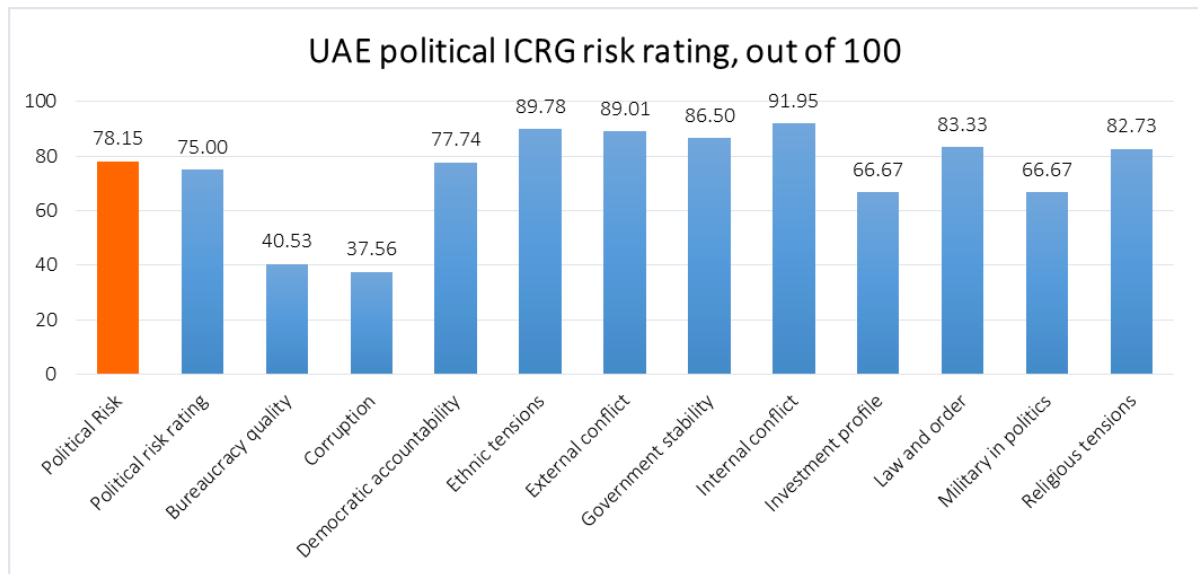


Figure 9 Bahrain political ICRG risk rating (*Source: Ramady, 2014*)

2.4 Composite Risk Rating

Figure 10 shows the comparative risk rating for the three countries based on the ICRG.

UAE has the best overall composite rating with 82.82 then Bahrain follows with a rating of 78.86, and then Saudi Arabia with a rating of 78.83.

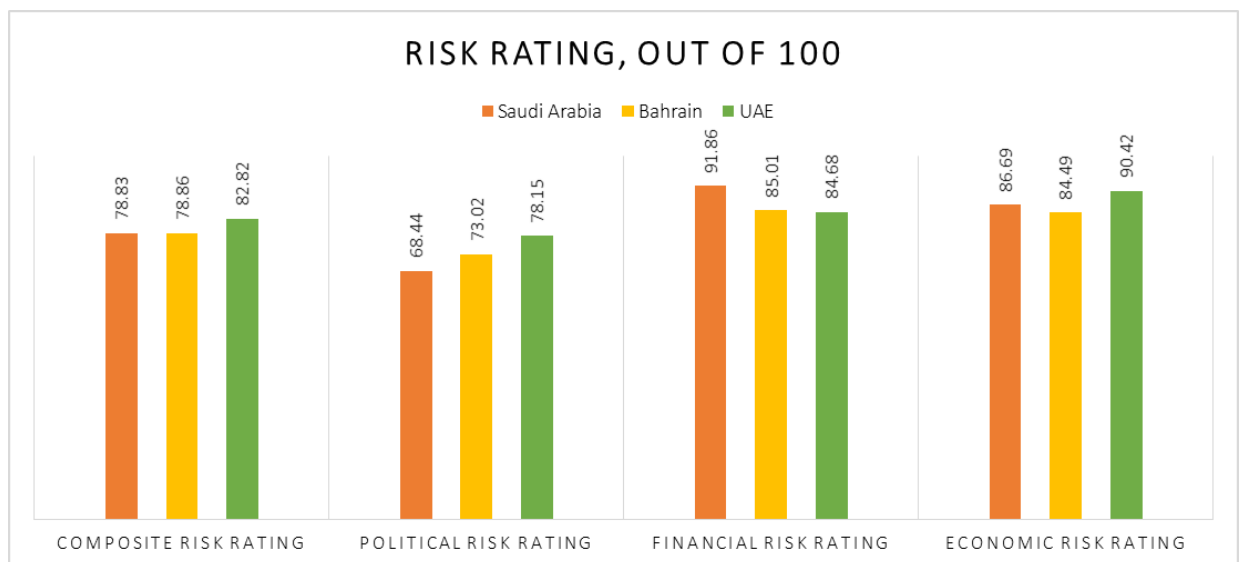


Figure 10 Comparative risk rating (*Source: Ramady, 2014*)

3. Risk Register

Table 4 summarizes the risk register at the level of corporate, strategic business unit and project level.

Risk Description and Impact	Level	Probability	Impact	Mitigation
Saudi Arabia				
Introducing income tax on foreigners or added tax on domestic products and services	Corp	Medium	High	Finance to advice on the impact and ways of mitigation
Enforcing employment of nationals to reach Saudi citizen employment quotas	SBU/Project	High	Medium	Define a skill set and positions suitable for nationals
Launching single GCC currency	Corp	Low	High	Finance to advice on the impact and ways of mitigation
Currency de-pegging from the dollar	Corp	Low	High	Finance to advice on the impact and ways of mitigation
Large-scale protests / major political disturbances	Corp	Low	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties

Terrorist attacks	Corp	Low	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties
Dealing with corrupt officials	SBU	High	Medium	Declare an anti-corruption policy
Bahrain				
Return of an expatriate labor tax	Corp	Medium	Medium	Finance to advice on the impact and ways of mitigation
Large-scale protests / major political disturbances	Corp	Medium	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties
Iranian attacks	Corp	Low	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties
Dealing with corrupt officials	SBU	Low	Medium	Declare an anti-corruption policy
Setting official national quotas	SBU/Project	Medium	High	Define a skill set and positions suitable for nationals
Currency de-pegging from the dollar	Corp	Low	High	Finance to advice on the impact and ways of mitigation
UAE				

Setting official expatriate labor quotas	SBU/Project	Medium	High	Define a skill set and positions suitable for nationals
Currency de-pegging from the dollar	Corp	Low	High	Finance to advice on the impact and ways of mitigation
Dealing with corrupt officials	SBU	Low	Medium	Declare an anti-corruption policy
Islamist militants attack	Corp	Low	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties
Large-scale protests / major political disturbances	Corp	Low	High	On-site engineers to be register with the embassy upon arrival Losses to be shared equally amongst all project parties

Table 4 Risk register

4. Conclusion

The three countries are exposed to economic, financial and political risks. However, the risk is considered low for the three countries.

According to the ICRG ratings and the analysis held by this report, UAE has the best rating against the three risk categories.

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