Ensuring the sustainability of localised businesses

Xavier Jopart, General Manager, Fisheye Consulting, Brussels & Jean-Marc Riegel, Partner, PIVOT LLC, Doha, May 2022

For several years, Qatar, like its GCC neighbours, has embarked on a localisation strategy. This strategy, supported among others by the MOCI, QDB and InvestQatar, aims at diversifying the economy away from oil & gas revenues, create employment, and position Qatar as a hub in several sectors (education and research, tourism, downstream gas industries, financial sector, etc.).

Countries implementing a localisation strategy opt to activate various levers to encourage the establishment or the development of onshore businesses. These levers range from the creation of a business-friendly environment to more active strategies such as the requirement for a minimum "localisation" level in government procurement contracts or, even, protective measures to shield local industries from the competition of imported products and services.[1]

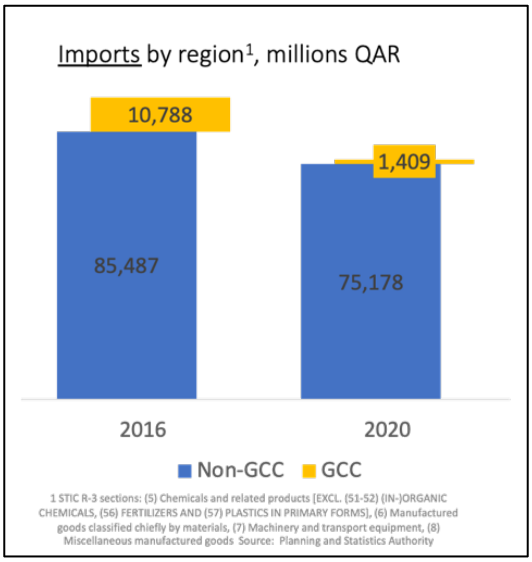

Figure 1

The COVID-19 pandemic disrupted supply chains in many countries, developing and mature alike. This has prompted them to revisit their industrial fabric and intensify the localisation of some elements of value chains[2] (as an example, the re-onshoring of some industrial activities was one of the hot topics in the recent French presidential election).

In Qatar, the pandemic compounded the already challenging environment created by the 2017 blockade imposed on the country. The blockade and the pandemic disrupted supply lines in many sectors at a time where the country was in a massive investment and development streak, triggered among others by the preparation of the World Cup 2022 infrastructure.

As these developments could not be delayed and the country needed to continue functioning, some industries turned to other, farther, suppliers creating its own set of challenges. Others saw an opportunity to localise the production of erstwhile imported products (Figure 1).

The result of this "forced localisation" was a substantial increase in operating factories in the country, especially in some industrial sub-sectors (figure 2)

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[1] "As Supply Chains Localize, Industrial Policy Springs Back", BCG, November 2021
[2] "Resetting Supply Chains for the next normal", McKinsey, July 2020

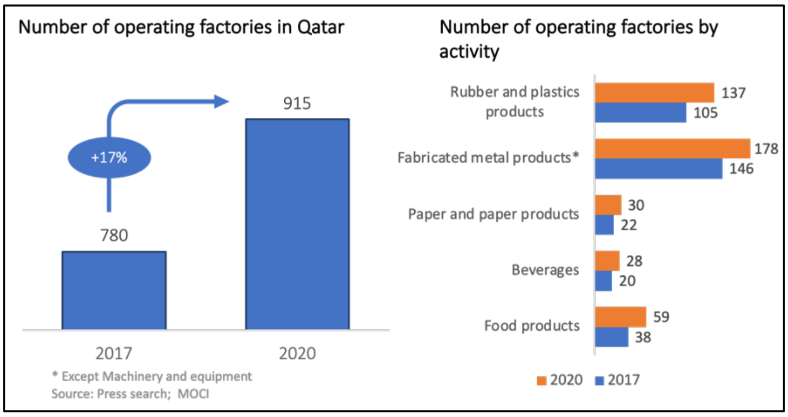

Figure 2 – Number of operating factories (before COVID-19 impact)

As the blockade is progressively lifted and imports are likely to come rushing back, the viability and sustainability of some of these ventures comes in question. Are they competitive enough in the quality of their products and their proicing to compete with exports from Saudi Arabia or the UAE? Do they have an opportunity to leverage their capacity to start exporting?

Companies and government institutions should be asking themselves these questions now and put in place strategies to ensure the sustainability of these activities.

In light of the lifting of the blockade, businesses established since 2017 can be grouped in three broad categories:

1. Businesses that are *strategically critical* for the country: these are businesses that must continue to function, potentially supported by subsidies, as they ensure the country's independence in areas such as defence, telecommunication and data, and food supply. Those industries should be seeking to improve their profitability (including exploring export opportunities) as much as possible to reduce the need for government support.

2. Businesses that are currently profitable and who will not suffer from the lifting of the blockade, because they are already competitive, and for whom the reopening of the border could create export opportunities. These companies have the potential to be groomed into *national champions* by a combination of internal initiatives (commercial strategy, capacity management etc.) and active institutional support.

3. Businesses that will *struggle* once the borders reopen as they have not reached a sufficient level of competitiveness. In this category, three main subgroups can be identified:

    a. The businesses that are *close to competitiveness* and can turn themselves around on their own through better cost management and rationalisation

    b. The business that currently function *sub-scale* (i.e., whose production is substantially below their capacity). To reach competitiveness, these businesses will need to seek to build scale through consolidation or collaboration (e.g., mutualisation of production assets, group procurement) with some of their competitors

    c. The businesses that *cannot reach sustainability* through rationalisation and/ or consolidation and whose future cannot be guaranteed

Companies cannot afford to adopt a "wait and see" approach to the next few months. Borders will eventually reopen, and the country is likely to see a decrease in infrastructure investments after the World Cup. Companies should start thinking today about their strategy for 2023 and beyond. Practically, they should first identify which of the three categories mentioned above they belong to and develop action plans to improve profitability (cost reduction, better pricing strategy, consolidation, etc.) and potentially capture more volume (exports)

Institutions in Qatar also have a role to play in supporting the rationalisation of the localised businesses. As they develop the next stage of the economic diversification and localisation strategy, InvestQatar, the MOCI, QDB and the Ministry of Finance should adopt a joint and coherent approach that considers the landscape of existing businesses in the country and the three clusters mentioned above:

1. For strategically important businesses, the authorities should support business rationalisation, diversification, and international expansion (provided it can be viable, at an acceptable cost from the country)
2. For potential national champions, once they are identified, the authorities should put in place a supporting framework, mixing access to finance, talent, and advisory services to help the development of these companies
3. For struggling companies, support should be provided on a *selected* basis to these companies that *demonstrate* the ability and willingness to improve. The support could come in several forms:
    a. Access to advisory services and cost reduction programmes
    b. Provision of additional financing based on sound and stress-tested business plans
    c. The creation of more liquidity in the SME equity market, for example through an SME fund that could help companies access capital but could also foster the creation of a yet inexistant SME M&A market

In addition, a "surgical" approach to reopening the borders, managing import barriers and taxes may help shield Qatar-based companies a little longer while they improve profitability and prepare to compete again. But these barriers will eventually have to be lifted.

The recent increase in oil & gas prices provides an unexpected windfall on the government budget to fund this industry support approach. While the 2022 government budget was based on oil price at $55 a barrel, the baseline consensus has been revised to $100/$110 a barrel. This will improve the expected budget from an 8 billion QAR deficit to a surplus of somewhere around 50 billion QAR.
This surplus could partly be deployed in funding *focused and targeted* programmes to support the sustainability of some of the local industries. To avoid squandering resources, these programmes should have clear and *stringent eligibility criteria* to select participating companies and ensure the highest success rate.

Finally, as not all companies will manage to face the challenges of the post-World Cup, post-blockade world, the authorities should try to reduce the stigma associated with business failure, noting that most of the very successful global entrepreneurs have faced failure in some of their ventures and that "cutting losses" is generally less costly than artificially maintaining a failing business afloat.