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The Changing Middle Eastern and African Markets

—Why the current emphasis on the Middle East and Africa?—

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Economic growth in the Middle East and Africa has been driven by a natural resource boom. In the Middle East and Africa, some countries are already as wealthy as are some of the ASEAN (Association of Southeast Asian Nations) member countries in terms of the number of high income earners. In the future, Africa's young population will greatly exceed that of China as well as that of India. The number of young people in the Middle East is predicted to continue to surpass that of the United States. These growing young populations are expected to contribute to market expansion.

Against this background, European and U.S. companies have already been fully committed to their efforts to enter the Middle Eastern and African markets, with several having achieved sales levels of several hundred billion yen to as much of one trillion yen.

For many Japanese companies, the Middle Eastern and African markets seem very distant, causing misconceptions about doing business in these markets. For the Middle East, common misconceptions include: (1) the "Arab Spring" makes the region politically unstable, (2) the markets are limited to those related to oil and natural gas, (3) the Gulf countries are a collection of small states, and (4) living under the influence of Islam results in harsh living conditions. For Africa, those include: (1) only specific industries participate in the markets, (2) the market scale of each country is only about several million to several tens of millions of people, (3) the market is only for low-quality, low-priced products, and (4) the market is only for "rehashed" products and services.

What is required of Japanese companies is to dispel their misconceptions and correctly recognize the realities of doing business in the Middle East and Africa, and then to pursue the business opportunities that these markets present.

I Why the Current Emphasis on the Middle East and Africa?

In 2013, Prime Minister Shinzo Abe made a tour of the Middle East, the first in seven years by a Japanese prime minister. That same year, the 5th Tokyo International Conference on African Development (TICAD V) was held in Yokohama. In addition, many Japanese companies have entered both the Middle Eastern and African markets one after another. Considering these situations, it is fair to say that the year 2013 was Japan's "year of the Middle East and Africa."

1 Natural resource boom leads to high economic growth

Why the current emphasis on the Middle East and Africa? The main reason is the high levels of economic growth achieved in these regions because of the increased demand for natural resources over the past few years. Centering on the Gulf countries, which consist of the six member states of the Gulf Cooperation Council (GCC), namely, the United Arab Emirates (UAE), Oman, Qatar, Kuwait, Saudi Arabia and Bahrain, the Middle East produces an abundance of oil and natural gas. Similarly, in Africa, the development of oil and gas fields has been pursued in recent years, and the continent is also rich in reserves of precious metals such as platinum.

West Texas Intermediate (WTI) prices (typical crude oil futures prices; see Note 1 of Figure 1) give us a numerical means of understanding the resource boom that has been going on in the Middle East and Africa. As shown in Figure 1, the plot of the gross domestic product (GDP) is almost identical to that of WTI prices in the Middle East and Africa. These graphs suggest that the economies of the Middle East and Africa have grown at a rate commensurate with the increase in demand for oil from emerging countries such as China.

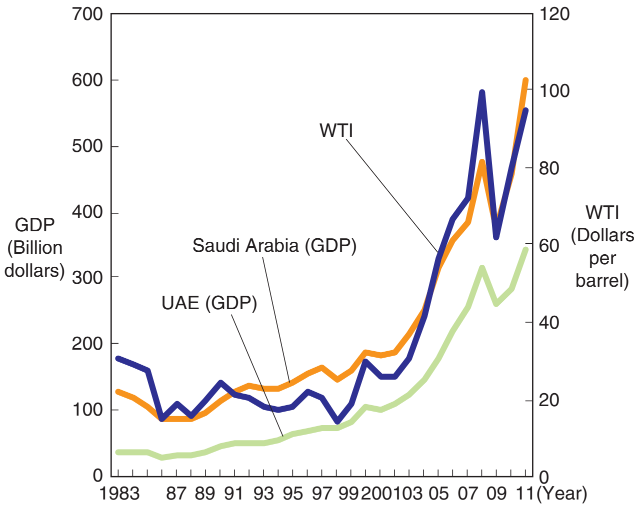
2 "Mining" and "personal consumption" contribute to economic growth

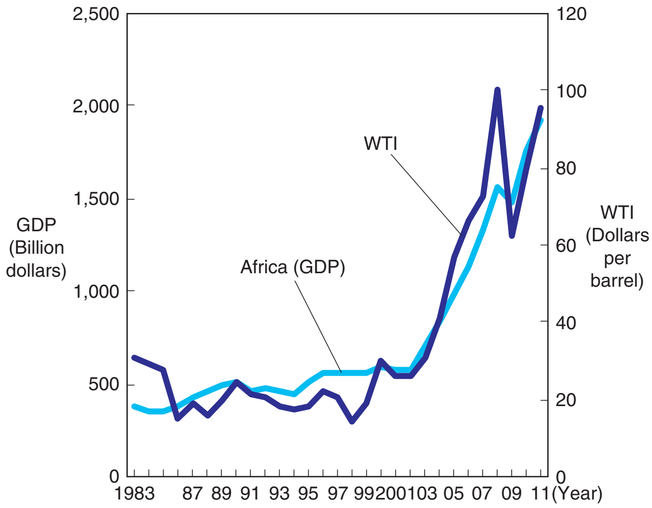
In order to understand the characteristics of the economic structure of the Middle East and Africa, we analyzed contributions to economic growth as well as to added value in 54 African countries, the UAE, India, China and the world as a whole (Table 1). This analysis showed that "personal consumption" and "mining" made major contributions to the economies of the Middle East and Africa. The factors behind this growth differ from those of China, which has achieved economic growth through the development of manufacturing and the resulting formation of fixed capital, as well as from those of India, where growth has depended on personal consumption stemming from the acquisition of foreign currency such as that through migrant workers. In the Middle East and Africa, foreign currency reserves have grown because of an increase in the prices of natural resources, leading to a virtuous circle whereby the stimulation of the local economy by such increase has resulted in growth in personal consumption.

3 A level of wealth comparable to that of ASEAN

Japanese companies simply cannot ignore the fact that continued economic growth in the Middle East and

Figure 1. Changes in crude oil prices and trends in gross domestic product (GDP) in the Middle East (Saudi Arabia and UAE) and Africa





Notes: 1) WTI stands for West Texas Intermediate. WTI refers to high quality crude oil that is produced in West Texas and Southeast New Mexico. With its low sulfur content, it is easy to refine and make greater amounts of gasoline, kerosene, etc. Because of its overwhelming trade volume, WTI is used not only as a benchmark in oil pricing but also as a key indicator of the world economy. 2) UAE stands for the United Arab Emirates.
Sources: Compiled based on the website of the U.S. Department of Energy for crude oil prices and "World Economic Outlook" published by the International Monetary Fund (IMF) for GDP.

Africa has led to some of the 54 African countries having a level of wealth equal to that of the ASEAN (Association of Southeast Asian Nations) member countries that have been attracting considerable attention in recent years (Figure 2). For example, in South Africa, about 900,000 households have a disposable income of at least $75,000 per year. This figure is more than that of Malaysia and that of Indonesia. In Egypt, which was widely reported as being in turmoil between 2010 and 2012 as a result of the "Arab Spring" uprisings, there are about as many wealthy households as there are in Thailand. Thanks to its petroleum resources, Nigeria, with its large population of about 170 million, is now wealthier than Vietnam. Morocco and Tunisia are only slightly behind Vietnam in terms of the number of wealthy households.

Such wealthy households are well able to afford the products and services that Japanese companies have developed for the Japanese domestic market and those of other developed countries. Therefore, given the income levels of these countries, it is reasonable to say that Japanese companies could realistically make an entry into the Middle Eastern and African markets. In fact, many Japanese companies in the home appliance, automobile, food and amusement industries are already offering products in the Middle Eastern and African markets at

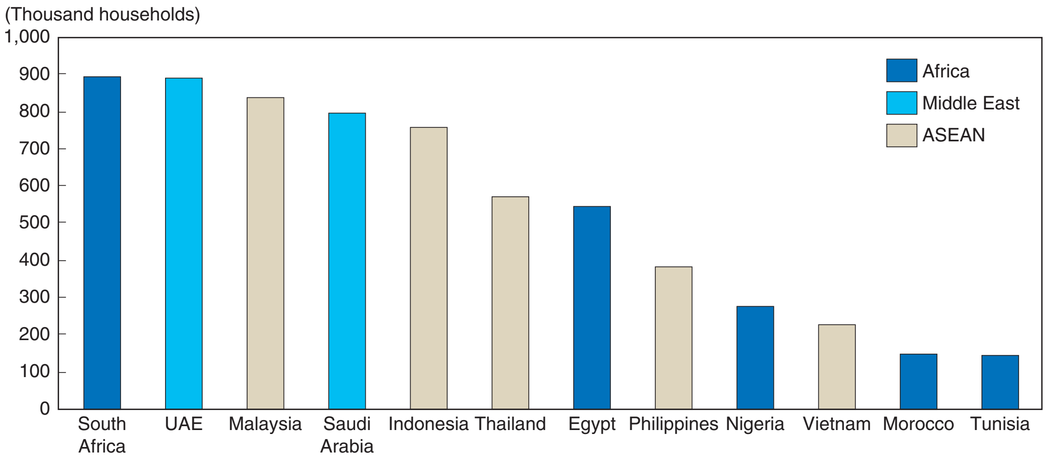
Table 1. Contribution to economic growth Note 1 and percentage of total value added Note 2 in 54 African countries, UAE, India, China and the world

Contribution to growth (2001 – 2011, unit: %)

		54 African countries	UAE	India	China	World
Contribution to economic growth	Personal consumption	56.6	47.3	53.2	32.7	54.9
	Government consumption	17.3	7.1	11.5	12.5	18.4
	Gross capital formation	23.5	31.2	39.4	52.1	25.0
	Trade surplus	1.9	14.4	– 6.7	3.8	1.6
Percentage of total value added	Agriculture, forestry, fisheries, etc.	16.2	0.2	15.2	9.2	5.1
	Mining	24.2	44.5	4.3	7.7	8.4
	Manufacturing	8.3	5.4	13.4	32.4	17.6
	Construction	5.8	10.5	9.0	7.1	5.9
	Wholesale, retail, restaurants and hotels	14.0	10.1	18.8	11.4	14.6
	Transport, communication	7.8	7.7	7.3	4.3	6.9
	Other	23.7	21.6	32.0	28.1	41.5

Notes: 1) Contribution to economic growth was measured by analyzing the factors that contributed to GDP growth for the period from 2001 to 2011. Because of the application of exchange rates, the total is not 100 percent. 2) Percentage of total value added was measured by analyzing the industries that contributed to growth in value added for the period from 2001 to 2011. Because data for Chinese manufacturing were available only from 2004, data for 2004 and subsequent years were used to estimate those for previous years.
Source: Compiled based on United Nations "National Accounts Main Aggregates Database."

Figure 2. Number of wealthy households in major countries in ASEAN, the Middle East and Africa



Note: The above bar graph shows the number of households with a disposable income of at least $75,000 in 2012 (purchasing power parity (PPP)) in each country.
Source: Compiled based on data published by Euromonitor International.

prices on a par with or even higher than those in the Japanese domestic market.

4 Large populations of young people

Another attractive aspect of the Middle Eastern and African markets is the large population of young people (Figure 3). As of 2010, the under-25 population of the Middle East was approximately 143 million, exceeding that of the United States, which stood at about 105 million. Considering that Japan's under-25 population is only about 30 million, it is easy to understand the enormity of the market. The population of young people in Africa already surpasses that of India and that of China. Moreover, according to the United States Census Bureau, this figure is expected to increase at an alarming rate, reaching about 876 million by 2030.

If the powerful engines of the economies of the Middle East and Africa continue to run steadily, such as resource prices that are expected to remain stable, these young populations will be able to enjoy the benefits of economic growth. When these huge populations begin to consume, the Middle Eastern and African markets for consumer goods and so on will grow explosively.

In addition, as a rule, young people are not particularly conservative in terms of consumer behavior. Rather, they have the characteristic of quickly responding to new products/services, brands, trends, etc. Therefore, an increase in the number of young people means an increase in the number of consumers who are open to foreign products including those of Japan, which is one of the attractions of these markets for Japanese companies. Furthermore, as these populations of young people, who have high levels of education and are highly motivated to work, continue to increase, they themselves can be regarded as constituting a huge available labor force.

5 Foreign companies achieve annual sales of more than several hundred billion yen

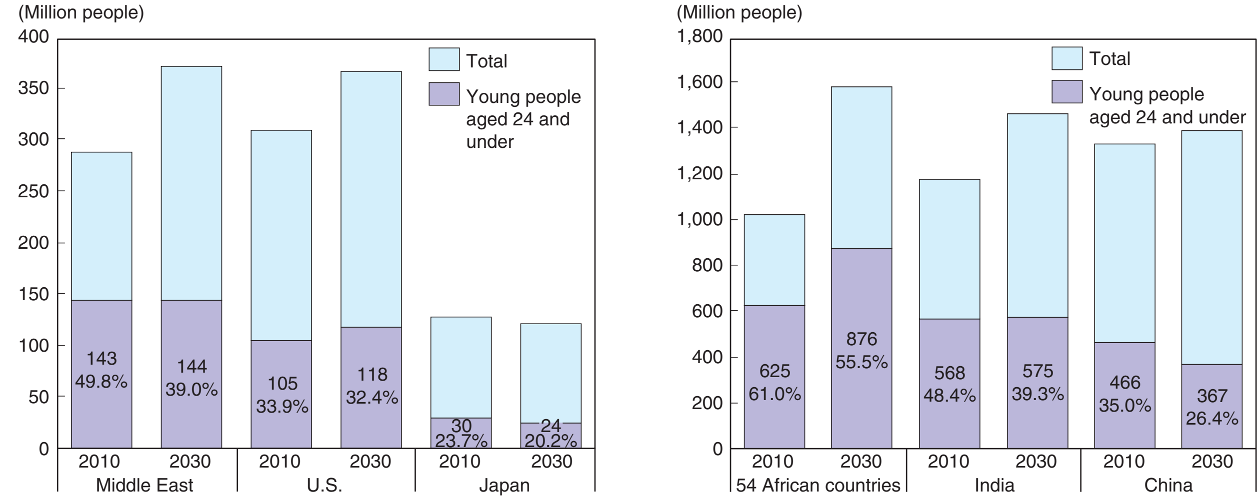
Many of the foreign companies that have moved into the ever-growing Middle Eastern and African markets have already reached annual sales in the order of several hundred billion yen (Figure 4).

For example, in the field of construction machinery, Japan's Komatsu has achieved sales in excess of 100 billion yen in the Middle East and Africa. However, its competitor, Caterpillar, has sales of more than 1 trillion yen when the European market is included. A similar case can be found in the field of heavy electrical machinery where, in the fiscal year ended March 2013, the sales of Mitsubishi Heavy Industries, which sells products such as gas turbines, reached 70.9 billion yen in these markets. However, General Electric (GE) was able to realize sales of more than 1 trillion yen in the same markets.

In the field of food products, Nestle, which sells small-portion powdered drinks and baby food, achieved sales of about 300 billion yen in Africa. Of Japanese companies, Ajinomoto entered the Nigerian market in 1991, and has developed a business selling small portions of its Umami seasoning in Nigeria and Côte d'lvoire. Among Japanese companies doing business in Africa, Ajinomoto has a good and long established reputation. However, even for Ajinomoto, whose business is mostly in Nigeria, its sales of 10 billion yen fell far behind those of Nestle, which operates throughout the continent.

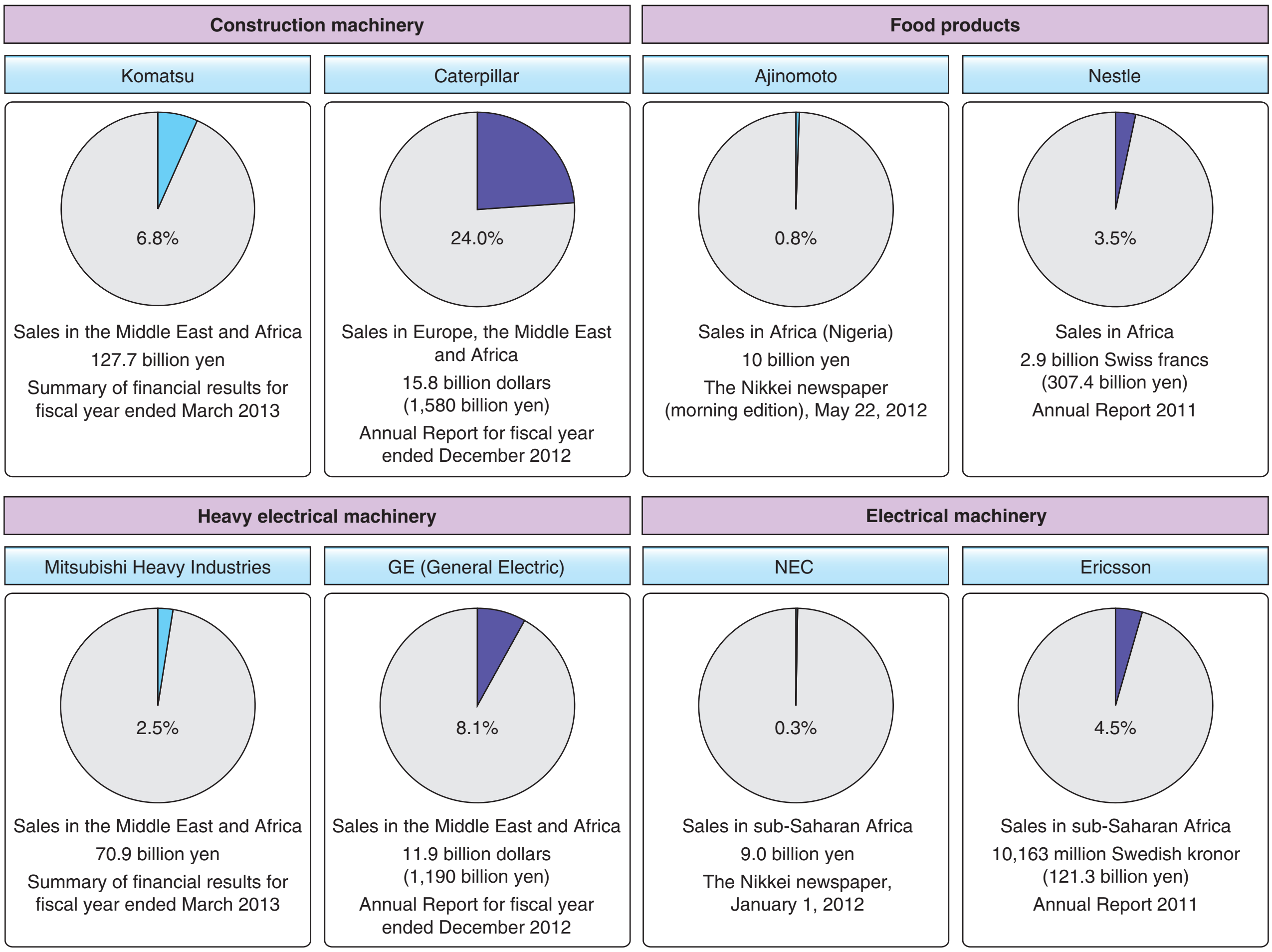
In the area of communications equipment, Ericsson has grasped a business opportunity in the development of communications infrastructure for mobile phones, etc. In 2011, it achieved sales of about 120 billion yen in sub-Saharan Africa (the area of the African continent that lies south of the Sahara Desert). In contrast, the

Figure 3. Changes in under-25 population and its percentage distribution in the Middle East, U.S., Japan, 54 African countries, India and China



Note: The Middle East in this bar graph does not include the North Africa region.
Source: Compiled based on data published by the United States Census Bureau.

Figure 4. Comparison of the amount of sales in the Middle East and Africa between Japanese companies and European/U.S. companies



Note: Sub-Saharan Africa refers to the area of the African continent that lies south of the Sahara Desert.
Sources: Compiled based on IR information published by each company and material published by the mass media.

sales of NEC, which is also operating communications infrastructure business in the same sub-Saharan region, stand at only 9 billion yen.

In this way, compared to other foreign companies, Japanese companies are not fully benefiting from the economic growth that is seen in the Middle East and Africa. In order not to miss the opportunities presented by these markets, they must advance into the Middle East and Africa as quickly as possible.

II Misconceptions and Realities of Doing Business in the Middle East

One of the reasons that Japanese companies are slower to enter the Middle Eastern and African markets, relative to European and U.S. companies, is thought to be their unfamiliarity with the markets because of their physical distance from Japan and differences in their cultures.

As part of its support for their moves, Nomura Research Institute (NRI) has held interviews with many Japanese companies that have been interested in expanding into the Middle Eastern and African markets. Through these interviews, it has become clear that many misconceptions about these markets remain.

1 Misconception (1): The Arab Spring makes the region politically unstable

The first misconception is that “the political situation in the Middle East is generally unstable as a result of the Arab Spring.” It is a fact that, since the Arab Spring, socio-economic confusion continues in many of the countries in the two regions.

However, even within these two regions, in the Gulf countries that are rich in oil and natural gas reserves, the effect of the Arab Spring has generally been minimal, and they enjoy a high level of socio-economic stability. The main reason for this stability is that backed by their abundant financial resources based on oil and natural gas, the Gulf countries such as the UAE and Saudi Arabia can provide their citizens with generous welfare services, leading to a low level of dissatisfaction with the political system. In fact, given that the UAE and Saudi Arabia are seen as “safe havens” within the

Middle East, offering shelter from the effect of the Arab Spring, there has been an increase in the amount of foreign direct investment in these countries in recent years. Furthermore, because tourists who might have otherwise visited Egypt are coming to the region, more and more tourists are visiting the Emirate of Dubai, part of the UAE.

2 Misconception (2): The markets are limited to those related to oil and natural gas

The second misconception is that "the markets in the Middle East are limited to those related to oil and natural gas." As was stated above, it is certainly fair to say that the economy of the Middle East is built on oil and natural gas.

Nevertheless, as the major contribution of "personal consumption" to economic growth suggests, the Middle East presents a very significant consumer goods market. For example, in the UAE, there are currently no less than 80 large and small shopping malls. The large malls contain many of the world's well-known brands as their tenants in the areas of fashion and apparel, and include amusement facilities. According to the 2012 "How global is the business of retail?" ranking, compiled by CBRE, Inc., which ranks the openness of retail markets to global retailers, the UAE came in second after the U.K. while Saudi Arabia was tenth, both placing higher than Japan, which was ranked in sixteenth place (Table 2).

Thus, we can say that the retail market in the Middle East is generally open to foreign companies, including those from Japan. As such, there are business opportunities waiting to be taken by Japanese companies.

3 Misconception (3): The Gulf countries are a collection of small states

The third misconception is that "among the Middle Eastern countries, the Gulf countries have benefited from their oil and natural gas reserves; nevertheless, any one of these countries is small, and offers only a relatively unattractive market as a target of business development." While Saudi Arabia can be regarded as an exception with its population of about 29.2 million, the scale of the markets is undoubtedly small. For example, the UAE has a population of only about 9.2 million and Qatar of about 2 million.

However, although the Emirate of Dubai has a resident population of only about 2.1 million, every year it plays host to 10 million tourists. The Dubai Department of Tourism and Commerce Marketing aims to increase this number to 20 million people a year by 2020, giving the country a very large transient population. In addition, the Middle Eastern countries all share a common bond in the Arabic language and their Islamic heritage. Therefore, by marketing in Arabic and developing products and services that demonstrate an understanding of Islamic culture, companies can apply their sales efforts to more than one country. Some European and U.S. companies have already taken this approach. For example, PepsiCo in the area of beverages, L'Oreal in cosmetics and Procter & Gamble (P&G) in household goods all have been marketing their products in the entire Middle East region. Within the entire region, about 400 million people share a common heritage of the Arabic language and Islamic culture, thus constituting a huge market.

Table 2. Global ranking of retailer representation in 2012

Order	Country	Level of retailer penetration (%)
1	U.K.	56.7
2	UAE	53.1
3	U.S.	50.3
4	Spain	47.5
5	China	47.2
6	France	46.9
6	Germany	46.9
8	Russia	44.5
9	Italy	42.9
10	Saudi Arabia	41.1
16	Japan	36.2

Source: Compiled based on "How global is the business of retail?" by CBRE, Inc.

Figure 5. Misconceptions and realities of doing business in the Middle East

Misconceptions		Realities
(1) The Arab Spring makes the region politically unstable	→	The Gulf countries function as "safe havens"
(2) The markets are limited to those related to oil and natural gas	→	The consumer goods market is growing explosively
(3) The Gulf countries are a collection of small states	→	About 400 million people share a common bond of Arabic language and Islamic culture
(4) Living under the influence of Islam results in harsh living conditions	→	There are stores selling religiously prohibited food products such as liquor and pork to non-Muslim customers

4 Misconception (4): Living under the influence of Islam results in harsh living conditions

The fourth misconception is that "living in the Middle East under the influence of Islam results in harsh living conditions, making it difficult to develop a business." Indeed, even among Middle Eastern countries, people in Saudi Arabia, for example, are required to pray five times a day, prompting retail stores and restaurants to close each time, and the sale of alcohol is forbidden, even to foreigners. Because of these restrictions, Japanese representatives assigned to Saudi Arabia might find the lifestyle there somewhat limiting compared to that in Japan.

However, in Bahrain and the UAE, both of which can be reached by land from Saudi Arabia, there are liquor stores aimed at non-Muslim customers, and the supermarkets have sections selling pork, the consumption of which is forbidden by Islam. Currently, there are about 3,000 Japanese residents in the UAE alone. Their eating and drinking habits are basically the same as at home in Japan.

Within the countries of the Middle East, strict Islamic law is not applied uniformly. Rather, in many of these countries, foreigners can follow a lifestyle that is not so different from that which they enjoy at home.

The above misconceptions and realities of doing business in the Middle East are illustrated in Figure 5.

III Misconceptions and Realities of Doing Business in Africa

In the same way as for the Middle East, Japanese companies have some misconceptions about the African market that are rooted in unfamiliarity, which hinder the entry of these companies in the market.

1 Misconception (1): Only specific industries participate in the markets

The first misconception is that "because business in Africa is centered on natural resources and infrastructure, business opportunities exist only for companies in those fields, with nothing for other industries such as manufacturers of consumer goods."

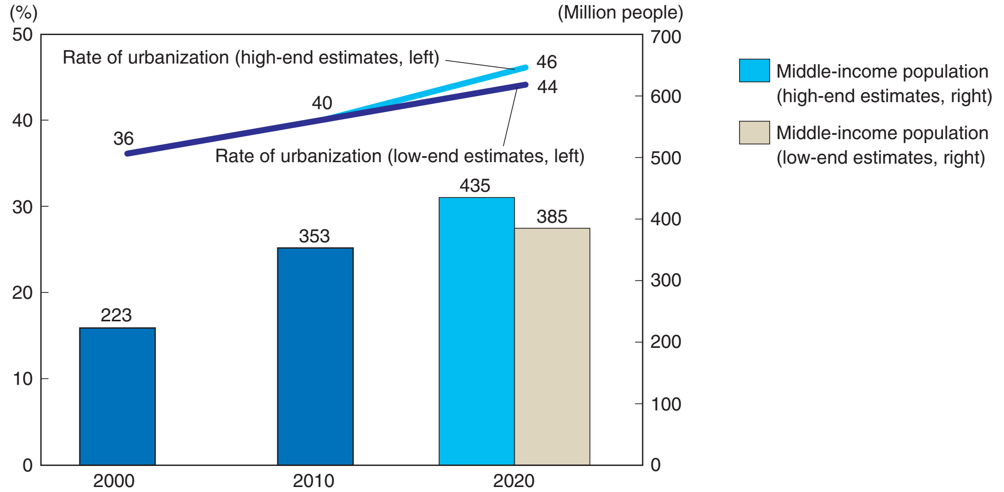
However, given the rise in resource prices, the African economy is growing rapidly, together with the size of the middle-income population. Urbanization is also progressing. According to the African Development Bank, the middle-income population (defined as those earning between 4 and 20 dollars per day) grew from around 223 million in 2000 to around 353 million in 2010, and is projected to reach about 435 million (high-end estimate) by 2020 (Figure 6). With this increase in the size of the middle-income population, business opportunities have been surfacing for a wide range of non-resource-related industries including consumer goods manufacturing and retailing.

2 Misconception (2): The market scale is only about several million to several tens of millions of people

The second misconception is that "because the market scale of any one African country is small, there are only a limited number of countries in which there is room for business development." Certainly, the continent of Africa contains no fewer than fifty individual countries. Many of these countries have a small GDP, not even reaching the level of Japan's cities.

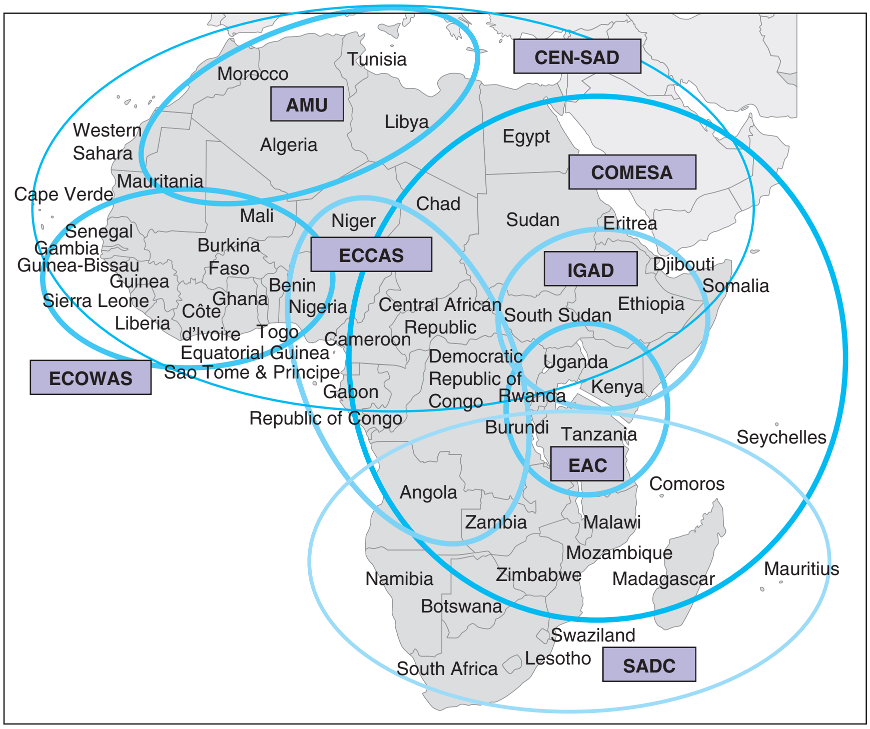
Nevertheless, within Africa, economic communities are being developed, and these communities represent huge markets on the scale of several hundred million in terms of population (Figure 7). Among these economic communities, for example, the East African Community (EAC) has lifted intra-regional tariffs and made

Figure 6. Increase in middle-income population earning 4 – 20 dollars a day and the rate of urbanization in Africa



Source: Compiled based on "Africa in 50 Years' Time," the African Development Bank.

Figure 7. African economic communities



Representative economic communities	Population (Million people)	Community GDP (Billion dollars)
Common Market for Eastern and Southern Africa (COMESA)	440	508
Community of Sahel-Saharan States (CEN-SAD)	490	861
Economic Community Of West African States (ECOWAS)	300	372
Southern African Development Community (SADC)	270	658
Inter-Governmental Authority on Development (IGAD)	220	151
East African Community (EAC)	140	84
Arab Maghreb Union (AMU)	90	383
Economic Community of Central African States (ECCAS)	140	210

Sources: Map: Compiled based on various materials. Table: Compiled based on United Nations "World Population Prospects" 2010 data for population; International Monetary Fund (IMF) "World Economic Outlook" 2011 data for community GDP.

improvements toward enabling one-stop customs clearance, thus promoting economic integration within the region. Western companies that have led the push into the African market, such as Nestle and Ericsson, have established their regional headquarters in Africa with an eye to the member countries of each of these economic communities.

3 Misconception (3): The market is only for low-quality, low-priced products

The third misconception is that "only low-priced products and services such as those made in China and India sell well in the African market, and there is no room for high-quality, high-priced Japanese products."

As explained in Chapter I, within Africa, there are already some countries with as many high income earners as in the ASEAN countries. Therefore, it could well be possible to develop a business that targets these high income earners. In addition, undertaking product development and marketing based on the values of African consumers should enable achieving successful sales by impressing consumers with high levels of value even though prices are higher than those of products made in other countries such as China. For example, Sony has developed audio devices that stress the deep bass sounds that Africans enjoy, and has gained a major share of the South African market, even for high-priced products.

4 Misconception (4): The market is only for "rehashed" products and services

The fourth misconception is that "because human resources are not developed in Africa, the majority of products and services available on the market are only rehashes of those previously offered in the developed countries."

While this notion is partially correct, the situation in Africa is changing. One of the reasons for the growth of the African economy over the last ten years is that there has been a major reduction in the number of regional

Figure 8. Misconceptions and realities of doing business in Africa

Misconceptions		Realities
(1) Only specific industries participate in the markets	➡	A wide range of industries can participate
(2) The market scale is only about several million to several tens of millions of people	➡	With an eye to economic communities, the market scale is several hundreds of millions of people
(3) The market is only for low-quality, low-priced products	➡	There is actually a market consisting of consumers pursuing high quality, good design and well-known brands
(4) The market is only for "rehashed" products and services	➡	There is actually a market consisting of consumers calling for innovative products and services

conflicts, and Africa has become politically stable. As a result, education systems have improved, leading to much better literacy rates among young people in many countries. As such, the quality of the workforce is improving. Furthermore, although talented Africans tended not to return home in the past after studying in the U.S. or Europe, the growth of the African economy has prompted many of them to return to their home countries. There has also been an increase in the number of cases in which they start new businesses. In addition, IBM and Samsung Electronics have been working with local universities to develop products and services for the African market. Overall, there has been an increase in the number of companies from developed countries making use of local human resources.

The above misconceptions and realities of doing business in Africa are illustrated in Figure 8.

Up to this point, the author pointed out some of the misconceptions that are prevalent among many Japanese companies regarding doing business in the Middle East and Africa. For Japanese companies that have generally been slower than their Western counterparts in moving into these markets, which resulted in losing many business opportunities, it is high time that they dispelled these misconceptions, learned the realities and became aware of the opportunities presented by the Middle Eastern and African markets.

In NRI's *Chiteki Shisan Sozo (Knowledge Creation and Integration)*, Vol. 22, March 2014, which featured the Middle Eastern and African markets as frontier markets, in addition to this paper, two other papers described the specific strategies that Japanese companies could take in entering each of the Middle Eastern and African markets. They are "Chuto he no shinshutsu senryaku (Strategies for entry in the Middle Eastern market)" written by Junji Koike, Koichi Hayashida, Naoya Shimokoshi and Norihito Miwa, and "Saigo no kyodai shijyo Afurika shijyo ni muketa 4tsu no shinshutsu senryaku (Four strategies for entry in the African market, which is the last major market)" written by Junji Koike and Tokutaro Hiramoto (both papers are available only in Japanese).

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