GRANT ROGAN

CEO, Blenheim Capital

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Grant Rogan has a long track record in the wider Middle East, having begun his career in the sector in the 1970s working in Saudi Arabia, Turkey and elsewhere.

His work in the Arabian Gulf has included assisting in the development of offset rules for some of the leading states in the region, establishing the Qatar Science and Technology Park and the creation of infrastructure projects and aircraft leasing companies. Offsets are industrial compensation in return for defense purchases.

Rogan founded Blenheim Capital in 2006 to provide offset consultancy and project services to companies and governments around the world, with the Middle East a key target area.

In 2011, the company became the only offset services provider to be authorized and regulated by the UK Financial Services Authority (now the Financial Conduct Authority).

Q. Offsets are fueling industrial expansion in the United Arab Emirates [UAE] and other Gulf Cooperation Council [GCC] states. What's the extent of the obligations being taken on by foreign companies?

A. As a group, the GCC is the fastest growing market for offsets in the world. There is some debate about the size of those obligations, but we estimate that by 2020, it will be in the region of $100 billion to $150 billion, if you count existing and projected procurements. If you look at nations like UAE, Saudi Arabia, Kuwait and Oman, who have offset programs, the next four years will see the numbers grow at an exponential rate. Actually, the offset requirements are even larger when you add in the huge support costs required through the 20-25 year life of a program.

Q. With those numbers, won't market saturation become a danger?

A. People need to gear offset obligations to the ability to absorb them, otherwise you lose the economic benefit. The issue for the customer is, do they enforce the penalties for companies missing their targets or do they give people time to implement their programs and push out the penalty triggers? My advice has been to offset authorities to not limit the potential for the discharge of offset obligations to one particular sector but open it up for projects across the entire economy. In so doing, there will be a greater potential for avoiding things such as saturation.

Q. Can the availability of sufficient qualified local staff keep up with the aspirations of the UAE and others?

A. The UAE is like many gulf and Middle East states where there exists skilled manpower limitation and the domestic competition for that qualified manpower is becoming an issue. I think this is going to be the biggest inhibitor in terms of industrial development generally, not just offsets. Unless governments are prepared to look at importing skilled expatriate labor in the interim, the issue will limit how fast they are able to grow their industries managed and controlled by their nationals. The problem would be a need for a policy shift, which would bring along with it security and social issues as well and it's one of the things they are all trying to avoid.

Q. Are defense contractors not concerned about the financial and reputational risk of taking on that scale of obligations in the region?

A. Because offset regimes have performance obligations with penalties attached to them and because of the magnitude and geographic concentration, the amount of exposure in the gulf region is raising questions for the first time with the multinational corporations. They have traditionally had exposure on contract performance, now they have added exposure, which is the offset obligations. It's very much in the eye of CEOs and chief financial officers.

Q. Has UAE efforts to establish an export presence created problems for foreign partners?

A. It is an issue. An export drive is one of the key things we are seeing right now across the region and not just the UAE. Countries are looking to create a niche within the global supply chain of their goods and services suppliers in the defense and aerospace sectors, and that's bringing up a new debate over the issue.

Q. Why would it be contentious?

A. Most importantly, it's the inability of foreign companies to be the majority owner, which is a problem. Majority ownership normally has to be local so you have a multinational being asked to partner with a local company, take a minority interest in that venture and bring to the table technologies that could be taken away from their home factory and then seeing that joint venture selling back into the global supply chain of the original manufacturer and others. That's what people are struggling with.

Q. Are these ventures viable without export success?

A. Take a look at Tawazun in the UAE. What they are looking for right now is very much about joint ventures with foreign direct investment focused on employment of nationals and focused on exports. The fact is, without breaking into the export market, many joint companies in the region are probably not sustainable in the long term. As an offset authority in an emerging market, if you don't have the economies of scale and you can't export, you end up directly or indirectly having to subsidize to make the venture profitable, and that's a drain on the economy. The challenge for Western contractors is, how do you meet the aspirations of the buying government while not giving away industrial crown jewels, which end up in the export market? The problem comes from the difficulty you have as a minority shareholder.

Q. The UAE rewrote its offset rules in 2010. Has that worked out well for them?

A. One of the most positive things the government did was introduce offset credits for input into projects — items like capital investment and technology transfer now earn you credits to set against offset obligations. Previously, that wasn't the case. It was just credits for output only — profit, for example. Now you can get credits for both. The UAE got that right but they put a ceiling of 30 percent of the offset obligation allowable in input credits. My personal belief is that they should have put a floor in at 30 percent not a ceiling, leaving themselves the ability to negotiate on a case-by-case basis in order to drive the maximum value for the UAE. If you have foreign suppliers put in, say, 50 percent, you have them even more on the hook in terms of long-term strategic commitment. What the UAE has done is fantastic, they just should have given themselves a little more flexibility, I believe. A Tawazun executive recently told me that in the last 18 months, they had handled more foreign investments as a consequence of the rule change than all the previous years of offsets put together, which is fantastic.

Q. The UAE is often looking for more than just offsets on some big deals, though?

A. There are sometimes wider issues in play. Defense treaties, financing and, in many cases, industrial collaboration requirements run parallel with the offset obligations. Look at the UAE's fighter competition. High-level discussion with the government is taking place in terms of industrial collaboration.

It's a distinct dialogue from the talks companies are having regarding offset. It doesn't mean necessarily doing one satisfies the other. Some of these things are genuine collaborative deals, which are not in themselves offset solutions. It's an interesting dynamic companies are having to deal with.

Q. Foreign companies have been voicing concerns over the UAE offset process. Can you see any likelihood of change?

A. We are hearing of some changes in approach. At DSEi in September, Tawazun [which is mandated by the UAE government to implement the offset policy] met with suppliers in a Defence Contractors Council gathering to discuss the subject. People who attended the meeting reported signs of flexibility by Tawazun on issues like the use of third parties to support activities. There was also a degree of support in terms of giving companies more leeway in meeting offset obligations early in the project. So there are signs of more flexibility in the time allowed to discharge obligations. I don't believe they will be too patient with defense and aerospace companies who think they can kick the can down the road hoping it goes away. My feeling is that time is running out for people not fulfilling their obligations.

Q. What is happening in Oman and particularly Qatar where there isn't much in the way of offset?

A. Offset policy is an active discussion in Doha right now. There are proposals on the table, which would have them up and running in 90 days, and certainly in time for a decision in the fighter competition. Don't forget there is also the projected $150 billion spend for the 2022 World Cup that could attract massive offset. Elsewhere, Oman has new guidelines awaiting royal ascent. Offset amounts will remain the same at 50 percent, but there are notable differences in terms and conditions compared with the existing rules, including encouragement for partnering.

Q. Is there still reluctance to doing offsets with the UAE?

A. People forget that in the UAE, offsets were the brainchild of Crown Prince His Highness Sheikh Mohammed bin Zayed Al Nahyan, so when they criticize offsets they are criticizing the client who is the crown prince, deputy supreme commander of the UAE armed forces, chairman of the offset authority and a string of other key government industrial posts. □

By **Andrew Chuter** in London.