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StoneTurn Insight

Oman: Attractive Investment Prospects, Approach with Diligence

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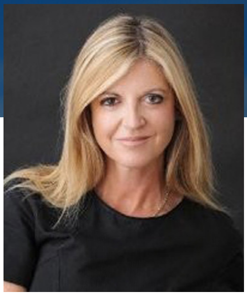

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The current COVID-19 crisis will continue to have a devastating impact on the global economy and, in particular in Oman, on the oil, aerospace and defence sectors. While Oman appears to be successfully containing the spread of COVID-19, its economy will need a speedy revival of the oil sector, which has been seriously impacted by a record cut in output to prop up oil prices amid the coronavirus pandemic. Post the pandemic, Oman will remain a very important market for U.S. and UK aerospace and energy firms.

Oman may not be as well-known as its neighbours the United Arab Emirates and Saudi Arabia. Yet it has avoided much of the flashy consumerism and aggressive foreign policy agendas that dominate the reputations of other Gulf states. The country is well-regarded as a regional peacemaker and mediator: it has stayed out of Yemen's increasingly bloody civil war and is not involved in the Qatar blockade. Despite the fact that Oman remains an absolute monarchy with extremely limited freedom of expression, it has not attracted the same level of international attention for human rights abuses as Saudi Arabia or the UAE. In essence, Oman escapes many of the potential reputational pitfalls faced by British companies looking to invest in the Gulf.

Robust due diligence and controls can help investors limit their risk exposure in Oman. **Turn to us** for assistance navigating any new or continuing investment opportunity in the sultanate.

Power Transition

The death of Sultan Qaboos bin Said, the Arab world's longest-serving ruler, in January this year brought Oman back into the international spotlight. After nearly five decades in power, Qaboos's successor, Haitham bin Tariq, has been widely hailed as the continuity candidate. Haitham is a popular choice, reportedly among both the Omani people and the UAE and UK governments. Unlike Qaboos, who remained single and became increasingly reclusive in later life, Haitham is married with children and is known to be gregarious.

It is likely that the new sultan will maintain his predecessor's policies of prioritising internal political stability, while maintaining an independent foreign policy agenda and acting as a peacemaker in the region. But Haitham's greatest challenge is domestic—the World Bank estimates that youth unemployment in Oman stands at nearly 50 percent.

British Partnership

The transition of power has highlighted both risks and opportunities for British businesses working in the sultanate. Oman is a major UK partner and Britain surpasses the U.S. in terms of strategic, economic and diplomatic relationships in the sultanate. Britain is Oman's largest source of foreign direct investment (FDI), with British nationals the biggest Western expatriate group in the country. Relations with the UK will likely remain strong but should not be taken for granted. Unlike Qaboos, Haitham is not driven by sentiment.

In the days after Sultan Qaboos's death, UK Prime Minister Boris Johnson and HRH the Prince of Wales rushed to Oman's capital, Muscat, to offer their condolences and congratulate the new Sultan. In contrast, the U.S.'s response was more muted, with a smaller, later delegation led by the Energy Secretary, Dan Brouillette.

UK-Omani relations are notably strong within two of the largest and most important sectors of the Omani economy: energy and defence.

Oil and Beyond

Oman's oil industry may be smaller than its Gulf Cooperation Council (GCC) neighbours, but oil revenues account for nearly 22 percent of national GDP, according to the World Bank's most recent figures. As the largest non-OPEC oil producer in the Middle East, Oman is able to maintain a more independent energy policy.

Shell and BP have made major investments in the country's energy industry, comprising a significant portion of UK FDI into Oman. Shell has a large stake in the state-owned Petroleum Development Oman (PDO) and a liquefied natural gas (LNG) plant in Sur on the northeastern coast, as well as processing plants and pipelines. Both companies have an extensive network of retail petrol stations and downstream sales.

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Gas plays an increasingly important role within Oman, and BP's $16 billion investment in the flagship Khazzan project signals confidence in the sector. Gas is now a key domestic energy source and forms a central part of the Oman Vision 2040 diversification plans, as the economy transitions away from oil. There is a rising demand for cheaper and cleaner energy sources to fuel the expected expansion of domestic manufacturing and other energy-intensive industries. The role of BP and Shell signifies the importance of British companies within these plans.

Strategic Hub

Oman also has a large defence sector, in which the British state and private companies have historically played a significant role. It was British officers that helped Sultan Qaboos come to power in 1970, and there is a strong, enduring security and intelligence relationship between the UK and Oman.

> Oman's strong links to the UK government and private sector, coupled with a positive international reputation, make the country an attractive market for investment by British companies.

Oman ranks fourth globally for annual military spending as a percentage of GDP (only Saudi Arabia, Libya and Eritrea spend more). The UK remains Oman's largest supplier of defence equipment, and the country is deemed a "priority market" for defence and security exports by the British government. Babcock, BAE and Rolls Royce all have substantial operations in Oman. Cooperation continues through regular joint military exercises and police training.

In early 2019, the UK and Oman signed a new joint defence agreement that allowed the Royal Navy to use al-Duqm port on the central Omani coastline, securing a strategic base in the Arabian Sea.

Al-Duqm is of particular importance because its position outside the Strait of Hormuz allows free access to the Gulf, bypassing what is a crucial yet vulnerable oil choke-point. Oman is the only GCC member with a coastline outside both the Strait of Hormuz and Bab al-Mandab.

The Iran Factor

Investment in Oman is not without risk and it is important that British companies interested in doing business in the sultanate conduct a thorough assessment of any potential partners.

Oman's status as a regional peacemaker creates opportunities and potential liabilities. The country's role as middleman between Iran and the West means that there are a significant number of Iranian companies based there.

Iran's presence in Oman exposes foreign partners in local ventures to the risk of sanctions through inadvertently working with Iranian-owned entities. More concerning still are the multiple Islamic Revolutionary Guard Corps (IRGC) front companies present in Oman. Media reports and U.S. sanctions lists show that these businesses stretch across multiple sectors including defence, logistics, construction and financial services. Complex corporate structures and layering of subsidiaries and parent companies can make it extremely challenging to disentangle legitimate local Omani business from entities potentially linked to the IRGC.

In 2018, the U.S. accused Oman of turning a blind eye to IRGC activity in the country, leading to the interception of a number of merchant vessels. Ultimately nothing was found, and Oman vehemently denied the U.S.'s allegations.

The Omani government is well aware that its relationship with Iran puts it in a difficult position. On the one hand, it feels compelled to tolerate Iran out of fear of stoking regional conflict. On the other hand, it understands Western concerns over Tehran. While investors should remain alert to the possibility of IRGC front companies in Oman, anecdotal evidence suggests that there are significantly more of these in Dubai.

Tackling Corruption

Oman's inclusion on the European Commission's blacklist of "non-cooperative tax jurisdictions" highlights yet another potential risk of doing business in the country. Oman joins seven Pacific and Caribbean nations (American Samoa, Fiji, Guam, Samoa, Trinidad and Tobago, the U.S. Virgin Islands and Vanuatu) that the EU has condemned for "abusive tax practices." As a result, EU countries can apply certain defensive measures against Oman, including requiring increased monitoring and additional documentation for transactions with Omani companies.

There are also persistent problems with corruption in some sectors of the Omani economy. This is a particular risk within public sector procurement because the small size of the country's business and political elites means that nepotism and close relationships that extend beyond the professional are common. Foreign businesses working on government contracts have also reported significant payment delays, as well as difficulties recruiting qualified staff as a result of the government's "Omanisation" drive.

"Omanisation," which requires companies to hire set quotas of local staff, is an attempt to address crippling unemployment and is rapidly reducing the expatriate population. However, businesses are struggling to recruit Omanis into construction and engineering roles, leaving a widening capacity gap. In the past, the state has responded to unemployment by continually expanding the public sector, leaving the country with an unsustainable wage bill.

Oman's strong links to the UK government and private sector, coupled with a positive international reputation, make the country an attractive market for investment by British companies. However, economic upheaval in the coming years is likely as the government attempts to steer a delicate path between reducing the population's reliance on the state and the risk of discontent with the regime. Oman may have to start spending within its means, spelling the end of the era of gifts and lavish hospitality.