

Middle East

# Point of View

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Fall 2013

## Transcending boundaries



### Friend or foe?

Gas, Russia and the Middle East

### Keep your hat on

Embracing cloud computing

### I do. Or do I?

Employee engagement

### Seeing the future clearly

Oman's Vision 2020

**Deloitte.**

**87** Eighty seven years  
in the Middle East

Fall 2013  
Middle East Point of View  
Published by Deloitte & Touche (M.E.)

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In one of the opening scenes of the highly acclaimed 1989 movie *Dead Poets Society*, Robin Williams a.k.a. Mr. Keating, the new English teacher, stands on his desk and urges his students to do the same in order to look at the world from a different perspective and to always “seize the day,” the moment, daring them to transcend the sometimes rigid boundaries of tradition and conservatism imposed on them by their home and school environment.

Mr. Keating’s unorthodox views and teaching methods eventually cost him his job, but not before he had already changed his students’ lives, we are led to believe, forever.

Transcending boundaries, be they physical or metaphorical, pervade this issue of *Middle East Point of View*. In his enlightening article on Gas, Russia and the Middle East, *Who goes there, friend or foe?* Kenneth McKellar points to the difficulties the two energy powers have in forging a strong partnership despite the complementary aspects of their respective gas businesses.

Ben Hughes, in his article *The Project Finance Compass – East and West*, explains how the “irrepressible rise of the Public Private Partnership as a way of executing major projects” in the developed economies has yet to make the leap into the Gulf economies, despite the fact, he says, that “adopting project finance to fund a PPP is one of the best ways to achieve sustainable and profitable, operational growth – even here in the GCC.”

Perhaps one of the best examples of transcending one’s own boundaries in this issue comes from Alfred Strolla and Phaninder Peri’s article on Oman. Strolla and Peri’s thorough account of the Sultanate’s development plan focusing on diversification points out how, “in a mid-sized, open economy in which the biggest driver of

growth so far has been oil, managing the transition to a more diversified economy is challenging. Fortunately,” they say, “Oman’s government has taken a number of steps in terms of efficient economic planning and implementation of various social development initiatives that have contributed to the success of the Omani economy.”

Borders of a more physical kind are pointed to by Ralph Stobwasser and Collin Keeney in their article *Risk, why is it your problem?* Stobwasser and Keeney explain how businesses that are looking towards better prospects in markets other than their own also face risks of bribery and corruption, which are brought into sharper perspective by the rising trend of cross-border regulatory action and the increasing focus of investors on governance and transparency.

Employee engagement through corporate volunteerism, moving out of the IT department and embracing “The Cloud,” innovation – in and of itself a break through limitations – and human resources in the region are the other topics explored in this issue of *Middle East Point of View*, which continuously seeks to transcend all boundaries and bring you insights on the hottest topics within, and without, the borders of the region.

#### **ME PoV editorial team**

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# Who goes there: friend or foe?

## Gas, Russia and the Middle East

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Russia and the Middle East both supply gas to Europe and to Asia. In theory that makes them competitors. They are also both affected by Chinese demand and North American supply and, in theory, that gives them a common cause. Should Russia and the Middle East be enemies or friends?



### The effects of growing gas-to-gas competition

The European and Asian gas markets are in flux. Gas-to-gas competition is rapidly growing in importance, with lower-priced spot supplies increasingly undermining the higher-priced long-term supply contracts that have traditionally dominated the market. As a result, Russia and the Middle East are being forced to adapt to the more liberalized practices of European and Asian markets. On the basis that “a problem shared is a problem halved” there may be merit in Russia and the Middle East co-operating to supply these markets in a way that they have not achieved before.

Long-term, oil-indexed contracts are under serious scrutiny as overall demand for gas decreases in Europe, while new, non-Russian, non-Middle Eastern sources of supply increase. Shale gas in the U.S. has freed up Liquefied Natural Gas (LNG) – originally designed for American ports – to address European and Asian spot markets. As a result, spot prices are now lower than the oil-indexed prices of Russian and Middle Eastern contracts, with the result that gas from these sources has become among the most expensive in the world. The extent of this shift is illustrated by France, a champion of nuclear power, increasing its imports to over 16 billion cubic metres (bcm) despite flat domestic consumption. Another example of this shift is in the U.K. where the spot prices at the virtual trading hub there, the National Balancing Point (NBP), are increasingly recognized in the market as independent benchmarks.

To achieve this shift in 2011 the NBP attracted 22 bcm of alternative gas supplies, 85 percent of which was sourced from Qatar, bringing Qatar’s total share of the European gas market to over 10 percent. With Belgium and the Netherlands physically connected to the U.K. where the NBP lies, European spot price influence is spreading eastwards towards the German border, where Russian gas prices have been fixed through long-term contracts. As a result, the big Russo-German pipelines, which were necessarily financed by long-term contracts and have formed the backbone of European supply over the past 50 years, are operating at less than full capacity.

Key participants in the European gas market have acted accordingly. Statoil signed a GBP13 billion NBP-anchored supply agreement with the U.K.’s Centrica, which in turn signed a 3.26 bcm per year deal with Qatar. Spain’s Gas Natural has contracted to receive LNG based on U.S. Henry Hub prices from 2016-17 onwards, following BG Group. As a result, in 2011, almost half of Europe’s gas contracts were concluded outside long-term contracts.

### GECF – a GASPEC?

What would happen to liquidity if Middle Eastern sources were to not supply Europe with current volumes? A more coordinated supply approach to Europe would certainly benefit Russia and this is where a Russian/Middle Eastern axis might play out. Russia is a founding member, and currently holds the top position,

in the Gas Exporting Countries Forum (GECF) comprising some of the world's leading natural gas producers and exporters. It is not a cartel in the same sense as OPEC (Organization of Petroleum Exporting Countries) in that it does not control marginal production in an effort to influence prices. There are structural differences in global natural gas and global oil that make this type of control difficult. Nevertheless, the GECF provides a venue for its members to discuss topics of interest such as production projects, exports, etc. Its members – which include Algeria, Bolivia, Egypt, Equatorial Guinea, Iran, Libya, Nigeria, Qatar, Russia, Trinidad and Tobago, and Venezuela – control 36 percent of world production and 47 percent of global trade. Kazakhstan, the Netherlands and Norway have observer status at the GECF. Major natural gas producers that are not affiliated with the GECF include Australia, Azerbaijan, Canada, Indonesia, Malaysia, Oman, Turkmenistan, the United States (the world's leading natural gas producer) and the United Arab Emirates.

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## Spot prices are now lower than the oil-indexed prices of Russian and Middle Eastern contracts, with the result that gas from these sources has become among the most expensive in the world

At the first GECF summit held in Doha in 2011, Russia indicated its keenness for Qatar to focus on Asia and to market LNG under long-term oil-indexed contracts rather than to European spot markets. Qatar however, emphasized its contractual commitments to Europe, particularly in the face of Russia's desire to continue to supply Asian markets. Yet a number of commentators

have indicated that the supply of LNG to Asia under longer-term contracts would be more profitable for Qatar than the supply to European markets on a spot basis in the short- to medium-term. Qatar is currently selling around 36 bcm a year of gas to Asia. Netbacks on Qatar's spot LNG sales into Asian markets are around USD14 per million British Thermal Units (mmbtu), around twice the figure achieved in the U.K. and Northwest Europe, where benchmarks are currently trading at about USD 8/mmbtu.

However the demand situation in Asia is not straightforward enough for Qatar simply to focus its efforts there. Asian demand would need to use up to 23 bcm of diverted Qatari LNG from European markets. On the face of it, this looks possible. The disaster at Fukushima has increased Japanese demand by some 11 percent. South Korea has been a core demand market for Qatar for many years. India's geographical location means that LNG will be its major source of gas supplies, whilst the maturing gas provinces of Malaysia and Indonesia are importing increasing quantities of gas these days. But the swing demand market in Asia is China, where demand is expected to increase by over 5 percent per annum to 2030. Just because China needs gas however, does not mean that this gas will necessarily come from Qatar, or from Russia.

### **And then there's China**

China has started to diversify supplies effectively by signing numerous memoranda of understanding with major suppliers for prospective supplies whilst securing supplies from Central Asia. Turkmenistan is an important player, with 30 bcm of Turkmen gas expected to flow into the Chinese mainland by 2015 (China produced 97 bcm in 2010 and consumed 109 bcm, but its import needs are set to grow sharply). Additional agreements towards 65 bcm are in place with Uzbekistan and Kazakhstan. China-Turkmen prices have fallen to around USD 6-7/mmbtu and in addition, burgeoning Australian LNG production (forecast to be the largest in the world



by 2018) has proven attractive to Chinese buyers. It is in China's interest to ration its Qatar LNG imports at current prices and to allow gas-to-gas competition to develop further in Europe, as that will help it in negotiating lower prices with Russia for larger quantities (up to 60 bcm) in the short- to medium-term and with Central Asian suppliers in the medium- to long-term. It may well be in China's interest to retain Qatar as a marginal rather than a base-load supplier in order to force down the price of pipeline gas. Russia has so far been unable to replicate, in China, the 50 year-old success that it enjoyed in delivering pipeline gas to Germany and to the rest of Europe. In the meantime, China has secured a portfolio of alternative supplies and has earmarked future domestic shale production of 30 bcm per year.

Given these challenging conditions for both Russia and Qatar, one option might be for Russia to start limiting gas sales into Asian markets, ensuring that China starts to use Qatar supplies as base-load supply. Greater progress than to date would need to be made in offering Qatar major Russian upstream swap agreements and downstream stakes possible in Europe. Any significant Qatari shift towards Asia will see Russia's spot market pressures eased in Europe with few other producers looking likely to substitute Qatar's supply.

#### Shale – evolution or revolution?

The second GECF summit in Moscow in 2013 took place against the background of significant shale gas production in the U.S., increasing competition for customers and uncertainty over future gas demand, prompting some analysts to call current market conditions the "Dark age of gas." Leonid Bokhanovsky, the Secretary General of GECF, however changed "Dark" into an acronym: Development, Affordability, Reliability and Known (Energy), all attributes of natural gas. He did acknowledge that the "current challenging areas for all gas-exporting countries and other energy participants include vulnerability in the security of demand, energy policies in place – mainly in consumer countries and particularly within Europe – and the European Union plans to diversify its energy supply and to develop local energy resources."

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## It is in China's interest to ration its Qatar LNG imports at current prices and to allow gas-to-gas competition to develop further in Europe, as that will help it in negotiating lower prices with Russia for larger quantities

As far as shale gas is concerned, GECF remains of the view – as does the International Energy Agency, which represents the OECD (Organization for Economic Co-operation and Development) demand-side countries – that the shale gas "revolution" has not yet occurred. The ability to replicate the very favorable conditions under which shale has been developed in North America, elsewhere in the world and especially in Europe (where there are legal constraints for possible development of resources) is largely unproven, except in the one area critical to both Qatar and Russia, namely China. A key assumption underlying the North American shale "threat" to Qatar and Russia is that North America will export unfettered volumes of LNG to both European and Asian markets. However, there are powerful lobbies – economically, in the form of users of gas for power generation and industrial feedstock – and environmentally, in the form of opponents to hydraulic fracturing, who may curb such exports. This opposition echoes the many plans a decade ago for LNG regasification plants for the United States which never came to fruition.

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## The ability to replicate the very favorable conditions under which shale has been developed in North America, elsewhere in the world and especially in Europe is largely unproven, except in the one area critical to both Qatar and Russia, namely China

Nevertheless, shale gas has already forced Qatar and Russia at least to consider, if not implement, alternative export strategies. North America is no longer (at least for now) a significant export market for Qatar whilst Europe and Asia (Qatar and Russia's target markets) could be significant import destinations for North American shale-produced LNG. As far as fuel sources for power generation are concerned, cheap shale gas is displacing coal to the extent that coal is now more attractive for power generation in other parts of the world.

### **The Middle East is not just Qatar**

Important as Qatar is, there are other major Middle Eastern countries that we should not forget: Algeria, Oman, Yemen, Egypt and the U.A.E. together produced 54 bcm of LNG in 2012. Algeria and Egypt are particularly interesting, given their proximity to European markets and to Russian alternative supply into Europe.

Algeria may hold shale gas resources much greater than its conventional reserves, which are already substantial. In March 2013 Algeria passed a new set of amendments to its hydrocarbon law to address shale gas in the country.

Depending on the development of its unconventional natural gas resources and its conventional resources, Algeria could become a more significant natural gas producer and exporter. However, a difficult business environment may continue to limit its potential. In 2011, Algeria produced 79 bcm and exported 51 bcm, with 45 bcm going to the E.U. Although Algeria is focusing on preserving its resource base and not expanding production too quickly, with domestic consumption possibly outstripping exports within the next decade, Algeria continues to expand its connections to Europe. In 2011, the Medgaz pipeline from Algeria to Spain was opened with an initial capacity of approximately 8 bcm per year. Despite this new addition, Algerian exports to Spain do not have much direct impact on the rest of Europe, as the interconnection between Spain and France is limited. In addition to Medgaz, Algeria exports natural gas to Europe via the 12 bcm Maghreb-Europe pipeline to Spain and the 6 bcm Trans-Mediterranean pipeline to Italy. Algeria has also announced plans to expand its LNG export capacity.

Since 2005, demand for natural gas in Egypt has been on the rise, increasing almost 57 percent over the time period. Although production has grown as well, the subsidy-driven demand has hindered the government from offering attractive terms for international companies to continue developing Egypt's resources. Additionally, much of Egypt's remaining natural gas is in difficult-to-access, high-cost areas, which contributes to the lack of interest by many international natural gas companies. That said, British Petroleum signed a deal in 2010 that was substantially higher than previous contract terms. Since the resignation of Hosni Mubarak, Egypt's natural gas infrastructure in the Sinai Peninsula has been attacked many times, disrupting gas shipments via two separate pipelines to Israel and Jordan. Egyptian exports to the E.U., which are solely in the form of LNG, dropped almost 12 percent in 2011, after dropping almost 35 percent in 2010. The Arab Gas Pipeline from Egypt to Jordan, Lebanon and Syria has been planned to

extend to Turkey in order to move Egyptian natural gas to Europe, but given the issues surrounding Egypt's natural gas sector this is highly doubtful. Production in 2010 fell for the first time in over a decade, but stabilized in 2011. With domestic consumption likely to continue increasing and production probably declining, exports are not likely to increase for some time. In part to meet its export commitments, Egypt announced in December 2012 that it would begin importing LNG, possibly as early as 2013. Depending on the orientation of a new government (i.e. whether it promotes Western investment in Egypt's energy sector) and whether the government addresses its natural gas subsidies, this deterioration of Egypt's natural gas sector could be reversed.

It can be concluded that at least in the medium-term, Algeria and Egypt are unlikely to exert significant influence in Europe in terms of increased supplies.

#### **The Middle East and Russia: not close enough to be friends or distant enough to be enemies**

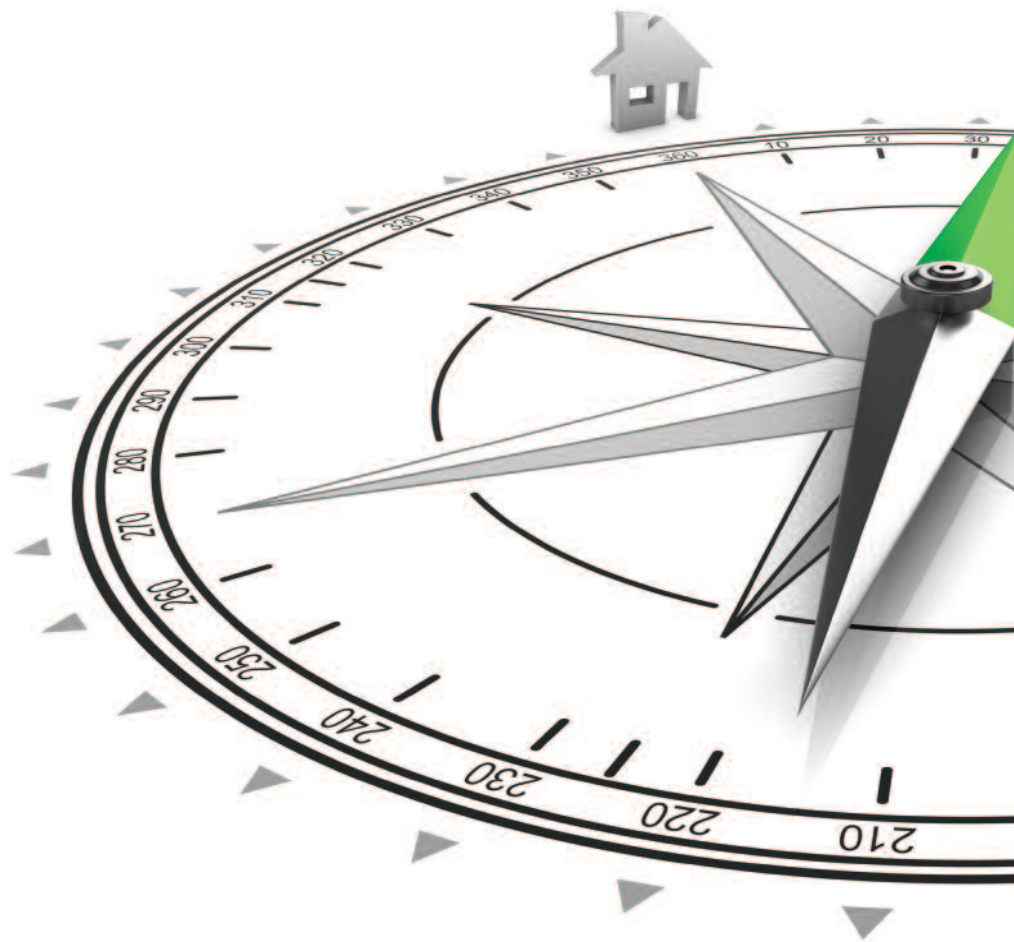
The gas map of the world is too complicated, fragmented and dynamic to enable the forging of a strong partnership between Russia and the Middle East. The United States and China also have their own divergent agendas for gas and these are affecting the global gas supply/demand balance. The countries of the E.U. are caught in the middle and, due to their large number, differing market conditions and geographies, have never been (and are unlikely to be) able to act as one single economic bloc with the focused market power to dictate terms to major gas suppliers.

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## The gas map of the world is too complicated, fragmented and dynamic to enable the forging of a strong partnership between Russia and the Middle East

Yet it would be foolish for Russia and the Middle East to regard themselves as enemies in the global gas market. They have many complementary aspects to their gas businesses. One is focused on the delivery of pipeline gas, while the other focuses on LNG. Both cannot ignore the supply issues that the U.S. poses, or the demand conundrum of China. We can therefore conclude that the relationship between these two key gas-producing regions will ebb and flow according to the supply, demand and prices of each gas year. And, as we know, no gas year is ever the same.

by **Kenneth McKellar**, Middle East Energy  
& Resources Leader, Deloitte Middle East



# The project fi

## East and West

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If there is one defining feature of major public sector construction projects over the last two decades in developed economies, it is the irrepressible rise of the Public Private Partnership (PPP) as a way of executing major projects. How does the Middle East, the liquidity-rich Gulf in particular, compare?

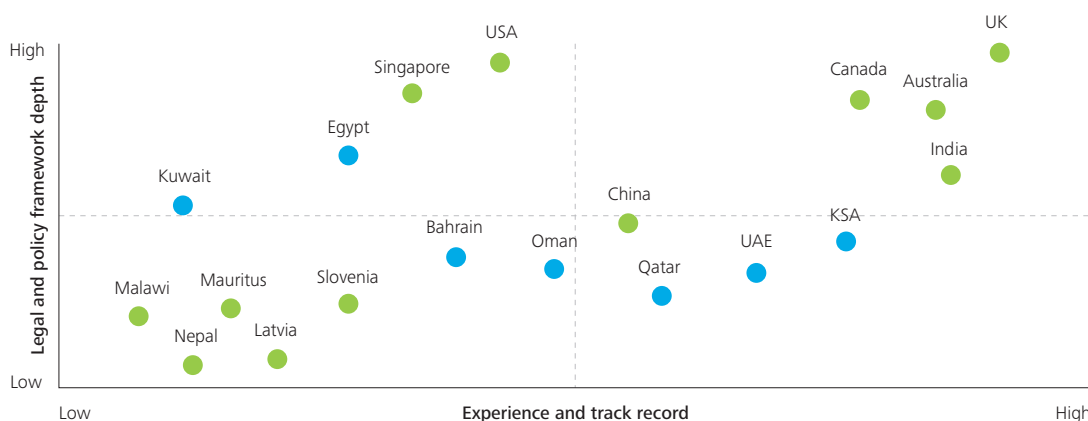


# Finance compass

The key inertia behind any PPP is project finance, the key funding mechanism required to undertake any major capital or infrastructure investment. Since 1992, the PPP Forum estimates that 630 Private Finance Initiatives (PFI) in the United Kingdom alone have been put in place, covering an investment of some USD 100 billion. The U.K. has historically been a forerunner in the field of PPP, but less so more recently as project finance became too

expensive. Across the Gulf Cooperation Council (GCC), PPP is at a more embryonic stage. Across the region, there has been little PPP activity in historically core PPP sectors such as transport, health and education, particularly since the crash in 2008. The map below clearly shows where GCC countries rank in terms of PPP maturity globally and highlights the need for a much better regulatory framework.

Comparison of global and MENA countries on PPP maturity



Source: Markab Analysis

Project finance, in and of itself, is highly volatile with finance rates ranging from single digit figures to rates in the mid-teens, depending on a number of variables, including existing relationships with funders or prior experience. What this means is that the viability of those projects funded by project finance are extremely susceptible to financial market swings or the propensity to risk afforded by project finance lenders.

The pass or fail test for the PPP relies on whether value for money is achieved and affordability underpins this. However, as the cost of finance has risen, PPPs have in turn become much more expensive for the public sector.

Governments across the GCC typically have the resources to fund large-scale capital projects, thereby obviating the need for project finance in the first place.

Indeed, the very term "project finance" means different things in each geographic location. Across the GCC, project financing is typically a short-term, direct funding stream to facilitate a construction project, typically 3-5 years. This contrasts sharply with the more traditional term project finance, which is a much longer-term view in more established PPP markets, such as India, Europe and the U.S.

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Across the Gulf Cooperation Council (GCC), PPP is at a more embryonic stage. Across the region, there has been little PPP activity in historically core PPP sectors such as transport, health and education, particularly since the crash in 2008.

#### When cynicism meets irony

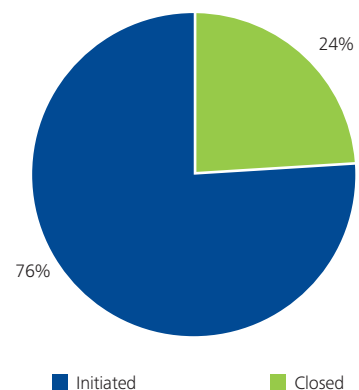
Moreover, there is widespread cynicism about the viability of PPPs in the region as the majority of PPPs that actually close are restricted to major Infrastructure, Water and Power Projects (IWPP). Other PPPs that are either proposed or under due diligence invariably fail to close.

#### The situation in the Gulf

In the GCC, the opposite is true. Whilst there may be liquidity in the market, the terms of borrowing are heavily stacked in favor of loans from the Treasury. As with most other markets across the globe, project finance is expensive and unless the financial terms or the project itself are an attractive proposition to the private sector, then this will remain the case.

The very nature of a PPP, of course, relies upon the availability of project finance and the ability for a scheme to pass a "value for money" test. Traditionally, PPPs have been an ideal way for the public sector to transfer risk to the private sector or for those without the land or capital up front to fund a scheme.

PPP deals initiated and closed in the GCC region (2005-2011)



Source: Deutsche Bank, "The challenges and potential for private financing of infrastructure in the GCC," May 2011

Yet, ironically, at a time when the availability of project finance has been significantly hindered by the tightening of global credit markets, calling its viability into question, there are several factors that could see it, and PPPs, rise once again to prominence.

Across the GCC, this might be particularly relevant. While many GCC countries have the financial resources to facilitate their own projects, they do not always have the skill base to undertake huge infrastructure projects and may instead opt to use a PPP to harness the expertise and appetite for risk of the private sector.

Major IWPP schemes benefit from private sector involvement, for instance, as the size and complexity of these projects dictate innovation, significant human resource and direction. The most notable examples of this can be found in Qatar, Kuwait and Saudi Arabia most recently.

#### Lowest cost driven by market forces

The most obvious mistake is to view the cost of a project purely in terms of a fixed price established through the bidding process. As discussed earlier, PPPs are major, 15-25 year investments funded through long-term finance. The original rate of borrowing may be re-financed and/or may change at pre-determined intervals throughout the course of the borrowing. If margins at the outset are tight, then the first place to look is often the build costs, which could have ramifications in the long-term.

A contractor constrained by bringing in a project on budget with tight margins might easily look for ways to cut their own costs, whereas collaboration between two parties, even in the GCC, may actually become a mutually beneficial partnership which may derive enormous long-term advantages.

Of course, choosing a more expensive bid is no guarantee that such adversarial relationships will not emerge and careful project management is always a means by which to avoid this. It is clearly more of a risk when competition is so fierce.

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## In the GCC, amidst a backdrop of political cynicism about PPPs and their perception of giving control to the private sector, the argument for providing genuine value for money resonates just as loudly as it does in struggling markets elsewhere

In the GCC, amidst a backdrop of political cynicism about PPPs and their perception of giving control to the private sector, the argument for providing genuine value for money resonates just as loudly as it does in struggling markets elsewhere. If the public sector in GCC countries cannot see the potential benefits that a private sector partner can bring to a major infrastructure project, then there is little hope for PPP, in the region.

#### Conclusion

This leads us full circle. Adopting project finance to fund a PPP and construct a project through a long-term partnership with the private sector is one of the best ways to achieve sustainable and profitable, operational growth – even in the GCC.

The subtle distinction between lowest cost and value for money must not be lost in the current economic climate. It is inevitable that cost has become a major factor, but innovation and flexibility are also needed to create new ways of getting things done on major infrastructure projects. By breaking down traditional barriers of mistrust in the private sector, the right investors will come to the fore, and with the right consultant who is experienced in this sector, it is a recipe for success.

by **Ben Hughes**, assistant director, Infrastructure & Capital Projects, Deloitte Corporate Finance Limited (Regulated by the DFSA), Middle East



# Oman

## 20/20 vision





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Once a middle-income economy heavily dependent on depleting oil resources, the Sultanate of Oman has been actively pursuing a development plan focusing on diversification, industrialization and privatization, with the objective of reducing its reliance on the oil sector's contribution to GDP, currently at 48.44 percent (USD 37.8 billion) and creating more employment opportunities for the rising number of young Omanis entering the workforce. And the outcome? The Public Authority for Investment Promotion and Export Development (PAIPED) was recently recognized at the United Nations Conference for Trade and Development held in Geneva for its efforts to promote non-oil products.

### Vision 2020

The Omani economy had been on a steady transformation course through development plans, beginning with the first Five-Year Plan (1976–1980). At the instruction of His Majesty Sultan Qaboos bin Said, Vision 2020, a plan for Oman's economic future up to the year 2020 was set, outlining the country's economic and social goals, which include:

- Economic and financial stability;
- Reshaping the role of government in the economy and broadening private sector participation;
- Diversifying the economic base and sources of national income;
- Globalization of the Omani economy;
- Upgrading the skills of the Omani workforce and developing human resources.

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The industrial sector has for long been the foundation of Oman's long-term diversification strategy as it is also capable of meeting the country's social development needs and generating more employment opportunities

### Growth potential

During the last decade Oman had set apace a reform program aimed at developing and diversifying the economy and releasing its potential for growth with the ultimate goal of promoting development and competitiveness through increased government spending on key sectors and stimulating private investment.

Oman's economic growth strategy underlines the development of simple industrial chains, particularly in basic manufacturing and allied activities as well as other industries that will enhance the Sultanate's position and offer a competitive advantage in the region.

The industrial sector has for long been the foundation of Oman's long-term diversification strategy as it is also capable of meeting the country's social development needs and generating more employment opportunities. There is no doubt that the contribution from industry has played a significant role in shaping the Sultanate's economy in terms of accelerated growth, sustainable economic and social development and creating new jobs; however, other sectors such as tourism and gas-based industries, banking and finance, healthcare and insurance, agriculture, retailing, aviation and recently the railways project, have also been key components of the government's diversification strategy (see below).

The mineral industry in Oman, for instance, is on a strong growth path. Oman's mineral resources include chromite, zinc, limestone, gypsum and silicon among others. A large number of investors have been drawn into the sector as it is potentially expected to contribute significantly to the country's GDP. Several industries have been developing around the mineral sector as part of the national development process, which as a result, has boosted the employment opportunities for a young Omani workforce as well as contributing to the nation's GDP.

One of the benchmarks for sustainable development and increased private investment is increased investment in infrastructure. Accordingly, the continuous development of Oman's infrastructure and the availability of investment funds for such development projects is a determinant factor for the future growth of the economy. Government spending during the past few years on infrastructure projects such as roads, airports, seaports, hospitals and health centers cannot be overlooked.

#### **Omanization**

Omanization as a national objective is regulated and monitored in the public sector and, most recently, in the private sector as well. The government, along with various industry segments, has initiated training and development programs to enhance the skills and competencies of nationals in various fields and promote the employment of nationals in the private sector. The aim has been to match the supply of labor locally with market requirements. It is intended to see Omani nationals playing a leading role in all areas of employment – both in trade and professions – in the Sultanate. The natural consequence of this process has been the prioritization of education and training.

#### **In-Country Value (ICV) strategy**

In-Country Value (ICV), which refers to the total spend retained in the country to aid in job creation, development of human resource capabilities and establishment of industries locally to stimulate productivity, has been growing in importance in Oman, particularly in the oil and gas sector.

ICV aims at enhancing the value of goods, services and skills in the sector and stimulating local production and manufacturing in order to reduce the imports of goods and enhance the provision of services in Oman, thereby reducing dependency on external experts and improving the skills and capabilities of Omani nationals by increasing their contribution to the activities of the oil and gas sector.

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One of the benchmarks for sustainable development and increased private investment is increased investment in infrastructure. Accordingly, the continuous development of Oman's infrastructure and the availability of investment funds for such development projects is a determinant factor for the future growth of the economy.

#### **Conclusion**

In a mid-sized, open economy in which the biggest driver of growth so far has been oil, managing the transition to a more diversified economy is challenging. Fortunately, Oman's government has taken a number of steps in terms of efficient economic planning and implementation of various social development initiatives that have contributed to the success of the Omani economy.

Other factors that have contributed to Oman's success include the significant rise of foreign investment in many sectors as a result of competitively low tax rates in the region. The development of Small and Medium Enterprises (SMEs) together with ICV strategy lays a solid foundation for self-reliant industry and modernization of the economy. Despite the various challenges within the region and in the country, Oman's economy is set on the right path of sustainable growth, development, diversification and progress.

### Industry

- Development of industrial estates in Sohar, Sur, Salalah, Nizwa and Buraimi.
- The provision of natural gas to the industrial estates in Sohar and Salalah has helped promote the expansion of those industries reliant on large quantities of energy.
- Tax exemptions are an incentive to the development and expansion of the industrial sector, which contributes significantly to the country's GDP, currently at 16.3 percent (USD 12.9 billion).
- The Duqm region is one of the newest industrial areas growing in prominence with a port and industrial zone project that will transform the area into a major economic development center in which the port will act as facilitator unlocking the potential growth opportunities. The Duqm port & dry-dock will be one of the major ports in Oman with its strategic location. This port is also equipped with a ship repair yard and dry-dock facility, which is the first of its kind in Oman.
- Oman has also started to build a rail network that is expected to link major ports, industrial areas and free zones at Sohar, Salalah and Duqm with a wider GCC network.
- An accelerated program to add significant new capacity to increase the supply of power and water to meet the rising demand in the Sultanate, essential for sustained growth and development.

### Human Resources

The Omani government has a strong desire to have Omani nationals play a leading role in all areas of trading and professional employment in the Sultanate. As a result, education and training are prioritized and have been a cornerstone of each of the Sultanate's five-year development plans. The Ministry of Education's commitment to a sector that – while maintaining traditional values – is modern and advanced, is reflected in its range of educational programs, including the basic education system, designed to meet the demands of modern science and culture in the information age.

### SMEs

- The past few years have witnessed greater focus on the growth and development of small and medium enterprises (SMEs) to compete in the international arena, beyond the domestic markets.
- Establishment of the Public Authority for Small and Medium Enterprises Development (PASMED), an independent body created to encourage young entrepreneurs and to provide support in terms of technical, financial, training, marketing and management, all necessary fields for aiding these enterprises during the coming periods.
- The Omani government anticipates sizeable expansion of jobs created from the development of SMEs. The planned expenditure on the SME sector in 2013 is estimated at RO12.9 billion, almost 30 percent up from 2012.

### Tourism

- Tourism is being developed as an important and sustainable socio-economic sector of the Sultanate of Oman in a manner that reflects the Sultanate's history, cultural and natural heritage and spirit of traditional hospitality. Tourism will facilitate economic diversification, the preservation of cultural integrity and the protection of the environment of the Sultanate.
- According to the latest statistics, tourism contributes approximately 2.4 percent to Oman's GDP and is expected to increase to 3 percent by 2020. There is a significant increase in investment in the tourism sector creating considerable jobs.

## Taxation

In 2009, Oman introduced a new tax law that consolidates a number of ministerial decisions, interpretations and practices arising from the previous 28-year old law, along with the introduction of certain new tax regulations.

One of the noteworthy changes brought into the new tax law was the elimination of the discrimination in tax rates between the branches of foreign companies and Omani companies/establishments and the introduction of a unified rate of 12 percent applicable to all establishments. Further, under the U.S. Free Trade Agreement, American companies can register a limited liability company with 100 percent foreign ownership without the involvement of a local partner.

The reduction in tax rates, the amendment to the definition of "permanent establishment," which is now in line with the Organization for Economic Cooperation and Development (OECD) and the free trade agreements entered into by Oman, has encouraged and increased foreign investment in Oman.

Another major change introduced by the new tax law is a shift from a territorial system of tax to a global system of tax, whereby revenue earned outside Oman is also taxed and which, consequently, increases the government's revenue from tax.

The new executive regulations to the new income tax law that came into force in tax year 2012 and apply to all accounting years ending after January 1, 2012, provide clarifications and specify guidelines and rules in relation to the provisions of the new tax law.

As part of simplifying the compliance and thereafter the assessment process, the tax authorities introduced 18 new different tailor-made forms enabling them to collect relevant information on a timely basis at the time of compliance, which is expected to speed up the assessment process. It is worth noting that the new provisions also include exemptions for small businesses for filing returns and financial statements and from mandatory tax registration and compliance on fulfillment of certain conditions. Tax deductions now require more detailed documentation than in the past. Provisions of penalty for non-compliance introduced in the new tax law are likely to be implemented soon.

With implementation of Islamic finance regulations, the tax authorities are currently reviewing the tax laws and are likely to introduce amendments to accommodate the effect of the Islamic finance transactions.

Various service improvement measures to tax payers have already been, or are in the process of being implemented. These include establishing a Large Tax Payers Unit (LTPU), online portals and revamping of the tax system among others.

by **Alfred Strolla**, managing partner, Oman, Sudan and Yemen, Deloitte Middle East and **Phaninder Peri**, senior manager, Tax, Deloitte Middle East



Corruption, money laun  
**Risk, why**



ndering, tax evasion and sanctions

# is it your problem?

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As businesses continue to face a challenging economic environment in most developed economies and are looking towards rapid-growth markets with potentially better prospects, they also face the risk of higher levels of bribery and corruption. The rising trend of cross-border regulatory action and the increasing focus of investors on governance and transparency have brought these risks into sharper perspective. Leading companies are responding with enhanced compliance and due diligence measures, robust internal audits, enhanced investigative capabilities, whistleblowing and leveraging off the latest data analytical tools. The precautionary adage: better safe than sorry, has never been more pertinent.

In a recent panel discussion hosted by Deloitte on the subject of "Risk, why is it your problem?" it emerged that corporate counsels in the region have two immediate concerns related to navigating the challenges that come with operating in an international business environment over the next 6-12 months: the increased volume and complexity of international regulatory and legal obligations on the one hand, and the risks associated with expansion into new markets on the other. Those two factors frequently converge – especially when the expansion involves emerging or lesser-developed markets where prevailing local business practices are at odds with international norms. With that tension comes one very large risk: the risk of the company committing an act that yields a cross-border regulatory enforcement action.

Attendees were especially concerned about the reputational damage, fines and profit disgorgements that can accompany non-compliance with cross-border regulations. This is notably acute for those expanding into emerging markets where pressures to establish and grow their business in a new market frequently raise challenges with regard to regulation and compliance.

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There are numerous ways that companies and the individuals who run them can brush up against the long arm of the U.S. authorities. Examples of current priority matters for U.S. authorities include corruption, money laundering and tax evasion.

The impact of cross-border business practices are placed in even sharper perspective through an increasing trend under the Foreign Corrupt Practices Act (FCPA) of prosecuting executives and individuals with control responsibility over organizations that have violated anti-corruption legislations.

#### **What are the cross-border enforcement priorities that companies should be concerned about?**

There are numerous methods that companies and the individuals who run them can brush up against the long arm of the U.S. authorities. Examples of current priority matters for U.S. authorities include corruption, money laundering and tax evasion.

**Corruption** - The driving force of anti-corruption enforcement continues to be the U.S. Securities Exchange Commission (SEC) and U.S. Department of Justice (DoJ) through the FCPA, with recent fines amounting to over USD 2.7 billion between 2010-2012. In 2012 the SEC and DoJ collectively enforced actions against 23 corporations. During the first six months alone of 2013, 17 actions have been enforced. With the passing of the U.K. Bribery Act in 2010 and the aggressive promotion of anti-corruption legislation by Organization for Economic Cooperation and Development (OECD) countries, bribery and corruption are appearing increasingly on the agenda of governments around the world. Although enforcement of the U.K. Bribery Act has gained little public traction, the Act does give the U.K. Serious Fraud Office sweeping powers to prosecute bribery anywhere in the world and thus compliance with it needs to be a headline issue for companies with U.K. connections, irrespective of the geography of their operations.

**Money laundering** - Anti-money laundering regulations have yielded U.S. authorities some of the largest fines on record, underscoring the challenge that international financial institutions face in enforcing consistent compliance of policies across widespread and loosely-integrated overseas networks. However, it is not just extra-territorial enforcement that organizations face, local authorities are also tightening their regulations.



The Dubai Financial Services Authority (DFSA), for instance, has just published a new Anti Money Laundering (AML) rulebook, which came into force on 14 July, 2013. As anticipated, this rulebook places significant focus on a “risk-based approach” and on the assessment of money laundering risk, in terms of both business risk and customer risk assessment. Organizations operating in the Dubai International Financial Center (DIFC) will need to familiarize themselves with the changes in the regulations.

**Tax evasion** - Another U.S. law designed specifically with cross-border enforcement in mind is the Foreign Account Tax Compliance Act (FATCA). FATCA, designed to prevent tax avoidance of U.S. citizens abroad through foreign (non-US) financial institutions (FFIs) will begin to be implemented in 2014, and should be an immediate and current concern for any financial services institutions. The Act requires FFIs and non-US non-financial entities to identify and disclose their U.S. account holders and members or face a new 30 percent U.S. withholding tax. The U.S. Internal Revenue Service (IRS) expects the Act to raise USD 7.6 billion in tax revenue over a 10-year period (and perhaps a small fortune in fines as well), and will have a direct and profound impact on FFIs that have any U.S. proprietary investments, account holders, or financial dealings. Compliance with FACTA will require organizations in the financial services sector to implement enhanced Know Your Client (KYC) and AML due diligence and acquire deeper knowledge of IRS rules.

**Economic and trade sanctions** - Particularly relevant in the Middle East – given the region’s history as a trading entrepôt and the presence of sanctioned regimes – are the host of laws and regulations controlling trade and flow of funds that add an additional layer of risk and complexity to conducting business internationally. These laws, covering a range of goods and services, target an even wider range of regimes, organizations and individuals even. Authorities such as the U.S. Office of Foreign Assets Control (OFAC) are aggressively

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## Violating anti-corruption, tax evasion, money laundering, trade sanctions or human rights laws are examples of a handful of different ways that a company can tarnish its reputation through careless overseas activities

employing new tools to more closely and effectively implement sanctions, such as prohibiting international banks from accessing U.S. dollar markets if they are considered to be providing financial services to entities on sanctions lists. OFAC in 2012 completed or settled 16 enforcement actions and collected penalties of over USD 1.1 billion. There is no sign that OFAC’s vigor is dying down.

### How can companies avoid being the next headline story?

Reputation is key to every organization – it is good to be in the news, but only for the right reasons. Once damaged, reputation can be very difficult to repair, particularly where integrity is called into question. Violating anti-corruption, tax evasion, money laundering, trade sanctions or human rights laws are examples of a handful of different ways that a company can tarnish its reputation through careless overseas activities. Allegations of corruption seem to get the most attention recently, because of the high-value fines being doled out by the U.S. authorities, as well as their eagerness to cast the broadest shadow possible. Risks are increasing, but standards are not. It seems there are few companies who can truly claim to be exempt from U.S. oversight.

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## Companies should prevent being caught by surprise with an overseas authority brandishing a statute they never thought would apply to them

**Third-party due diligence** - FCPA corruption settlements frequently cite the role of third-party agents such as vendors, joint venture partners, government liaisons, customs and immigration agents and acquired entities in alleged violations. Although we are seeing a greater reliance on outsourcing key functions to third-parties, especially in emerging markets, it is no longer possible to circumvent risk through a third-party. Determining the potential risk of third-party corruption requires organizations to consider factors such as the type of third-party with which they are planning to engage, the services to be provided, the locations in which parties operate and the level of interaction that they may have with the public sector.

Organizations looking to expand into new markets should regularly perform integrity and corruption due diligence on third-parties and should ensure that they conduct KYC procedures on new clients to ensure compliance with anti-bribery and corruption and AML regulations.

### **Compliance culture and “tone from the top”**

To avoid falling foul of the FCPA or any of the local authorities who are increasingly joining the enforcement bandwagon, organizations and executives responsible for compliance can take a number of steps – including demonstrating a strong “tone from the top” approach

and implementing a robust corporate governance framework containing a defined ethics and compliance policy. Officers, directors and employees should be issued guidelines, policies, and should be regularly trained on anti-bribery, anti-corruption (ABC) compliance. Potential risks should be highlighted to employees and suppliers, whilst compliance covenants should be included in contractual agreements.

### **Internal risk assessment and risk management** -

Another proactive step that companies can take is to conduct risk assessments. This is critical in any area of compliance concern (be it corruption, fraud, environmental or other) and includes conducting reviews of operations, comparing the objectives of controls with individuals’ understanding of those controls and their responsibilities, identifying deficiencies and developing a prioritized action plan to plug any gaps. Furthermore, implementation of a whistleblowing hotline and regular reviews of compliance with an understanding of the firm’s policy are all crucial to demonstrate to authorities that organizations are committed to compliance and that any violations are the result of individual or “rogue” action, rather than the result of shoddy controls or, worse, corrupt business practices.

The US Dodd-Frank Act poses a significant challenge to companies operating in the crosshairs of U.S. regulators. Provisions for whistleblower protection and reward mean that every company needs to be especially diligent about implementing a robust compliance program. A fundamental component of that program should be a whistleblowing program that encourages employees to report their concerns internally, rather than succumb to the temptation to report externally and seek a reward from the U.S. authorities.

Companies should also consider including a broader review of fraud risks in any corruption risk assessment and vigorously investigate any potential violations. Organizations should be aware that would-be makers of corrupt payments frequently use methods that mirror other forms of fraud thus, an emphasis on fraud in the corruption risk assessments may help tighten down controls in areas that might escape the attention of the anti-corruption compliance teams. Proactively tackling any corruption or fraud identified within an organization embeds the notion that the company is attentive to the subject. The knowledge that someone is watching is in itself the greatest deterrent to would-be perpetrators of any number of potential violations.

**Whistleblowers** - Another significant piece of U.S. legislation that is likely to have significant ramifications on extra-territorial enforcement is the Dodd-Frank Act. A component of Dodd-Frank is a whistleblower protection and reward program that effectively offers a bounty to whistleblowers who take their allegations directly to the SEC/DoJ (should their allegation yield a fine to either authority). The policy allows employees to disclose information without fear of reprisal, thereby enhancing corporate transparency and accountability. It however also encourages employees to report concerns internally (rather than externally) which can lead the company to self-investigate and report if necessary.

Given these pressures, it may well be that non-U.S. companies should consider implementing a new form of risk assessment: the risk of U.S. regulatory action to establish a clear and complete picture of the different ways in which they may be exposed to cross-border enforcement by significant overseas regulators, and evaluate the controls and monitoring mechanisms they have in place to alert themselves to risk as it arises. Companies should prevent being caught by surprise with an overseas authority brandishing a statute they never thought would apply to them.

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## Growth and expansion can no longer be separated from corporate awareness and ethical conduct

In light of the growing emphasis on cross-border enforcement and the very direct impact it can have on the control persons within an organization, the question arises: who should be responsible for these risks within an organization? While it is certainly important to have a broad range of staff trained on matters of critical risks and to generally raise risk awareness within an organization, there may be no “one size fits all” risk framework applicable to all companies and industries. It is important that the risk management framework is fit for purpose and each organization should be aware of the risk factors most relevant to it and its industry. Assessing what is appropriate can be complex and many companies seek external advice to ensure that they are benchmarked appropriately. Going forward, it may be important to include in that benchmarking the company’s awareness and attentiveness to the complex web of international regulations to which they may be exposed. Growth and expansion can no longer be separated from corporate awareness and ethical conduct.

by **Ralph Stobwasser**, director, Forensic, Deloitte Corporate Finance Limited (Regulated by the DFSA), Middle East and **Collin Keeney**, director, Forensic, Deloitte Corporate Finance Limited (Regulated by the DFSA), Middle East

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### Endnotes

1 Held at Legal Week’s 6th annual Middle East Corporate Counsel Forum in Dubai on 15 May, 2013.



# “I do.” *Or do I?*

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Over the last decade the business world has shown significant interest in the concept of employee “engagement.” Identified as an internal state of being – physical, mental and emotional – employee engagement brings together concepts of work effort, organizational commitment, job satisfaction and optimal experience. But does the social engagement of employees lead to a lasting and successful marriage? Yes, says this author.

Employee engagement is about being positively present at work by willingly contributing intellectual effort, experiencing positive emotions and meaningful connections to others. This gives employee engagement three dimensions:

- Intellectual: related to the job and how to enhance it;
- Affective: linked to feeling positive about doing a good job; and
- Social: concerned with taking opportunities to discuss work-related improvements with others at work.

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## Perhaps one of the most distinctive characteristics of Gen Y is their search for ‘meaning’ in the work place, a platform that encourages them to contribute to society

Deloitte’s Volunteer IMPACT 2011 survey found that Millennials who frequently volunteer are more likely to be proud, loyal and satisfied employees as compared to those who rarely or never volunteer. The same research showed that those who participate in employer-sponsored volunteerism were 52 percent more likely to feel very loyal toward their company than those who did not participate. The report also found that 70 percent of Millennials want to work for a company that is committed to its community. Of all Millennials surveyed, 61 percent said that whether an organization were committed to its community and sponsored volunteerism, would have an influence on whether they accept a job offer or not (Deloitte, 2011).

Extensive studies have demonstrated the importance of employee engagement to organizational performance as a business concept that addresses employees’ levels of interest and commitment to the job, resulting in a positive attitude towards one’s occupation and firm and consequently leading to greater productivity. Gallup’s Q12 Meta-analysis of 1.4 million employees conducted in 2012 and examining business performance, shows a positive correlation between employee engagement and business outcomes despite tough economic conditions. More specifically, Gallup found that engaged employees are more productive and customer-focused, as well as more likely to stay with their employers (Gallup® and Q12®, 2013).

### Enter the Millennials

The study, which covered different dimensions of employee engagement, shows that employee engagement with corporate volunteerism is increasingly being identified as a key element in attracting and retaining top talent (see box). This correlates tightly with a prevailing characteristic of the current Generation Y, or the Millennials: defined as being between the ages of 21 and 35, the fastest growing segment in today’s workforce and the most sought after talent despite the prolonged recession. Perhaps one of the most distinctive characteristics of Gen Y is their search for meaning in the work place, a platform that encourages them to contribute to society. It is important to understand and engage with members of the Millennial generation as they will represent the bulk of the workforce, the future of economic and social life and the future of business.

While many have claimed that employee engagement predicts employee outcomes, organizational success and financial performance, a considerable number of leaders question the return on investment (ROI) in terms of the amount of time and resources spent trying to address employee concerns. In fact, some observers warn that fixating on ever higher engagement survey scores is wrongheaded and may backfire if employers fail at improving the metrics and ensuring that their more “engaged employees” are behaving in ways that promote higher productivity.

### The importance of social engagement

Recognized or not, without a motivated and engaged workforce, even the most brilliant business strategies can falter. The affinity that employees feel toward an employer has the power to create a competitive advantage that can be hard to imitate and is inextricably linked to organizational performance (Deloitte, 2011). Studies indicate that organizations that have engaged employees actually outperform those who do not. In fact, employers who take into account the connection between corporate volunteerism and employee engagement can reap substantial rewards. By sponsoring volunteerism, a company has the opportunity to communicate the values it shares with its employees, which in turn can result in a more engaged and committed workforce that drives the firm's competitive advantage (Madison, 2012).

Companies seeking to enhance organizational commitment by means of volunteerism may have more success if their employees have the freedom to select from a wide array of volunteer opportunities. This is driven by the increased agreement with organizational values and increased perception of the organization that employees report as a result of participating in employer-sponsored volunteerism (Madison, 2012).

### I do. Do you?

At the moment, employee engagement initiatives addressing community involvement and corporate volunteerism are being incorporated into the backbones of leading organizations. Forward-looking companies seeking a lasting "marriage" with their employees are encouraged to embrace the trend and establish social engagement as a differentiating agent of their firms. These organizations should emphasize the importance of employee engagement through offering a holistic kind of experience to their workforce and aligning with their passions if they wish to retain the talent that other firms are competing for.

by **Soughit Abdelnour**, senior manager, Human Resources, Deloitte Middle East

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# *The Cloud*

## A CIO's survival guide

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Despite a grand entrance into the technology arena, cloud computing has become a point of contention in some organizations. While some department leaders have bypassed their trusted IT departments completely and procured services directly from cloud providers to address immediate needs – claiming reduced costs, faster time to market and improved user experience – some CIOs are not convinced. So how does a CIO survive and remain relevant within the organization if the cloud is viewed as a threat to their existence? Embrace the cloud and evolve your value proposition.





Cloud computing entered the technology arena with great fanfare and promise, presenting a paradigm shift in how technology would be offered – and consumed – and promised to demystify what IT departments across the globe actually do in their “top secret” data centers to make today’s companies run with such intelligence and agility.

Although technology providers have remained fully committed to investing in cloud capabilities, with many changing their entire business model to expand their cloud solutions and capabilities, many Chief Information Officers (CIOs) are still not convinced and are waiting for the buzz to pass. But several years into the paradigm shift, the topic remains very much alive and has become even more relevant, not only for Chief Information Officers but also for Chief Financial Officers, Chief Marketing Officers and many Chief Executive Officers as they struggle to align the ever-so-growing appetite for technology in the modern enterprise with all the complicated technology costs and processes that continue to grow year on year.

In many organizations it has almost become a weapon of sorts, with CFOs threatening IT budgets with the cloud and CIOs aggressively combating the claims of their own trusted providers with arguments of unique capabilities and protection that can only be provided by their internal experts.

The cloud discussion in many organizations starts as a financial opportunity to drive efficiency into technology spend that is immensely complicated and never fully

understood by anyone but the CIO. System licensing models, capacity planning forecasts, software support contracts, business continuity configurations and non-production landscapes are lively conversations when explaining the total cost of ownership to a department leader sponsoring a new business initiative. In contrast, the cloud offerings seem almost too simple. You determine what you need, for how many users and the method of payment. At times it can really be that simple but in most cases there are additional items to consider and should be fully evaluated in advance of any commitment. What is a technology leader to do when their CMO requests a global media streaming solution to allow real-time presentations, knowledge sharing and improved corporate training within six months and presents the request with board approval and funding? This will require new skills, new technology and possibly a revamp of the entire infrastructure. However, the budget approved only covers a fraction of what is needed and was based on marketing material from a cloud provider and monthly pricing presented on the provider’s website. For technology leaders they will not know where to start.

In many companies it may not quite happen this way but for many this is how expectations are first set. As the CIO, do you admit defeat and walk away? Let the CMO bring in their preferred vendor and remove yourself from the conversation?

Never. If anything, the CIO should wear the internal hat of cloud expert, never the anti-cloud lobbyist. Become well versed in what the market offerings are proposing

and how. Understand how they can be leveraged within your company, the pitfalls as well as the hidden costs and considerations. Update your enterprise architecture and strategy to consider cloud technologies and how they will fit into the broader landscape for business intelligence, reporting and data protection. In some cases, selecting a cloud offering is the only feasible solution. Prepare for this in advance. Be the first person engaged when a cloud idea arises, put in place the necessary controls and capabilities that will prevent the cloud from disrupting what is already in place and working today and champion the change across the organization.

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**As the CIO, do you admit defeat and walk away? Let the CMO bring in their preferred vendor and remove yourself from the conversation? Never. If anything, the CIO should wear the internal hat of cloud expert, never the anti-cloud lobbyist.**

Many technology leaders spend endless hours ensuring that all systems are built to last and performing as expected. Systems are up and running, sufficient capacity is on hand, operating procedures are in place, all while keeping a close eye on variable costs. In the cloud-enabled world you may not be as involved in the daily details of operating such technical elements. However, someone has to be aware of what is happening every day. Are services meeting the contracted levels of performance and stability? Are business and user expectations being met? As the CIO

and custodian of all things technology, embrace this opportunity to become the broker between your business and cloud providers. You may not own the assets nor have visibility in how they are operated but you do have the responsibility of ensuring the business is realizing the value of their investment. Put in place strategic vendor management disciplines that consistently measure the cloud provider's performance with effective controls that drive accountability. Benchmark their performance and capabilities against competitors and ensure that the needs of your business are clearly understood and delivered upon. This may feel closer to a procurement officer role but as the trusted technology expert, the CIO is best positioned to interface with cloud providers and manage the commercial relationship on behalf of their business. Do not compromise on expectations and results because the service is being managed externally.

#### **What happens if the cloud turns to rain?**

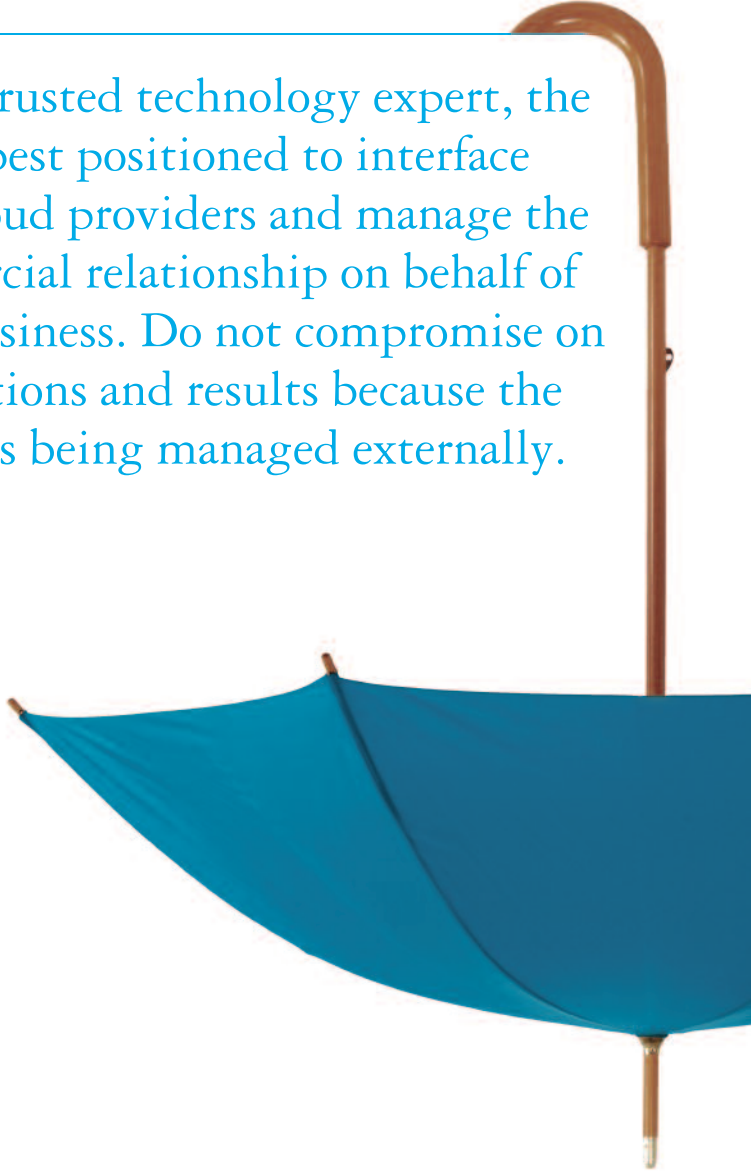
The greatest fear and hold off for most organizations adopting cloud services is the loss of control. Mature providers have responded well to this concern and offer very comprehensive and stringent agreements that cover the best interest of any organization with the appropriate recoveries, penalties and warranties. But what do you do when disaster strikes? Do not wait for the unforeseen, be proactive.

- Governance and controls - Alongside the effort to update the enterprise architecture and strategy, revisit governance processes, security standards and compliance programs to ensure that cloud-based services are considered and provisioned for. Put in place specific standards that must be complied with for all cloud-based services, detail requirements that must be met to uphold security posture and be explicit on what must be considered prior to committing to any service. This should not evolve into a situation in which cloud services will never qualify, but rather a guideline of how to proceed and what to watch out for. If anything, this should simplify the review and selection process.

- End users - The ever-growing popularity of BYOD (Bring your own device) and mobility solutions has introduced many consumer-focused solutions that are leaking into the enterprise. It is very challenging to stay ahead of all the solutions and services that are being downloaded by users every day. An easier approach to adopt is one of education and policy. Help users understand how to protect themselves and their employer in the digital world. Define usage policies that clearly articulate how information should be handled, shared and protected. Make it simple but make it clear.
- Business continuity and exit - Establish a plan for the worst-case scenario. Implement an exit strategy that ensures that you have access to your information and the ability to recover from a technical or relationship crisis. Understand the impact and planned reaction in the event of a major failure and test this. Test the security, privacy controls and procedures of the cloud provider to understand the potential for exposure or breach. As the guardian and protector of all digital assets, ensure that data hosted outside of your control is included in your risk management reviews, security assessments and planning.

The cloud has come a long way and will continue to evolve in capability and relevance. It will force change within organizations and disrupt business-as-usual for IT departments across the globe. However, the cloud will not replace enterprise IT departments. To fully realize the potential, prepare your organization and yourself to capitalize on this window of opportunity. Lead the change through proactive planning, embrace the change through increased knowledge and participation and embed the cloud within your IT strategy with effective standards, controls and measurements.

by **Basit Saeed**, Chief Information Officer, IT,  
Deloitte Middle East



As the trusted technology expert, the CIO is best positioned to interface with cloud providers and manage the commercial relationship on behalf of their business. Do not compromise on expectations and results because the service is being managed externally.





# Innovation

## A chimera no more

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Innovation is celebrated far and wide, but the lack of a shared, accurate definition has undermined our collective ability to manage it effectively. The implications are anything but academic. Companies that treat an attack based on differentiation as if it were breaking important trade-offs may overreact, but mistake a true innovator for the merely different and the pain can last for decades.

Like the old chestnut of the bumblebee's flight, innovation seems to work in practice but not in theory. There are myriad examples of success from which we can draw inspiration, yet almost no one seems able to innovate repeatedly and on purpose. Practitioners continue to lament the unpredictability of innovation, the more Zen-like among them embracing the idea that failure is inevitable. Who hasn't been told something to the effect that if you're not failing often, you're not trying hard enough? It's difficult to know if this is powerful advice or just defeat cloaked in the rhetoric of victory.

In such circumstances, it is common practice to invoke the parable of the six blind men and the elephant, with the hope that progress lies in synthesizing the many and divergent views. Unfortunately, such a path is not available to those who wish to understand innovation, for this field of inquiry faces a much more fundamental problem: where the blind men knew that they each had purchase on the same animal, when it comes to innovation, many of us hold parts of entirely different beasts.

Think of the variety and diversity of initiatives in most organizations that seek to bask in innovation's golden light. From disruptive new product initiatives to efforts to introduce recyclable cutlery in the commissary, there is precious little that doesn't seem to qualify. It is not an elephant we seek to describe, but a menagerie. Imagine now the sightless six grasping, respectively, the wing of a condor, the body of a lion, the horn of a rhino, and the fluke of a whale. It is unsurprising, if disappointing, that our efforts to make innovation manageable have conjured only chimeras.

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If we are to become similarly effective at managing innovation, we need to define what it is in practical, useful terms. Only then can we assemble the parts of the creature that truly belong together.

Few other fields in applied management labor under this burden: hedging financial risk belongs to finance, while motivating and rewarding employees falls to a subfield within human resources and reducing the variation in the output of a manufacturing process belongs to operations management. Managers can be effective in these domains largely because the implicit or explicit definitions that limn the boundaries of each tell them what they need to know in order to achieve specifiable outcomes and how to improve over time. If we are to become similarly effective at managing innovation, we need to define what it is in practical, useful terms. Only then can we assemble the parts of the creature that truly belong together.

#### **More than a harmless drudge**

Establishing a useful definition to guide any field of inquiry is not an esoteric exercise but the most practical of first steps. Unfortunately, it is a step we have yet to take for innovation, which has been plagued, almost since its inception, with far too broad a notion of what it might encompass.

The trouble began with the seminal work of Joseph Schumpeter in the 1930s and 1940s. Almost single-handedly, the Harvard economist convinced a discipline obsessed with marginal cost competition that what really mattered was innovation, which he defined as "the introduction of new goods...new methods of production... the opening of new markets...the conquest of new sources of supply...and the carrying out of a new organization of any industry."<sup>1</sup>

Consider now what this definition places within innovation's remit. Do we really think that finding a Chinese distributor for CAD software (opening new markets) requires the same sort of management processes as shifting from bricks to clicks in the retail sector (establishing a new organization)? Does exploring digital fabrication or additive manufacturing (3-D printing as a new method of production) raise challenges that are sufficiently similar to those arising from finding substitutes for rare earth metals in the high-tech sector (new sources of supply) that they can be treated as one and the same?

A reasonable question is whether having a common definition matters all that much. Can't we follow the lead of Potter Stewart, a late Justice of the U.S. Supreme Court, who famously averred that when it came to obscenity, he knew it when he saw it?<sup>2</sup> As a practical matter, the answer appears to be no. In a seemingly direct riposte to the Potter Stewart school of thought, recent literature identified 60 distinct definitions of innovation, prompting the derisive conclusion that researchers had collectively abandoned the question of definition entirely, leaving it "to the reader to intuitively understand what is now a popular subject in management literature."<sup>3</sup>

When definitions are offered, they collectively lack the coherence necessary to create a solid, common foundation. Is innovation "the creation of new knowledge and ideas to facilitate new business outcomes,"<sup>4</sup> "the effective application of processes and products new to the organization and designed to benefit it and its stakeholders,"<sup>5</sup> "the generation, acceptance, and implementation of new ideas, processes, products, or services,"<sup>6</sup> or something else altogether?

The lack of a shared, accurate definition has undermined our collective ability to manage innovation effectively because we cannot determine what matters and why.<sup>7</sup> One study identified 9 factors and 31 subfactors that determined success.<sup>8</sup> Another revealed 55 factors and a metastudy of the field itemized 42 subfactors clustered into 10 factors.<sup>9</sup> In short, efforts to understand innovation are looking at phenomena that are the same in name only, so it is no surprise that there are wildly different opinions about what matters most.<sup>10</sup>

How shall we get out of this muddle? We cannot adopt the lexicographer's conceit and attempt to derive a definition from how the word is used. Yet on what basis and with what authority would we – or anyone else, for that matter – impose a definition?

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## The lack of a shared, accurate definition has undermined our collective ability to manage innovation effectively because we cannot determine what matters and why

### No free lunch?

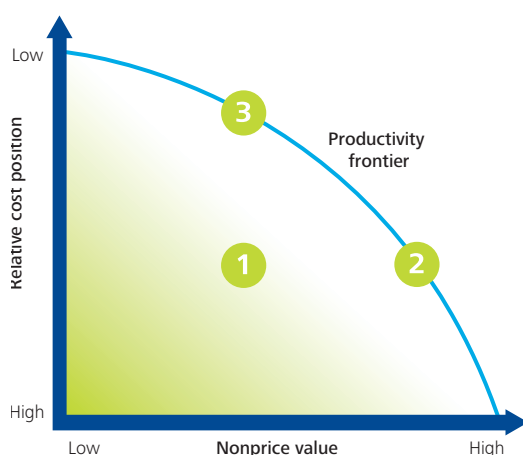
There is perhaps a third way: rather than infer or impose a definition, we can perhaps derive one by following to its logical conclusion the microeconomic theory at the heart of modern competitive strategy.

In his 1996 article "What is strategy?" Harvard Business School professor Michael E. Porter synthesizes over 20 years of writing, research and reflection on the implications of microeconomic theory on business competition.<sup>11</sup> He concludes that different strategies are defined by the trade-offs in the performance of the activities that define the value created by a business model.<sup>12</sup> Porter illustrates this framework using two dimensions of customer value: price and nonprice. (Nonprice value is really a vector of all the different dimensions of performance that customers want. For instance, in the case of automobiles, these might be safety, acceleration, styling, roominess and so on).

Delivering any given bundle of nonprice benefits always incurs a cost – it is tough, after all, to get something for nothing. The minimum cost required to achieve a specified nonprice value is not some fixed Platonic ideal: it is whatever cost is incurred by the lowest-cost provider in the market. Similarly, the level of any nonprice value that can be provided at any cost has a maximum: no matter what you're willing to pay, you cannot have a car that goes from 0 to 60 in 2.8 seconds and gets 75 miles per gallon in the city. The limits of what can be provided at what cost describe the "productivity frontier" for a business model at a point in time.

## A company's strategy, then, is defined by the trade-offs inherent in its business model, or the activities it performs in order to deliver value to customers

**Figure 1. The productivity frontier**



**Source:** Adapted from Michael E. Raynor, *The Innovator's Manifesto*, 2011

In figure 1, at point 1, a firm can appear to break trade-offs and deliver greater nonprice value without an increase in cost; that is, it can move "right" to point 2 (an increase in nonprice value) without moving "down" (an increase in cost). This is because a firm is merely wringing out inefficiencies that others already know how to avoid. In other words, at point 1, it really can get something for nothing by working smarter rather than harder. Firms that have reached the frontier of

what a given business model can do are "operationally excellent," in Porter's terms.

Once a firm gets to 2, however, that is as smart as it can work: The frontier defines the limits of what is possible at that moment. Of course, one could exploit different types of trade-offs to reach a different point on the frontier, competing instead at 3 by moving "up" (a reduction in cost) from 1 without moving "left" (a reduction in nonprice value). Once firms are at the frontier, however, changes in cost and nonprice value are inextricably linked: more of one necessarily means less of the other. Thus, 2 and 3 are qualitatively different strategies because they are at different points on the same frontier.

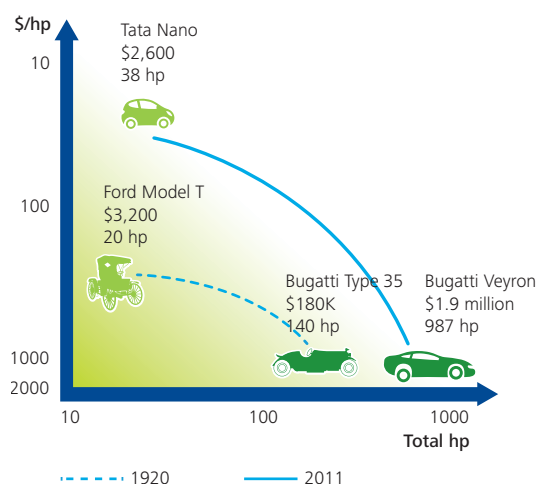
A company's strategy, then, is defined by the trade-offs inherent in its business model, or the activities it performs in order to deliver value to customers. A company's business model is strategically differentiated to the extent that it exploits a different set of trade-offs than its competition, choosing, for example, to provide higher quality but at higher cost and hence price.

For all its power, this model is essentially static because it takes the production possibility frontier (PPF) as given and fixed. This is a useful assumption, but like many assumptions, it eventually buckles under the weight of accumulating reality. In the auto industry, for example, the trade-off between cost and power has changed dramatically over time.

Today, for example, one of the least expensive machines that we are willing to call a "car" (a closed-body private transportation device with a given passenger capacity and range) is the Tata Nano. Its price (a proxy for relative cost) is approximately USD 2,600, and it has 38 horsepower. At the other end of the spectrum is the Bugatti Veyron, which at USD 1.9 million delivers 987 horsepower. These two automobiles define, to a reasonable approximation, the PPF of the trade-offs between cost and power in the commercial market for automobiles (figure 2).



**Figure 2. Production possibility frontiers in the automotive industry**



Source: Wikipedia; company websites; Deloitte analysis

It will come as no surprise that 90 years ago the industry was subject to different constraints. In 1920, a good candidate for the cheapest car generally available was the Ford Model T, which cost USD 3,200 (in 2013 dollars) and delivered 20 horsepower. Back then it was still a Bugatti (the Type 35) at the other extreme, which cost USD 180,000 inflation-adjusted and delivered 140 horsepower.

It's worth noting that breaking a trade-off does not necessarily translate into commercial success: some innovations disappoint when the trade-offs broken are not broken in ways valued by customers. For example, the Nano has faced some headwind in finding marketplace acceptance. March 2013 Nano sales were down 86 percent from a year prior and only 229,157 units have sold since inception. The reason seems to be

that many scooter owners aren't upgrading to the Nano because it isn't viewed as a "real" car and car buyers view the Nano as inexpensive and too akin to a scooter.<sup>13</sup> In other words, although the Nano falls between a car and a scooter, it is still too close to a scooter. Consequently, commercial success seems to lie in being more like a car.

Independently of the commercial success, from an engineering standpoint, this outward expansion in the automotive sector's PPF means that the combination of cost per horsepower and total horsepower readily available in a minivan today would have been unfathomable to the engineers contesting Le Mans during the interwar period. Such movement does not pose a problem for Porter's notion of strategy since minivans in 2013 do not compete with racing cars from 1923. Yet this somewhat contrived example reveals how the accretion of many small improvements over the years can yield dramatic improvement overall.

Conceptually, of course, there is no difference between any one of those small improvements and their collective impact on automotive performance.

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**It's worth noting that breaking a trade-off does not necessarily translate into commercial success: some innovations disappoint when the trade-offs broken are not broken in ways valued by customers**

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## How then are we to think of those products or services that expand the frontier compared to their contemporaries and, rather than competing by making different sets of trade-offs, compete by breaking trade-offs? We propose that strategy is defined by the trade-offs you exploit, while innovation is defined by the trade-offs you break.

How then are we to think of those products or services that expand the frontier compared to their contemporaries and, rather than competing by making different sets of trade-offs, compete by breaking trade-offs? We propose that strategy is defined by the trade-offs you exploit, while innovation is defined by the trade-offs you break.

Establishing the utility of a definition is not something one does with regression equations or purely deductive arguments. This definition will have to prove its worth one case at a time and gain currency only through adoption. To begin to make the case for defining innovation this way, consider four competitive battles and how viewing them through the lens of innovation as “breaking trade-offs” brings into focus what happened and why.

### **Beer and wings**

In an oft-told tale, the structure of today’s American beer market is a legacy of prohibition. With the repeal of 1919’s 18th Amendment to the U.S. Constitution through the passage of the 21st Amendment in 1933,

the manufacture and sale of alcohol was once again legal. Americans, so the story goes, wanted their beer cheap, fast, and in large quantities. The only breweries that had managed to stay afloat were those big enough to diversify into other businesses, and so America’s brewing industry has long been dominated by a relatively small number of megabrewers: today, the two largest, both global players, have 75 percent market share between them.<sup>14</sup>

Beginning in the 1970s, however, smaller microbreweries began to crop up. Focusing on specialty formulations – bocks, pale ales, wheat or honey beers and so on – microbreweries brew small batches, distribute locally and often use highly idiosyncratic ingredients and processes. With 10 percent of the U.S. beer market today, microbreweries see themselves as innovative and are frequently described as such by the popular media.<sup>15</sup>

In truth, however, they are simply exploiting cost/performance trade-offs to appeal to less price-sensitive segments of the beer market. They have not found a way to make “better beer, cheaper.” Rather, they sacrifice economies of scale in their supply chain, production and distribution in the pursuit of other dimensions of performance that matter to the customers they court. They have not expanded the frontier of the beer industry, merely staked a claim to a different spot on the same frontier.

Megabrewers have responded by launching their own craft beer brands, addressing increasing market fragmentation with a careful balancing of production efficiencies and product differentiation. Leveraging production facilities and expertise, supply chains and even marketing spend, the craft beer divisions of the major brewers are really no different from traditional line extensions one might see in any consumer products industry. One of the majors in the United States has a portfolio of over 250 craft labels, and megabrewer craft brands are now growing faster than microbrewery volumes.<sup>16</sup> The result has been a new competitive equilibrium in the beer market, with the majors taking constant and careful measure of the craft beer segments of the markets they serve.

Incumbents are not always able to mount such effective responses to competitive incursions, however. Consider the fate of established airlines at the hands of low-cost carriers (LCCs). At one level, it is a mirror image of the same problem the larger brewers faced. New entrants popped up in response to regulatory changes that allowed them to exploit different cost/performance trade-offs that appealed to more price-sensitive segments of the market for air travel. Incumbent airlines typically responded in much the same way the megabrewers responded to microbreweries, comparing the marginal cost of leveraging existing assets such as planes, airport gates, reservation systems, loyalty programs and staff with the total cost of setting up something from scratch. This strategy led them to launch LCC divisions that were very often closely tied to the core operations, just as the megabrewers have done.

Yet the outcomes were far less favorable. Over a 13-year period, there were six major attempts by incumbent airlines to launch an LCC division, none of which proved successful. Continental was first out of the gate with Continental Lite (1993–1995), followed by United’s Shuttle by United (1994–2001), whose run overlapped with Delta’s Delta Express (1996–2003). US Air took a kick at the can with MetroJet (1998–2001). Delta’s Song (2003–2006) was a second at-bat for the Atlanta-based carrier and United tried it again with Ted (2004–2009). What kept going wrong?

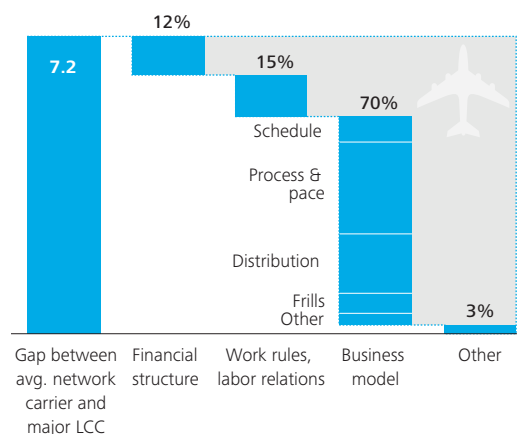
The problem was that, unlike the microbrewery challenge, the stand-alone LCCs were true innovators, delivering comparable performance at a cost that incumbents could not match (figure 3). They were not merely exploiting trade-offs in the interests of differentiation; they were breaking trade-offs, that is, they were innovating.

Microbreweries opened up new growth opportunities in the beer industry by creating products that appealed more directly to what had been latent, unserved market segments. The megabrewers’ response was effective at least in part – and perhaps in large part – because the

## The major management consultancies of the day overreacted because they mistook mere differentiation for a true innovation

**Figure 3. Drivers of a major LCC’s cost advantage over incumbent airlines**

US networks and a major LCC (737-300: Stage length, seat density, and factor cost adjusted)



Source: Adapted from Michael E. Raynor, *The Innovator’s Manifesto*, 2011

organizational context of their response was appropriate to the nature of the challenge. Faced with the need to differentiate their product, they used the organizational tools of differentiation but kept those elements of the underlying business model that did not need to change. This allowed them to exploit their inherent cost and distribution advantages. Incumbent airlines, however, mistook a true innovation for mere differentiation. Consequently, when they too reached for the tools of differentiation, their responses fell dramatically short.

## Treat an attack based on differentiation as if it were breaking important trade-offs and you will likely overreact, but mistake a true innovator for the merely different and the pain can last for decades

It needn't have turned out this way. What might have happened had the megabrewers responded to the microbreweries as if they were true innovators? How bad could it have gotten for them? What if the airlines had better understood the nature of the threat they faced? How effective a response might they have mounted? We can never know for sure, of course, but for some insight into these questions, consider the experiences of Intel in microprocessors and incumbent management consulting firms during the dot-com era.

### Silicon Valley vs. Silicon Alley

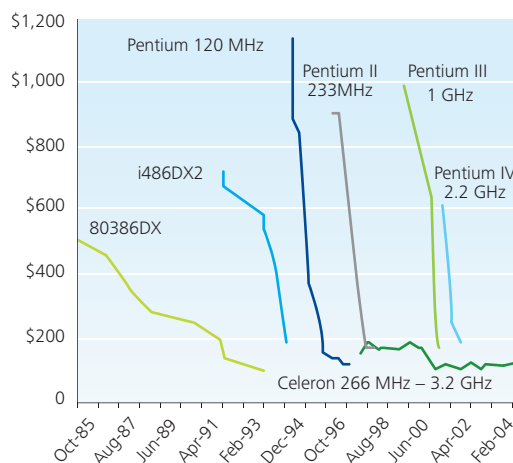
From 1985 to the end of the twentieth century, Intel enjoyed near hegemony in the chip business thanks to its ability to introduce increasingly faster chips on an increasingly shorter life cycle. Yet in 1999, for the first time, Advanced Micro Devices (AMD) had higher market share than Intel in the U.S. retail desktop segment with 43.9 percent, thanks largely to its gains in the sub-USD 1,000 system segment.<sup>17</sup>

AMD had gained this lead by beginning early – in the mid-1990s – to focus on less demanding tiers of the market, where chips that were less powerful than the best that Intel had to offer were welcomed with open arms, especially since they were being sold at much lower prices than Intel's highest-performing products. In other words, AMD captured a different segment of the market by making different trade-offs among dimensions of performance and cost.

So far, this is just the beer example with higher capital intensity. However, unlike the microbreweries and far more similar to the case of the LCCs, AMD had set itself on a trajectory of performance improvements that promised to break the cost/performance trade-offs that, at that time, defined Intel's product roadmap. What looked in cross section like a segmentation-based attack was actually the beginning of one based on innovation.

Intel's response was to establish a new unit in Israel, far away from the core operations in Santa Clara, California, to focus on building what would become the Celeron processor. Based on the Pentium "chassis," the Celeron was a deliberate attempt to fight back with a lower-cost, lower-priced, lower-performance microprocessor. Launched in 1998, the Celeron's performance improved dramatically even as its price remained constant (figure 4). It quickly became the largest line of processors by revenue in Intel's history. Only in the last few years has Intel phased out the Celeron and replaced it with Atom, Intel's new line of low-price microprocessors.

**Figure 4. Price and performance of Intel microprocessors, 1985–2005**



Source: Adapted from Michael E. Raynor, *The Innovator's Manifesto* 2011,

Now cast your mind back to the late 1990s. Venture capital partnerships prowl university campuses, showering millions in seed financing on anyone who could spell “dot com.” (At least it felt that way). No industry seemed immune from the corrosive yet generative, terrifying yet exhilarating impact of the Internet, including management consulting. The so-called Fast Five (in a dig at the consulting arms of the then Big Five accounting firms) of RazorFish, iXL, Scient, Viant, and marchFirst were scooping up the cream of the business school crop and securing high-profile engagements with not just other start-ups but even the incumbent firms’ major clients. With dot-com era financing to sustain them, the Fast Five were eager to take equity rather than cash in payment, and, unencumbered by established process or allegedly outdated paradigms, they promised a level of creativity and insight mainstream firms couldn’t even aspire to.

After two or three years of this, even the bluest-blooded consulting firms began to respond in ways Intel would have recognized. They set up new divisions with new names, new brands, new locations and seemingly unprecedented autonomy. They looked for talent in entirely new places, claiming that they didn’t want all those MBAs after all, and that Ph.D. students in physics and math were just what they needed. They aped the “payment in equity” with some clients and developed new compensation models, sometimes based on ghost equity in the division itself in an effort to create the buzz of a true e-consultancy and the high-powered reward structures that implied.

None of it lasted long or amounted to much. Scient and iXL became part of Razorfish, which is today part of Publicis, a multinational advertising and public relations company. Viant was acquired by divine inc., which went bankrupt in 2003, and marchFirst went public in March 2000 and was defunct by May 2001. Most of the mainstream consulting firms, if they talk about this period at all, do so with some chagrin. Their new divisions were closed, the ping pong tables disposed of, the new business models and compensation systems abandoned.

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Providing high degrees of organizational autonomy and developing new business models seems to increase dramatically the likelihood that one can eventually break the trade-offs that define an industry’s existing frontier. Taking advantage of this insight, however, demands that we apply this advice only where appropriate – that is, where innovation is in fact called for.

The major management consultancies of the day overreacted because they mistook mere differentiation for a true innovation. Thanks to the economic and sociological phenomenon of the dot-com bubble, new market segments emerged that wanted, for a time, a different set of price/performance trade-offs. But the e-consultancies that sought to capitalize on those preferences had not created a new frontier. They were at best seeking to exploit trade-offs and were a long way from breaking them.

#### **The end of the beginning**

These case studies reveal the importance of understanding at a fundamental level what is and isn’t innovation. Treat an attack based on differentiation as if it were breaking important trade-offs and you will likely overreact, but mistake a true innovator for the merely different and the pain can last for decades.

As these examples illustrate, at least some of what is prescribed for successful innovation can be very effective. Providing high degrees of organizational

autonomy and developing new business models seems to increase dramatically the likelihood that one can eventually break the trade-offs that define an industry's existing frontier. Taking advantage of this insight, however, demands that we apply this advice only where appropriate – that is, where innovation is in fact called for.

## By consistently defining the underlying phenomenon, perhaps it will be possible to move beyond arguments over the factors and subfactors of innovation and engage the real question: how to innovate effectively

Identifying these circumstances means having a practical, accurate definition of innovation, and “breaking constraints” would appear to meet these criteria. In each of the four cases examined above, it would have been possible to map the cost/performance profiles of the market opportunities in play and determine with sufficient precision whether innovation or differentiation were likely to be the more effective response (figure 5).

For innovation researchers, we hope our definition will help bring some consistency to the field so that it can emerge from its current pre-paradigmatic welter. By consistently defining the underlying phenomenon, perhaps it will be possible to move beyond arguments over the factors and subfactors of innovation and engage the real question: how to innovate effectively.

**Figure 5. Matching organizational responses to competitive opportunities and threats**

Innovation (Breaking trade-offs)	Incumbent airlines respond to low cost carriers with LCC divisions <b>Failed</b>	Intel responds to AMD with the highly autonomous Celeron unit <b>Succeeded</b>
<b>Basis of market opportunity</b>	<b>Failed</b>	<b>Succeeded</b>
Differentiation (Exploiting trade-offs)	Megabrewers respond to microbreweries with craft beer brands <b>Succeeded</b>	Incumbent consultancies respond to e-consulting with highly autonomous divisions <b>Failed</b>
	Differentiation (Marginal cost analysis)	Innovation (Autonomy and new activity sets)
	<b>Mechanisms of organizational response</b>	

**Source:** Adapted from Michael E. Raynor, *The Innovator's Manifesto*, 2011

For practicing managers, who are deliberate or de facto consumers of management theory, we hope our definition will allow them to screen the advice they receive and identify the nuggets that speak to the problems they actually face. Is it any wonder that so many see “predictable innovation” as an oxymoron when so much of the advice on offer is actually targeted at an entirely different outcome?

Whatever the merits of our definition, we remain convinced that one is needed. Only when we attempt to synthesize our elephant from the parts of an elephant will innovation be a chimera no more.

by **Michael E. Raynor**, director with Deloitte Services LP and its Innovation theme leader and **Heather A. Gray**, manager with Deloitte Services LP

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# Human capital trends

EMEA and Global: more similar than you think





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In a recent survey<sup>1</sup> conducted with business leaders and human resources (HR) executives world-wide, almost identical top five trends were identified and similar top three HR and Talent concerns were noted. While each region has its own specifics and challenges, the below highlights more commonality than difference in what is driving the HR and Talent agenda today.

#### **Top leading trends**

The challenge for any organization, on the most basic level, is having the right leadership and people with the right skill sets in the company when you need them. In practical terms, this means HR needs to be embedded in the business and anticipate what programs they need to execute for their business strategy and this will vary

based on the business. Regardless of the business model however, there is a need to shift away from the basics of HR operations and employee relations in order to break the cycle of ineffective programs that lack focus on direct organizational benefits or that solve business problems.

The trends that emerged as most highly relevant today (currently shaping – or should be shaping – talent and HR strategies and programs) include:

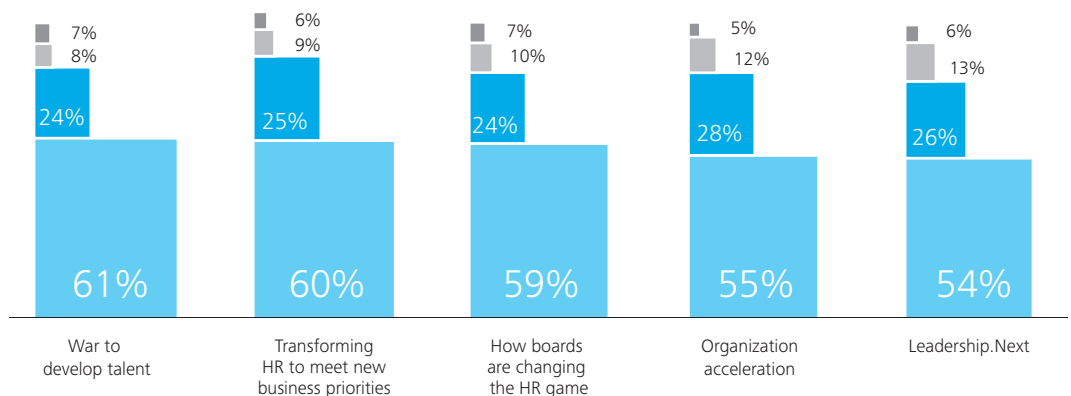
- The war to develop talent: the talent management trend is switching from recruitment to development.
- Transforming HR to meet new business priorities: HR transformation efforts are continuing to shift their focus to business priorities, concentrating on areas such as talent, emerging markets and the HR organization.
- How boards are changing the HR game: to seize new opportunities for sustainable growth and manage heightened risks, boards of directors at high-performing organizations are pulling Chief Human

Resources Officers much deeper into business strategy – and far earlier in the process.

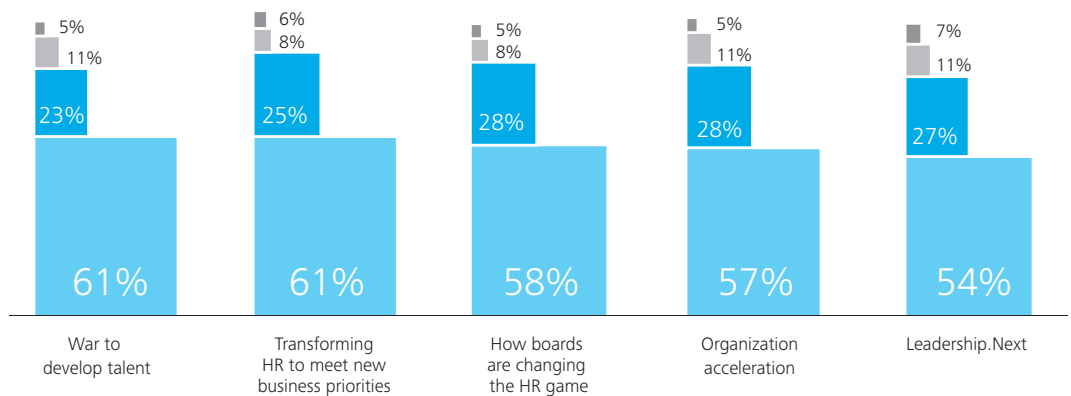
- Organization acceleration: faced with tougher, more numerous challenges, today's organizations are demanding more from their change initiatives by pursuing strategies that are customized, precise, and sustainable.
- Leadership.Next: yesterday's leadership theories are not keeping pace with the velocity of today's disruptive marketplace. Organizations are seeking a new model for the age of agility.

Besides a difference in order of rank, the focus of EMEA and Global are almost identical.

#### EMEA top 5 trends



#### Global top 5 trends



- This trend is highly relevant today
- This trend is relevant in the next 1-3 years
- This trend is relevant 3 years and beyond
- This trend is not applicable

One trend highlighted as of high relevance today by the smaller number of ME participants is “Branding the workplace” which focuses on enhancing the talent value proposition and innovating the talent brand. Talent brand and corporate brand are two sides of the same coin. Social media has erased whatever lines used to exist between them.

### Top three HR and Talent concerns

When executives were asked about the most pressing talent and HR concerns facing them today, for Global as well as EMEA, the top three turned out to be identical. EMEA executives are almost equally concerned about “developing leaders and succession planning” (49 percent) and “sustaining employee engagement” (46 percent). Global executives are even more concerned about leadership development than their EMEA counterparts; more than half of the executives (55 percent) reported that “developing leaders and succession planning” is their top concern.

One of the pressing concerns is sustaining employee engagement/morale which could indicate the high priority of the first leading trend of EMEA, “the war to develop talent.” In addition, connecting HR and talent with business critical priorities is a concern which is linked to a leading trend called “transforming HR to meet new business priorities.”

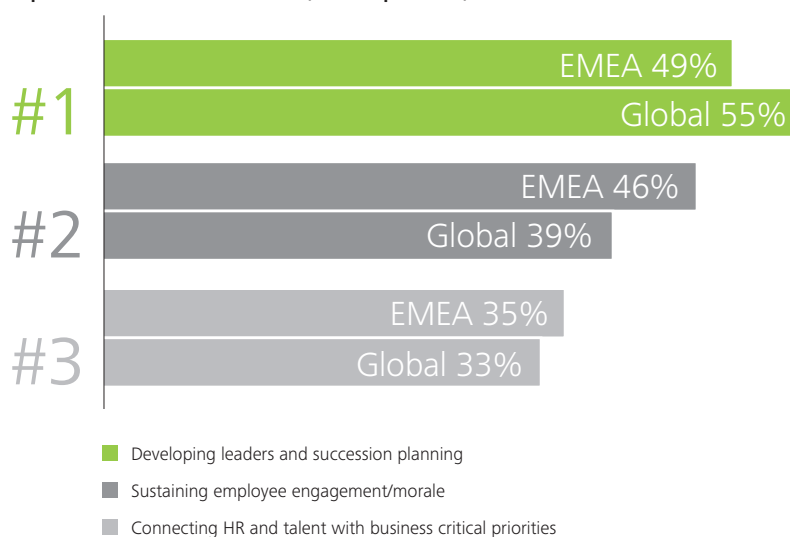
It is worth noting that the executives who participated in the survey appear to recognize 2013 as a pivot point in terms of economic expectations, with recession fears fading and optimism growing, while their Gulf counterparts were already in the optimism mode.

### Conclusion

Given that the key global trends and issues are identical across the regions, looking at how others are tackling their HR and Talent issues should enlighten executives into solving their own in a more effective way. Even small missteps can have big unintended consequences so paying attention to these trends can spell the difference between success and failure.

by **Ghassan Turqieh**, partner, Consulting, Deloitte Middle East

Top three HR and Talent concerns (% of respondents)



It is worth noting that the executives who participated in the survey appear to recognize 2013 as a pivot point in terms of economic expectations, with recession fears fading and optimism growing, while their Gulf counterparts were already in the optimism mode

### Endnotes

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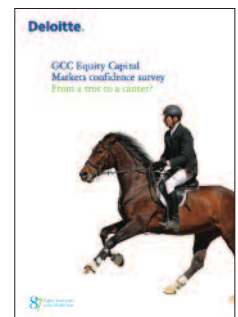
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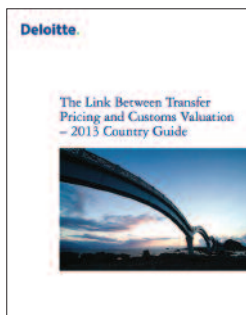
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**The open talent economy**  
People and work in a borderless workplace



**Human Capital Trends 2013**  
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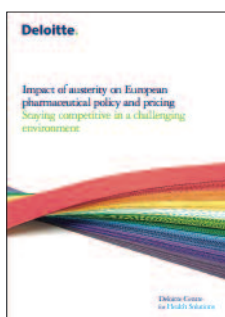


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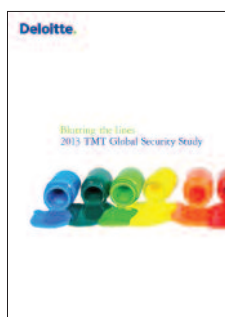


**Health Care and  
Life Sciences**



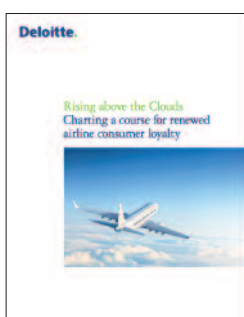
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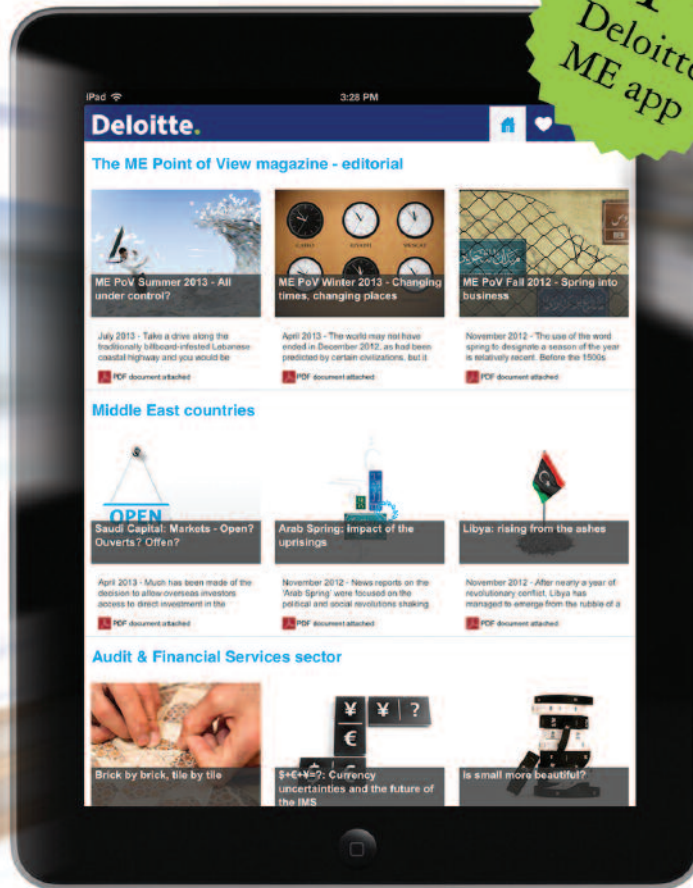
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