International Business Report

Global profit outlook weakens while GCC remains optimistic

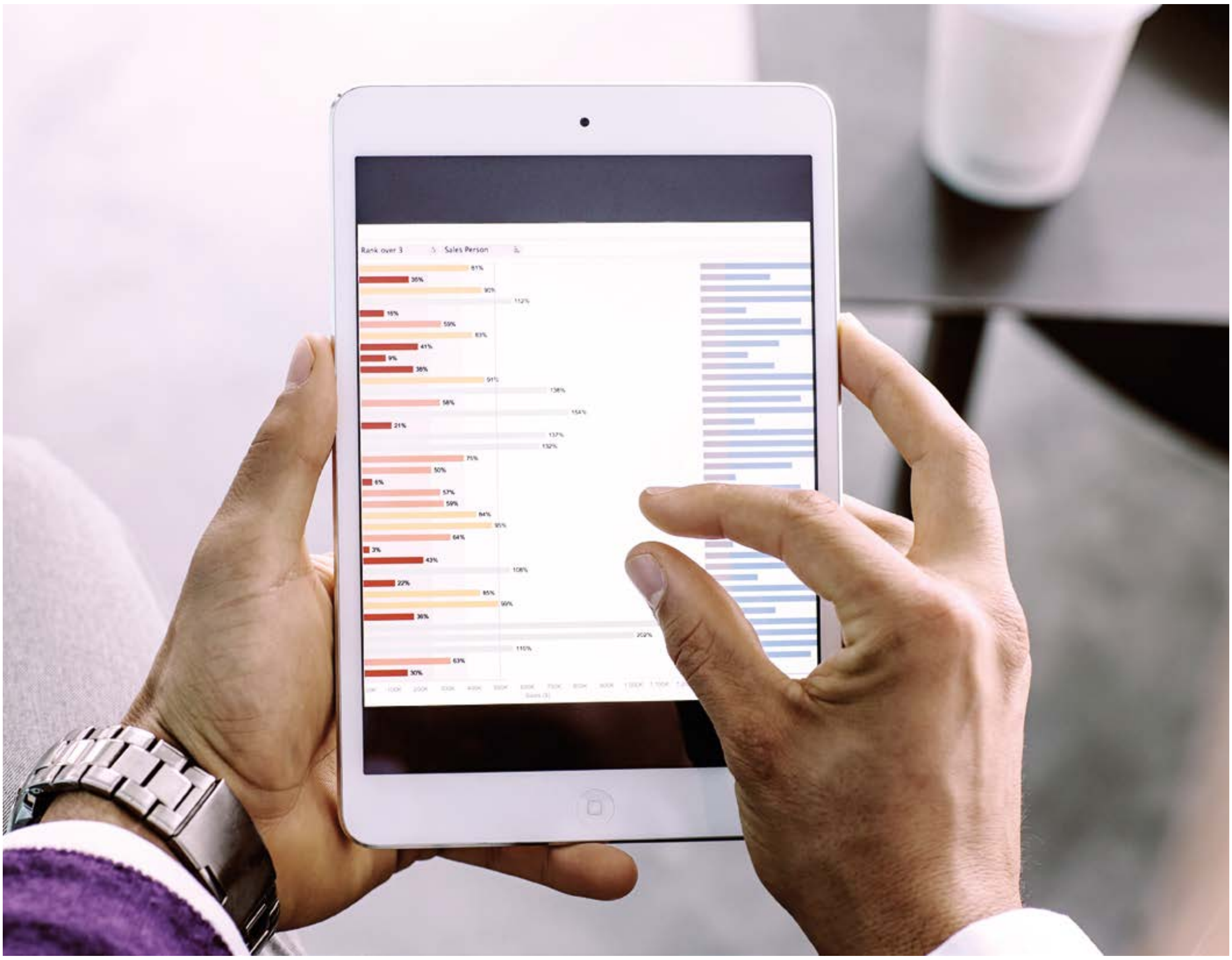
November 2017

Profit outlook weakens globally whilst GCC optimism remains strong

Grant Thornton's quarterly business survey of 2,500 businesses in 36 economies, the International Business Report (IBR), provides insight into the economic and commercial issues affecting medium to large businesses, both privately-held and public.

The most recent survey, conducted in the third quarter of 2017, found a weakened global profit outlook amid rising wage pressure and a lack of skilled workers. Like its global counterparts, the Gulf Cooperative Council (GCC) countries of Bahrain, Kuwait, Oman, Qatar, Kingdom of Saudi Arabia (KSA) and the United Arab Emirates (UAE), are also experiencing a skills shortage as the region embarks on ambitious programmes toward significantly more diversified economies.

So, where does global business optimism stand? We asked this of business leaders and their answers reveal that while the proportion of businesses who expect profits to increase over the coming 12 months has fallen, optimism remains high. In the GCC, confidence levels are recovering and economic growth is set to increase.



Global profit outlook weakens while wage pressures rise

The deterioration comes amid concern over the growing lack of skilled workers, which has reached a record high around the world. In reaction to the shortage, a growing number of firms now plan to increase pay, creating further profitability challenges, and possible inflationary pressure in the need to eventually raise product pricing.

The skills shortage begins to bite

The concerns over profits come as the shortage of skills gain pace.

Worldwide, 38% of business leaders say this constraint now weighs on their firms. This is the highest figure ever recorded within the Grant Thornton survey and is a trend visible across most regions. Companies are having to compete for skills - both to retain those they have and recruit those they need. The evidence suggests that a record numbers of businesses, faced with competing for skilled workers, plan to offer pay rises over the next 12 months (78%).

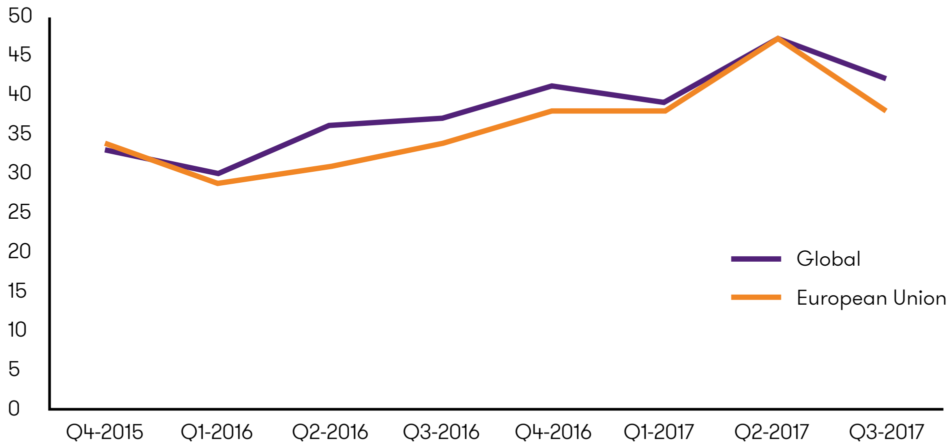
Globally, the overall position for business optimism is remains relatively high at +49%. This is down 2pp on Q2, and follows five consecutive quarterly increases in business sentiment.

Long-term global growth in the spotlight

Nine in ten of the world's largest economies have reduced their profit outlook for the coming year.

The findings show that globally, the proportion of businesses who expect profits to increase over the coming 12 months has fallen, down from net 47% in Q2 2017 to 42% in Q3. Of the world's ten largest economies, only Japan bucks the trend. Notably, the outlook on profits has weakened in: the US (down 10pp), China (-3pp), Germany (-25pp), the UK (-4pp), France (-2pp) and India (-15pp).

Proportion of businesses expect profits to increase



Source: IBR 2017

The impact will be significant and are a real threat to long term growth. A firm's ability to invest in future long-term growth through R&D or plant and machinery could be limited by its need to divert profits towards payroll. Furthermore, if profits are depressed, businesses may look to increase the price of their goods and services – which creates inflationary pressure. As businesses plan for the coming months and years, it will be critical to ensure a balance so that other investments are not abandoned altogether.

The UK goes against the flow as Brexit takes a toll

The IBR findings show that one of the standout falls in profitability expectations in Q3 was in the UK, where the proportion of firms expecting increased profits dropped to 39% - the lowest figure in over five years. The UK has also suffered a dramatic drop in business optimism, plummeting to its lowest figure since Q1 2013, at just 9%.

The downward trajectory for optimism in the UK is at odds with its G7 counterparts and many EU neighbours. Overall the fundamentals in the UK remain robust. But businesses hate uncertainty and there are signs that concerns over Brexit are weighing heavily on the UK's business leaders. However, if clarity over Brexit timings can come soon, there is a chance to turn things around – particularly as revenue and export plans remaining relatively healthy. The effect of Brexit on the GCC remains unclear, but the expectation is that the weaker Sterling and strong relationship between the UK and the region will result in new trade agreements, with GCC companies investing further in the UK and growing their operations there.

Optimism remains buoyant

Despite profit expectations dipping in the world's two biggest economies, the IBR reveals that they are driving overall positive sentiment.

Optimism among firms in the US is well above the global average at 70% in Q3, while Chinese business optimism has hit a three-year high of 52%. This is reflective of a surprise bounce in trade growth so far this year. The World Trade Organisation has revised its forecast for trade expansion in 2017 up to 3.6%.

GCC

Confidence levels recovering amid higher oil prices

In the GCC, the outlook is positive. Stagnating oil prices and political instability may have dampened business sentiment and hiring plans at the start of the year, but economic growth is set to increase as of 2018 supported by higher oil prices and non-oil sector growth.[1] GDP in the UAE is predicted to grow at an annual rate of 2.8% during period 2018-2021, higher than previously forecasted and at a faster rate than the rest of the region.[2]

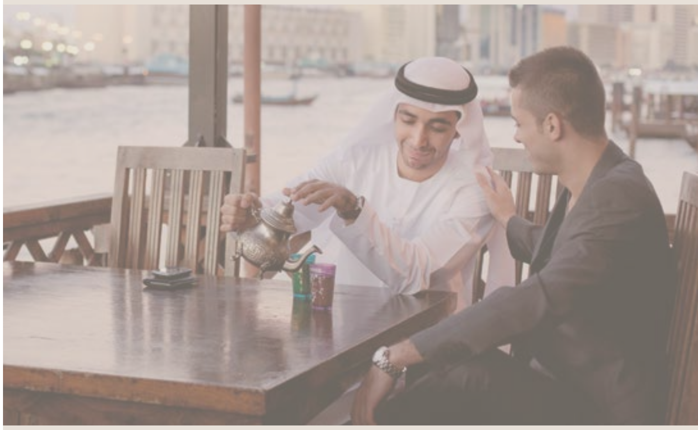
Large-scale projects such as Expo 2020 in Dubai are driving demand for new hires, as is the introduction of value added tax (VAT) in 2018 in KSA and the UAE. Voluntary employee turnover, however, has increased to 39% of organisations over the last three years,[3] and this coupled with renewed growth in local job markets has made for challenging times.

Long-term regional growth plans

Governments in the region, determined to diversify away from hydrocarbons and reduce public wage bills, are creating jobs in new sectors and focusing on developing knowledge-based economies, and building smart cities. Information and communication technology (ICT) and the Internet of Things (IoT) will form the basis of these smart cities, with the aim being to use technology to improve the quality of life for its citizens, and make all aspects of society from governance to transport, environment, and health, more efficient and more sustainable.

Investment in these cities of the future not only creates infrastructure projects with Saudi Arabia and the UAE projected to invest approximately $49.3bn in smart city projects to 2025,[4] but it also creates new technology focused roles in the key industries of power, transport, education, telecommunications, hospitality, and healthcare. The implementation of such ambitious plans and the emergence of new sectors each require unique and often rare skills, which will place further pressure on countries in the region to attract and retain skilled workers. The UAE is attempting to increase the number of "highly skilled" workers, those with tertiary qualifications, to 40% of the workforce by 20215.[5]

Regional Reform



KSA: Vision 2030 plan and National Transformation Plan sets out the kingdom's future, less dependent on oil and more focused on private sector entrepreneurship. Sale of 5% of state oil giant - Saudi Aramco, expected to take place in 2018 and estimated to raise as much as $100 billion will underwrite ambitious infrastructure plans.

UAE: Strategy for the Future together with several strategy programmes map a path from 2021 up to and beyond 2071 to mark the centennial anniversary of the country's inception. These plans envisage the UAE as a centre of excellence for training, education, technology and innovation, with success already being measured in the use of 3-D printing for building projects, and being noted as the region's financial centre and fintech hub.

Kuwait: "New Kuwait" 2035 strategy aims to transform the country into an economic and cultural hub to create jobs, attract foreign direct investments and facilitate knowledge transfer in the fields of renewable energy, information technology, and the services sector.

Wage pressures and the impact of VAT

After a difficult year in 2016, which saw companies cut operating budgets, widespread redundancies, lower hiring activity, and the cost of living rise at a rate higher than salary increases, 2017 has been more positive. A survey by online recruitment firm GulfTalent found that job cuts were predicted to fall from 40% of respondents in 2016 to 23% in 2017.[5] More firms also planned to expand their workforce: increasing from 41% in 2016, to 47% in 2017, with manufacturing and healthcare having the most positive outlook. The number of firms planning to increase headcount has also risen, increasing from 41% in 2016 to 47% this year.[6] Mercer's 2017 Cost of Living Survey, however, continued to rank Dubai (19) as the most expensive city in the world, followed by Abu Dhabi (22), and Riyadh (52), while Muscat (92), and Jeddah (117) are among the least expensive cities in the region.[7] The introduction of a 5% VAT in the UAE and KSA as of January 2018 will likely cause inflation to continue to increase over the next two to three years.

Smart cities will attract talent

As the region struggles to attract and retain talent, smart cities will help attract expertise, digital natives, and entrepreneurial businesses. Smart cities are being developed throughout the GCC, such as KSA's Smart Riyadh, Abu Dhabi's Masdar City, and Qatar's Msheireb Downtown Doha project, which aims to install more than 500,000 sensors to help operate a variety of services from building security to automated waste collection.

Dubai is leading the way and has recently published its action plan in which it seeks to transform the emirate into one of the smartest cities in the world by 2021. As part of the plan, Dubai aims to completely digitise government services and become paperless, eliminating the need for physical visits to it customer service centres, and instead deploy blockchain technology for all Dubai government transactions, and use artificial intelligence (AI) system "Saad" to read data from various government and private enterprise sources to provide reliable information and official answers to customer queries.

Recognising these smart city initiatives, the United Nations has recently designated Dubai as the local data hub for the Middle East, North Africa and South Asia region, enabling Dubai to join a global network of innovative cities committed to sharing data, learning, and solutions to further innovation, and build smarter, more sustainable, and more prosperous cities of the future.[8]

Skills vs machine challenge

Digitisation provides several benefits, particularly with smart technology such as AI, robotics, virtual reality, augmented reality and cloud computing. These will require workforces to develop new skills.

- The Dubai Government has already made estimated savings of US$1.17bn through shared government smart services since 2003.[9]
- UAE based Mashreq Bank recently announced it could become branchless as all services would be available online and AI could replace customer service representatives with chatbots.[10]
- In Dubai, over 600 typing centres used in the processing of visas are currently being phased out and instead replaced with just 50 Amer Business Centres housing smart systems to process visa and residency transactions all under one roof.[11]
- Automation could replace close to half of all work activities in the GCC: 41% in Kuwait, 46% in Bahrain and Saudi Arabia, and 47% in the UAE.[12]

Tasks are being replaced by technology, but these are the time-consuming, repetitive, and mundane ones. Skillsets will need to adapt to the jobs of the future: by 2020, 21% of core skills in the countries of the GCC will be different compared to skills that were needed in 2015.[13] In Dubai, blockchain technology for example is estimated to replace 25.1 million hours of document processing time.[14] As some jobs disappear, new more creative ones will take their place. Automation will enable people to afford time to more valuable work such as innovation and strategy, and roles that require passion, creativity, ingenuity and entrepreneurship. Instead of replacing humans, technology will assist humans. Tasks such as collecting and analysing vast amounts of data for example, can be automated with the output supporting humans to make better decisions.

Despite global uncertainty around geopolitical and macroeconomic outcomes, overall levels of business optimism around the globe remain relatively high. While not immune to global challenges, and despite regional uncertainty, business confidence in the GCC is recovering. Buoyed by the recent recovery in oil prices, and driven by the need for economic diversification, the region is capitalising on the latest innovations, and deploying digitisation, disruptive technology, and automation to improve the quality of life for its citizens, and to build profitable, efficient, and sustainable economies.

[1] https://www.icaew.com/en/technical/economy/economic-insight/economic-insight-middle-east
[2] http://www.arabianbusiness.com/politics-economics/378406-gcc-economic-growth-forecast-to-strengthen-from-2018
[3] https://www.roberthalf.ae/sites/roberthalf.ae/files/pdf/noindex/robert-half-middle-east-salary-guide-2017.pdf
[4] http://gulfbusiness.com/smart-cities-gcc-seeing-transformation/
[5] http://www.arabianbusiness.com/why-uae-expats-want-more-from-skilled-economy-659421.html
[6] https://www.gulftalent.com/resources/employment-news/gcc-jobs-set-to-recover-in-2017-led-by-manufacturing-and-healthcare-76
[7] https://mobilityexchange.mercer.com/Insights/cost-of-living-rankings
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[10] https://www.cnbc.com/2017/05/11/mashreq-ceo-foresees-branchless-future-for-uae-bank.html
[11] https://www.khaleejtimes.com/nation/amer-to-replace-typing-centres-from-november
[12] http://www3.weforum.org/docs/WEF_EGW_FOJ_MENA.pdf
[13] Ibid
[14] https://www.khaleejtimes.com/technology/in-blockchain-we-trust

IBR 2017 methodology

TThe Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,600 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in over 36 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally.

The data in this report are drawn from interviews with more than 2,600 chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 36 economies conducted between October and December 2016. The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1000 employees; in the United States, those with US$20m to US2bn in annual revenues; in Europe, those with 50-499 employees.

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