Multinationals in the Middle East: Challenges and opportunities

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ABSTRACT
This introduction to the special issue on Multinationals in the Middle East first reviews the historical growth and development of multinational enterprises (MNEs) in the territory extending from Morocco to Turkey alongside the southern and eastern shores of the Mediterranean as far east as Iran, and south to Sudan and Yemen. Then, several opportunities and challenges affecting MNEs in the region are discussed, including economic and social diversity, non-market strategies and entry-mode choices, and animosity toward MNEs. The seven papers featured in the special issue that address these topics are then discussed.

The Middle East refers to a socio-political and cultural area that does not have precise borders (Budhwar & Mellahi, 2007: 2). For the purpose of this special issue, we adopt a broader definition of the region as defined by international institutions to include all territory extending from Morocco to Turkey alongside the southern and eastern shores of the Mediterranean as far east as Iran, and south to Sudan and Yemen (Ahmed, 2008). The term “Middle East” was first introduced in 1901 by U.S. admiral Alfred Mahan (Ali, 1999), before it was adopted in official correspondence of Britain (Ali, 1999). However, given the diversity of ethnicities, languages, and religions in the region, the degree of uniformity expected in a definition of a region may not be a true reflection of its diverse reality.

The Middle East region has garnered its fair share of coverage in academic literature and current news. Much of these writings, however, concentrate on political turmoil and conflicts in the region (Kamalipour, 1997). Judging by the disproportionately negative news coverage depicting the Middle East as a region in continuous turmoil, one would expect it to be an inconsequential market for multinational enterprises (MNEs). Yet, the Middle East is home to many of the world’s largest MNEs, most of which enjoy a sustained profitability from their operations in the region (Kavoossi, 2000). Indeed, the list of MNEs operating in the region resembles a roster of the Fortune 500. In the hospitality and retail industry, MNEs have established a beachhead and penetrated almost every nook and cranny of the vast Middle Eastern market.

The presence of multinational enterprises (MNEs) in the Middle East is not a new phenomenon. The history of modern MNEs in the Middle East can be traced back to Ottoman era. The Ottoman bank was founded in 1856 in the Galata business district of Istanbul, the capital of Ottoman Empire. This was a joint venture between British interests, the bank de Paris et des Pays-Bas of France (Bank of Paris and the Netherlands – currently known as BNP Paribas) and the Ottoman treasury. Similarly, other MNEs, such as Nestle, located their sales subsidiaries, agents, and commercial representatives, in major commercial cities, such as Istanbul, Izmir, Jafa, Alexandria, and Cairo, as well as in other parts of the empire (Koese, 2008). Koese (2008) argues that the ethnically, religiously, and linguistically diverse Ottoman capital proved to be an important training laboratory for Nestle (and perhaps for many other MNEs), enabling the company to develop the strategic and coordination skills needed to succeed in the heterogeneous and complex global marketplace. Ideas and marketing tools developed in Istanbul, according to Koese (2008: 727), “would later be deployed to European market” – early evidence of reverse knowledge transfer.

In the oil sector, MNEs established a foothold in the Middle East in the 1930s when most of the region was colonized by European powers. The few independent Middle Eastern governments, such as Saudi Arabia, signed concessionary agreements with Western MNEs to explore the host country for oil.¹ Most MNEs in the oil and gas sectors were nationalized in the 1970s when local govern-

¹ Saudi Arabia signed an agreement in 1932 with Standard Oil of California to explore oil in the kingdom.
ments reaffirmed their sovereignty by nationalizing strategic sectors and imposed restrictions on MNEs (Stevens, 2008). Over the past two decades, however, in their quest to join the WTO, generate jobs, and upgrade their technological capabilities (Dasgupta, Keller, & Srivivasan, 2002), Middle Eastern governments have found themselves with few alternatives but to open their doors to MNEs (Mellahi, Guermat, Frynas, & Bortmann, 2002).

Given the recent increase in the number of MNEs in the Middle East, this special issue is concerned with opportunities and challenges facing MNEs in the region. Its aim is to further our understanding of the features of the contexts for managing MNEs in the Middle East and shed light on the different management approaches used by MNEs is the region. The special issue’s main justification lies in the fact there is still a dearth of knowledge on this important region. Godley and Shechter (2008: 632) describing research on MNEs states that “some parts of the globe have remained aloof. Given its economic and political importance, the most glaring omission is the Middle East.”

To date, little is known for instance on management practices by MNEs in the region: Do MNEs apply home country practices? Do they adapt their practices to host countries? There is equally the question of entry modes: How do MNEs enter the region? What are the most appropriate modes of entering the Middle Eastern markets? Are economic actors given the pivotal role played by non-market actors, such as local governments and national institutions in shaping the business environment, research is needed to show how, why, and illuminate the conditions under which, national institutional arrangements contribute to MNEs strategic capabilities that form a basis for competitive advantage in the host country market. Further, substantial economic and political changes have been underway in most Middle Eastern countries which prompt the need for a closer look at emerging business opportunities and challenges for MNEs operating or considering entering the region.

The literature on management in the Middle East focuses on management culture (A. Ali, 1995; A.J. Ali, 1995; Mellahi, 2003), Arab and Islamic work values (Mellahi & Budhwar, 2010; Riddle, Ralston, Mellahi, Butt, & Dalgic, 2007) and ethics (Rettab, Ben Brik, & Mellahi, 2009; Rice, 1999) specific management functions such as HRM (Budhwar & Mellahi, 2006, 2007; Mellahi & Al-Hinai, 2000), and marketing (Luqmani, Yavas, & Quaraeshi, 1989; Razouk & Al-Khatib, 1993; Melewar, Turnbull, & Balabanis, 2000), and historical case studies of MNEs in the region (Andersen, 2008; Blaszczyk, 2008; Godley & Shechter, 2008; Koese, 2008). While this body of literature is informative, it does not fully capture the challenges facing MNEs in the region.

1. Economic and social diversity and FDI in the Middle East

The Middle East is a highly diverse region. Diversities in the region do not end with languages, ethnicities and religions. Countries in the region also have a diverse range of political and economic systems. Although Ali’s (1995a, b) describes most Middle East economic systems as sheiko-capitalism, in which he examines several variation of this model, some of the countries in the region may not necessarily be classified within the sheiko-capitalist pattern (Budhwar & Mellahi, 2007). For instance, from market sophistication point of view, with a relatively high market development, Turkey, Tunisia, and Iran are better positioned than other Middle Eastern countries. Iran has the largest and more mature middle class in the region (Ali, 1999), while Turkey with relatively developed economic institutions and integration with the EU, displays a somewhat different pattern than Ali’s sheiko-capitalist model.

From an economic standpoint, the region displays an uneven picture not only of countries endowed with enormous oil resources – representing the bulk of the world’s oil reserves – but also those with very limited resources burdened with an extreme concentration of wealth and poverty (Freedom House, 2007). While GDP growth has been impressive in some countries of the region (e.g., United Arab Emirates (UAE) 8.5%, Kuwait 8.5%, Turkey 7.4%, Jordan 7.2%, Saudi Arabia 6.6% all above the regional average of 6.2% in 2006), others have been performing well below the regional average in the same year (e.g., Lebanon 1%, Morocco 1.7%, Tunisia 4.2% Iran 4.2%, and Syria 4.7%) (World Bank, 2006). GNI per capita figures varies from the lowest of $870 (Yemen) to $38 420 of highest (Kuwait). Based on GNI per capita figures (World Bank, 2007), Middle Eastern countries can be clustered into three main groups. The natural-resource based, high income countries of Kuwait, UAE, Bahrain, Saudi Arabia, and Libya; the medium income countries of Turkey and Lebanon; and the remainder, which are largely low-income countries, regardless of their natural resource base. Therefore, income and wealth distribution in the region creates a large economic distance between countries, which should trigger cross-border transaction and investment activities between countries in the region.

Despite the great market potential for MNEs in the region, barriers to foreign direct investment still exist in most Middle Eastern countries. While there has been an increased trend of FDI inflow to the region compared to other developing and emerging regions of the world, the Middle East emerges as one of the most underperforming region (Apaydin, 2009). The region’s share in the total world FDI inflow was about 8% in 2007 (Apaydin, 2009). The cluster of Gulf Cooperation Countries (i.e., UAE, Kuwait, Bahrain, Oman, Qatar and Saudi Arabia) is the least performing in the region. These countries attracted only a modest proportion of total FDI inflow (2.3% of total world inflows in 2007) (Hussein, 2009). The most of remaining FDI inflows to the region have been invested in countries that have managed to remove entry barriers and create a climate conducive for foreign investment. For instance, Turkey, Egypt and Tunisia attract 34% of total FDI inflow to the region. These countries, to a certain extent, have been able to liberalise their FDI regulations and remove most of FDI related entry barriers. The market size also plays an important role on the pattern of FDI inflows. Countries with a larger market size appear to attract more FDI inflows.

The size and type of operations, as well as the entry mode of MNEs, are also significant dimensions of FDI in the Middle East. In a study of MNEs operating in the Middle East, Fiegenbaum, Shaver, and Yeung (1997) found that MNEs with operations in the Middle East are much larger than those that do not operate in the Middle East. Apart from size of investing firms in the Middle East, the internationalisation level of MNEs operating in the region are relatively higher than firms without operations in the Middle East. Fiegenbaum et al. (1997) found that MNEs operating in the Middle East derive higher proportion of their sales from foreign sources than MNEs without operations in the Middle East, which is an indicator of level of internationalisation of MNEs operating in the “Middle East” region. This pattern can be explained by instabilities and challenges in the region that inexperienced firms might face. Studies that examined intra regional FDI in the Middle East found that 11.7% of foreign venture formations in Turkey are sourced from the Middle East (Demirbag, Tatoglu, & Glaiser, 2007). Similarly, 18.4% of foreign investment firms registered with GDFDI of Turkey are classified as Arab and other Islamic countries (Demirbag, Glaiser, & Tatoglu, 2007). In relatively larger Middle Eastern markets, such as Turkey and Egypt, there appears to be a very modest FDI flow from neighbouring countries, while intra-regional FDI remains very minimal for the whole region.

2. Non-market strategies and entry mode

Whereas MNEs in the 1980s entered into Middle Eastern countries primarily to acquire natural resources and low-cost
factors, the remarkable rise in income in some parts of the region has recently attracted market-seeking MNEs. Some MNEs, such as American computer chip manufacturer, Advanced Micro Devices (AMD), South Korea’s LG Electronics, and China’s white goods powerhouse, Haier, have set up manufacturing operations in the region. World famous multinational retailers also have established business in the region, including Sweden’s Ikea and Spain’s Zaras. Business-to-business service companies are opening operations in the region as well, such as the American management consulting firm, Watson Wyatt Worldwide and India’s T’gi, Wipro Limited.

Regardless of the motive for entering the region, one of the fundamental decisions an MNE makes when entering the Middle Eastern market are the selection of local partners, and appropriate mode of entry. Given the market failures and institutional voids in the Middle East (Mellahi, 2007), affiliation with powerful business groups or political actors is a sine qua non for successful operations in the region. Affiliation with the right partner is not only an insurance policy that shields the MNE against opportunism from powerful actors and institutions, but it also often provides the MNE with preferential treatment, and access to scarce and highly valuable political resources. Blaszczyk’s (2008) study of DuPont in Iran during the 1970s and Andersen’s (2008) study of the Danish construction firm Kamsax demonstrate the importance of political capital in the Middle East. These studies show how lack of legitimacy as a result of weak embeddedness in the institutional environment and lack of adaptation to changes in the institutional environment, results in dramatic failure.

In most Middle Eastern countries, MNEs offer the full array of entry choices ranging from simple export to fully owned affiliates. The most prevalent entry modes are franchising and joint ventures. Entering through wholly owned subsidiaries is very limited. Hanson, Raymond, Mataloni, and Slaughter (2001) study of U.S. MNEs entry into foreign markets reports that the number of wholly owned affiliate of U.S. MNEs in the Middle East decreased from 267 affiliates (1.8%) in 1982 to 233 affiliates (1.1%) in 1998, and the number of majority-owned affiliate decreased by 4.7% between 1982 and 1998. The low level of entry via wholly owned affiliates reflects the need for local partners.

Our preliminary research shows that international joint ventures are more dominant in the oil, extraction industries, manufacturing and banking sectors, while franchising is the dominant mode of entry in the food, retail and hospitality industries. As in most emerging economies, business groups dominate the business landscape in the Middle East. This ranges from powerful families in Gulf States to powerful charitable religious foundations in Iran known as Bonyads. These groups have in their portfolios large number of companies in diverse industries and control large part of the economy. For instance powerful business groups such Alshaya, a private Kuwait family business and one of the region’s leading and most influential retailing franchises in the Middle East, has licensing and franchise agreements with major household retail brands such as Next, Body shop, Top Man, Dorothy Perkins, Starbuck, Miss Selfridge and Debenhams.

3. MNEs and animosity in the Middle East

As noted earlier, MNEs operations in the Middle East are fraught with pitfalls and tensions, partly because they are often entangled in international and political affairs. In particular, conflicts and wars in the Middle East create considerable challenges for MNEs operating in the region. Among the notable challenges is animosity towards products made in western countries or by western MNEs. Animosity is the “remnants of antipathy related to previous or ongoing military, political, or economic events” (Klein, Richard, & Marlene, 1998: 90). In the streets of the Middle East, there is a strong opposition to U.S.’s foreign policy in the conduct of the war against terrorism and anger over the US pro-Israel policy (Mahmood & Pisani, 2009; Shoham, Davidow, Klein, & Ruvio, 2006) which often fans the flames of a deeply seated resistance to the spreading of western consumption values by MNEs. As put by Knudsen, Aggarwal, & Maamoun (2008: 17-18): “the turmoil in the Palestinian territories, the war in Iraq, U.S. support for Israel, the Danish cartoons that were considered blasphemous in the Muslim world because of their depiction of Muhammad in a derogatory manner, and the Dutch anti-Islam film (Fitna) have fueled anti-Western sentiments in the Middle East obliging western MNEs to battle boycotts and public relations nightmares.” This animosity has shaped consumers attitudes towards MNEs and has created unavourable, albeit often short-lived, views of western MNE-made products (Bahaei & Pisani, 2009). Klein et al. (1998: 90) argue that “consumers might avoid products from the offending nation not because of concern about the quality of goods, but because the exporting nation has engaged in military, political, or economic acts that a consumer finds both grievous and difficult to forgive.” Examples of boycott are numerous and range from consumers refusing to buy products made by western, mainly U.S., MNEs that were considered to be “friends of Israel” to super-markeks refusing to stock Danish products following the Danish cartoons affair.

Anecdotal evidence suggests that MNEs are often hard hit by these boycotts. Sainsbury’s – a leading British supermarket chain – was forced to exit from Egypt (Bowers, 2001) and Arla Foods’ long established beachhead in the Middle East market was seriously challenged as a result of the boycott of Danish products in 2006. Arla took proactive actions to re-establish itself in the region by, dissociating itself with, and publically denounced the cartoons in full-page advertisements in over 25 leading Middle Eastern newspapers (Landen, 2007; Knudsen et al., 2008). These actions coupled with positive engagement with the religious and civil communities in the Middle East justifying why they should not be held accountable for the cartoons changed the call for boycott in the Arab street from “boycott Arla to buy Arla.” Arla’s response to consumer boycott in the Middle East is not an isolated case. In recent years, MacDonald’s put out an advertisement in local newspapers condemning the Israeli raids in Palestinian territories and Amazon.com had to terminate its affiliation with the Jerusalem Post (Knudsen et al., 2008; Armbuster, 2002). Other MNEs such as KFC, Coca Cola, and Starbucks emphasized their global nature and contribution to host countries development (Fisk, 2002). The boycott cases reveal two points. First, to borrow from The Economist, “consumer boycotts are becoming an epidemic (in the Middle East) for one simple reason: they work” (1990: 69). Second, as the above examples suggest, consumer boycott of MNEs in the Middle East is more typically linked to international political events rather than unethical corporate practices. However, although animosity against western MNEs is linked to specific political events, remnants of antipathy left by past events linger long after the event is over which may “dual up” and exacerbate the level of animosity caused by future events (Amine, 2008).

4. The special issue

The special issue consists of seven papers. The special issue contains one article about FDI performance, one article on internationalization and modes of entry, one article on business groups, one article on marketing, two articles on human resource management by MNEs, and a final paper on crisis management by MNEs in the Middle East. Each of the pieces in this special issue makes an important contribution to our knowledge on MNEs in the Middle East.
The opening paper by Demirbag, Apaydin, and Tatoglu examines survival of Japanese subsidiaries in the Middle East. The paper's arguments evolve around concepts of economic distance, freedom distance and subsidiary density. The Middle East provides a unique opportunity to test economic distance and freedom distance dimensions’ impact on performance of subsidiaries. This paper adopts both institutional and transaction cost perspectives in identifying factors affecting survival of Japanese subsidiaries in the Middle East. Demirbag et al., argue that the level of development of market supporting institutions have an impact on survival of MNEs' subsidiaries. Based on these findings, the authors argue that foreign investors may find it beneficial to hedge their risk of entering countries with high economic freedom distance by handpicking those where a solid network of their compatriot subsidiaries has been established.

Cuervo-Cazurra paper focuses on non-sequential internationalization of firms from the Middle East. The non-sequential model provides an alternative explanation of the selection of the country in which to start internationalization. The author argues that a firm may develop knowledge in its home operations that is useful for its international expansion, helping it to select a non-sequential internationalization. The main message that comes out of this empirical study is that heterogeneity in the knowledge base of the firm prior to internationalization is a key factor. This paper develops a critical analysis of how knowledge and different types of knowledge influence the firm’s internationalization. Cuervo-Cazurra further argues that the firm can follow a non-sequential internationalization and enter countries that are very different from its home country for its first expansion abroad.

Yaparak and Karademir propose a new perspective for MNEs from developed countries entering emerging markets. The authors use case examples of Turkish MNEs’ cooperation with developed country MNEs to enter both the Middle Eastern and Central Asian markets. Their conceptual arguments focus on developed country MNEs' co-operation with third countries (an emerging market MNE) or learning achieved by developed country MNEs from developing country MNEs to operate in turbulent environments.

Kirca’s paper examines the association between market orientation strategies and performance of the subsidiaries of MNCs located in Turkey. The paper develops a framework for the link between market orientation and performance in the Middle East. Using data collected from managers of subsidiaries of MNCs located in Turkey, the paper shows that market orientation has a significant positive relationship with performance and this relationship is moderated by subsidiaries efforts to satisfy and retain customers.

Forstenlechner and Mellahi’s paper examines the process of cultivating external legitimacy through the employment of host country nationals by MNEs affiliates in the United Arab Emirates. The study reveals that in while a minority of MNEs employ locally because of the sense of appropriateness, most MNEs do so to obtain economic rents from government institutions. The study shows that peer pressure exerts a significant influence on the adoption of localization, as MNEs tend to benchmark themselves against each other. Interestingly, the study reports that MNEs do not appeal to the wider public, but perceive the government as the only body that can confer legitimacy.

Soltani and Wilkinson’s paper examines international assignees’ perceptions and experiences in a sample of Iranian-based MNC affiliates in high growth sectors. The study sheds light on the forces that affect the performance of international assignments and HQ-subsidiary relations in Iran. The study found that international assignees’ perceptions of managing an MNE affiliate in Iran was often formed prior to their departure ad their performance is strongly linked to the level of congruence between HQ and assignees’ managerial orientation. Interestingly, the paper reports that performance tends to deteriorate when assignees are requested to conform to HQ policies and practices.

Jallat and Shultz’s article considers management lessons for MNEs in the tourism sector in the Middle East. This interesting case study provides an in-depth insight into crisis management strategy of InterContinental Phoenicia hotel in Lebanon. The authors highlight four key learning points, namely rehearsal of preparations, standardising procedures, leveraging parent company resources and knowledge, and managing MNEs’ culture vi-à-vis national culture of the host country. The authors also highlight complexity of stakeholders’ network in the Middle Eastern context and challenges of crisis management in a very turbulent environment and suggest that the stakeholder network in Lebanon (and in the Middle East more generally) is complex – sometimes cooperative, sometimes adversarial – and hence plays a crucial role in crisis and recovery.

We are indebted to a number of people who helped bring this project to fruition. We are deeply grateful to the editors of the Journal of World Business for providing us with the opportunity to edit this issue. We are indebted to the reviewers for their useful suggestions and critical remarks. Finally, we thank the authors for providing us with stimulating and insightful papers. The seven papers included in this Special issue, what we think are, some of the key issues facing MNEs in the Middle East. However, this is just a start and more research is required to understand fully the challenges facing MNEs in the region. We hope that the articles in this special issue provide a foundation for future research on this important region.

References


2 Reviewers for the special issue: Meghna Ayyagari, the George Washington University; Muzaffer Bedur, Boğaziçi University; Tamer Cavusgil, Georgia State University; Simon Chadwick, Coventry University; Reid Cick, the George Washington University; David Collings, NUI Galway; Wade Danis, Georgia State University; Pauline Dibben, University of Sheffield; Esra Gencuruc, Koc University; Kate Gillespie, The University of Texas at Austin; Keith Glaster, University of Sheffield; Erdener Kaynak, The Pennsylvania State University; Daniel Laufer, Yeshiva University; Xiaohui Liu, Loughborough University; Andy Lockett, University of Nottingham; Mehdi Majidi, American University; Martina Mcguinness, University of Sheffield; Alex Mohr, University of Bradford; Pari Namazie, Atieh Roshan Consulting; Jennifer Oetzel, American University; Daragh O’Reilly, University of Sheffield; Noel O’Sullivan, University of Sheffield; Linda Hui Shi, University of Victoria; Jennifer Spencer, the George Washington University; Po Sun, Fudan University; Ekrem Tatoglu, Bahçeşehir University; Erik Thun, Oxford University; Adrian Wilkinson, Griffith University; Geoff Wood, University of Sheffield; Sibel Yamak, Galatasaray University; and Yi-Ying Chang, University of Abertay Dundee.


