



PodCast e-Memo 1

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January 30th, 2009

The Dubai Economic Challenge

Dubai is generally known for its Tennis Challenge's tournaments, its Golf and Rugby Challenges, but today its having to deal with a challenge of a very different nature. A challenge resulting from the result of the collapse of the global credit markets resulting in a cascading negative effect on Dubai's real estate markets.

Let me try to first explain the problem in very simple terms. The cornerstone of Dubai's economic activity for the last 3-4 years was real estate. Let us assume that the value of this real estate was \$300 Billion. Now everybody played these real estate market from professionals, to businessmen, to businesses seeking short term windfall profits, to the real estate developers. And all of these players had leveraged themselves with domestic banks or international banks or investors. Additionally local banks often got their liquidity from international credit markets. When those collapsed, liquidity collapsed and this resulted in a collapse of credit within the UAE, and in turn the real estate markets. Additionally this market was dominated by speculators, not occupiers, and therefore when the speculators left, the real estate markets got significantly hit. So, no short term liquidity and no demand. I must also remind those that take comfort in saying the real estate is safe because it is a physical asset – well, true if the assets were physical. Remember a lot of the real estate investments were made in projects off-plan – so the actual asset does not really exist.

So what happens now? For one, I think people are underestimating the challenge, and many will soon find their business in grave financial trouble. Creditors will not pay up, and lines of credit that one assumed existed, will no longer exist, because the banks themselves have a liquidity crunch. If firms don't act quickly, they will simply miss payroll, and their survival will be in doubt.

So there is action required both at a company level and at the government level.

At a company level, they need to start slashing cost immediately, and unfortunately that means headcount. If 30%-50% of the transactions have disappeared it simply means that headcount needs to go with its associated cost. Release the headcount in a humane way with 90 day notice period. Its is better to do this than not doing it at all. Then start running financial sensitivity analysis on your cash flow. Assume half your bank limits have disappeared, 30% of your customers will default, and your growth will be flat. By hook or by crook ensure your cashflow positions hold. And be forward looking. One has to assume for the short term the opportunities nearer to home may be limited and that there is markets that have oil and gas wealth like Qatar and Abu Dhabi, where there is local liquidity and where there is still latent demand building. Therefore the strategy will now need an international component with the corresponding skills internally. Also have the guts to shut down business or plans that are no longer viable.

And what should the government do? For one, it will need the Central Bank to pump liquidity into the system. Without that everything will be frozen. Secondly it will need to bail out the real estate sector in some way. That doesn't mean that every single real estate company will need to be supported, but no half complete buildings should dot the skyline. Consolidation & acquisition of the right firms should be allowed. Many will go under and they should be allowed to. Finally lessons from this experience must be learnt. Don't assume that leverage is perpetual and will always be there. Be careful of expanding too quickly without proof of concept. Balance between attracting opportunist and creating genuine demand. And lastly build an economy on a three legged stool, not on one, so it is stable for the long run.

Dubai has always been a land of opportunity. It has always welcomed people from most countries with open arms creating opportunities for business, personal wealth and professional development. If businesses and governments act on some of the points I have made today, the future will remain bright. However lessons must be learnt. Remember it's not about winning and succeeding in the short run. Nation building is a long term exercise.