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INSIDE VIEW: Nothing ventured, nothing gained



As Middle Eastern start-ups Souq.com and Careem make headlines, venture capitalists in the region anticipate rapid growth.

Philip Dowsett of Morgan Lewis assesses the opportunities and challenges.

In recent years, Dubai has become the Middle East and North Africa (MENA) region's jurisdiction of choice for the start-up and venture capital industry. Over the past few years, Dubai has promulgated many efforts to cement this status. According to a recent report, the UAE leads the MENA region as home to 42% of its start-ups, followed by Egypt with 12%, Lebanon 9% and Jordan 8%. However, a number of other MENA countries are launching similar initiatives to try to capture a portion of this fledgling market. In the past year, Saudi Arabia launched ambitious

plans in the country's 2030 Vision programme to depart from being an oil-dependent economy and encourage female participation in the workforce. It has also made a \$3.5 billion investment into a US tech company [Uber]. Oman has launched the country's first equity-based venture capital firm, Innovation Development Oman Holding, with initial capital of \$129 million, and the Oman Investment Fund has launched its \$200 million 'Oman Technology Fund'. Meanwhile, the Qatar Development Bank has launched a \$365 million 'SME Equity Fund' to provide capital to innovative start-ups and entrepreneurs. The venture capital industry is an established industry in the West, with venture capital investment in the US last year totalling around \$58.6 billion and in Europe \$16 billion. In MENA, the sum stands at around \$800 million. The MENA region is playing a challenging game of catch-up. Nevertheless, in the past decade, progress and achievements are notable.

Seeking unicorns

The rise of venture capital in the Middle East has primarily been led by protagonists such as Wamda Capital, STC Ventures/Iris Capital, Middle East Venture Partners and Beco. Although most of the activity has been from MENA-based investors, there has recently been increased interest from foreign investors too. Transactions include: Series A and B investments in Fetchr, which attracted interest from Silicon Valley venture capital firms; the Series A investment by Russian venture capital firm AddVenture in ServiceMarket (formerly MoveSouq); a majority European-based investment in Sprii (formerly Mini Exchange); and, of course, the recent high-profile buy-out of Souq.com by Amazon. For many tech-based start-ups, locality and operational bases are flexible compared with traditional asset-based business. In addition, there are attractive tax-free opportunities in basing an operation in a MENA country. One may question why the MENA region has not attracted more start-ups. Reasons include:

- Operations in the MENA region are not without their hurdles. Although operating across state lines in the US and across Europe means managing different laws and regulations, there are numerous synergies and similarities. However, in MENA, operating across the region often involves grappling with laws and regulations that are generally more simplistic in their nature and often have yet to modernise to address technology businesses, resulting in ambiguities and uncertainty around operations. There are often complex issues relating to foreign ownership (which differs in each country) as well as varying demographics.

- The ownership issue. A number of Gulf Cooperation Council (GCC) countries require local ownership, and this can be a struggle for foreign investors to get to grips with. On the positive side, several such countries have 'free zones' affording 100% foreign ownership, which circumvents this concern, but, depending on the nature of the business, sometimes an 'onshore' company in the same country is required, which then requires local ownership (and structuring appropriately to protect the assets).

- We need a unicorn (or two). In the same way that proof of concept is often vital in a start-up, MENA needs headline-grabbing deals and exits to legitimise its standing. The Souq.com exit and the recent \$100 million investment by STC in

Careem (MENA's answer to Uber) suggests the region is making progress.

- The cost issue. Setting up in the GCC can be more expensive than doing so in Europe and the US. However, there are more cost-efficient options, including establishing in Egypt, Jordan or Lebanon. That said, it is not uncommon for start-ups from these countries to look to relocate their headquarters to Dubai when finances permit.
- Geopolitics and negative press. Unfortunately, one thing holding back investment in the MENA region are negative headlines which have, in the past, had the tendency to overshadow the successes, growth and increased stability throughout much of the region.

Challenging

The MENA region is not Silicon Valley. One of the challenges as a start-up in the region is the lack of transparency over financing terms and investment criteria, as well as the difficulty in obtaining information on potential suitors for investment. Because of the limited number of deals, benchmarking terms is difficult. There is also no real access to the same reports or insight into financing terms that can be obtained by start-ups in the US and Europe. The MENA Private Equity Association has sought to address this problem and provide more visibility on structures, terms and investors; however, information is still difficult to obtain. Consequently, venture capital investors are often in a stronger negotiating position in the MENA region than elsewhere. Investors hold most of the cards and know how to play them. On the positive side, many of the principals working for the leading venture capital firms in the region are sophisticated and seasoned, and with the advent and maturing of the venture capital industry in the MENA region, these individuals and firms have endeavoured to adopt best international practices and proper documentation to ensure the MENA region can compete from a sophistication perspective. The venture capital industry is quickly becoming an industry in its own right in the region. Concerted efforts have been made by governments to foster an entrepreneurial spirit and accommodate start-ups. Based on the past few years and the plans of various governments, the region is positioning itself to capture its own share of the venture capital market. It will be interesting to see if anyone can topple Dubai from its pedestal as the home of MENA venture capital.

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