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Conquering the UAE through a successful market entry strategy

Hydrocarbons, new technologies, building and civil engineering works, but also luxury tourism, renewable energies or agribusiness, the United Arab Emirates (the "UAE") offers tremendous business opportunities for companies and such opportunities are enhanced as a result of the currently pursued policy of economic diversification[1]. In the UAE, generated profits are net of taxes and natural persons and legal entities are not subject to income tax and corporate income tax[2].

Yet, there is good reason not to rush into this highly competitive market which lies at the crossroads of Europe, Asia and Africa. Haste could lead an investor to opt for an expansion strategy that seems the fastest to implement, but that may be implemented in the wrong place, with a partner that does not meet the investor's expectations or through an inappropriate business structure.

Entering the UAE market must be a mature decision and the local factor must be carefully taken into account.

The UAE is assuredly a prime destination for business, but only if there is a clear-cut market entry strategy. There exist two main routes to the UAE market: direct export (1) and establishing a physical presence on the market (2).

1. Direct export: The UAE agent

In order to test the UAE market, foreign companies may directly appoint a local commercial agent. This solution can be used to limit investment costs while maintaining a pivot structure in the Middle-East. In addition, it is important to have a local contact as the UAE have a trade culture where face-to-face contact is essential. Long-distance business relationships are hardly conceivable. That being said, a good knowledge of the protective status granted to commercial agents is required.

The commercial agent must be a UAE national or a company fully owned by UAE nationals. Under applicable law, commercial agents may register their contract with the Ministry of Economy, in which case, they automatically benefit from a number of rights:

- Exclusivity: They have the exclusive right to import the products covered by the agency agreement and the ability to block the principal's exports that are not shipped to them;
- Commissions: They are entitled to receive commissions not only on the sales they make but also on the sales that are not made by or through them, even if such sales are directly achieved through a third party;
- Termination: They are entitled to receive an end-of-agreement compensation, even if the termination occurs as per the contractual provisions agreed upon by the parties, in case of non-renewal or termination of the agency agreement without due cause[3].

2. Establishing a physical presence on the market: Taking the local factor into consideration

The creation of a local business entity in the UAE is valuable because it enables to be in direct contact with the local clients and to better assess their preferences. Market proximity favors the appropriate adjustment of products or services. However, entering the UAE market is not an easy thing given local specificities that must be taken into account by foreign investors.

2.1. Representative office and branch

Foreign companies may conduct their operations in the UAE through a branch or a representative office. The difference between these two legal structures lies in the fact that a branch may carry out the business activity for which it has obtained a license while the representative office may only engage in the marketing and promotion of the products and services of its parent company. As such, a representative office is not entitled to enter into commercial transactions or sell products in the UAE.

It should be noted that both the representative office and the branch are required to appoint a local services agent who must be a UAE national (and who benefits from the same protections as the commercial agent, apart from the payment of commissions as the local service agent is not engaged in any business activity).

2.2. Companies

The main feature common to all types of UAE companies[4] is that foreign investors who intend to create a local NewCo may not hold more than 49% of the capital of such NewCo; the remaining 51% must necessarily be owned by one or several UAE national(s).

Inevitably, this prompts the question of how to choose the local partner, also called "local sponsor". Business activities that require little assistance will lead foreign investors to choose a local sponsor who is not pro-active or "dormant". Conversely, the choice of an active and dynamic partner should be made on the basis of the potential partners' influence and network, not only within the Emirate in which the NewCo is set up but also in the other Emirates, which can provide a real added value to foreign investors.

The obligation imposed on foreign investors to assign to the local sponsor a 51% interest in the NewCo does not preclude the insertion of specific contractual provisions in the by-laws and shareholders' agreement. As such, the local federal law does not forbid the possibility to provide in the by-laws that only the foreign shareholder shall be entitled to appoint the managers, to veto the most important decisions of the NewCo, to receive the monies derived from the winding up of the NewCo and, most import in practice, to receive more than 49% of the distributed profits. As such, in practice, it is acceptable in the UAE that the foreign shareholder receives up to 85% of the distributed profits.

It should be noted that an overhaul of UAE corporate law has been announced and discussed for many years and could result in foreign investors being entitled to own more than half of the capital, if not 100%, of a local company or to limit, depending on the business conducted, the number of companies in which 51% of the capital must be held by a local sponsor. Yet, at the time being, this political will has not been translated into a law.

2.3. Free trade zones

Every single Emirate offers to foreign investors the possibility to set up operations in a free trade zone. There are currently about 30 free trade zones established in the UAE. Foreign investors who elect to set up in a free trade zone may incorporate a wholly-owned entity and avoid having to contract with a local sponsor. They benefit from an exemption from all import and export duties, full repatriation of profits and capital is expressly permitted and there is no exchange control regulation.

However, companies set up in a free trade zone being considered as "*offshore*" companies, they may not conduct business on the territory of the UAE and can have business relationships in the free trade zone only. As a matter of fact, free trade zones have been established to group activities and create competitive clusters.

If foreign investors want to expand beyond their free trade zone, they will be subject to UAE corporate law, have to create a legal structure where they must deal with a local sponsor.

3. Recommendations

When devising a strategy to enter the UAE market, foreign investors must mature their decision, avoid taking hasty actions and clarify any concerns. Indeed, depending on the selected route, they will not enjoy the same room for maneuver. It must be kept in mind that, outside free trade zones, UAE law imposes the presence of a local sponsor within the NewCo. As such, it will be necessary to determine the type of investment (direct export vs. local presence) and its geographical location (within or outside a free trade zone) before getting ready to conquer the UAE.

[1] The UAE is diversifying its economy and preparing for the post-oil era. Through the Abu Dhabi 2030 project, this Emirate wants to further sectoral diversification and promote the emergence of several business sectors. This offers opportunities for investors and entrepreneurs wishing to expand internationally.

[2] Only oil, gas and petrochemical companies and branch offices of foreign banks are required to pay corporate income tax in the UAE.

[3] To terminate or not renew the agency agreement, the foreign principal must prove the existence of misconduct/breach by the commercial agent.

[4] The most common form of corporate vehicle used by foreign investors in the UAE is the Limited Liability Company.