

**INVESTMENTS AND VERTICAL INTEGRATION - CATALYST
FOR DEVELOPMENT IN THE OIL INDUSTRY OF AN EMERGING MARKET:
THE CASE OF REFINING IN KUWAIT**

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This paper explores the possibilities of investment in the oil sector of a developing market and elaborated the advantage of vertical integration in a market where secondary raw materials are in shortage. I study a detailed of investment appeals and values that matters in investing. I argued that relevant business plans, based on vertical integration would create opportunity for FDI investment in Kuwait, where industrial development has always been faced by formidable obstacles including poor resources, which limits the manufacturing industries. I document that investors, are more selective in choosing company to invest in, mostly influenced by on values which are in no way in direct relationships with the financial performance. I hypothesize that this selection is caused by the modern market trend, where changes is the order of the day and competitiveness, R&D and excellent management strategy are important to adapt to these continuous changes. In line with this hypothesis, I document that to address the problem of labor force, necessary intellectual assets plans need to be researched; this I argue can help provided an avenue for expansion and greater productivity or profitability, thereby appealing for more FDI in Kuwait.

The modern trend of development in the world is characterized by globalization; it covers practically all the basic aspect of public affairs, it is accompanied and portrayed as unavoidable and irreversible process which is expanding and has complicate the economic interrelation and interdependence of different countries . A Crucial moment is that linked with factors which are capable of controlling such spontaneous process, bringing into them elements of orderliness and that of task-oriented. Industrial development in Kuwait has always faced formidable obstacles. Kuwait, so rich in oil, is poor in most other resources, which limits the manufacturing industries that can be established. No metallic minerals and few suitable nonmetallic minerals are locally available. Most raw materials for the early industries--for example, cement--had to be imported. The limited supply of fresh water is another constraint. In a country without streams and with few underground sources, water is crucial to industrial development. The pre-oil system, where local sailing boats carried water from Iraq to Kuwait, could not meet manufacturing needs. The small size of the domestic market restricts production for local consumption to small-scale operations. The open economy, which was maintained before and after the discovery of oil, provided little protection from foreign competition. The small Kuwaiti labor force, possessing limited

skills, is another constraint. After the discovery of oil, labor costs escalated, and in a few years wages in Kuwait were higher than those in almost any other area of the Middle East, further hindering industrial development. Also, the commercial tradition in the country predisposes most entrepreneurs to invest in trade rather than manufacturing. As a result of these obstacles, industry, excluding oil-related industry, expanded very slowly. The Kuwait economy is relatively small with 2004 GDP being approximately USD 53 billion. Kuwait's primary export is oil; however it imports almost all capital equipment, agricultural commodities, processed foods, manufacturing equipment and consumer goods. Kuwait two-way trade is not very diversified with Kuwait exports to the United States, Japan and Korea accounting for over 40% of all Kuwait export earnings. Likewise, the United States, Germany and Japan account for approximately 35 percent of all foreign imports to Kuwait.

The discovery of oil in 1938 by Kuwait Oil Company (KOC), a London-based joint venture of the Anglo-Persian Oil Company (now BP) and Gulf Oil (now Chevron Corporation), under a concession granted by the then Amir of Kuwait, Sheikh Ahmad Al-Jaber Al-Sabah created a demand for new industries, initially satisfied by the oil company itself. Oil operations particularly needed water, electricity, and refined petroleum products, and these were the first modern industries created in the state. The government took over production of water and electricity, expanding the systems and subsidizing their use. Air conditioning provided the largest demand, with peak summer loads more than five times minimum winter loads, creating substantial idle capacity for about six months of the year. The need for larger and more regular supplies of water, no matter how costly, compelled KOC to install the first desalination plant. In 1953 the government installed the first unit, which had a capacity of 3.8 million liters per day. Subsequently, the government claimed that it had developed the most advanced continuously operating desalination facilities in the world [1].

Although oil spurred the first industries in Kuwait, after the initial push, oil did not generate much in the way of new industries locally. As a result of the many obstacles that industry faced and in light of the massive oil revenues, the government began to play a major role in all industrial development. The government undertook some efforts at diversification in the 1950s, but the first major push for industrialization occurred with the

establishment of the Ash Shuaybah Industrial Zone in 1964. The zone comprised electricity and water distillation plants, expanded port facilities, metal works, and plants manufacturing chlorine, asphalt, cement, pilings, and prefabricated housing. The government provided such necessary facilities as roads, gas, electricity, water, sewerage, port facilities, communications, and rented or leased industrial sites at nominal rates. Most of the larger industrial facilities were located in the zone. Other small manufacturing establishments were located in the populated parts of the country.

The government provided a range of incentives to private manufacturers who were predominantly local 51 percent Kuwaiti ownership was required of all businesses. In addition to infrastructural support, financial aid included equity capital and loans. In 1974 the government created the Investment Bank of Kuwait to provide medium- and long-term industrial financing at low interest rates. The government also gave local industry preference in government purchases, protection from imports in some cases, and exemption from customs duties and taxes. In the 1970s, the government's Industrial Development Committee and the Industrial Bank of Kuwait established a number of incentives for private-sector participation, such as technical aid and preferential guaranteed markets in state industry. Nonetheless, industry in Kuwait never enjoyed the same level of state support that it did in other gulf states. The government, having made a conscious decision to invest its revenues overseas and locally in such human resources as education and health care, gave only minimal support, by the standards of other oil-producing countries, to non-oil manufacturing.

Over the decades, extensive developments occurred both in the upstream and downstream elements of the industry: Kuwait Oil Company started refining operations with the Mina Al-Ahmadi Refinery in 1949; Kuwait National Petroleum Company (KNPC) was formed in 1960 as a joint venture between the government and private sector and started operations at the Shuaiba Refinery in 1968; In the meantime, development had also taken place in the Neutral Zone, which Kuwait shares with the Kingdom of Saudi Arabia. The Mina Abdulla Refinery was built as a result of this partnership.

A Short summary of the three major refineries in Kuwait are as follow [2]:

- *Mina Abdullah refinery*: Built in 1958 by the American Independent Oil Company, Mina Abdullah was passed to the Kuwaiti state in 1975 and transferred to KNPC in 1978. Spanning 7,835,000 m², and located 46km south of Kuwait City, Mina Abdullah is capable of refining 240,000 Barrels-per-day (BPD). Mina Abdulla Refinery is supplied with crude oil from the southern reservoirs farm via a pipeline of 24 inch diameter. The refinery contains nos.2 crude oil tanks with a total capacity of 300 thousand barrels in addition to a big number of operations and export reservoirs with a total capacity of approximately 3 million tanks at Mina Abdulla Refinery. The refined products and navy fuel are pumped from the export reservoirs to two docks inside the sea, the diameter of the first is 16 inches for transferring products and the second is 12 inches for transferring marine fuel. This pier is capable of filling tankers with load limit above 100,000 tons at a rate of 8000 barrels per hour. As for the second pier, it is approximately 3 miles away from the coast with water depth of 60 feet. It is connected with the pumping station on the coast via two submerged pipelines, the diameter of the first is 24 inches for transferring products and the diameter of the second is 12 inches for transferring marine fuel. It has a capacity for filling tankers with load limit of 150,000 tons at a rate of 18000 barrels per hour. An artificial island was built for shipping the products of Mina Abdulla in 1988, 5 kilometers away from the coast, supplied with two piers to receive and ship marine tankers with load limit ranging from 25,000 tons to 270,000 tons. Products are pumped through six submerged lines with diameters ranging from 12 to 24 inches.
- *Mina Al-Ahmadi refinery*: Initially built in 1949, the refinery was handed over to KNPC in 1980. Spanning 10,534,000 m², it is located 45km south of Kuwait City with a production rate exceeding 415,000 BPD. Ahmadi Refinery is supplied with crude oil from the southern reservoirs farm in Ahmadi via a pipeline of 24 inch. The refinery includes 3 reservoirs for crude oil with a total capacity of 600 thousand barrels approximately, in addition to a big number of operations reservoirs and

export reservoirs with a total capacity of around 6 million barrels. Refined materials produced by Ahmadi Refinery are exported via Mina Ahmadi through its northern and southern docks.

- *Shuaiba Refinery*: Built in 1966, Shuaiba Refinery was the first refinery in the region to be built by a national company. The refinery spans 1,332,000 m² and is located 50km south of Kuwait City within the Shuaiba Industrial Area. The refinery has a capacity of 195,000 BPD. Shuaiba Refinery is supplied with crude oil from the southern reservoirs farm in Ahmadi via a pipeline of 24 inches diameter. The refinery contains one reservoir for crude oil with a capacity of 229,100 barrels in addition to 68 tanks for refined materials with a total capacity of 10,7 million barrels at Shuaiba Refinery. There is also two pipelines of 23/24 inches diameter connecting Shuaiba and Ahmadi refineries for treatment and export of some refined materials produced by Ahmadi refinery at Shuaiba refinery units. Refined materials produced at Shuaiba refinery are exported through Mina Al Shuaiba at rates ranging from 500 tons per hour up to 150 tons per hour. These materials are transferred via ten lines with diameter ranging from 8 to 16 inches to the oil pier at Mina Shuaiba consisting of four docks, two external docks with depth extending to 35 feet and the other two are internal with depths up to 40 feet. The shipping pier has a capacity with tankers with 50 thousand to 100 thousand load limit.

The three refineries are connected with each other via a network of pipelines to exchange and transfer petroleum products among them in order to achieve the required flexibility for the operations.

KNPC has released plans to build a fourth refinery and is currently searching for international firms to design and construct it. The refinery is expected to have a capacity of 615,000 bpd, making it the largest refinery in the Middle East.

Throughout the 1980's, expansion and integration occurred continued as in the domestic operations all exploration and production operations fell under the command of KOC. In addition, KNPC assumed responsibility of Kuwait's three largest refineries. This allowed each company to specialise in its own field.

The operation of KPC in the Foreign Downstream Operations has been significant between 1983 and 2004, as it acquired most of Gulf Oil's refining and marketing operations in Western Europe. Airport refuelling operations throughout Western Europe and Hong Kong were also expanded. Today, Kuwait Petroleum International (KPI) established in London to manage expansion interests, today markets approximately 301,000 barrels of products per day in Western Europe with an additional 90,000 barrels per day sold directly from its two refineries through more than 4,000 retail stations, and operates its own refinery in the Europoort and Milazzo [3]. The company is also looking into further international expansion in the near and Far East, these would boost the oil sector of the Kuwaiti economy.

As it is well defined, Investment is the use of money to compensation for the old and the creations of new production capacity leading to capital growth, also as an asset or item of value that is purchased to generate a profit at some future point or use for maintenance and creating increment of basic capital for a certain period.

For a company to satisfy its consumers, upgrade its production technology and survive against global competition, additional investment resources is inevitable.

The main sources of investment are depreciation charges, financial institutions, local services, government and the foreign sector. In the State of Kuwait, there are three specialized government-owned banks providing medium and long-term financing. The Industrial Bank of Kuwait offers financing for industrial and agricultural related projects. The Kuwait Real Estate Bank offers financing of residential and commercial property developments. The Credit and Savings Bank acts as a type of loan agency for the purchase of single-family or multi-family residential units [4].

An important role is played by the interrelation between the tax system and an amortization policy in the advance investment sector in the economy of majority of the industrially developed countries, as they stimulate accelerated amortization. In the early 90', the shares of amortization allocation in gross investments were (%): Japan - 50, Germany -64, USA -70.

The most essential factor at the moment, influencing the process of enterprises mobilization of its own sources of financing innovations is determined by the size of

amortization allocation. As is known, the evaluation of the size of amortization allocation, depends on the approaches used for the determination of the composition and amortized cost of properties, a methodology used for the reference of this property to this or that amortization group and an established procedure for the estimation of amortization's sums [5].

A key novation is the provision of opportunity for the enterprise, by using two methods for accrued amortization - linear and the accelerated amortization. Linear method is a monthly sum of amortization allocation, calculated by multiplying the rate of amortization and an initial establishment cost. The rate of amortization (a) is calculated using the following formula:

$$a = [1/T] \times 100 \%,$$

where T - period of useful utilization of the object of amortized properties.

While accelerated amortization is concern with the monthly sum of amortization, calculated by multiplying the norm of amortization with the residual amortization properties, represent itself as the difference between the initial establishment cost and the sum accrued amortization. The formula used for calculating the rate of amortization is:

$$a = [2 / T] \times 100 \%$$

Having are wide range of opportunities of the allowances cost for amortization property, the enterprise can plan a more flexibly strategy for the realization of innovative projects , with a perfect view of the operation specific of the concrete market, moral and physical deterioration of the available fixed funds and the actual earning capacity of their business.

It is necessary to note that, the growth opportunities of an enterprise on its self-financing innovative activities depends on the efficiency of the tax reform, of which the key task is the elimination of deficiency of tax system, which is mainly focused, on the realization of its fiscal function to the detriment of function stimulating foreign capital that have diversified influence on economy of the host country.

The imported capital will replace the internal sources of financing investments. The importation of capital in any forms would provide an inflow of assets, this on its own side

would promote the credit scope of a country. Its influence on a reduced interest rate of bank credits serves as an additional stimulus for internal investments.

Objectively, foreign capital cannot function as a self-increasing cost, without setting in motion the local productive forces, which serve for manufacturing, in the first instance as a fixed capital. In this case foreign investments are capable of increasing production efficiency and expanding the commodity markets, brought about by an increase in the level of technology and a return in labor assets (through renewal of outdated machinery and equipment, implementing modern technologies and adaptations to the requirements of the world market), and also an improvement in the organization and production management, profound marketing researches and application of industrial logistics schemes.

By far the more favorable way of getting required financing for any commercial organization is by attracting individual and investment organizations. Private investors are those who invest their monetary resources either on a short-term basis; or even more, in higher-risk projects, because they are generally looking for a longer-term investment. Such investors are typically wealthy individuals or, as is now often the case, a group of such people investing through a structured arrangement. Investment industries are credit and financial institutions, which operate with capital issues (Commercial and investment banks, insurance company, investment and pension funds, etc.) [6].

In the present day, majority of commercial organizations in developing countries wholly depend on bank credit as the only additional source of financing. The banks tend to be the first port of call for these organizations, and the types of lending they can supply are very flexible. If an organization does need to invest in compliance-led upgrades to facilities, banks are the preferred options. They may not, however, always be interested in high-risk, high-rewarded scenarios. Banks are particularly good for short-to-medium-term funding, so therefore in order to attract additional funds, a company must possess a high investment appealing force, sufficient enough to convince investors to invest their financial resources. The Gulf Investment Corporation (GIC) with its headquarters in Kuwait was established by the governments of the Gulf Cooperation Council (Bahrain, Kuwait, Saudi Arabia, Qatar, Oman and the UAE). The GIC is a multi-service financial institution. Its primary objective is to offer a wide range of financial services to both corporate and private

investors. The GIC offers portfolio management, financial advisory services, bond and equity issues, direct investment support and capital market activities. Investment is focused on manufacturing, agriculture, industrial services and minerals exploration [7].

As well known, Foreign Direct Investment (FDI) is the movement of capital across national frontiers in a manner that grants the investor control over the acquired asset. In this view point, it would be quite suitable to classify the Kuwait economy as a transition economy, as its investment and petroleum policy provides maximum advantages for foreign investors.

Most West Asian economies are progressively easing laws and regulations relating to FDI, in line with efforts to diversify away from oil. They are also strengthening FDI incentives. Liberalization of FDI applies particularly to non-energy sectors that have been experiencing an intraregional investment boom. Over 90% of policy measures introduced in West Asia at the national, regional and multilateral levels were favorable to foreign investors. The Kuwaiti Government is also planning^A to reduce corporate tax rates from 55% to 25% to attract FDI in non-oil industries

Inflows of foreign direct investment (FDI) were substantial in 2005. They rose by 29% – to \$916 billion – having already increased by 27% in 2004. Inward FDI grew in all the main sub-regions, in some to unprecedented levels, and in 126 out of the 200 economies covered by UNCTAD. Nevertheless, world inflows remained far below the 2000 peak of \$1.4 trillion. Similar to trends in the late 1990s, the recent upsurge in FDI reflects a greater level of cross-border mergers and acquisitions (M&As), especially among developed countries. It also reflects higher growth rates in some developed countries as well as strong economic performance in many developing and transition economies [8].

Based on the report, a new feature of the recent M&A boom is increasing investment by collective investment funds, mainly private equity and related funds. Unlike other kinds of FDI, private equity firms tend not to undertake long-term investment, and

^A *Legislation is expected to be passed by mid-2007, enabling Project Kuwait, a \$7 billion plan to encourage foreign investment and development of oilfields in northern Kuwait, to start in the first half of 2008 (EIU2006b). There is no corporate tax for Kuwaiti nationals.*

exit their positions with a time horizon of 5 to 10 years (or an average of 5-6 years), long enough not to be regarded as typical portfolio investors.

FDI inflows into the 14 economies of West Asia soared by 85%, the highest rate in the developing world in 2005, to reach a total increase of about \$34 billion. High oil prices and consequently strong GDP growth were among the main factors that drove this increase. In addition, the regulatory regime was further liberalized, with an emphasis on privatization involving FDI notably in services: for instance, power and water in Bahrain, Jordan, Oman and the United Arab Emirates, transport in Jordan, and telecommunications in Jordan and Turkey. The United Arab Emirates collectively received inflows of \$12 billion, to become the largest recipient of FDI in West Asia in 2005. FDI inflows in West Asia have gone mainly into services, including real estate, tourism and financial services. There is also increasing FDI in manufacturing, especially in refineries and petrochemicals, though there is little FDI in the primary sector, as most West Asian

Countries do not permit it in upstream activities in the energy industry. It was stated in the report that, West Asia is becoming a significant outward direct investor. Traditionally, most of the region's petrodollars have gone into bank deposits and portfolio purchases abroad, particularly in the United States. This is changing in both form and location. Unlike the previous periods of high oil revenues, the present phase is witnessing substantial outward FDI in services, in developing as well as developed countries. One motivation for this has been to forge stronger economic ties with the emerging Asian giants, China and India, but investment has also gone into Europe and Africa. Deals such as the above-mentioned acquisition of P&O by DP World, and the purchase of Celtel International (Netherlands) by Kuwait's Mobile Telecommunications illustrate this trend. Notable cases of South-South FDI include the purchase of a 25% share by Saudi Aramco in a refinery in Fujian, China, and a possible Saudi equity partnership with India's ONGC in a refinery in Andhra Pradesh, India.

However, based on the report, Kuwait was classified as a High FDI potential country with a Low FDI performance unlike UAE which is in the same potential group but aiming a High FDI performance. Here by Kuwait has not been a favorite location for top

100 TransNational Companies (TNC), though prospects for FDI point to a new growth in 2006.

Moreover, three oil exporting countries, Kuwait, Saudi Arabia and the United Arab Emirates, were responsible for 88% of outward intraregional investment during this period. In 2005, outward FDI flows from the region rose to \$16 billion, compared to \$7 billion in 2004.

These trends reflect efforts undertaken by countries in the region, notably since 2000, to diversify their economies and improve the investment climate, liberalize the services sector and strengthen regional integration; example is the Greater Arab Free Trade Agreement^B provides for zero customs duties. The shared language, culture and religion of West Asia have also played a crucial role [9].

In the Sectoral trends, FDI in the Kuwait manufacturing sector has been soaring, notably in the energy-related industries, including oil refining and petrochemicals, bolstered by continuing high global demand. FDI in manufacturing has also been taking place, for instance in textiles, as well as in areas related to oil and gas. In the case of inward FDI, the shift towards services is in response to increasing liberalization and promotion of FDI in this sector, whereas the rise of FDI in manufacturing is mainly in downstream activities (part of manufacturing) since FDI in upstream activities in the energy industries is not allowed in most West Asian countries [9]. The *services* sector continued to attract the most foreign investment in Kuwait in 2005, mainly through cross-border M&As. Continued efforts of Kuwait to diversify its economies and promote FDI further through liberalization and deregulation of non-oil industries, together with booming real estate and financial markets, played a vital role in spurring inward FDI flows to these industries.

The upward trend in inward FDI flows to West Asia is expected to continue in 2006, driven by high GDP growth (forecast at over 5%), ongoing economic reforms and high oil prices. Although recent surveys (e.g. by A. T. Kearney 2006 and JBIC 2006) do not suggest a rush of foreign investors to the region, their business sentiments are likely to remain stable.

^B The GAFTA members in West Asia are Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, the Syrian Arab Republic the United Arab Emirates and Yemen.

Table 1

FDI Flows for West Asia 2003-2005
(Millions of dollars)

Host economy	FDI inflows			FDI outflows		
	2003	2004	2005	2003	2004	2005
Bahrain	517	865	1 049	741	1 036	1 123
Kuwait	-67	24	250	- 4 962	2 528	4 709
Lebanon	2 860	1 899	2 573	611	827	715
Turkey	1 752	2 837	9 681	499	859	1 078
Yemen	6	144	-266
United Arab Emirates	256	359	12 000	991	1 007	6 661
Kuwait	-67	24	250	4 962	2 528	4 709
Lebanon	2 860	1 899	2 573	611	827	715
Oman	489	200	715	153	250	44
Qatar	625	1 199	1 469	-2	192	352
Saudi Arabia	778	1 942	4 628	83	709	1 183

Source: World Investment Report 2006 (WIR06)

From the reports of FDI Confidence Index 2005, more than half of global investors choose R&D investment locations based on three attributes: 52% consider lower R&D costs, 51% the availability and quality of local R&D labor, and 50% view intellectual-property protection as the main factors. The quality of universities and research centers, and IT infrastructure came in 4th and 5th respectively with 46% and 42% respectively. About one-third of investors consider regulatory environment (36%), reputation for creativity and innovation (35%), and the ability to tailor products and services (29%) as the top attributes when considering an R&D investment location. Roughly 28 percent consider market size critical, while 26 percent view government R&D as the most important factor [10].

In the view point of E.I.Krylov, V.M.Vlasovoj and M.E.Egorokvoj's, appealing investment - is an economic category, characterized by effective usage of the companies wealth, payment ability, sound financial position, upgraded technical and economical level of production, qualitative and a high competitiveness in production [11], but these is mostly related to the financial aspect of appealing investment. This assumption is suitable for project based organizations and management entities with capital issues. Nonetheless, this assumption does not cover commercial organizations in which their financial statement plays a lesser role to its venture investment ability. For over the past 10 years, not only financial performance measures are used by investors to evaluate and decide on investments in an enterprise. This situation has created a heightened emphasis on finding new ways to increase performances, which has led to the search for new business models.

We made investigation on how investors evaluate and decide on investments in companies. Decision taken by investor depend on more than financial performance measures alone but also the Intangibles. After surveying a large group of these analysts, we came up with a list of important intangible:

- Strategy Execution
- Management Credibility
- Quality of Strategy
- Innovativeness
- Ability to Attract Talented People
- Market Share
- Management Experience
- Quality of Executive Compensation
- Quality of Major Processes
- Research Leadership

In April 1999, Forbes ASAP magazine, and the Wharton Research Program on Value creation in organizations described the major intangible assets. The team studied how to evaluate non-financial assets and how to create real life, accurate metrics that could be used in routine business by investors, managers, and analysts. In effect, the objective was to separate financial and intangible characteristics and determine how each one was

related to stock value. The study divided companies into durable goods manufacturing, non-durable goods manufacturing, and financial services and attempted to identify what metrics could measure intangible value. Oil companies were included in the non-durable category. The research has shown the following oil company intangible characteristics (in order of decreasing importance) are most correlated to share value:

- Innovation
- Management
- Employee
- Quality
- Brand
- Technology
- Alliances

Analysis showed that both financial and non-financial factors influence stock price to the same degree [12].

This means that while companies concentrate to a large extent on financial performance and the reporting of that performance, investors are linking to other factors in formulating their view of a company's value—like brand value, technology, and innovation. This conclusion suggests that companies should concentrate some effort on communicating their intangible values to investors.

In relationship to strategic planning for development of any Oil and gas exploitation, petroleum refining is a vital plan in the aspect of increasing the production capacity of the company. Such approach correspond to the best practices of world leaders in the Oil and gas sector, where they are oriented not only in exploring crude oil, but in refining and realization of several highly-prized petrochemical products. This is dominant especially in Kuwait where FDI in upstream activities in the energy industries is not allowed. In a new drive to attract investors, Kuwait Petroleum Corporation (KPC) said its long-term upstream and downstream development projects would require an investment of KD16.2 billion (\$55 billion) over the next two decades. Thereby increasing production capacity to 4 million bpd by 2020 from the current output of over 2 million bpd. In order to meet this production capacity, substantial investments will be required. The plans will

require active cooperation of the private sector and international contractors, even as KPC is in charge of the upstream and downstream sectors in Kuwait.

The modern trend of development in the world is characterized by globalization; it covers practically all the basic aspect of every business. Vertical Integration is part of diversification strategy for growth and development that differ from the others. A vertically integrated company is one where the system works as one, not minding the versatile technological processes involved in the effort to control all level of production; it involves exploration of raw materials, transportation, refining and sales. Therefore, vertical integration is an effective business tool of management in the oil and gas sector. In the case of Kuwait, due to the expansion in oil industry operations, KPC was established to bring together under one umbrella the nationally owned companies operating in the fields of oil production, processing and transportation. Kuwait Oil Company's responsibilities under the KPC's umbrella are the exploration, drilling, and production of oil and gas within the State of Kuwait. Kuwait Oil Company is also involved in the storage of crude oil and delivery to tankers for export. Vertical integration, in the refining sector in which one company manages the entire process; from refining the crude product to generating the various petroleum and petrochemical product to transportation and completing the final sales in gasoline stations, has so far been a successful investment model. It has the benefit of reduced production cost, shipping costs and insures oversight over the handling. But it requires large investments by a single entity.

Future plans of Vertical Integration of KPC's which would include the development of other energy source, is securing natural gas imports from neighboring countries in order to satisfy Kuwait's future energy demand, especially in the electricity production sector. The proposed new refinery would primarily supply low sulphur fuel oil to Kuwait's plants. But with the expected import of natural gas into Kuwait, this refinery would be upgraded to an export refinery later [2].

KPC's strategic plans include creating viable investment opportunities for the private sector. This has resulted in the establishment of a new company to assist in the privatization of fuel marketing by running some of the state's local fuel stations.

Here we are hypothesizing that for a future development in the Kuwait downstream sector, Vertical integration between the Upstream production, Gas transportation, Condensate refinery, Ethylene petrochemical plant, Gas marketing and distribution, Power generation and Water desalination project are quite inevitable.

In Kuwait, the problem of labor force and necessary intellectual assets plans need to be researched. Manpower and labor market issues have gained increased prominence in Kuwait over the past few years due to the growing annual influx into the local labor market of Kuwaiti graduates from universities and other institutions of higher education [13]. Given the present structure of the Kuwaiti economy and its manpower requirements, such issues are likely to remain at the top of the policy agenda well into the future. The labor force in Kuwait is composed mainly of expatriates. These represent more than 83 percent of the total, while native Kuwaitis account for only 17 percent of the country's labor force. The structure of the labor force in Kuwait is not ideal, and that is due mainly to such factors as the nature of available jobs, the level of education, required skills, and so on. The greatest challenge currently facing Kuwaiti officials is the question of how to restructure the country's economy so as to render it more dependent on private sector initiative and at the same time expand the participation of Kuwaiti citizens in the labor force. Utilities such as electricity, water and telecommunications engage a large number of Kuwaiti citizens. Revenues accrued in these utilities do not cover more than five percent of running costs, and a sizable portion of the latter consists mainly of wages and salaries. Therefore a number of measures must be considered in order to overcome Kuwait's labor market problems and make it possible for Kuwaitis to seek jobs in the private sector, and more especially in private refining and petrochemical companies.

An important measure would be to restructure the country's educational system so as to enable it to meet the needs of the local private sector and to emphasize the importance of vocational training. Kuwait cannot claim any real development in the future unless it relies on its own labor force. Hence, foreign labor must be systematically phased out in tandem with the restructuring of the country's educational system [14].

On July 9, 2001, the Kuwaiti government announced an ambitious five-year privatization program, the plan outlined a wide range of activities, but with little detail. The

first year called for privatizing some gas station outlets and part or all of Kuwait Airways, which has operated at a loss since 2000. Year two initiated privatization of post office, telegraph, and telecommunication services. Years three and four will complete the telecommunication privatization and initiate the privatization of the Ports Authority and Public Transport Company. The fifth and final year targets the power and water sectors, as well as Kuwait's Petrochemical Industries Company (PIC). The energy and power sector has seen the most progress in privatization. Forty of the 120 government-owned gas stations have been privatized, with plans to privatize the rest in two additional rounds. The outcome will be three competing gas station companies, with gas still subsidized by the government and set in a price range. The government-owned lubrication oils plant was privatized in 2004 as were the coke smelter operations. Kuwait's PIC is now operating a joint private venture with Dow Chemicals called Equate, and the operation has proven to be a successful, profitable model of both privatization and foreign investment. On the heels of Equate's success, Dow and PIC have formed two more ventures which have already been tendered. These efforts are some of the steps the government is implementing to boost the local labor force [15].

Base on Research and Development, there are no specific restrictions on foreign participation in government-financed or subsidized research and development, but little activity of this kind has occurred to date. The Kuwait Institute for Scientific Research (KISR) has expressed interest in working with foreign firms [16]. The government would welcome programs that provide expertise unavailable locally, but these are likely to be evaluated on a case-by-case basis.

Finally, oil market volatility can be reduced by making the necessary downstream investments. Although basically a responsibility of consumer countries and international oil companies, OPEC member countries, both individually and in partnership, have taken the initiative to invest in downstream projects both inside and outside their borders. Between end 2005 and end 2011, OPEC projects, either already under construction, being planned or under consideration, total 5.6 mb/d of expanded refining capacity. The accumulated investment required for the realization of these projects, based on the estimations by the secondary sources, would amount to around \$68.0 billion within the

period from 2006 to 2011. This is part of OPEC's ongoing efforts to ease market volatility and moderate prices to levels consistent with healthy economic growth, particularly in developing countries [17].

The main macroeconomic factor likely to have a favorable influence on such growth in Kuwait downstream sector, while the microeconomic factors include increased corporate profits, with a consequent increase in stock prices that would boost the value of cross-border M&As. Institutional factors including, in particular, the continuing liberalization of investment policies and trade regimes will also contribute to Kuwait investment appeal. Moreover a low inflationary environment is one of the factors that would help to maintain low interest rates and loosen monetary controls in Kuwait's economy. The future path of long-term interest rates in the downstream sector of Kuwait depends on success in maintaining price stability. Moreover, Technological Parks – free investment zone – are needed to attract foreign investors in agriculture, technology, tourism and other non-energy activities.

In conclusion, until the necessary investments are undertaken in the downstream sector of the industry in an emerging economy, volatility is likely to remain a feature of the oil market. It is also important in a market economy that, precise and qualitative researches are been embarked on, not only featuring financial performances alone but also the intangible assets, which play a major role in investors' decision making. Such project as production modernization and construction of petrochemical units with diverse product outputs will enhance the effective utilization of production capacity of the refinery. Implementation of these plans, as well as effective utilization of R&D would generate the needed investment and lead to an increase of FDI in the country, thereby boosting the downstream sector and making it competitive and versatile. Implementation of the necessary investment strategies and the research of intangible assets would provide domestic refiners with additional incentive to increase capacity, even though demand growth for oil products.

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