THE REPORT

Bahrain 2011

ECONOMY
BANKING
INSURANCE
TRANSPORT
ENERGY
TOURISM
REAL ESTATE
TELECOMS & IT
INDUSTRY
CAPITAL MARKETS
CONSTRUCTION
INTERVIEWS

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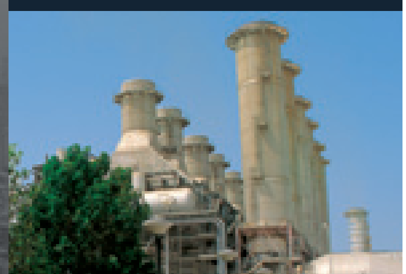

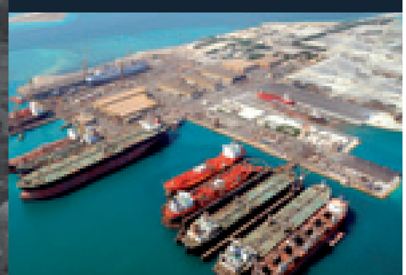

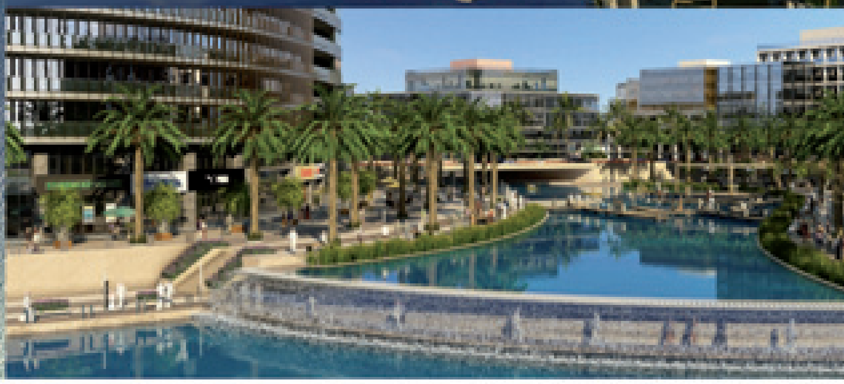

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A solid base

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In recent years Bahrain has increasingly focused on efforts to diversify its economy, reducing its dependence on the extraction of its limited hydrocarbons resources and turning to a model based primarily on services and manufacturing. The government has identified several high-potential growth areas, including finance, IT and tourism, and it is working to increase the role that these sectors play in the economy.

COUNTRY PROFILE

ECONOMY

BANKING

CAPITAL MARKETS

ISLAMIC FINANCE

INSURANCE

Golden opportunity

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As of March 2011, the Islamic banking sector had total assets amounting to \$24.6bn, representing about 12% of Bahrain's banking sector. The country was the world's fifth-largest sukuk market in 2010, with some \$680m of Islamic bonds issued, and the government is encouraging secondary trading of these assets. Diversifying Islamic financial products will be a focus for the industry during the coming few years.

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OXFORD BUSINESS GROUP

Transformation initiative

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After decades of leveraging its reserves to power industry, Bahrain is now working to identify alternative fuel sources. Exploration continues and the Kingdom is even looking abroad for imports, while enhanced oil recovery is expected to boost production at home.

ENERGY

TRANSPORT

REAL ESTATE & CONSTRUCTION

IT

TELECOMS

INDUSTRY

TOURISM

Linking up

Page 105

Creating more effective connections through the expansion of ground, sea and air networks is strengthening Bahrain's role as a regional centre of commerce. Large sums have been invested to upgrade the road network, while the opening of a new port has increased container volumes. The logistics industry is also benefitting from the improved facilities and infrastructure.

Success by design

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Detailed planning and a concerted effort to reduce its reliance on hydrocarbons have seen Bahrain's manufacturing sector expand rapidly. In 2009 manufacturing surpassed oil and gas extraction as a contributor to GDP. This shift is primarily due to the establishment of industrial parks and logistical zones, which offer attractive incentives to investors.

New angles

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Diversification is central to the government's agenda for boosting tourism, and there are plans are in place to promote a range of attractions, including sporting events, meetings and conferences, as well as cultural heritage sites and ecotourism destinations. Hotel capacity is being extended, while infrastructure to support cruise stops is taking place at the ports.

Surging forward

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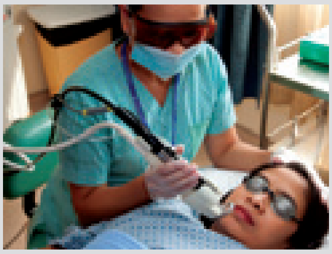
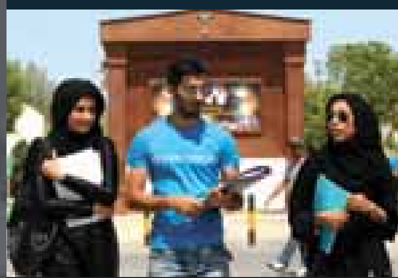
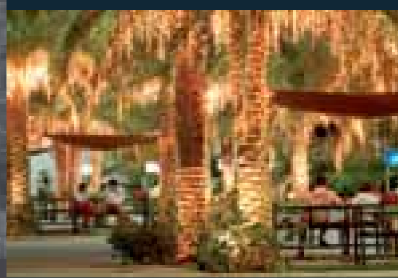


As a result of population growth and a rise in lifestyle-related illnesses, the demand for medical services has been increasing steadily. The government is reforming the sector and considering the introduction of a compulsory health insurance scheme. Private sector participation will help improve standards.

Country Profile

An established centre for commerce and transport
Continuing efforts to further diversify the economy
Ensuring preservation of local culture and traditions
A focus on strengthening education and health





Truly elite

The country is a regional centre for finance and banking

At the heart of the Gulf

Competitive advantages in a business-friendly environment

Meaning "two seas" in Arabic, the Kingdom of Bahrain's name literally refers to the springs that once supplied its sweet-water aquifers and the salt-water seas that surround the island.

HISTORY: The Kingdom can trace its beginnings to the Dilmun civilisation nearly 6000 years ago. Due to the country's strategic location in the Gulf, Bahrain has long attracted the attention of empires, and over the years it has been influenced by various powers including the Persians, Sumerians, Assyrians, Babylonians, Arabs, Portuguese and the British.

Bahrain formed an integral part of ancient Mesopotamia by linking the mainland to key trading partners through established sea lanes. This allowed the area to flourish as a commercial centre, with traders and merchants forming the backbone of the local economy and subsequent settlements benefitting from the islands' location.

GOVERNMENT: In 1971, Bahrain declared independence from the British government and became an independent state. Since 2002 Bahrain has been a constitutional monarchy headed by the King, Sheikh Hamad bin Isa Al Khalifa. He assumed the throne in March 1999 after the passing of his father, Sheikh Isa bin Hamad Al Khalifa, who had ruled the country as an emirate since 1961.

The head of the government is the Prime Minister, Sheikh Khalifa bin Salman Al Khalifa, while the Crown Prince, Sheikh Salman bin Hamad Al Khalifa, serves as commander of the Bahrain Defence Forces and chairman of the Economic Development Board.

In November 2000, the current monarch established a committee to transform Bahrain from a hereditary emirate into a constitutional monarchy, a status it received in February 2002 and which led the head of state to change his title from Emir to King. In the same year the King also announced a string of reforms that sought to modernise the government. A bicameral parliament was reconstituted after its suspension in 1975. The legislature consists of a lower house, the Chamber of Deputies, which is elected by universal suffrage, and an upper house, the Shura (consultative) Council, which is appointed by the King. Both houses consist of 40 members. Elections for the lower house of parliament were held in October of 2010 and elected members serve four-year terms.

STRIKING OIL: Regarded as something of a leader in the region, Bahrain was the first nation to strike oil in the Middle East. The discovery of oil in 1932 sparked a rapid transformation of Bahrain's economy, with the emergence of the petroleum business heralding a process of modernisation and a shift away from traditional industries such as pearl diving and fishing. In addition to being the first country in the region to discover oil, Bahrain is also home to the oldest oil refinery in the Middle East.

ECONOMIC OVERVIEW: Conscious that its hydrocarbons resources are finite, Bahrain has from an early stage pursued a policy of economic diversification. As a result, the government has successfully positioned the country as one of the leading financial capitals in the Middle East, known for its robust and well-regulated financial services sector. Additionally, the Kingdom has a well-developed industrial sector and is home to one of the largest aluminium smelters in the world, Aluminium Bahrain, or Alba.

The country has done well in a range of international rankings, placing first in the Middle East in the Heritage Foundation/WSJ 2011 Index of Economic Freedom and second in the World Bank's "Doing Business 2011" report, among others.

FINANCIAL SERVICES: However, it is financial services that is considered to have benefitted most from Bahrain's policy of economic diversification. As of April 2011 the country was home to 409 banks and financial institutions. It is also a major offshore banking centre with more than 370 such institutions.

ISLAMIC FINANCE: More recently, Bahrain has become one of the major centres for the Islamic

Leveraging its central location in the Gulf, the Kingdom has become a centre for transport and trade

financial services industry and hosts regulatory agencies and institutions for the sector, including the Accounting and Auditing Organisation for Islamic Institutions (AAOIFI), the International Islamic Financial Market (IIFM) and the Islamic International Rating Agency (IIRA). In addition, as of 2010 the Kingdom was home to 27 Islamic banks as well as 18 providers of sharia-compliant insurance, or *takaful*.

TRANSPORT: Given its location it is no surprise that Bahrain has also successfully established itself as a transport hub for the Northern Gulf. Competitive advantages in this area include its international-standard port, excellent road infrastructure, a growing airport and the national flag carrier, Gulf Air.

TOURISM: Tourism is another of the Kingdom's key economic sectors. Well known in the region for its relatively relaxed atmosphere, Bahrain attracts a large number of tourists from other GCC countries, as well as further abroad. In line with the plans for the broader economy, Bahrain has been strengthening its tourism sector as part of the broader programme of diversification. To this end, authorities and companies in the private sector have been working together, and this increased collaboration has laid the foundations for future growth.

Over recent years the nation has been gaining a reputation as a cruise destination, while international sporting events have brought in record crowds. In addition, cultural tourism and ecotourism are also on the agenda. Facilities geared towards the meetings, incentives, conferences and exhibitions segment have been enhanced and a number of upcoming developments, including expo@bahrain, an indoor meeting and exhibit centre that will have some 145,000 sq metres of indoor meeting and exhibit capacity, should help to cement Bahrain's position as a regional centre for business travellers.

Ecotourism also holds much potential for Bahrain. In particular, Al Areen Wildlife Park combines a conservation research and wildlife protection facility with an educational tourism opportunity. The park is home to some 50 species of animals, 90 species of birds and 80 species of plants. Ecotourists are treated to a guided tour of the park from the comfort of an air-conditioned bus. In addition to the tour, the park operates a number of educational programmes for visitors of all ages.

TRADE AGREEMENTS: Bahrain's free trade agreement (FTA) with the US, signed in 2005, was the first such bilateral agreement between a GCC country and the world's largest economy. The bilateral FTA, which came into force in August 2006, has consolidated already strong economic links and expanded trade and technical cooperation between the two countries. It has also helped diversify the Kingdom's export streams, especially for petrochemicals and fertiliser exporters, while at the same time acting as a catalyst to encourage inward investment.

In addition to the US, the Kingdom's major trading partners outside the GCC bloc include Japan, China, Germany and India. While other FTA deals are also being pursued, these are likely to take place through the multilateral GCC framework.

GEOGRAPHY: The total area of the Kingdom is 757.5 sq km, although this is expanding with continuing land reclamation projects throughout the country. The archipelago consists of some 33 islands in total. The four main islands, Bahrain Island, Al Muharraq Island, Sitra Island and Umm An Nasan, make up approximately 95% of the total land area and are connected by causeways. The country has some 161 km of coastline – a figure that is increasing, along with the total area, due to ongoing land reclamation.

The Kingdom of Saudi Arabia is Bahrain's closest neighbour across the Gulf of Bahrain to the northwest. It is connected to the island state by the 25-km King Fahd Causeway. The State of Qatar lies approximately 28 km from Bahrain's south-eastern coast. Plans are under discussion to link the two countries via a 40-km causeway that on completion would be the longest fixed link in the world.

The Kingdom's capital, Manama, and the northern part of the main island more generally house a large portion of the country's population. Manama has a population of approximately 182,000 and the majority of towns are connected to the capital.

Other major cities include Riffa, Sitra and Isa Town. Muharraq is the second-largest island and also houses the second-largest city in Bahrain, of the same name. Muharraq was the previous capital of Bahrain and it also hosts the Bahrain International Airport.

The highest point in the Kingdom is Jebel Al Dukhan, at 122 metres, with the majority of the island comprising low-lying desert. Only 2.82% of the land is arable and agrarian land is confined to a 5-km strip on the northern coast where date, almond, fig and pomegranate trees are grown.

CLIMATE: Bahrain has two distinct seasons: a hot and humid summer and a relatively mild winter. Summer begins around April and continues through October. The average temperature in the summer months is 36°C with highs reaching 48°C. Sandstorms are not uncommon during the hot mid-summer months. Winter is from November to April when the weather is relatively cool with temperatures ranging from 15°C to 24°C. The weather is the coolest between December and March when the north winds pass over the Kingdom. The country receives very little rainfall, most of which occurs during the winter months, averaging 77 mm annually.

NATURAL RESOURCES: Local natural resources include oil, gas, fish stocks and pearls. Agricultural production is extremely limited due to the arid desert landscape. Traditional mainstays of the economy such as fishing and pearl diving have taken a back seat in overall economic output since the discovery of oil in 1932 and, in the case of the latter, the development of the cultured pearl industry.

Although it was the first Gulf state to discover oil, Bahrain has not found vast quantities of hydrocarbons like many of its neighbours. The government has plans to increase both the exploration and production of oil and natural gas, recently awarding several off-shore exploration blocks and increasing on-shore exploration efforts. The Kingdom receives additional quantities of hydrocarbons from the Abu Safa field, which is shared with Saudi Arabia.

Rising domestic demand, increasing industrial production and a recent surge in development have made apparent the need to secure further supplies of natural gas. As a result, the country is pursuing a multipronged strategy, which includes both accelerating efforts to boost domestic production and securing energy resources from abroad.

Water resources are also limited. The Dammam aquifer, the main source of fresh water, has been overused and as a result desalination plants have become the main supply of potable water.

POPULATION: According to figures from the 2010 census, the Central Informatics Organisation put the number of inhabitants in Bahrain at approximately 1.23m, with this comprising 568,400 nationals and

The nation has invested heavily in the development of an advanced education system

666,200 non-Bahrainis. Foreign nationals accounted for some 54% of the total in 2010, up from 2001, when they made up around 38% of the population.

The country is host to a multicultural and diverse population with a large number of expatriates. Approximately 51.1% of the population are citizens of Bahrain, the GCC or other Arab nations; 45.5% are from Asia or Oceania; 1.6% are from Africa; and the remaining 1.3% are from Europe and the Americas. Given the large expatriate workforce, males account for around 62% of the population. Approximately 329,510 individuals reside in the Capital Governorate, home to the capital of Manama.

The Bahraini population is relatively young, with approximately 35% under the age of 25 and less than 3% 65 years of age or older. The Kingdom's birth rate is 15.4 per 1000 people per year.

LANGUAGE: Bahrain's official language is Arabic. Bahraini Arabic is the most widely spoken and is very similar to Khaleeji (Gulf) Arabic. However, English is also in widespread use and is the primary language of business in large part because of the wide variety of nationalities in the country. It is often visible on street signs and other indicators, and is provided on most official documentation. Farsi, Urdu, Hindi, Malayalam and Tagalog are the Kingdom's other most common languages. English is a compulsory second language in local schools.

RELIGION: Islam is the official religion of the Kingdom and some 98% of Bahraini nationals are Muslim, with both Shia and Sunni populations. Bahrain is tolerant of other religions, and churches, synagogues and temples can be seen alongside mosques. In the 2010 census, 70% of the country's population was listed as Muslim and 30% as members of other religions. Expatriates are free to openly practice their religion and due to the large amount of foreigners in the country, there are sizable Christian, Hindu, Buddhists and Sikh populations. Bahrain is also home to a small indigenous Jewish community.

Summers are hot and humid, while winters are relatively mild

CULTURE & PAST: Another central feature of the nation is its rich history. Home to the ancient Dilmun civilisation and numerous other powers throughout the centuries, archaeological sites are dispersed throughout modern-day Bahrain.

Important local archaeological sites include the 3000-year-old temples at Barbar; Qalaat Al Bahrain, built in 2300 BC by the Dilmun civilisation, which is a UNESCO World Heritage site; Qalaat Arad Fort built in the 15th century; and the Royal Tombs. The Bahrain National Museum also showcases artefacts from the past 6000 years of the island's history.

Bahrainis are well known for their basket weaving, pottery and handicrafts, in addition to jewellery making. Gold and pearls have been central to Bahrain's history, and their importance, both past and present, can be seen in souqs and museums.

Given its central role in Bahraini society, Islam is one of the most significant influences on national culture. While the country is known for its relatively liberal atmosphere, developed through centuries of trading, certain social and cultural norms are still expected to be observed by locals and foreigners.

Bahrain also values the role of women in society and a growing number work in various sectors of the economy. Along with a more relaxed, liberal atmosphere than some states in the Gulf, this helps make Bahrain an attractive place for expatriates.

Notwithstanding, the authorities have been very keen to ensure that Bahrain's rich culture and heritage are preserved and that they do not get sidelined by the ambitious economic development plans that the government has embarked upon. Under Vision 2030, the country's long-term economic development plan, the country aims to move away from oil and gas towards a number of other sectors, including tourism, ICT, finance and education.

EDUCATION: Bahrain has a strong reputation in the field of education. In 1919 it was the first country in the Gulf to open public schools for boys, with schools for girls following soon after in 1928.

The government invested a large percentage of its early hydrocarbons revenues in the development of an advanced educational system. This commitment continues today, with education figuring heavily in the 2011-12 budget, as has been the case for government spending plans throughout the past decade. In total, around 12.5% of total expected government spending in 2011-12 will go toward education, a slight increase from 11% the previous year.

The government pays all educational costs for its citizens. During the 2009/10 school year, there were a total of 125,603 students enrolled in Bahrain's public schools. These included 62,666 students at the primary level, 32,177 at the intermediate level and 30,760 at the secondary level. The enrolment rates are around 95% – the highest in the region. Bahrain's literacy rate, which hovers around 90%, is also among the highest in the region.

Tertiary education has also seen significant investment in recent years and draws students from all over

A growing number of women work in a range of sectors of the local economy

the region. There are approximately 20 universities, colleges and institutes in Bahrain serving a total of some 40,000 students.

A number of these higher education institutions are specialist-centred and help to develop specific skill sets demanded by the private sector. One such organisation is the Bahrain Institute for Banking and Finance (BIBF). Additionally, the country is also home to a range of vocational training centres.

Aware of the increasing competition in the region, Bahrain has put added emphasis on quality assurance, increasing vocational training, internships and on-the-job work experience, as well as boosting enrolment rates in higher education institutions.

To this end, the Quality Assurance Authority for Education and Training (QAA) was established in 2009 with the task of reviewing and assessing schools, universities and training institutes, as well as conducting national exams. To date the QAA's assessments have been highly regarded.

HEALTH: Health care is another sector where Bahrain has paved the way for other GCC states. The Kingdom is home to the oldest hospital in the region – the American Mission Hospital (AMH), which was founded in 1902 by the Reform Church of America. Until 1948 AMH provided health care not only for Bahrain but also for Saudi Arabians. The Ministry of Health was created in 1973 and it adopted a large portion of AMH's policies.

The government fully subsidises health care for all Bahrainis. There are 10 government hospitals and 13 private hospitals. In 2009, the total number of outpatient visits was 5.6m, of which some 83% were to government hospitals. Health care continues to be a focus of the authorities as the population has grown significantly. Additionally, the high incidence of lifestyle-related illnesses such as diabetes is a growing problem, and policy development and investment is being channelled into combating this as well as increasing the capacity of tertiary care facilities.

Sheikh Khalid bin Ahmed bin Mohammed Al Khalifa, Minister of Foreign Affairs

Regional ties

OBG talks to Sheikh Khalid bin Ahmed bin Mohammed Al Khalifa, Minister of Foreign Affairs

How can regional integration among the Gulf Cooperation Council (GCC) states be further improved?

SHEIKH KHALID: The countries in the GCC face many of the same challenges economically, politically and socially. Therefore, it is necessary for us to address those issues collectively. Established shortly after most of its states gained independence, the GCC was a giant leap towards the creation of a system that promotes common policies. We believe that integration can be achieved despite obstacles. Accelerating joint ventures, such as the planned railway system and monetary union, will greatly enhance those prospects.

How do you see the role of the GCC developing in terms of global trade and investment?

SHEIKH KHALID: Although GCC states are small in terms of size and population, they have experienced tremendous growth due to high global demand for petroleum and other natural resources that exist abundantly in the Gulf. Nevertheless, we recognise that these resources are finite and must further develop sectors other than energy if we wish for growth to continue. This requires investment in infrastructure and industry, as well as engaging in reform that will create a foundation for a globally competitive private sector. Our efforts will be assisted by signing a free trade agreement (FTA) with Europe, which has been stalled for nearly two decades. The GCC's economy is unique and its advantages must be exploited while diversifying our sources of revenue in order to achieve sustainability.

Given the FTA Bahrain has with the US, is it fair to assume that you would be an advocate of bilateral rather than regional trade agreements?

SHEIKH KHALID: Bahrain works together with its Gulf Arab neighbours through the GCC to achieve the highest level of defence, economic and social cooperation. The importance of regional ties cannot be stressed enough. However, in order to promote economic growth and achieve Bahrain's 2030 vision that seeks to achieve economic sustainability and end oil dependence, it is vital for us to establish trade agreements with sizable markets that enhance trade opportunities. Since Bahrain and the US have a strong relationship that can be traced back to the late 19th century, it is natural for the two states to strengthen ties by signing a FTA.

How is regional policy being developed in terms of Iran? How are the GCC countries working together to find a resolution to differences?

SHEIKH KHALID: The Bahraini government, along with its GCC counterparts, seeks to co-exist with Iran on the principles of good neighbourliness and non-aggression. However, as the statement issued by the Council of Ministers of the GCC to the UN Security Council outlines, the GCC regrets and rejects Iran's tendency to meddle in the internal affairs of Bahrain, Kuwait or any other GCC nation. We are alarmed by the recent unprecedented levels of interference through direct and indirect methods. Iran's expansionist ideology has also led to the non-peaceful settlement of the problematic issue of the occupied UAE islands, in which Iran failed to agree with the UAE's constructive solutions.

What do you say to those who argue that the GCC should be taking a greater role in assisting and finding a peaceful solution to the situation in Libya?

SHEIKH KHALID: The Libyan regime's unwillingness to resolve internal matters peacefully has required the international community to react. The turmoil has reached a point where it will be difficult to formulate a peaceful solution without a unified international response. The GCC, in cooperation with international players, recognises the Transitional National Council as the legitimate representative of the Libyan people. To preserve the unity of Libya, we call for an immediate ceasefire. Urgent measures have been required to ensure that a political transition takes place. We support the no-fly zone in Libya and urge Qaddafi to recognise the democratic aspirations of the Libyan people.

Economy

Finance leads expansion, followed by manufacturing
Revised 2011-12 budget sees major spending outlay
Training Bahraini workers to replace foreign labour
GCC-wide economic integration efforts
Funding and assistance schemes target SME expansion

Real GDP grew 70% in 2000-09 at an average annual rate of 6%

A solid base

Diversification continues apace in the Gulf's most open market

As the country has no personal or corporate taxation, except in the oil sector, and a strong record on intellectual and property rights, it has earned a well-deserved reputation for being business friendly.

Although it is the least hydrocarbons-rich of the Gulf states, Bahrain is one of the most forward-thinking. Having long since realised that it cannot rely on oil and gas exports to ensure its continuing prosperity, the Kingdom has strived over the past several decades to diversify its economy away from the extraction of natural resources and towards a more sustainable model of development based on manufacturing and the provision of services, especially finance. In doing so, the Kingdom has earned a reputation for being a regional trailblazer and built the GCC's most open economy.

The country's economic diversification dates back to the 1980s, when the conflict in Lebanon prompted many international banks to relocate their regional headquarters to Manama. Since then, Bahrain's financial sector has flourished and expanded in new directions, such as the provision of Islamic banking. Meanwhile, the Kingdom built up its industrial capacity, particularly in the realms of oil refining, petrochemicals production and aluminium smelting, all of which benefitted from the country's supply of hydrocarbons, which provided a ready source of energy and feedstock for its growing economy.

Over the past decade, Bahrain's economy has continued to progress as the government embraced privatisation and enacted reforms that have liberalised the country's labour market and improved its regulatory environment. Since 2008, these efforts have been coordinated under the Abu Dhabi Economic Vision 2030. The plan outlines a comprehensive national economic strategy that is aimed at encouraging innovation, entrepreneurship and job growth. Economic Vision 2030 is being spearheaded by the Economic Development Board (EDB).

Much of Bahrain's economic expansion in the past decade was due to growth in the financial sector, whose output nearly doubled, as well as real estate and property development.

INTERNATIONAL RECOGNITION: With no personal or corporate taxation, except in the hydrocarbons sector, a strong track record on intellectual and real property rights, minimal impediments to foreign investment and no restrictions on capital repatriation, Bahrain has developed a business-friendly reputation, which the Bahraini government has understandably seized upon and made the centrepiece of its international branding efforts.

More importantly, from the foreign investor's perspective, international surveys agree with this assessment. In early 2011, the Heritage Institute ranked Bahrain 10th in the world – just one spot behind the US, and ahead of every other country in the Middle East – in its Index of Economic Freedom, while the World Bank ranked Bahrain 20th out of 183 economies in its "Doing Business Report 2011".

While recent unrest may understandably have had a temporary impact, the fundamentals upon which these accolades were based remain unchanged. As Bahrain's economy bounces back from what was a slower-than-expected first quarter of 2011, further reforms – and a planned revision of the national economic strategy – will be key.

A GROWTH STORY: Bahrain's economy performed well over the past decade, as output, jobs, exports and wages all rose consistently. Real GDP increased 70% between 2000 and 2009, at an average annual rate of 6%, according to the EDB's 2010 annual review. Much of that was due to growth in the financial sector, where output nearly doubled. Real estate and property development also suffered and still have not fully recovered from the global slowdown, the review noted. However, according to the annual review, Bahrain was able to avoid a recession in 2009, posting real GDP growth of 3.1%, thanks to a strong performance from the manufacturing sector and a government stimulus package.

The economy also diversified over that period. Figures from the EDB's annual review show that the financial sector increased from 19% to 27% of GDP between 2000 and 2009, while manufacturing grew from 12% to 16%, construction from 4% to 7%, and transport and communications from 8% to 9%. Meanwhile, and in line with the government's plans, the crude petroleum and natural gas sector declined in importance, falling from 24% to 13%, while government services dropped from 16% to 14% over the same period. Trade held steady over the course of the decade at around 8% of GDP.

Bahrain's economy picked back up in 2010, with growth accelerating particularly strongly in the fourth quarter. Nominal GDP grew 11.8% for the year as a whole, reaching BD8.25bn ($22bn), Reuters reported, largely on the strength of gains in tourism, manufacturing and finance. Real GDP increased 4.5% for the year, with most of the gains coming from the non-oil segment, which grew 4.9%, according to data from the International Monetary Fund's (IMF) "Regional Economic Outlook for the Middle East and Central Asia", published in April 2011.

This upward trend was expected to continue in 2011, but the unrest in February and March may have some impact on growth. However, rising oil prices in the wake of broader volatility in the region should help offset those losses. In any case, Bahrain, and much of the rest of the region, is unlikely to return quickly to pre-2009 levels of growth. Indeed, many welcome more moderate growth as the so-called boom years had their downsides too.

FINANCIAL SERVICES: The finance sector in Bahrain enjoyed tremendous success over the past decade, over which it increased by an average annual rate of 13%, outpacing GDP growth by a healthy margin, the EDB's annual review showed. It contributed 26% to the country's overall output between 2000 and 2010, and accounts for more than a quarter of GDP today. With roughly $220bn in assets, according to the *Financial Times*, and over 14,000 employees, two-thirds of whom are Bahraini, it will remain crucially important to the national economy for the foreseeable future, even as its rate of growth slows.

Most of the growth in the financial sector was driven by the expansion of foreign wholesale banks, which are prohibited from seeking retail deposits but can take in funds from investors or the interbank market, and which are mostly engaged in offshore transactions in other GCC states. As a result of its foreign exposure, Bahraini offshore banking was inevitably hit hard by the global financial crisis, contracting by 15% in 2009. However, this was largely offset by growth in the domestic retail banking segment, and the sector as a whole declined by less than 1% that year, according to the EDB's annual review. Given the influence of offshore property-development loans in the portfolios of Bahraini wholesale banks, the EDB had also predicted that the sector would begin recovering from the downturn, as in fact it did over the course of 2010.

Bahraini banks have in general posted strong results for the first quarter of 2011 and at the time of going to press it was not known what impact the unrest in February and March might have on figures. The UK's *Financial Times* identified that investor confidence had been impacted and that there had been some withdrawal of capital from the country.

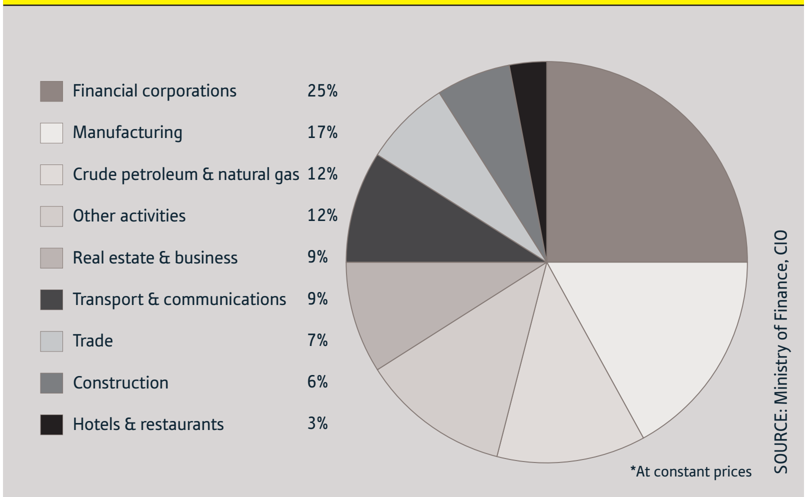
Tourism accounted for around 3.2% of overall GDP in 2009

Nevertheless, the government is confident that the sector will be able to withstand the turmoil. As a representative of the EDB said at a news conference in April 2011, no large financial institutions have announced plans to leave the country.

TOURISM: While financial institutions experienced a dip in 2009, the tourism sector – as proxied by hotels and restaurants – remained strong in 2010, increasing its output by 15.2% in nominal terms, or 10% in real terms, despite a 19% decline in visitor arrivals for the year, the EDB's annual review noted. As a result, it contributed 3.4% of GDP in 2009. The industry continued to grow during 2010, according to the EDB, but it, too, has been hit by the recent troubles, as tourists and business travellers have stayed away. The unrest in the early part of the year came at a particularly bad time for the hospitality industry, in the midst of its peak season. According to press reports, hotel occupancy rates during that period dropped from the high 90s to the 20s or 30s; one report estimated that the tourism industry lost approximately $500m overall as a result of the unrest.

The financial sector has seen tremendous growth over the past decade: it contributed 26% to overall output between 2000 and 2010 and accounts for more than 25% of GDP currently.

GDP by economic activity, 2009*



In late 2010 the real estate sector began to recover, and property development is slowly normalising

The construction and real estate sector has also yet to fully emerge from the fall it experienced after the onset of the global slowdown. In line with regional trends, it declined in 2009, by 9.7%, as demand softened and financing became more difficult. By late 2010, the sector had begun to recover somewhat. According to the EDB's annual review, however, property development is expected to remain more or less flat for the foreseeable future, and the overall market will probably recover more slowly.

STRONG PERFORMERS: While the finance, tourism, and construction sectors have been experiencing somewhat slower growth, the manufacturing sector has continued to perform strongly, posting an increase of 11.4% in 2010. That is in keeping with the sector's longer-term trend, which saw it grow by 45.3% over the preceding five years, as it overtook the oil extraction sector to become the second-largest contributor to Bahraini GDP, with a share of 16%. Indeed, between 2000 and 2010, the manufacturing sector contributed about 18% to the Kingdom's overall economic output growth, ranking second, behind only the financial sector.

In recent years, the manufacturing sector has begun to diversify, as businesses have courted the expanding regional market for food and beverages, electrical machinery and fabricated metal products, among others. Nevertheless, the sector remains heavily concentrated in the refined petroleum and aluminium smelting segments.

The manufacturing sector has continued to perform well as it is diversified, including the food and beverage, electrical machinery and fabricated metal products segments.

In fact, three majority state-owned companies, the Bahrain Petroleum Company (BAPCO), the Gulf Petrochemical Industries Company (GPIC) and Aluminium Bahrain (Alba), constituted roughly 70% of the sector in 2008, according to the EDB's "Bahrain Economic Quarterly, First-Quarter 2011" report.

All three of those companies are in the midst of expansion. BAPCO has recently entered into a joint venture with Finland's Neste Oil Corporation to build a new 8600 barrel-per-day (bpd) lube base oil plant, which is scheduled to come on stream in the autumn of 2011; GPIC is planning to break ground on a new plant to increase its production capacity of methanol and urea within the next 12 months; and Alba is conducting feasibility studies about the possibility of increasing output on two of its existing production lines as well as adding a new line. Moreover, in November 2010, Alba became a publicly traded company, raising a total of $338m in an initial public offering of 10% of its shares. These investments should put the refining, petrochemicals and aluminium industries in Bahrain on a solid footing in the years ahead. If commodity prices continue their upward march – aluminium prices increased 41% year-on-year between 2009 and 2010 – manufacturing may capture an even larger share of the Kingdom's GDP in 2011.

ENERGY BACKBONE: While Bahrain has made significant progress over the past decade in further diversifying its economy, the energy sector remains an important contributor, with crude petroleum and natural gas accounting for 13% of GDP in 2009. That number represents a substantial decrease from the year 2000, when oil and gas accounted for just under a quarter of the country's total economic output, but it is likely to rise again in 2011, as both oil prices and the Kingdom's crude output increase.

Bahrain is in the midst of an unprecedented $20bn expansion of its oil and gas sector, with $5bn earmarked for modernising and improving the country's flagship refinery in Sitra, and $15bn pledged for further development of its eponymous onshore field, with the goal of boosting production from around 33,000 bpd in 2008 to 100,000 bpd by 2020 through the application of enhanced oil recovery (EOR) techniques (see energy chapter).

Final production figures for 2010 have not yet been released, but according to Tatweer Petroleum, a joint venture between Bahrain's National Oil and Gas Authority and the US's Occidental Petroleum that has recently been put in charge of all upstream activities at the Bahrain Field, by the end of the year it had managed to boost output by 25%. That was the sector's first increase in 33 years.

Meanwhile, Bahrain has recommenced offshore exploration in its 7652 sq km of territorial waters and embarked on an ambitious deep-gas exploration programme. While it remains to be seen whether or not those efforts will pay off, the Kingdom's production of oil and gas is still expected to increase further over the next several years, thanks to its embrace of new technologies, and that process is bound to have significant knock-on effects for the wider economy. Indeed, according to the EDB, development of the country's existing onshore field will make the single largest contribution to the growth of business investment and capital goods imports in the Kingdom over the next decade.

Even if production were not to increase, the energy sector is still expected to grow in relative importance over the short term as a result of increased

oil prices. After plummeting to a low point in 2008, the cost of crude had been recovering steadily for some time; in early 2011, it spiked. Underpinned by fundamentals, average spot oil prices rose by some 25% between August 2010 and January 2011, reaching $95 per barrel, the IMF reported.

Then, over the next two months, amid greater volatility as unrest spread from Tunisia to Egypt and other parts of the Arab world, prices shot up another 16% to $110 per barrel. Even if prices decline somewhat over the course of the year as the crises of the Arab Spring abate, they are likely to remain higher than their 2008 levels for the foreseeable future. That fact, combined with the Kingdom's efforts to expand its hydrocarbons production capacity and to move its petroleum-based exports up the value chain through higher-value-added refining, should make the energy sector a major contributor to the Kingdom's economic growth in 2011.

BUDGET: Even as hydrocarbons declined in relative importance as a component of overall GDP, they remained predominant as a source of government revenue. Indeed, since the state levies no non-oil corporate or individual income taxes, it depends heavily on its revenues from the National Oil and Gas Authority to finance its annual budget. According to the Ministry of Finance, oil and gas revenues accounted for BD1.4bn ($3.73bn), or 83%, of the government's total income of BD1.7bn ($4.53bn) in 2009. That was roughly the same as the previous year, when they accounted for 85% of revenue, though it was higher than the 76% anticipated by the 2009 budget. Final accounts for 2010 have not yet been released, but the budget for that year anticipated a similar 77% share of BD1.46bn ($3.89bn). The most recent budget assumes that net oil and gas revenues will reach BD1.9bn ($5.07bn), or 87%, of the government's BD2.2bn ($5.87bn) of income in 2011.

For most of the preceding decade, through 2008, Bahrain enjoyed substantial surpluses; as a result, the government's debt-to-GDP ratio more than halved, dropping to 15%, according to the EDB's 2010 annual review. However, as government expenditures rose with oil prices, they outpaced other revenues, causing significant non-oil deficits. When oil prices plummeted below $35 per barrel in early 2009 and public spending increased to make up for

Budget for 2011-12 (BD m)

	2011	2012
Revenue		
Oil	1997.86	2058.01
Non-oil	252.42	252.42
Grants	0.04	0.04
Total revenue	2287.88	2348.03
Expenditure		
Recurrent	2488.58	2375.02
Project	635	700
Total expenditure	3123.58	3075.02

SOURCE: Ministry of Finance

The US was Bahrain's biggest trading partner in 2010, followed by China, Russia, Switzerland and Norway

decreased private investment in the wake of the global financial crisis, this underlying structural deficit was exposed. As a result, according to IMF data, the government's fiscal balance shifted dramatically from a surplus of 4.9% of GDP in 2008 to a deficit of 6.6% of GDP in 2009 and 7.8% of GDP in 2010.

SPENDING PLAN: In order to help combat this imbalance, the government intended to hold spending increases for 2011 and 2012 at just slightly higher than the rate of inflation. However, the government has subsequently approved a revised two-year budget of BD6.2bn ($16.54bn), reflecting a 44% increase in expenditures. Most of the increased spending is being directed towards social initiatives, such as a $500m affordable housing project and a programme for disbursing $2660 to every Bahraini family.

These additional expenses will be offset by a 10-year, $10bn stimulus package called the Gulf Development Programme. The package is being offered to Bahrain by Saudi Arabia and other GCC countries, and provided prices of crude remain high, it is padded by increased oil revenues. As a result, the IMF is forecasting budget a surplus of 1.6% in 2011. However, the average of analysts polled by Reuters predicted a deficit of 1.4% of GDP over the same span.

BONDS & RATINGS: The bond market, meanwhile, has been relatively unperturbed. While the yield on Bahrain's 10-year US sovereign bond crept up to 6.79% in February, prices on its 2014 Eurobond did not move dramatically, and indeed fell to just under 3% in May. In June 2011, however, Moody's downgraded Bahrain's credit rating to Baa1 from A3. As of March 2011, Fitch and Standard & Poor's have both downgraded Bahrain's long-term rating to BBB, still an investment-grade rating. As a result, by May 2011, credit default swaps, effectively the cost of ensuring state debt, had risen by almost 45% on the year.

INFLATION: Consumer price inflation (CPI), however, remains low. The country's average inflation rate has long been the lowest among the GCC member

The revised two-year budget for 2011-12 includes a 44% rise in expenditure, with money allocated for a $500m affordable housing project and to disburse $2600 to every Bahraini family.

Hydrocarbons taxes are the main source of government revenue

Trade growth continued into 2010, with imports rising 19.8% to $13.3bn and exports increasing 18.7% to $18.4bn. The International Monetary Fund has forecast further expansion in 2011.

states, having never risen above 3.5% in the last 10 years, according to the IMF. The rate fell from 2.8% in 2009 to 2% in 2010; the fund expects the rate to increase slightly to 3% in 2011. Thus far, however, the rate has actually declined in 2011.

Indeed, according to data from Bahrain's Central Informatics Organisation, as of April 2011 the Kingdom was actually experiencing deflation of 2.3% year-on-year, owing to the government's 25% reduction in regulated housing prices, which dragged down the consumer price basket. Despite these declines, by the end of the year, the government's fiscal stimulus measures are expected to have added upside pressure, lifting CPI rates.

TRADE: As its consistently high ranking in recent international surveys indicates, Bahrain's economy is one of the most open in the world. Over the five years up to 2008, the Kingdom's exports doubled in volume and increased in value by some 166%. The impact of the global slowdown was felt in 2009, as both imports and exports declined, the first by 29.2% to $11.1bn, and the latter by 26.5% to $15.5bn, according to IMF data. However, as the world emerged from crisis in 2010, the country's trade growth resumed, with imports rising 19.8% to $13.3bn and exports rising 18.7% to $18.4bn. Even in the wake of the Kingdom's recent troubles, the IMF projects further increases in 2011, with imports growing 11.3% to $14.8bn and exports performing even better, swelling 26.1% to $23.2bn. The former's relatively modest rate in comparison to the previous year is attributable to the increase in petroleum refining and aluminium production capacity, the EDB says, as some oil imports will be replaced by local production and capital equipment imports will slow in the aftermath of recent industrial expansion. Exports will be driven by the same fundamentals – increased production capacity – as well as by rising prices for oil and aluminium.

The US accounted for 14.5% of Bahrain's trade in 2010, making it the Kingdom's biggest trading partner, which is not surprising considering the two states implemented a free trade agreement in 2006. China occupied second place, with 13.9% of Bahrain's trade, followed by Russia with 8.5%, Switzerland with 6.7%, Norway with 4.3%, Japan with 3.8%, Turkey with 3.6% and India with 2.4%. Trade within the GCC itself continues to grow, buoyed by the GCC Customs union that is beginning to come into effect.

Foreign direct investment (FDI) inflows followed a similar pattern, growing from 2005 to 2008 – during which period Bahrain attracted more foreign investment than other GCC countries, as a share of nominal GDP – then dropping off in 2009 as a result of the global financial crisis. In the UN Conference on Trade and Development's 2010 "World Investment Report", Bahrain moved up from 24th to 23rd in the report's index of inward investment potential.

Bahrain's current-account surplus rebounded in 2010 to $1bn, or 4.6% of GDP, after falling sharply the year before to $600m, or 2.9% of GDP. The IMF foresees this trend continuing throughout 2011, with the surplus burgeoning to $3.5bn, or 13% of GDP.

OUTLOOK: Before the troubles of early 2011, the EDB was working on a revised national economic strategy, the goal of which was twofold: first, to eliminate the structural government deficits and return to budget surpluses; and second, to deemphasise the finance, construction and government sectors in favour of high-potential areas such as manufacturing, oil and gas, information technology, and tourism.

Now the EDB is working on a new report, which is expected to identify the sectors most affected by the unrest and to outline a plan for aiding stricken businesses. Needless to say, some of its prescriptions are likely to change in light of recent events; but its underlying goals will necessarily remain the same.

One of Bahrain's main challenges in the coming years will be providing jobs for its growing young population – and one of the Kingdom's best solutions may be encouraging the growth of small and medium-sized enterprises, as well as entrepreneurialism more generally (see analysis). The good news is that the Kingdom is aware of these challenges and – thanks to the ramping up of its oil and gas output – it will soon have more resources to meet them.

Top trade partners, 2009

Rank	Partner	Trade (€ m)	Trade (%)	Imports (€ m)	Imports (%)	Exports (€ m)	Exports (%)
1	EU27	2234.2	9.7	1852.60	28.4	381.6	2.3
2	Saudi Arabia	1991.4	8.7	1521.60	23.3	469.9	2.9
3	US	856.8	3.7	528	8.1	328.8	2
4	Japan	676.9	2.9	341.4	5.2	335.5	2
5	India	546.5	2.4	193	3	353.5	2.1
6	China	513.2	2.2	375	5.7	138.2	0.8
7	UAE	481.1	2.1	171.1	2.6	310	1.9
8	South Korea	429.4	1.9	222.5	3.4	206.9	1.3
9	Switzerland	288.6	1.3	219.8	3.4	68.8	0.8
10	Singapore	263.7	1.1	65	1	198.7	1.2

SOURCE: IMF, EU

Sheikh Mohammed bin Essa Al Khalifa, Chief Executive, Economic Development Board and Chairman, Tamkeen

Supporting development

OBG talks to Sheikh Mohammed bin Essa Al Khalifa, Chief Executive, Economic Development Board (EDB) and Chairman, Tamkeen

How is the EDB supporting the private sector following the recent period of unrest?

AL KHALIFA: International businesses in Bahrain have privately and publicly restated their commitment to doing business in the Kingdom. The EDB is in constant communication with investors and the business development team at the EDB has already reached out to over 300 companies to ensure that their day-to-day operations have not been significantly affected and to try to manage any specific issues that they may have.

What policies are being developed to further encourage businesses to enter Bahrain?

AL KHALIFA: Events of the past months should not affect the long-term outlook for the country. This is due to a set of factors that include, but are not limited to, the recently approved government budget of $16.4bn for 2011-12, representing a 44% increase in expenditures; the Gulf Development Programme, which allocates additional funds amounting to almost BD377m ($1bn) per year for the infrastructure budget over the next 10 years; and the rise in oil and aluminium prices. Steps have also been taken to accelerate housing construction and boost jobs within the private and public sectors. Initiatives such as the support programme for small and medium-size enterprises (SMEs) and the suspension of labour fees for a six-month period will help with short-term momentum for the economy.

How are youth addressed by the Economic Vision 2030? Do you foresee any changes by the government to accommodate them further in the future?

AL KHALIFA: Bahrain made a clear commitment to economic and social development and this commitment was, and continues to be, fully inclusive. Our greatest asset is the Bahraini people, and there has been significant focus and investment on development opportunities for young people. Over the past decade there have been a number of reforms which have underpinned Bahrain's already long-held understanding of the importance of education and training. We have continued to improve the skills of Bahrainis through a wide programme of education initiatives, and we host a number of facilities such as Bahrain Polytechnic and Bahrain University. There have already been tangible advances reflected in the number of Bahrainis employed in both the private and public sectors. The commitment to investing in our people will remain central to any plans that are put forward by government.

How do the initiatives of Tamkeen align with the goals of the Economic Vision 2030?

AL KHALIFA: Tamkeen's aim is to make Bahrainis "employees of choice" by providing them with the right mix of training and education – not just for the local job market but for the regional and international workplace as well. Economic Vision 2030 emphasises the need for a strong private sector, and Tamkeen has an innovative and generous private sector support programme that supports Bahraini companies through private sector financing and consultancy schemes, as well as human capital development initiatives. In response to the recent unrest, a fund of BD10m ($26.7m) has also been established to support around 2000 SMEs that have experienced short-term effects.

What programmes or educational initiatives are being explored or created by Tamkeen to develop the talents and skills of Bahraini youth?

AL KHALIFA: It is vital that we connect human and economic development. Tamkeen supports programmes that instil leadership and entrepreneurial skills among Bahrainis and follows up with mentoring and support through its private sector support schemes. As part of its initiative to modernise the educational sector, the government encourages the private sector to establish and run international syllabus schools. Besides the University of Bahrain, there are also a number of new private universities, including the first-ever off-site campus of the Royal College of Surgeons of Ireland.

Rasheed Mohammed Al Maraj, Governor, Central Bank of Bahrain

In control

OBG talks to Rasheed Mohammed Al Maraj, Governor, Central Bank of Bahrain (CBB)

How is strategy being developed in terms of the introduction of new banking licences and what are the local market considerations?

AL MARAJ: Our general policy is unchanged: the CBB remains open to granting new banking licences provided an applicant can meet our licensing criteria and can show a genuine business case. However, since the onset of the global financial crisis we have slightly modified our policy for granting banking licences. First, we believe that our domestic banking market is already very well served, and therefore we will not usually consider new applications for retail banks to operate in Bahrain.

Second, where an application is made to open a new bank, we will expect the shareholders to include an established financial institution with at least a 20% stake in the new bank. This reflects our objective of ensuring that new companies can benefit and learn from the skills and expertise of more experienced institutions, particularly international ones, especially in areas such as risk management and systems controls, which are so important to the sector.

We remain interested in applications from reputable foreign financial institutions, not only in banking but also in asset management and insurance, where Bahrain has a growing presence as a regional and international financial centre.

How much of a concern is inflationary pressure for Bahrain, and are you confident that the CBB has the tools to control it?

AL MARAJ: Looking back over the past 10 years, inflation in Bahrain has not been a major concern, averaging less than 2% over the decade. Inflation in the Kingdom remains well contained, and in fact we saw some slight deflation in the early months of 2011, so there are no major indications of emerging inflationary pressures in the economy. In view of this, we believe that the current interest rates set by the CBB are appropriate for today's economy.

Do you agree with the argument that interbank lending has changed forever? When do you think lending will return to pre-crisis levels?

AL MARAJ: "Forever" is a very long time to make a forecast. I certainly agree that the interbank lending environment has been changed fundamentally, though temporarily, due to the global financial crisis. In the past few years we have seen much greater aversion to risk on the part of major financial institutions, and this has made them much more cautious in terms of lending both to other banks and to borrowers in the wider economy.

This sort of reaction is not unexpected after a major financial crisis, but gradually confidence will return and lending will be restored to more normal levels. We are already seeing signs of this beginning to happen. However, central banks and regulators must also ensure that banks learn the lessons of the crisis and do not return to the lax lending practices that helped contribute to its creation.

What impact do you envisage the creation of a Corporate Credit Bureau having on interbank lending among institutions in Bahrain?

AL MARAJ: We have had a Consumer Credit Bureau in Bahrain for several years now, and the banking industry has found this to be a useful source of information about borrowers' credit histories and overall indebtedness. This information is essential to ensure that there is a strong credit culture in Bahrain, which both the CBB and the banking industry at large wish to see. The strength of this credit culture is reflected in the relatively good performance of retail banks during the recent economic downturn.

Overall, we are happy with the credit culture at most of our banks, and view the corporate credit bureau initiative as improving an already strong environment. As a result, we do not see the need to rush forward with this initiative but will take our time to ensure that it is introduced in the most effective way.

There are firm-by-firm limits on permit numbers for expat workers

Home-grown talent

Training and skills development to make locals the employees of choice

Like many other Gulf states, Bahrain is highly dependent on expatriate labour. According to the Economic Development Board (EDB), the public agency with overall responsibility for formulating and overseeing the economic development strategy, as well as attracting foreign investment, non-Bahraini employment increased more than three times faster than Bahraini employment between 2003 and 2009. As a result, as of the first quarter of 2011 roughly three-quarters of the Kingdom's employees – and some 666,172 of its 1.23m people, or 54% of its population – are foreign guest workers.

CHANGING COMPOSITION: The supply of relatively cheap foreign labour helped to drive economic growth over the past decade, particularly in manpower-intensive industries such as construction. However, as Bahrain looks to further diversify its economy by emphasising manufacturing and services – and by shifting more of the burden from the public to the private sector – it would like to change the composition of its labour force and increase the rate of Bahraini employment. The goal is to foster further economic development and raise the standard of living by making Bahrainis, rather than foreigners, the employees of choice.

Bahrain's Ministry of Labour has long been charged with helping locals find employment. Every unemployed Bahraini of working age must register with the ministry, and companies must inform it of their needs before advertising jobs so the ministry can attempt to make a match. This mechanism has proved highly effective, helping to reduce unemployment from roughly 14% five years ago to the 3.6-3.8% range today, said Tawfeeq Al Rayyash, the training affairs advisor to the ministry's High Council for Vocational Training. The ministry is working on a new information technology project, developed with the help of Microsoft, to streamline this process by providing employers with a database that lists all job seekers by experience, education and training.

In 2006, the Labour Market Regulatory Authority (LMRA) was established in order to collect labour market data and control the flow of foreign workers into Bahrain. In order to help "Bahrainise" the country's labour force, the LMRA limits the number of work permits that can be issued to expatriates and requires companies to hire a certain percentage of Bahrainis. The exact percentage is calculated on an employer-by-employer basis, depending on a firm's size and the sector in which it operates. If companies want to expand and hire more workers, they must hire locals first, before the LMRA will issue new work permits for foreign employees.

FREER FLOW OF LABOUR: In the past, Bahrain, like most members of the GCC, employed a sponsorship system that tied foreign workers to particular employers. If an expatriate worker quit his job, he lost his visa. The LMRA did away with this system in 2009; today there is a free flow of labour. Eliminating this policy has increased the competition between expat and Bahraini workers and has allowed the market to become more competitive. Since then, the wage gap between Bahraini and expatriate workers has nevertheless increased, rising to BD241 ($643) in first-quarter 2011 from BD231 ($616) one year earlier.

Some progress has already been made as a result of these policies. Total Bahraini employment rose to 141,263 in the first quarter of 2011. That represents a 2.1% increase year-on-year. Meanwhile, non-Bahraini employment decreased by 0.4% to 453,661, as 8.2% fewer work visas were issued and 19.2% fewer were renewed. The median monthly wages of Bahrainis also rose by 2% to BD449 ($1197). The private sector registered a larger increase, at 5.6%, than the public sector, at 1.2%, but wages are still lower in the former than the latter, reaching BD337 ($899) and BD585 ($1560), respectively.

According to the EDB's demographic assessments, the Kingdom's workforce is on the brink of a major and prolonged expansion. According to its estimates,

In early 2011, 54% of the population were foreign guest workers. The government is taking steps to lower this and make Bahrainis the first choice for available jobs. The market is more competitive now that foreign workers' visas are no longer tied to a particular job, however.

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the number of Bahrainis between the ages of 20 and 64 will increase from 268,000 in 2008 to 398,000 in 2019, growing at an average rate of 3% per year. Moreover, it expects a higher percentage of Bahrainis, and especially Bahraini women, to find or seek employment. As a result of these increases in both the working-age population and the proportion of job seekers, the EDB estimates that Bahrain will need to create an average of more than 7000 new jobs per year over the coming decade in order to satisfy the demands of its workforce.

CAPITAL DEVELOPMENT: To address that need, Bahrain established a labour fund, Tamkeen, with $175m of seed money in 2007. To support its operations, Tamkeen receives 80% of the labour fees collected by the LMRA, which charges companies BD10 ($27) per month for each of their foreign employees, and BD200 ($53) for two-year work permits. The former fees have been temporarily suspended while Bahrain recovers from the recent political turmoil. Tamkeen invests the fees collected by the LMRA in a number of projects designed to support the development of small and medium-sized enterprises (SMEs). At present, SMEs account for 99% of the firms in Bahrain and employ 70% of its workforce. By helping to create new firms and encouraging existing ones to expand, Tamkeen aims to create more jobs to satisfy the demands of the burgeoning population.

Enterprise support is only one of Tamkeen's mandates, however. The fund also invests in human capital development. "We strongly believe that human capital is key to economic growth," Ahmed A Hameed A Ghani Al Shaikh, Tamkeen's vice-president for enterprise and human capital development, told OBG. According to a 2009 study that the fund commissioned from Australia's Allen Consulting Group, many Bahrainis enter the workforce without the skills necessary for them to find a job. If the Kingdom is to increase the rate of local employment instead of continuing to rely on expatriates, Tamkeen estimates that around 3600 Bahrainis per year will require assistance and further training.

FILLING IN THE GAPS: Towards that end, Tamkeen has partnered with various academic institutions and private sector companies to implement training programmes in a wide range of sectors. Thus far, the organisation has launched 14 projects, with a total budget of BD30.8m ($82.14m), aimed at addressing identified skills gaps. These include projects in aeronautical engineering, nursing, accounting and finance, information technology and network engineering, hospitality, retail, administrative assistance, website development, quantity surveying and supply-chain management. So far these programmes have targeted 7322 beneficiaries.

Tamkeen has also implemented 20 employment initiatives, with a total budget of BD12.8m ($34.14m), to prepare Bahrainis for work in call centres, retail banking, the insurance industry, aviation, travel and tourism, Islamic finance, air-conditioning maintenance, engineering, information technology and the

There are state-backed programmes to improve skills and productivity among mid-career workers

public sector. These initiatives have thus far targeted 8688 beneficiaries. Moreover, it has also launched a BD1.2m ($3.2m) Talent Management Programme, which is designed to help develop leadership and human resource skills, and eight Work Ethics projects, whose budgets total BD2.5m ($6.67m). With the latter initiative, "the whole idea is to change the mindset of Bahrainis," Al Shaikh said.

In addition to these programmes, which are targeted at individuals who are seeking work, Tamkeen offers employers assistance in training and improving the productivity of their employees. These so-called Career Progression programmes, which have a budget of BD23.1m ($61.6m), provide up to BD2000 ($5334) to finance further training of mid-career, middle-income employees. They also subsidise the employees' salaries for as long as two years.

These training initiatives, which are employer-driven, can be conducted either in-house at the companies or through outside training providers. The goal of the programme is to help Bahrainis advance their careers, while also ensuring "that increases in salary are tied to increases in productivity", Al Shaikh told OBG. Tamkeen also funds projects to provide career guidance in schools.

Meanwhile, the Ministry of Labour is reforming its own vocational and graduate training programmes, and working to establish a system of occupational standards, based on the British model, whereby Bahraini employees will be assessed in terms of their skills, knowledge and competencies. Towards that end, it plans to open several skill-testing centres, which will assess Bahrainis and expatriates alike and prepare them for licensing.

As a result of these initiatives, Bahrainis entering the workforce over the coming decade will be more highly educated and better prepared for jobs that demand technological and professional expertise than their predecessors were, hopefully negating the need for such high levels of imported labour.

Tamkeen has implemented several programmes aimed at identifying skills gaps in the workforce and training Bahrainis to meet those needs. So far the organisation has launched 14 projects with a total budget of $82.14m.

The framework for a common regional market was adopted in 2008

Joint effort

GCC-wide economic integration continues to be put on hold

Negotiations for GCC-wide currency and monetary unions are ongoing. Cooperation of a different sort has taken the form of monetary aid for infrastructure works over the next 10 years.

In 2001, the six members of the GCC – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE – signed an agreement on economic integration that was to have led to the establishment of a currency union by January 2010. This agreement, which superseded a previous one dating from 1981, also aimed at establishing a common market among the GCC states. There has been some progress in the years since, but neither goal has come to fruition.

Building upon the 2001 agreement's initial momentum, the GCC states agreed in 2003 to form a Customs union, which would replace the six countries' different tariff rates with a single 5% import duty on most commodities. The union was also supposed to eliminate duties altogether on hundreds of foodstuffs and medicines, as well as raw materials and semi-manufactured goods imported for manufacture, imports required for development projects, and trans-shipments and re-exports.

Another step was taken in January 2008, when the GCC formally adopted a common market that, in theory, allowed for the free movement of goods, services and labour among its six member states; removed all barriers to cross-country investment and trade; and granted nationals of all GCC member states equal rights to property ownership and access to public services in all six countries.

NEGOTIATIONS & DELAYS: In practice, very little of this has been implemented, as most of the necessary legislation is not yet in place. The six GCC states have been unable to reach agreement on how to collect Customs duties or distribute the revenues. Thus, in September 2010, they agreed to shelve the Customs union for at least two years, though they continued to hold out hope of implementing an automatic clearance system in place of the present manual one. In May 2011, they decided to postpone the Customs union, this time until 2015.

Negotiations over the currency union have been similarly fraught. In 2005 the GCC countries agreed on certain basic requirements for implementing a common currency, such as limits on budget deficits, inflation and interest rates. However, Oman withdrew a year later; it has since repeatedly said that it is unlikely to rejoin soon. Then, in 2007, Kuwait dropped its dollar peg, opting for a basket of currencies instead, in the hope of curtailing inflation. This made convergence more difficult, since the other states' currencies are still pegged. Nevertheless, negotiations continued, and the remaining states singed another agreement in 2008, creating a GCC Monetary Council, which was meant to be a precursor to a regional central bank. Riyadh was chosen as the monetary council's headquarters in May 2009. Shortly after, the UAE dropped out of the project.

BENEFITS: A monetary union offers several obvious benefits: it would eliminate exchange rate risks as well as transaction and accounting costs; create a transparent pricing system; and provide further impetus towards a truly unified market, which would probably attract more foreign investment. It might also encourage widespread fiscal discipline and thereby lead to lower inflation and interest rates. Thus, Bahrain, Kuwait, Qatar and Saudi Arabia remain committed to the project – though they have had to delay its implementation as they pursue convergence on inflation and consensus on the central bank's functions. As of June 2011, there was no specific schedule for the establishment of either the central bank or the single currency. By most estimates, both goals are still a significant way from being realised.

In the meantime, events have seen council-wide cooperation of a different sort. In the wake of protests in Bahrain and Oman, the GCC decided to finance a stability fund, called the Gulf Development Programme. The programme, which depends mainly on contributions by Kuwait, Qatar, Saudi Arabia and the UAE, will deliver $1bn per year over the next 10 years to both Manama and Muscat, in order to help them build housing and upgrade their infrastructure.

SMEs account for 90% of firms and employ 70% of the workforce

Engines of growth

Training programmes and funding ensure smaller businesses thrive

Small and medium-sized enterprises (SMEs) play a major role in Bahrain's economy. According to data compiled by the Kingdom's Labour Market Regulatory Authority and its labour fund, Tamkeen, there are 29,600 SMEs in the country, which collectively employ 206,000 persons. That means SMEs account for 99% of the country's firms and employ 70% of its workforce. Perhaps unsurprisingly, in recent years they have begun to receive a great deal of attention.

Judging by the number of commercial registration certificates, Bahraini SMEs are concentrated in three main industries: trading, manufacturing and construction, representing 42%, 14.48% and 13.73% of such enterprises, respectively. According to Bahrain's Economic Development Board (EDB), SMEs contribute 28% of the country's GDP. SMEs engaged in trade account for almost 6.4% of GDP, while 5.6% comes from those involved in manufacturing and 4% from SMEs in construction. Other notable contributions include SMEs engaged in real estate (13%), transportation (1.6%), mining (1.5%) and private education (1%). Collectively, the EDB's 2010 annual review declared, SMEs are the Kingdom's "engine of growth".

LOCAL MODEL: The success of local SMEs has given rise to talk of a "Bahrain model" for SME development – and with good reason. Bahraini SMEs have not risen to such a high level of importance by mere chance. On the contrary, the government has exerted a concerted effort to develop them.

To systematise its efforts and assure that they are optimally suited to local conditions, it has formulated a uniquely Bahraini definition of SMEs – instead of simply adopting, say, the EU's or the World Bank's definition – based on a combination of the number of persons employed by a given enterprise and either its capitalisation or its turnover. Moreover, in contrast to other programmes that focus primarily on financing, the Bahrain model takes a holistic, long-term approach aimed at taking entrepreneurs from conception, through development, to implementation, and even expansion. Operating as far as possible in concert, organisations work to foster entrepreneurial ideals and provide seed capital for turning ideas into realisable concepts. They then offer grants and loans to get operations running; provide business support services, including help with marketing, accounting and IT; and, when the time comes, even help with advice and funding for expansion.

FINANCIAL SUPPORT: One of the most important of these is the Bahrain Development Bank (BDB). Founded in 1992, the BDB provides funding to SMEs as well as self-employed professionals, farms and fisheries. It offers loans ranging from BD5000 ($13,335) to BD500,000 ($1.33m) – and in special cases up to BD1m ($2.67m) – to support business that are still under formation as well as those that are in the start-up or more advanced stages.

Loans up to BD50,000 ($133,349) are fast-tracked and typically made available to SMEs within seven to 10 days. Medium-sized and large loans of more than BD100,000 ($266,697) require feasibility studies to be conducted by outside consultants such as KPMG or Ernst & Young to demonstrate that the projects are financially viable. Together with Tamkeen, the bank offers BD5000 ($13,335) grants to offset up to 50% of the cost of such studies.

The BDB offers conventional and sharia-compliant financing, the former at a 9.5% interest rate and the latter with a profit rate of 5.5%, to finance specific assets or provide working capital to SMEs in a range of sectors. Farms and fisheries qualify for special interest-free loans of up to BD20,000 ($53,394) and BD15,000 ($40,005), respectively. The bank also provides letters of credit to Bahraini importers and educational financing of up to BD20,000 ($53,394) at an annual rate of 7.2% for conventional loans and a profit rate of 4% for Islamic financing.

In 2002, the BDB began offering business advisory services, as well. The institution offers a five-day Entrepreneurship Orientation Programme, geared

Small and medium-sized enterprises are concentrated in three main industries: trading, manufacturing and construction. Other notable contributions come from SMEs in real estate, transportation, mining and education.

Assistance is offered on a long-term basis, from start-up loans to advice on marketing and expansion

towards university students and working professionals, that provides information about how to develop a business plan, analyse markets and manage financials, as well as a more advanced four-week Entrepreneurship Development Programme. To graduate from the development programme, trainees must produce a final business plan under the supervision of one of the bank's advisory branches.

In 2009, the BDB offered a total of BD52m ($138.7m) in financing, which was a 105.5% increase over the year before, when it offered BD25.3m ($67.5m). The 1288 projects it financed in 2009 – more than double the number it supported the year before – had a total investment value of BD76.5m ($204m) and added BD36.4m ($97m) to the national economy. They also created 4623 jobs and exported BD22m ($58.7m) worth of products, the latter an astounding increase of 422.6% year-on-year. In 2010, the bank received a 25-year loan of BD10m ($26.67m) from the Saudi Fund for Development to support expanded operations in 2011. As of July 2011, an increase from BD50m ($133.3m) to BD65m ($173.4m) had been approved by the government.

SME SUPPORT: Tamkeen is also active in SME development, offering various kinds of support under the rubric of its Enterprise Growth Management Programme. One scheme helps firms adopt high-tech equipment; another assists them with the implementation of quality management systems such as ISO, Kaizen, Lean Manufacturing or Six Sigma. Others help craft marketing and public relations strategies or employ consultancy services to improve their productivity. The fifth of its efforts focus on encouraging SMEs to participate in local and international exhibitions.

A variety of programmes are intended to train, support, fund and advise entrepreneurs. A central committee recently created by the government is intended to coordinate all of these efforts by determining what the business community needs and who should provide it.

All five efforts operate on the same principle, subsidising half the project's cost, up to BD10,000 ($26,670) for small enterprises and BD15,000 ($40,005) for medium-sized and large companies. Tamkeen also offers subsidies of up to BD3250 ($8667 for auditing and accounting services, or BD1250 ($3333) for auditing services alone. In partnership with the Bahrain Islamic Bank, Tamkeen offers sharia-compliant financing, up to BD50,000 ($133,349), for firms to help strengthen their information and communication technology infrastructure and improve their internal value chains. The financing is offered at a 0% annual profit rate, and Tamkeen also subsidises the principle at the following rates: 25% on one-year loans, 20% on two-year loans, 15% for three years, 10% for four and 5% on five-year loans.

Since 2010, Tamkeen has also sponsored entrepreneur networking events and provided workshops. It is in the process of implementing an awards programme to recognise excellence and is working to connect SMEs with experienced business mentors, who can help guide their growth. During 2011, it will begin supporting entrepreneurship activities in schools, offering entrepreneurship awards and developing model companies to highlight its programmes.

It also plans to inaugurate a business plan competition, featuring 100 participants, that will offer prizes, recognition and support to entrepreneurs looking to implement their ideas. Starting in 2012, it will begin distributing research and development and technology commercialisation grants. By 2014, it hopes to have developed a SME credit scoring approach, which would encourage more private lending.

COORDINATED EFFORTS: The Bahraini government has recently created a high-level committee, chaired by the minister of finance, to coordinate the efforts of all organisations involved in SME development in Bahrain, including the EDB, the BDB, Tamkeen, the Bahrain Chamber of Commerce and Industry and the UN Industrial Development Organisation (UNIDO). It is tasked with determining what else the business community requires, which actors can provide those services and what role the government should play. Thus far, it is working on three projects to address identified gaps. The first is an export development centre that would help SMEs enter new markets. The centre, which is still at the conception stage, will select sectors in which Bahrain has a competitive advantage, identify relevant companies and build up export consortia to assist SMEs that are too small to access international markets on their own.

The second project is to encourage large companies such as Aluminium Bahrain and the Bahrain Petroleum Company to source more of their parts and services from local SMEs instead of foreign suppliers. The third is to create a one-stop shop for SME development, so entrepreneurs can deal with a single portal that aggregates the services offered by different organisations such as Tamkeen and the BDB.

Although Bahrain still has room to improve when it comes to SME development, its efforts are already gaining international recognition. UNIDO has adopted the Bahrain model as its standard, and today the model is being applied around the globe, from China to North Africa. If Bahrain can continue to improve its training and promotion efforts for its SMEs, perhaps the rest of the world would do well to take note.

Jameel Humaidan, Minister of Labour

Investing in people

OBG talks to Jameel Humaidan, Minister of Labour

What are the challenges of the labour market and how are they being addressed by the ministry?

HUMAIDAN: The most pressing issue is making Bahrainis the employees of choice in the private sector. Addressing this challenge requires intervention by the state to reduce the labour gap and improve the skills of Bahrainis through lifelong learning such that they can meet the requirements of high-quality private sector jobs. The intent of the labour market reforms is to create equal opportunities in an organised and regulated market.

The ministry is primarily focused on skills development and maintaining the rights of all workers in Bahrain. It also encourages productive dialogue among all market participants and implements new schemes and programmes based on a continual evaluation of the labour market. We do not consider one aspect of our work more important than any other. Carrying out reforms in a balanced manner will help guarantee that our objectives are achieved.

To what extent do the Ministry of Labour (MoL) and Tamkeen coordinate their efforts?

HUMAIDAN: Cooperation between the MoL and Tamkeen is one of the fundamental conditions for the successful implementation of our labour market policies and an essential part of our commitment to the objectives of Bahrain's Vision 2030.

Coordination between the MoL and Tamkeen takes place at two levels. At one level, Sheikh Mohammed bin Essa Al Khalifa, the chairman of Tamkeen, and I discuss key policy issues related to employment and training for Bahrainis, with the ultimate goal of creating clear guidelines for the executive sections of both organisations. The second level of coordination involves directors and heads of sections in the two organisations, where the practical details of implementing policies are developed.

Recently a joint committee was formed that includes individuals from the MoL, the Labour Market Regulatory Authority (LMRA) and Tamkeen. This committee, which I head, was established to evaluate our strategies for the labour market for the next two years. We believe that continued and expanded cooperation is essential for the success of labour market reforms, and we are keen to coordinate our efforts and direct them towards serving Bahrain in the best way possible. We expect such coordination to continue and flourish.

How does the ministry ensure that graduates meet the demands of the labour market?

HUMAIDAN: In the past, we had a structural unemployment issue: jobs were available to graduates, but the positions did not match the requirements of those who were looking for jobs. In other words, graduates were not attracted to the openings that were available in the private sector.

We have been working with jobseekers and business owners and have successfully changed a lot of people's mindsets regarding employment options. Businesses have a substantial amount of input in identifying the training aims and objectives of the ministry and are involved in the development of professional training programmes. Indeed, we have started to close the skills gap in part by increasing the involvement of the private sector.

Why were LMRA fees recently frozen and what impact will this have on the private sector?

HUMAIDAN: Freezing these fees was a cabinet-level decision. The purpose of the change was to reduce the private sector's costs to help them recover from any possible negative impact of the disturbances in the labour market at the beginning of 2011. It is also expected that freezing the LMRA fees will stimulate economic development in the coming months by reducing the private sector's cost of employing foreign labour. The temporary elimination of this extra cost will also increase cash flow to businesses.

Talal Al Zain, CEO, Bahrain Mumtalakat Holding Company

A diversified portfolio

OBG talks to Talal Al Zain, CEO, Bahrain Mumtalakat Holding Company

What recent developments has Mumtalakat seen?

AL ZAIN: The Kingdom's investment arm is continuing its plan to develop and diversify its portfolio of assets by focusing on securing sustainable returns and wealth generation for Bahrain. The previous year has seen a number of important milestones that have strengthened the financial institution's capital structure and portfolio. Mumtalakat engaged Standard & Poor's and Fitch for its debut public credit ratings. Their assessments resulted in Mumtalakat's credit ratings being equalised to those of the sovereign, representing a strong validation of our strategy. Additionally, the firm raised $750m on international capital markets through a highly successful debut bond offering in June 2010 that was more than four times oversubscribed. In addition, as part of a continued commitment to the long-term diversification of our portfolio, we successfully concluded an initial public offering (IPO) of 10% of Mumtalakat's stake of Aluminium Bahrain (Alba) on the London Stock Exchange and the Bahrain Bourse.

What does the IPO of Alba mean for investors?

AL ZAIN: The 2010 IPO of Alba was an important step towards the implementation of Mumtalakat's long-term strategy, which is consistent with Bahrain's Economic Vision 2030, to create a well-diversified and balanced global portfolio across asset classes and geographies to generate long-term financial growth.

Working with the management of Alba, Mumtalakat helped to facilitate operational and organisational restructuring throughout 2009-10. With the listing, we managed to boost the profile and visibility of a world-class domestic company that measures up to international performance and governance standards.

The listing of Alba also presented a key opportunity for the firm to "share the wealth" with the people of Bahrain by allowing them to own a stake in an asset that has historically generated strong cash yields. The listing on the Bahrain Bourse also aided in the development and liquidity of the Kingdom's stock exchange.

How will expansion of the portfolio be achieved?

AL ZAIN: Mumtalakat's activities in 2010 put in place key foundations which continue to optimise our balance sheet and drive diversification efforts. We entered 2011 in a solid position with ample liquidity, which will allow for flexibility in executing our funding and portfolio strategy initiatives. In terms of our investments, we are following our asset allocation model on liquid asset classes. Such investments improve the mix of liquid and non-liquid assets in our portfolio. We also look for new domestic opportunities that can stimulate employment and trade. Our focus on enhancing the value of our existing portfolio of companies will remain a priority in 2011 and beyond. There are many opportunities for us to continue and expand our initiatives. The firm's focus remains on securing sustainable returns and wealth creation for future generations of Bahrain.

How has increased transparency and corporate governance altered investor operations ?

AL ZAIN: Our commitment to transparency and corporate governance has been recognised internationally and has facilitated our success in raising foreign capital. Mumtalakat is implementing benchmark management principles at all of its portfolio companies and has undertaken key transactions which involve the institutionalisation of transparency and corporate governance practices. For example, listing Alba on two exchanges imposed rigorous disclosure and governance requirements on the part of Alba's management and Mumtalakat, the main shareholder.

Which economic sectors offer the greatest opportunity for diversification and investment?

AL ZAIN: From a regional perspective, education, health care, industry and infrastructure continue to offer attractive opportunities for long-term international investors. However, no matter what economic sector companies decide to invest in, those that do benefit from the Kingdom's dynamic and talented workforce.

The medium-term outlook is similar to those of other GCC states

Balancing act

Temporary declines in some sectors are offset by growth in others

This is a period of transition for Bahrain's economy. The changes began in 2009, as a result of the global financial crisis. The Kingdom weathered the economic downturn relatively well: although its growth rate halved from the previous year, the economy still managed to expand by 3.1% in real terms, according to the Economic Development Board (EDB). But, as it turned out, the sectors that had been the most responsible for driving its growth over the past decade – finance and property development – were the ones most affected by the crisis, and not just for the short term. While both have bounced back from the trough of 2009, neither is likely to return to pre-crisis growth levels for the foreseeable future.

As a result, their share of GDP and their contribution to growth, while still significant, are likely to be more modest in the future. Fortunately, the economy can look forward to bigger contributions from other sectors, especially energy, manufacturing and – once it recovers from the recent unrest – tourism.

HEAVY HITTERS: Bahrain's economy expanded at a healthy clip from 2000 to 2009, growing at an average annual rate of 6%. Cumulatively, that amounted to an increase of 70% for the decade. According to the EDB, financial corporations played the largest single role over that span, accounting for 26% of the economy's growth between 2000 and 2010. Manufacturing came in second behind finance, contributing 18%, followed by government services (12%), transport and communication (9.1%), construction (9%), social and personal services (8%), real estate and business activities (7%), trade (5%), and hotels and restaurants (4%). Throughout the last six years of the 2000s, finance and construction played an even larger role, contributing more than half of total output growth, EDB statistics show.

In 2009, though, that picture changed, according to the EDB. The construction and real estate sector contracted, declining 9.7% year-on-year as expectations of future demand were scaled back and financing became scarce, with this having knock-on effects in the financial sector. Although insurance and domestic retail banking expanded during the year, wholesale banking dropped by 15% due to anxiety over the fall in global property prices and the consequent decrease in property-related lending.

As a result, the financial sector as a whole declined by just under 1% for the year. The economy was also hit by the decline in oil prices in 2009, but it was able to stave off a widespread recession thanks to healthy growth in both the manufacturing sector, which increased by some 6.5% in the year, and the tourism sector, which grew by 15.2%.

EXPANDING SECTORS: The financial sector bounced back in 2010, expanding by 5.8% in nominal terms and 4.2% in real terms, according to Bahrain's Central Informatics Organisation (CIO). So did the building and construction sector, which increased 3.6% in nominal terms and 3.4% in real terms, thanks to government capital expenditure, and real estate, which grew 1.9% at current prices and 1.6% at constant prices. Manufacturing continued the strong run it started in 2009, expanding by 20.1% at current prices and 11.4% in constant prices, as the hydrocarbons refining, petrochemicals and metal industries all benefitted from increased domestic demand and higher world prices for oil.

Thanks to the country's first increase in oil production in 33 years, the petroleum sector also expanded, by 22.5% in nominal terms and 1.8% in real terms in 2010. There was growth in transport and communications (9.2% in nominal and 7.3% in real terms), wholesale and retail trade (7.8% in nominal and 5.8% in real terms), and government services (3.8% in nominal and 3.2% in real terms), as well. According to the CIO, hotels and restaurants grew by 8.2% in 2010. Overall, in 2010, the economy enjoyed growth of 11.2% (nominal) and 4.5% (real).

In January 2011, the EDB, which is responsible for setting the Kingdom's overall economic strategy,

Finance, building and construction, and manufacturing all saw strong growth in 2010. Overall, in 2010 the economy expanded by 11.2% in nominal and 4.5% in real terms.


Real estate and construction was hit by the global slowdown as demand fell and financing became scarcer

predicted that real growth would average more than 5% between 2010 and 2014, with the economy expanding by 5.2% in 2011. Its multiyear forecast may yet prove accurate, but growth in 2011 could be impacted as a result of the unrest in February and March, adversely affecting several sectors.

TOURISM: The most drastic impact though has been in tourism and hospitality. According to the consultancy Deloitte, occupancy rates in Bahraini hotels fell to 26% in April 2011, down from 76% that month the year before. As a result, revenue per available room dropped from $193 to $52 for the month and from $186 to $93 for the year to date through May.

In part, the decline in visitors was simply due to logistics: the 25-km causeway connecting Bahrain and Saudi Arabia – by which some 9.5m of its 12m tourists arrived in 2010, according to the *Financial Times* – was closed for two months, from mid-February to mid-April 2011. However, when it reopened there was an immediate flood of Saudi visitors seeking to enjoy the Kingdom's leisure activities.

It has also been a matter of timing – the protests fell during the peak tourist season – and of lost opportunities. Because of the turmoil, two energy conferences were postponed: UNESCO moved a meeting of its World Heritage Committee to Paris and MEED relocated a seminar to Dubai.

More significantly, the 2011 Formula 1 Grand Prix, which draws 40,000 visitors annually, was cancelled after originally having been postponed. According to a study commissioned in 2008 by Mumtalakat, the race generates around $600m in direct and indirect revenue. That figure represents 2.6% of 2010 GDP. The decline in visitors has also had a negative knock-on effect on the Kingdom's retail sector as well.

Forecasts for overall 2011 growth range from 2.9% to 4.5%, and some are predicting an actual downturn. However, the majority of estimates forecast growth in 2012 and beyond due to sound fundamentals.

FINANCIAL SERVICES: The financial sector has also been affected, according to the Institute of International Finance (IIF). Banks have generally posted strong results for first-quarter 2011, but the effects of the turmoil are bound to emerge later in the year. It is not yet clear whether these effects will be temporary or permanent, however, the fact that none of the large financial institutions operating in the country have announced plans to pull out would appear to be a positive sign.

ENERGY & MANUFACTURING: Other sectors such as oil and gas and manufacturing have also been affected only marginally. For example, the Bahrain Petroleum Company had to shut down part of its production during the protests because of staff shortages. The firm has since laid off some 293 of its workers for absenteeism during the demonstrations and reported a $15.9m loss for the year's first quarter. However, these effects were relatively minor and limited in scope. Unlike the tourism and banking sectors, which depend on outside confidence, energy companies and manufacturers have been able to resume normal operations and are not expected to be adversely affected going forward.

FORECASTS: As of April 2011, Bahrain's Ministry of Finance was still predicting real GDP growth of 4.5% for the year. That figure represents the high end and would seem to be roseate. Analysts polled by Reuters in March 2011 forecast 3.4%; in April, while the International Monetary Fund predicted 3.1% – which was not far off the IIF's expectation of 2.9%. Banks' estimates are more varied. Barclays Capital forecast 1.4%, Citibank estimated 1%, and HSBC predicted that the Kingdom's economy would flatline. Others even predicted it could decline.

The good news is that at the time of writing, business was returning to normal and most analysts agree that growth will be better in 2012 and beyond. Indeed, the recent unrest is largely seen as an aberration and the country's economic fundamentals are otherwise sound. Bahrain's medium-term outlook is similar to those of its fellow GCC nations.

As long as stability is achieved and maintained, the country will remain an attractive destination for investment; and with the energy sector and the manufacturing sector both showing signs of expansion, healthy growth over the next decade seems likely, even if it is at a lower rate than from 2000 to 2008, owing to some uncertainty in the financial sector.

Public finances, 2008-10 (BD m)

Description	2008	2009	2010
Revenues	2677.6	1708.2	2175.6
Oil & gas	2281.2	1417.8	1852.1
Non-oil	396.4	290.4	323.5
Expenditure	2060.3	2082.2	2635.4
Current	1552.0	1692.3	1868.0
Project	508.3	389.9	767.4
Strategic projects	70.0	72.0	0.0
Surplus/deficit before rollover	547.3	(446.0)	(459.8)
Rollover for the period			
Projected	150.0	206.9	291.0
Current	25.2	72.6	22.4
Total rollover	175.2	279.5	313.4

SOURCE: Ministry of Finance

Craig Emerson, Australian Minister of Trade

Ever-deepening ties

OBG talks to Craig Emerson, Australian Minister of Trade

How can Bahrain help foster trade within the GCC?

EMERSON: Bahrain plays an important role in fostering the growth of trade and economic development through its position as a banking hub for the region; excellent transport connections; a regulatory environment that helps facilitate business; and being one of the longest-standing open economies in the region.

Australia also holds many advantages for businesses from Bahrain. These include a financial sector that has proved one of the world's strongest and most resilient in the face of the global financial crisis; strong and responsive management of fiscal and monetary policy; and the prospect of continued economic growth with buoyant global demand for Australian resources and agricultural products. Australia looks forward to enhancing its strong ties with Bahrain, and leveraging off Bahrain's advantages as a key member of the GCC.

What sort of initiatives might foster greater integration between Bahrain and Australia?

EMERSON: Two-way merchandise trade between Bahrain and Australia was $327m in financial year 2008-09, but decreased to $219m in 2009-10, reflecting the effects of the global financial crisis. However, the pre-crisis trade figures are an indication of the relationship's potential, and we can reach even higher levels through new initiatives to foster integration between our economies. The best platform for enhancing trade and investment ties may be the proposed Australia-GCC free trade agreement, negotiations for which commenced in 2007. Australia and Bahrain are working well together to reach a successful conclusion. Another area with potential for new initiatives is investment, where Australia and Bahrain have much to gain through cooperation in such areas as banking and Islamic finance.

Which sectors have the greatest growth potential in trade and cross-border cooperation?

EMERSON: Bahrain is a key market for exports of Australian cars, live animals, meat and wheat. Taken as a whole, the GCC is Australia's number-one export market for passenger motor vehicles, and Bahrain is a key constituent in this wider market.

Bahrain's key exports to Australia include aluminium, wire products and fertilisers. Australia looks forward to enhancing trade ties in these existing areas, but also to new areas of growth. Investment cooperation including in Islamic finance is a promising area, given Bahrain's prominence as a banking centre. Exciting opportunities also exist in the market for educational services, where there has been rapidly increasing enrolment by students from Bahrain in Australian universities.

How will the stabilisation of Iraq impact trade flows from Australia into the region?

EMERSON: As Iraq stabilises, its economy will diversify, opening opportunities for foreign partners in a range of sectors. Iraq's stabilisation will also facilitate increased trade and better relations between Iraq and its neighbours. Greater trade and investment between Gulf countries will lead to accelerated economic development in Iraq and across the region, promoting increased trade with Australia and other international partners, and better living standards for the Iraqi population.

Australian firms, already active across the Gulf, are beginning to take advantage of the trade and investment opportunities arising from the improving security situation in Iraq. Leighton Holdings is leading the charge, having secured a $733m contract to expand an offshore oil export facility in Iraq, and we expect the trend to continue as firms bid for Iraqi resource exploration licences and a range of commercial tenders.

Australia is also well placed to meet demand in the Gulf in other sectors, particularly agricultural produce. As a leading provider of educational services, Australia will also benefit from a greater number of students in the Gulf seeking high-quality tertiary education. Iraq's plans to increase oil production will further increase trade flows to Australia, which imported over $2.4bn of crude and refined petroleum from the Gulf in 2009.

Banking

A return to growth in assets following dip in 2009
Diversification the goal in wake of the global downturn
Regulator enhances its already strong reputation
Consolidation expected in the coming years
Preparation for the implementation of Basel III accords

The Kingdom has a pool of highly skilled financial workers

Back on form

A return to profit in 2010 has boosted spirits

Bahrain's reputation as a financial leader in the Gulf is the result of coordinated expansion that has been led by the government but carried out primarily by major private players.

In its quick and thorough response to the downturn, the Central Bank of Bahrain (CBB) proved again why it is regarded as one of the top financial regulators in the Middle East. Banks and related financial institutions are working to shore up their balance sheets and, with the support of the CBB, improve corporate governance. These developments, in conjunction with ongoing diversification efforts and an expected round of consolidation in the coming years, bode well for future growth.

HISTORY: Bahrain's reputation as a financial leader in the Gulf is the result of years of development and carefully coordinated expansion efforts, which have been led by the government but carried out – especially in recent years – primarily by major private players. The first bank in the Kingdom was UK-based Standard Chartered, which launched in 1920 after several years of negotiation with local leaders, who insisted the institution abide by sharia law. Over the next 50 years a number of international banks – many of them British – set up shop in Bahrain. By the mid-1960s Lebanon had become the region's acknowledged financial centre, though even then Bahrain, which is centrally located and more liberal than its neighbours, was a growing banking power. When the Lebanese civil war began in 1975, many of the country's banks and other financial institutions moved to Bahrain. The influx of these banks and banking professionals helped turn the Kingdom into a leading regional financial centre.

Bahrain has managed to retain its status as the Gulf's financial centre since then, despite increasing competition. Both Qatar and Dubai have worked to build up their financial sectors in recent years, but Bahrain has a number of inherent advantages. These include a large, highly skilled pool of financial workers; one of the most developed regulatory regimes in the Gulf; and proximity and road connectivity to Saudi Arabia.

OVERSIGHT: The CBB oversees all aspects of the local financial sector. Established in 2006, the CBB took over from the Bahrain Monetary Agency, which had been the primary financial regulator since 1973. The CBB has introduced a number of major reforms in the last few years. The regulator recently launched a new corporate governance framework in an effort to improve oversight at banks and financial firms. The bank is also working to implement the Basel III accord by 2012, and increase credit access for individuals and businesses alike (see analysis). "Bahrain has a strong regulator and a well-developed regulatory environment" said Mazin Manna, the CEO of Citibank's Bahrain operations.

BY THE NUMBERS: In February 2011, according to the CBB, there were 160 institutions in the sector, including 15 locally incorporated retail banks, 15 branches of foreign retail banks, 77 wholesale banks, 26 representative offices of foreign banks and 27 Islamic banks. There were 170 registered insurance and insurance-related companies, 46 investment firms, 11 brokers and 22 firms holding specialised licences, including trust services providers, money changers, financing companies and ancillary services. Banking accounts for around 85% of assets in the Kingdom's financial sector, according to a January 2011 report by Global Investment House, a Kuwait-based investment and financial research firm. Over the past five years the finance sector has been responsible for over 25% of GDP, just below oil and gas (25% for the same period) and well up on manufacturing and government services.

As of the end of 2010, according to figures from the CBB, the Kingdom's banks boasted total assets of \$222.2bn, up from \$221.8bn the previous year, though down from \$252.4bn in 2008. Banking assets grew exponentially in the years preceding the downturn. In 2003 the sector posted total assets of \$100.9bn, which grew to \$118.9bn in 2004, \$140.4bn in 2005, \$187.3bn in 2006 and \$245.8bn in 2007. While retail banks contributed to this expansion, most of the growth took place in the wholesale segment. Since the downturn hit the Kingdom, wholesale institutions, which are registered in Bahrain but only serve the local market within certain limitations, have been loss leaders (see analysis). Retail banks have remained a steady source of growth.

RETAIL: In 2010 retail banks had total assets of $65.6bn, up from $59.7bn the previous year, $63.7bn in 2008 and $49.6bn in 2007. The majority of the segment's 2010 assets – $34.9bn, 52% of the total – were held in Bahrain, though local retail institutions also have holdings in most other markets around the world, including Europe, Asia, North and South America, and throughout the Arab world. Three local institutions dominate the retail segment, namely National Bank of Bahrain (NBB), Ahli United Bank (AUB) and BBK (formerly the Bank of Bahrain and Kuwait. All three are listed on the Bahrain Bourse, the Kingdom's stock exchange, which was known as the Bahrain Stock Exchange until a rebranding in 2010.

AUB: AUB is Bahrain's largest bank and one of the largest banking institutions in the Middle East. In 2010 it boasted total assets of $26.5bn in 2010, up from $23.6bn in 2009. The bank posted net profits of $266m in 2010, up 32% from $201m the previous year, though down from a high of $296m in 2007. AUB's loan book was valued at $14.5bn in 2010, up from $13.3bn in 2009. The bank was formed as a result of a series of mergers in the early 2000s, but it can trace its presence in Bahrain to December 1977, when Ahli Commercial Bank was incorporated in the Kingdom. Today, AUB operates in eight markets around the world, including Bahrain, where it is headquartered, Kuwait, Qatar, Oman, Egypt, Iraq, Libya and the UK. AUB has the second-largest network in Bahrain, with 21 branches.

While the bank has seen continuous asset growth since the financial crisis, expansion slowed substantially in 2008 and 2009. Consequently, in 2010 the bank set out to improve its balance sheet, launching a number of initiatives and reform efforts. In April of that year it converted a major subsidiary, Bank of Kuwait and the Middle East, into a full-fledged Islamic bank, in an effort to tap into growing worldwide demand for sharia-compliant financial services. Also in early 2010, AUB acquired a 40% stake in the Libya-based United Bank for Commerce and Investment (see analysis). In late-April 2011 the bank benefitted from a $125m investment from the International Finance Corporation (IFC), the World Bank's private investment arm, which will go towards supporting AUB's long-term regional expansion plans and strengthening the institution's capital base in preparation for the implementation of Basel III.

BBK: BBK had total assets of $6.5bn in 2010, up from $6.05bn the previous year and $5.7bn in 2008. Net profits for 2010 reached $103.7m, up from $92.8m in 2009. The bank's loan portfolio was worth $3.39bn in 2010, up slightly from $3.36bn the previous year. BBK set up shop in the Kingdom in 1971. Around 18% of the institution is listed on the Bahrain Bourse, and a handful of firms in Bahrain and Kuwait own the rest. The bank is also listed on the Kuwaiti exchange. As of April 2011 BBK operated a 15-branch network in the Kingdom, and was in the process of building two more.

Like AUB, BBK saw slower growth in the post-downturn period, but in the past year the institution saw solid expansion. In late 2010 the bank successfully released a $500m bond that it had postponed earlier in the year. This was one of the first large-scale corporate bond

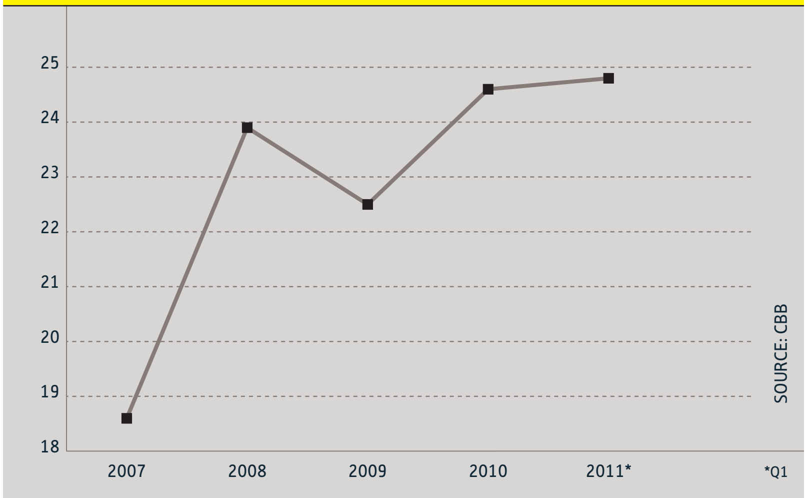
The retail banking segment is dominated by three local institutions

issues since the downturn. BBK has also continued to develop its online banking services, and has won a number of awards for its web portal, which caters to both retail and business customers.

NBB: NBB held assets of $6.1bn in 2010, up from $5.6bn the previous year. This includes $5.3bn in total deposits, up from $4.96bn in 2009 and $4.8bn in 2008. NBB posted 2010 profits of $114.4m, up from $114.1m in 2009. Launched in 1957, NBB was the first locally owned bank in the Kingdom. Today it has the largest network in Bahrain, with 25 branches, and is a leading provider of services for the local market. Private Bahraini shareholders own 51% of the bank; the remaining 49% is owned by Mumtalakat, the government's investment arm. In 2010 the bank worked to shore up its local business, improve its debt and equity arrangements with major investment clients, and expand its retail operations. With the government a key stakeholder, NBB takes the public interest into account when developing initiatives. For example, in April 2011 it launched a programme to assist small and medium-sized enterprises that have experienced difficulties in the wake of the

In 2010 retail banks had total assets of $65.6bn, up from $59.7bn the previous year. Just over half of this was held in Bahrain, though local institutions also have holdings in a range of other markets around the world.

Retail banking assets, 2007-11 (BD bn)

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CAREFUL OVERSIGHT

It is no accident that the Central Bank of Bahrain (CBB) occupies a leading role in the region. The regulator's solid reputation is the result of years of careful development paired with proactive oversight and strong monetary policy. The bank is responsible for a number of major innovations that have resulted in substantial improvements, not only in terms of the Kingdom's financial framework but in the region as a whole.

A shortlist of the bank's major accomplishments over the past two decades includes the creation and constant updating of the region's leading regulatory framework, the careful management of the international economic downturn, and the licensing of the numerous major financial firms that have made the Kingdom the home of one of the Gulf's largest and most developed financial industries.

More recently, the CBB has been working to shore up the sector against future economic crises. Patrick Gallagher, the CEO of HSBC, told OBG "The CBB is considering new legislation for capital, liquidity and deposit protection, though current regulations are in line with global standards." In late 2010 the bank issued new corporate governance requirements and the regulator is vetting the Basel III accords, and plans to work recently issued international regulations into the local framework within the next few years.

The CBB is also currently working with The Benefit Company (TBC), a private firm that oversees the Credit Reference Bureau (CRB). TBC has a long history with the regulator. The firm was established in 1997, when it won a licence from the CBB to operate Bahrain's ATM switching network. TBC now handles the majority of debit transactions in the Kingdom and runs the Dispute Management System, which handles interbank ATM disputes in the GCC. To further assist inter-bank transactions, TBC operates an electronic cheque clearing system that enables banks to send images of cheques to each other. TBC also manages systems which allow government and businesses to collect online payments.

In 2005 the CBB and the TBC launched the CRB, a secure online compendium of credit information and the credit histories of everyone who has ever received a loan in Bahrain. The CRB allows banks to make an informed decision when assessing whether or not to approve a loan for a given individual. "The system has created a uniform approach to loan applications," said Abdulwahid Janahi, TBC's CEO. Meanwhile, the firm's Corporate Credit Bureau, which is expected to be launched before the end of 2011, will compile similar data on local firms applying for credit.

downturn. Bahrain is home to a range of other locally incorporated banks, including Bahrain Saudi Bank, BMI Bank, Eskan Bank and the Bahrain Development Bank.

OTHERS: A number of major international players have also successfully rolled out retail operations. HSBC Bahrain, which is part of UK-controlled HSBC, has performed well post-downturn. "We took all our provisioning pain in 2009," said Patrick Gallagher, the bank's CEO. "During 2010 pricing was very competitive for major Bahraini corporates, driven by high liquidity in the local market. We have a substantial share of the local corporate market." HSBC Bank Middle East has been active in the region since the mid-1940s. In Bahrain the bank has four branches and two offshore entities.

Citibank is also active in Bahrain, operating a financial centre and two branches, with a third planned. Since the crisis hit, the US-based bank has been solidifying its retail business and focusing on corporate and investment banking. "We have a good market share of the retail business, especially cards, and have invested heavily in banking over the past few years. We withstood the financial crisis in Bahrain and this has allowed us to focus on growing our business," said Manna.

Other foreign banks include France's BNP Paribas; Standard Chartered; India's State Bank of India and ICICI Bank; Pakistan's United Bank and Habib Bank; and a handful of Middle East-based institutions.

WHOLESALE BANKS: While retail institutions came through the downturn mostly unharmed, the same cannot be said for many of Bahrain's wholesale banks. The regional offshore banking industry – including the Kingdom's wholesale banks, which were called offshore banks until a 2006 CBB-led sector reorganisation – fuelled the real estate boom that swept through the Gulf in the mid-2000s. The majority of these projects were high-end residential developments. When the downturn hit the region in mid-2008, global liquidity dried up, leaving many of these banks in the lurch. Many were left holding half-finished luxury residential developments or undeveloped land.

Awal Bank and The International Banking Corporation, both of which belonged to Saudi family-owned conglomerates, defaulted on their debts in mid-2009 and were taken over by the CBB, which put them under the control of local law firms. The wholesale banking segment has continued to lose value since the downturn. In 2010 the segment had total assets of $156.7bn, down from $162bn in 2009, $188.9bn in 2008 and $196.3bn in 2007. Though these losses have had a negative effect on the Kingdom's reputation, they have had little impact on the local banking sector, which is off-limits for wholesale institutions registered in Bahrain.

In early 2011 the wholesale sector was beginning to show signs of recovery. Banks have worked to diversify their balance sheets, with some of the larger institutions moving into the retail and Islamic segments, both of which are expected to drive growth in the coming years. Arab Banking Corporation (ABC) posted losses in 2008 and 2009, but had increased revenues in 2010. ABC had total assets of $28.1bn in 2010, up from $25.9bn in 2009, but down from a pre-crisis high of

Expected to be launched by the end of 2011, the Corporate Credit Bureau will compile data on local firms seeking credit, while a clearinghouse for interbank transfers among local firms is also on the way.

The Islamic financial services segment had assets of $24.6bn at the end of March 2011, 11.5% of the total for the banking industry.

$32.7bn in 2007. ABC has benefitted from its size – the institution is more diversified than many of its smaller competitors in the region, both in terms of markets and product lines. In addition to the Gulf, the bank is active in Algeria, Egypt, Tunisia and Jordan. In 2010 ABC carried out a $1.11bn rights issue, boosting overall capitalisation from $2bn to $3.11bn. This new capital will go towards the institution's long-term goal of becoming a fully diversified bank serving the MENA region.

Gulf International Bank (GIB), another major local wholesale institution, was hit hard by the crisis in 2008 and 2009. After recapitalising in 2010, however, GIB has seen a return to the black, pulling in revenues of $100.4m for the year, up substantially from losses of $152.6m in 2009. Other major wholesale players in Bahrain include Addax Bank, Investcorp Bank, the Securities and Investment Company, TAIB Bank and United Gulf Bank.

ISLAMIC BANKING: Bahrain is home to the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), one of the world's most respected Islamic financial standards issuers. The segment had assets of $24.6bn as of the end of March 2011, equal to 11.5% of total banking assets. Since the downturn hit the Kingdom in mid-2008, growth in the Islamic segment has flattened, hovering around $25bn.

The fact that Islamic banks have not lost much value highlights the ongoing demand for sharia-compliant products throughout the region and the potential for future growth in a more stable banking environment. "One of the core differences between Islamic banks and conventional banks is the amount of fiduciary risk," said Mohammed Bucheerei, the CEO of Ithmaar Bank. "Deposits at an Islamic bank are kept in a fund outside the bank itself, which leads to an increased level of trust in the industry." Bahrain is home to the largest number of Islamic banks in the GCC. Major players include Al Baraka Islamic Bank, Bahrain Islamic Bank, Ithmaar Bank, Gulf Finance House, ABC Islamic Bank, Arcapita Bank, Citigroup and Unicorn Investment Bank. HSBC and Deutsche Bank also operate Islamic "windows" as part of their conventional banking activities.

DEVELOPMENT TRENDS: As the largest banks work to shore up their balance sheets in the coming years, the sector will likely see consolidation. While it is unclear which banks will be involved, many of the smaller wholesale banks are expected to either merge with other smaller banks or be acquired by medium-sized institutions looking to diversify their holdings. Islamic institutions, which are expected to benefit from rapidly growing demand in the coming years, could potentially be at the centre of this upcoming merging activity.

Many leading local institutions are working to invest in new areas. While luxury real estate development remains sluggish, the affordable housing segment is poised for rapid growth in the coming years, due primarily to government investment. Other segments that offer opportunities for local financial institutions include infrastructure, education and industrial development.

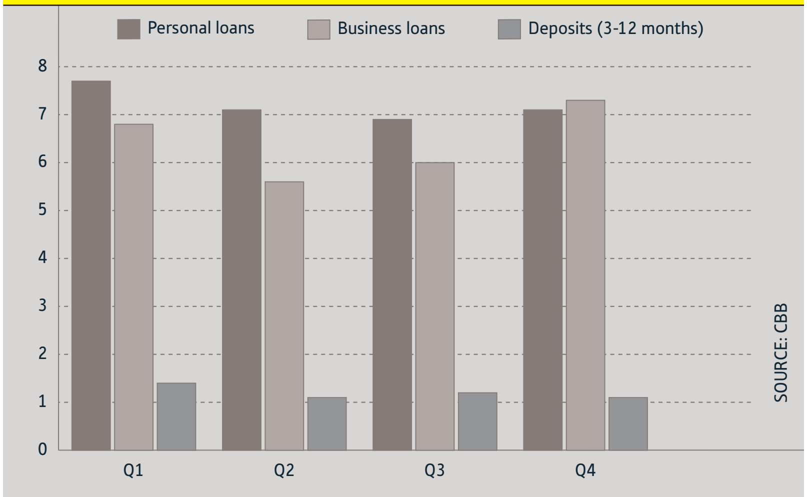
Bahrain has a cash-based economy, though cards – both credit and debit – are increasingly popular among the Kingdom's middle class. Card penetration in the MENA region is among the lowest in the world, and banks have been adding services and features to cards to promote usage in recent years. Bahrain's population is also increasingly internet savvy, which has resulted in steadily rising demand for online banking services.

HUMAN RESOURCES: Bahrain's financial workforce is one of the largest and most highly qualified in the region. As of the end of 2010 there were 14,342 financial services employees, up 1.5% from 14,137 at the end of 2009, according to the CBB. Bahrainis filled 66% of these positions. The banking sector has the largest percentage of total financial employees, with around 8782 at the end of 2010. The Kingdom is home to a substantial number of well-regarded, finance-focused training centres, including the Bahrain Institute of Banking and Finance (BIBF), which is in the top financial education facilities in the region. Launched in 1981, BIBF is funded by a mandatory 1% levy on income at every local financial firm. In return, banks and other financial institutions send their employees to the institute for training and accreditation in a wide variety of areas.

BIBF has worked to build up its Islamic training programmes in recent years to meet expanding demand for bankers and financial managers who are familiar with sharia-compliant products and services. "There is a vacuum in training for staff in sharia departments," said Mohammad Omar Farooq, the head of the BIBF's Centre for Islamic Finance. "We are working with the CBB and other government institutions to provide training in this area, which has been endorsed by the AAOIFI."

OUTLOOK: Bahrain's banks face a number of challenges, but confidence is returning and "business-as-usual" is the predominant sentiment. The sector is now well positioned for continued development and expansion in the coming years. Similarly, the fact that many banks have made significant gains in 2010 signals a turnaround for the local sector. As its recovery continues, troubled banks can be expected to improve or submit to a round of consolidation, which will boost the sector's overall growth. Regardless, it is clear that in 2010 the Kingdom's banking industry turned an important corner. With the financial crisis receding, local institutions are looking to the future with growing optimism.

Avg. interest rates, 2010 (%)



Adel El Labban, Group CEO & Managing Director, Ahli United Bank

The effects of new regulations

OBG talks to Adel El Labban, Group CEO & Managing Director, Ahli United Bank; Abdulkarim Ahmed Bucheery, CE, BBK; Jamal Ali Al Hazeem, CEO, BMI Bank; and Abdul Razak Hassan Al Qassim, CEO, National Bank of Bahrain

What does the proposed deposit guarantee scheme mean for the banking industry?

EL LABBAN: Like all deposit guarantee schemes, it provides a level of comfort for smaller depositors in terms of the ability to recover funds and is consistent with the best practices internationally. However, it does not provide a blanket guarantee for all deposits as some other countries in the region have established. The blanket guarantee scheme is not necessarily the best long-term solution for having a solid banking sector because the sector is not just about banks taking risks on borrowing clients; it also involves depositors taking risks on banks as well. For the depositor, accepting a lower return in a safer bank is a trade off. I believe the scheme in Bahrain is the correct approach because the depositor has to be aware of the financial strength and viability of the bank in which they are initiating the relationship. Additionally banks have to compete in attracting these deposits by offering the right return and risk profile to address their clients' needs.

BUCHEERY: The proper timing for the implementation of the scheme has already passed. I do not believe it is as necessary now as it was during the peak of the financial crisis. In terms of what it will bring as far as comfort for depositors, I do not believe it will have a great impact now. On an international level, I think the scheme is lacking because it would only double the guaranteed amount of deposits from BD10,000 ($26,667) to BD20,000 ($53,334), unlike some of our neighbouring countries where the whole amount of deposits is guaranteed. Additionally, the scheme will be funded by the commercial banks, which is a burden on the sector considering the total cost of the scheme would be BD600m ($1.6bn) funded over a number of years.

AL HAZEEM: It would require banks to provide funds upfront as opposed to the earlier scheme, under which funds were to be provided after the failure of a bank. It will also raise the maximum amount of the deposit guarantee by around 33%. This will likely result in reduced availability of credit across the sector, but this is not anticipated to be a major contraction, and is another example of the Central Bank of Bahrain (CBB) leading the region in adopting best practices. The move shows that certain lessons have been learnt in the wake of the recent global financial crisis.

AL QASSIM: There is already a deposit guarantee scheme available for all deposits in Bahrain, on a post-funded basis. That is to say, banks are required to contribute to meet depositor obligations of a failed bank only when an actual failure occurs. The proposal under consideration is to make the scheme pre-funded, meaning banks will be required to contribute a certain amount every year toward the fund. This change will have material cost implications for all banks in terms of an annual contribution which will impact bank profitability.

Since the existing scheme has worked to protect the banking system, it would be preferable to carefully consider all implications of the suggested change. For instance, what should the size of the fund be – should it be equivalent to the deposits of the largest bank, or the smallest bank or an average bank? Should the strength of each bank have a bearing in deciding its contribution? Would it be better to consider alternative contributions through a system of liquid investments retained by banks, but pledged to the deposit protection board? Proceeding without examining the implications of the proposed change and studying the alternatives could needlessly burden the system with additional costs when better options are available.

What are the implications of Basel III for banks?

AL HAZEEM: There are ongoing consultations with the CBB to assess the impact of the Basel III proposed liquidity and capital requirements on the Bahraini banking sector. Due to the new capital base measurements, some banks may need to raise additional capital if they are at the margin, whether foreign or locally incorporated, listed or private. Most of the local banks have good quality capital and they do not have significant hybrid capital (like preference shares), and therefore they

Abdulkarim Ahmed Bucheery, CE, BBK

should not be adversely affected. Under the Basel III norms, banks with trading books will need to carry additional capital. Hence, this would be favourable to local banks since most do not have a big trading book.

EL LABBAN: Basel III is a capital enhancement regime which affects the quantum and composition of the capital base of banks. It imposes higher levels of capital adequacy and a greater percentage contribution of core Tier 1 capital in the overall equation. It will be put into effect over a number of years, from 2013 to 2019. Its impact, depending on the pace at which the CBB decides to implement it, will not be too significant for the larger banks, whether local or offshore. Smaller banks will have to be assessed on a case-by-case basis.

AL QASSIM: The capital reforms under Basel III together with the proposed introduction of global liquidity standards should further strengthen the Bahraini banking system. Most of the reforms under capital are with regard to maintaining minimum common equity.

This may not have any major impact for Bahraini banks, as at present most of the bank capital is in the form of common equity. Some of the deductions proposed will impact the capital available for core banking business. This will depend on the final implementation guidelines from the CBB. The proposed liquidity standards are very important with regard to maintaining a balanced asset structure and the impact will vary for each bank depending on its structure.

BUCHEERY: The CBB has announced that there will be no problems for Bahraini banks to comply with Basel III requirements. The CBB has found that the banking sector in Bahrain is quite comfortable in terms of compliance. The Basel III requirements mainly focus on the composition of capital and on additional caution of capital to protect banks against unforeseen defaults in the future. The banks in the region and particularly in Bahrain have always formed their capital from core capital. There are few to no banks at all that have formed their capital from global depository receipt issues or sub-debts. The banks are well ahead of the requirements and the CBB has long imposed a minimum capital adequacy ratio of 12% when the rest of the world was working at 8%. This has somewhat restrained banks in Bahrain from utilising their capital but has prepared them well for the new era of Basel implementation.

What changes have you witnessed in lending patterns and how do you foresee domestic lending developing in the coming year?

BUCHEERY: To date there have been low rates of growth for domestic lending and I expect it will continue to be minimal for the coming year. Consumer lending has also been quite stagnant in 2010 and I expect it to grow very slowly in 2011 at rates of, at best, between 4% and 6%. The government can support lending by speeding up the process of projects, such as infrastructure, particularly through Mumtalakat, the investment arm of the government. Speeding up the process of payments for projects and contractors would assist lending as the construction sector is quite large in Bahrain. The cashflow of the construction industry is quite important so shortening the cycle of payment of receivables will reflect positively on the construction sector and subsequently positively influence the banking sector.

AL HAZEEM: Lending within the domestic market has had a volatile journey over the past few years. From the earlier credit crisis to the recent relative stability followed by a period of regional geopolitical stress, we have seen a lot of ups and downs in a short timeframe. Our preference remains with manufacturing, contracting and general trading services, as well as in infrastructure projects. We have also seen a trickle-down effect toward the SME segment through our larger clients. Given the revenue from the current oil prices, the fiscal policy of the government and the $10bn support package from the GCC, a lot of money will be pumped into the economy in the near future. Our lending strategy going forward is one that takes advantage of this cashflow. The focus is on quality credit, better risk management and making proper lending decisions. We foresee a surge

Jamal Ali Al Hazeem, CEO, BMI Bank

of infrastructure-related projects which will be secured by "assignment of government contract proceeds" – an area where banks will actively look to get involved. We also see potential for public-private partnership (PPP) sectors in the Bahraini economy.

AL QASSIM: Banks have become more cautious and aware of their risks. Banks are more circumspect in dealing with other parties as there is uncertainty in the marketplace about the quality of assets held by each bank. As a result, risk premiums have increased. Although there is ample liquidity available within banks, lending rates have not reduced as rapidly as interbank rates due to the credit risk premium sought by lenders. There has been a tendency for banks to withdraw to their home markets and to deal with known, trusted parties. Firms with sound business models are likely to continue receiving financing from banks while activities with uncertain cash flows and those which are more speculative will find it difficult to generate lender interest.

EL LABBAN: There has been a slowdown in growth in the private sector, both on the retail and business side, which is consistent with the after-effects of the global financial crisis and its regional ramifications. In 2009 we moderated our lending due to the fact that the risk premium in the market was unclear and the proper pricing of assets was difficult in such an environment, so there was little loan advance growth in our portfolio. In 2010 we took a more proactive stance on lending and our loans were up approximately 10% due to the greater market clarity available; allowing us to more accurately evaluate the financial soundness of companies and projects we are looking to deal with. Due to the current unrest in the Arab world, it is hard to say how domestic lending will develop in the coming year, as all banks will carefully reassess their risk appetites.

How can Bahrain better position itself to compete regionally as a centre for finance?

AL QASSIM: More than three decades ago Bahrain made a visionary move toward becoming a leading financial centre in the region, acknowledging the fact that hydrocarbons supplies will run out and that there is a need to diversify the economy to achieve progress. This early move has achieved its objective and today Bahrain is perhaps the most mature financial centre in the region. Over the course of the last five to eight years, realising the potential for Islamic banking, Bahrain took the lead in developing the necessary infrastructure to attract Islamic banking institutions, which again has proved successful. The key to success is the ability to look into the future and put in place the necessary infrastructure and support mechanism to constantly look for new avenues of economic development.

BUCHEERY: A lot has already been done to position the country as a financial centre and we need to ensure the continuity of it. The most important element to promote the country is the availability of human capital. Bahrain has a good supply of local talent to support the banking sector and a number of institutes and training facilities exist to continually support the development of the country's financial sector. What we need to ensure is the cost of operating in the country does not increase to the point that it becomes too expensive, whether through rental prices or operating costs.

EL LABBAN: Banks in Bahrain have to adopt an approach of real regionalism and not token regionalism. Real regionalism means you are based in Bahrain but have strong operations in the countries in the region you are targeting, which involves a higher level of investment and a greater commitment of staff and resources. Token regionalism refers to a strong bank in one market and setting up offices and small branches in other markets. This does not yield a lot of benefit in the medium or long term and becomes a transactional commitment to these markets rather than a strong sustainable commitment in the region. For Bahrain the way forward is regionalism because the local market is too small to give banks the prospects for solid growth.

AL HAZEEM: We believe that Bahrain has the potential to becoming a major destination for tourism, which

Abdul Razak Hassan Al Qassim, CEO, National Bank of Bahrain

is an important component in cementing its position as a major regional financial centre.

However, a higher level of investment into delivering on that promise is needed. This includes a lifestyle that competes with other more favourable destinations in the Middle East, particularly the UAE. A lifestyle that is accommodating and attractive to both the local and expatriate population will inadvertently lead to Bahrain being on top of the list for both reputed investors and financial institutions looking to either expand or set up their base within the GCC.

I am optimistic that recent steps towards strengthening the regulatory framework, improving infrastructure investment to facilitate more trade and foreign direct investment inflows, and the creation of a world-class financial exchange in the BFX are some of the measures that should help to ensure that Bahrain remains competitive for the long term.

What types of changes do you expect to see in wholesale banking loan portfolios given the traditional reliance on real estate investments?

BUCHEERY: Many wholesale banks have already started considering converting portions of their operations into retail banks. There are strong indicators that two of the largest Bahraini investment banks are looking to develop consumer banking operations in the GCC region, with Bahrain included. Wholesale banks will have to look at focusing on other areas and not just pure investments in assets such as advisory, real asset investment and investing in real economic sectors like industry, agriculture and services. So the wholesale banks will definitely have to look at sectors aside from real estate, especially considering they have suffered for a number of years due to the revaluation of their portfolios.

AL QASSIM: It would not be fair to say that conventional wholesale banks have traditional reliance on real estate investments. The portfolios of such banks show that non-real estate business constitutes the major part of their activity. Therefore, while the state of the real estate sector does impact business potential, these banks have adequate alternate business avenues to be able to withstand the real estate downturn. However, the same may not be true of the Islamic wholesale banks, and the results can be seen in the performance figures of such banks in the recent past. It will be necessary for these institutions to develop alternate models involving financing economic activity related to manufacturing, trading and services, rather than focusing mostly on real estate-related financing structures.

EL LABBAN: In our case, our real estate portfolio is about 20% of our lending business. Frankly, all banks have to go back to the basics. It is not prudent to concentrate in real estate or any other sector to the degree of exposure that some banks have adopted in the past. Some banks will be capable of reinventing their business models to achieve diversified portfolios and a reasonably managed low-cost deposit base and reduced reliance on income from interest and fees. Acting as a principal or quasi-principal investor in the real estate market through equity or very-high-loan-to-value debt transactions is not a sustainable recipe.

AL HAZEEM: Until the 2008 economic meltdown a majority of financial institutions, including Islamic and wholesale banks, had been heavily dependent on real estate as a core asset class which accounted for a substantial percentage of their balance sheet; this had negative implications after the crisis. At BMI, we will primarily focus on the Bahraini market and emerging markets with active and potential energy, aviation, shipping, industrial and manufacturing sectors to diversify the bank's asset base and therefore reducing real estate exposure. We will largely target governments, semi-governmental agencies, services, manufacturing, oil and gas exploration and production companies, airlines, and national bulk and tanker shipping companies. Also, we will act as arrangers for large corporations in Bahrain either by way of club deals or syndications. Furthermore, our SME department will continue offering new products to help increase our overall market share.

Local banks have worked to incorporate the previous accords

Standard practice

The regulator is in the process of implementing Basel III

In response to the international economic downturn that began in 2008, the Central Bank of Bahrain (CBB) has rolled out a number of new requirements for banks that operate in the Kingdom. In addition to these in-house changes, the CBB, like most other financial oversight entities in the world, has worked to integrate the Basel accords into its regulatory framework. The Kingdom introduced Basel II in 2008, and since then local banks have worked to incorporate the accord into their day-to-day operations. The CBB, in cooperation with other Gulf financial regulators, is currently in the process of vetting Basel III, which was developed and released by the Basel Committee on Banking Supervision (BCBS) in late 2010.

STANDARDS: The governors of the central banks of the member nations of the G10 founded the BCBS in 1974, in an effort to standardise practices around the world and increase integration in the global banking system. The three accords released by the BCBS in the past 25 years – Basel I in 1988, Basel II in 2004 and Basel III in 2010 – are merely recommendations, albeit from a leading group of international financial regulators. Most major financial markets have adopted the first two accords as law – Basel II is still in the process of being implemented at many institutions around the world, including some in Bahrain.

BASEL III: Expected to be adopted by most regulators in developed financial markets, including the CBB, Basel III was released by the BCBS in December 2010.

The accord is concerned primarily with capital adequacy rates and liquidity, and will require banks to hold more capital, increase transparency and strengthen risk coverage. Institutions will be obliged to raise their Tier 1 capital ratio from 4% (under Basel II) to 6%, and boost their Tier 1 common equity from 2% to 4.5%; harmonise Tier 2 capital and completely phase out Tier 3 capital; implement a new fixed capital conservation buffer of 2.5% of the value of their risk-weighted assets and an additional capital buffer of 0-2.5%, depending on local economic conditions; and adopt new, higher liquidity standards. While the minimum capital ratio will officially remain at the Basel II rate of 8%, the addition of the capital conservation buffer will bump the total amount of capital required to be held at a given bank to a minimum of 10.5% and a maximum of 13%, depending on local circumstances. According to the timeline laid out by the BCBS, it will take around seven years to fully implement Basel III, with most major markets – including Bahrain – planning to begin the process in 2012.

POTENTIAL IMPACT: Increasing capital on a national scale represents a major challenge for financial regulators and individual banks around the world. According to a February 2011 working paper published by the OECD's economics department, Basel III has the potential to diminish annual GDP growth by 0.05-0.15 percentage points in the medium term, as institutions work to fund the newly required buffers and boost liquidity. The IMF recently announced that it would offer support to institutions that are struggling to implement the new standards.

According to a January 2011 report from the multinational tax firm KPMG, Bahrain is well positioned to implement Basel III. The CBB's minimum capital adequacy requirement is 12.5%, well above the Basel III minimum of 10.5%, which means that most local institutions are already in line with some of the new regulations. "Basel III is expected to have a limited impact on the banking sector in Bahrain," said Mazin Manna, the CEO of Citibank's Bahrain operations. "The CBB has stringent regulations in place already. Five years ago it would have been a challenge to implement Basel III, but today it is a different story."

Adopting the new framework means Bahrain will be in line with the best international financial regulations available, and that the Kingdom will be somewhat insulated against future international financial volatility – after all, Basel III was specifically designed to protect the global banking system from future financial crises like the 2008 economic downturn.

The three accords released in the past 25 years by the Basel Committee on Banking Supervision are recommendations aimed at standardising practices around the world.

The Kingdom's banks held total assets of $222bn at the end of 2010

Managing the recovery

A measured response has mitigated the effects of the downturn

At the Bahrain Indian Society in May 2011, Rasheed Mohammed Al Maraj, the governor of the Central Bank of Bahrain (CBB), announced that the Kingdom's financial sector had not only survived the international economic downturn, but had already begun to recover the revenues lost. Al Maraj acknowledged that the country's wholesale banks were the hardest hit, but was optimistic about growth in this segment. He was also upbeat about the ramifications of the recent political unrest. "The banking sector has not been hurt so far, and there has certainly been no flight of capital," he said.

As of the end of 2010, according to the CBB, banks in Bahrain held assets of $222.2bn, up from $221.8bn the previous year. This represents a jump of less than 0.2% – an insignificant rise in most years, but a major improvement over 2009, when the sector lost $30.6bn – a drop of 12% – in total assets.

The retail segment, which has driven expansion in the sector since the crisis, grew by nearly 10% in 2010, posting assets of $65.6bn, up from $59.7bn in 2009. Apart from a loss of around 6% in 2009, retail has seen solid growth for the past decade. Local wholesale banks, on the other hand, have lost around $39bn since 2007, posting losses of around $10bn each year. As of the end of 2010 the wholesale segment had total assets of $157bn, down from $162bn in 2009, $189bn in 2008 and an all-time high of $196bn in 2007.

RESPONSE: The quick return to growth, despite losses in the wholesale segment, is telling. Bahrain's response to the downturn has been effective, both in terms of overarching government oversight and policies enacted at individual institutions. The country's banking sector, which is among the best-regulated in the region, was in a better position to deal with a large market disruption than many of its neighbours. Still, the fact that the industry has only posted losses for one year since the crisis says much about the Kingdom's financial leadership, both in the public and private sector.

IN AT THE HIGH END: Bahrain's wholesale institutions are incorporated in the Kingdom but can only serve the local market, with certain limitations. These banks must have a minimum of BD7m ($1.87m) for extending loans and taking deposits, and at least $100,000 for selling investment products. As a result, wholesaler banks spent the mid-2000s investing heavily in real estate, primarily in the high-end and luxury segments. These investments paid off from 2004 through 2007, when assets grew at a compound annual growth rate of 27.4%, according Gulf Investment House, a Kuwait-based financial services firm. When the downturn hit in 2008, however, these institutions experienced losses.

"Partially driven by speculative demand, some investment companies and banks invested heavily in real estate," said Mazin Manna, the CEO of Citibank's Bahrain operations. "They were able to book gains during the upturn and, subsequently, suffered losses."

Gulf Finance House (GFH), an Islamic wholesale bank launched in the Kingdom in 1999, is a typical example of the events at many local wholesale institutions during the pre- and post-crisis period.

In the years leading up to 2008, GFH invested heavily in major real estate developments throughout the region, borrowing from other banks to fund projects and setting up a number of subsidiary companies along the way. As an Islamic institution, GFH benefitted from the growing trend around the world for sharia-compliant finance, which was thought to carry less risk than that found in the conventional sector.

RESTRUCTURING: When the downturn hit, GFH was heavily exposed to debt financing products and the regional real estate market, which slowed to a halt during the crisis. With reduced income as well, the bank lost $2.2bn in assets between fourth-quarter 2008 and first-quarter 2009, before losing $728m more in 2009.

GFH has since taken a multi-pronged approach to raising capital and paying off its debts. In 2010 it posted losses of $349m, a major improvement on the previous year. Since the downturn the firm has divested itself of a number of its largest projects and subsidiaries, and reduced operating costs by 20%. As a result of this

The response to the downturn has been effective, both in terms of overarching government oversight and policies enacted at individual institutions.

The CBB has introduced measures to improve corporate governance

A number of wholesale banks are working to either launch a retail component or acquire an existing retail institution, in an effort to ensure reliable profits.

restructuring programme, the bank is on track to see a return to growth in the next few years.

RAPID REACTION: The retail segment suffered minor losses compared to the wholesale sector in the wake of the downturn. Most retail banks saw their revenues drop in the fourth quarter of 2008 before returning to growth by mid-2009, largely as a result of increased provisioning for non-performing loans and writing down investments. By 2010 the Kingdom's retail banks were being pointed to as an example of effective post-crisis management. Many wholesale banks are working to either launch a retail component of their own or acquire an existing retail institution in an effort to ensure regular, reliable profits for the foreseeable future.

The fact that the CBB did not have to bail out any local institutions or inject credit into the market reflects the sector's resilience. In September 2009 the CBB announced that the government would not step in to rescue local banks, and that banks should be supported by their shareholders. The regulator instituted a number of initiatives in response to the downturn, the majority of which were concerned with improving corporate governance at local financial institutions. Banks were required to submit their financial data to the CBB for review on a more regular basis than before the crisis, for example, and additional audits were required for end-of-year financial results.

In mid-2009 the regulator considered implementing a 30% cap on real estate exposure in banks' loan portfolios and a 40% cap in investment portfolios, but the plan was rejected when it was determined that many banks would not be able to comply with the new standards within a reasonable amount of time. In October 2009 the bank introduced new liquidity guidelines, requiring local retail banks to maintain a loan-to-deposit ratio of 75%. Previously the CBB did not maintain any fixed liquidity guidelines and only required banks to lower their loan-to-deposit ratio if it got out of hand. As of August 2009 the loan-to-deposit ratio of local currency deposits in the retail sector as a whole was around 109%. "The CBB is keeping a close watch on banks that are having trouble," said Jithesh Gopi, the head of research at the Securities and Investment Company, a local financial services firm. "They will not prop up failing institutions, but they will continue to work with them to improve their balance sheets."

CHALLENGES: While the Kingdom's retail banks have seen a return to profitability in 2010, a number of issues remain. Liquidity, which dried up in the wake of the downturn, has recovered over the past year, but most banks have yet to resume regular lending practices. "Liquidity is plentiful in the market," said Manna. "However, some banks are still reluctant to lend." Many institutions are wary of overextending themselves again, and so have locked down lending. This is not the case for all segments, of course – some companies have seen an increase in the availability of credit over the past year. Accessing credit continues to be a challenge for smaller players and individuals, though so long as the market continues to improve in 2011 and 2012 – and it is expected to – credit will likely become easier to obtain.

The Kingdom is currently considered overbanked in most segments

A fresh approach

Local banks are increasingly implementing new strategies

Three years after the international economic downturn hit, Gulf financial institutions are beginning to see a return to growth. As balance sheets continue to improve and the Kingdom's leading banks get back on their feet, the sector is expected to undergo a substantial number of transformative changes.

Currently the Kingdom is considered overbanked in most segments. Small and medium-sized institutions dominate the local market, and while a handful of larger banks are responsible for a substantial percentage of total assets, no single entity has made the jump from the regional market to the world stage. "During the property boom the average size of a bank in the region was smaller than the average size of a mega-project," said Rohit Chawdhry, the senior manager of treasury and investment at Bahrain Islamic Bank, a major local sharia-compliant retail institution. "Even now, three years after the crisis, there are far too many investment banks. Consolidation has to happen eventually." Similarly, in recent years most banks' investment portfolios have been heavily weighted towards real estate. Now that the economic crisis has proven this position to be untenable, many institutions are working to diversify their holdings into more sustainable, long-term segments.

Many of Bahrain's smaller and younger financial institutions, especially those that came up during the property boom in the mid-2000s and were heavily invested in luxury real estate projects when the crisis hit, will continue to face financial troubles for the next few years. A round of mergers and acquisitions could well be on the horizon, as these firms look to shore up their business and strengthen their balance sheets, and larger banks, the majority of which have recovered faster than their smaller counterparts, look to expand into new segments.

DIVERSIFICATION: This period of consolidation will likely be driven by diversification and expansion. Retail banks have managed to post continuous profits during the downturn, primarily by focusing on their core business – offering basic banking services to local consumers. On the other hand, the Kingdom's wholesale banks, which are not licensed to carry out retail business in Bahrain, have had to look for new areas in which to invest. A number of nascent local industries, many in the very early stages of economic development, stand to benefit from this.

In addition to moving into new areas, many of the Kingdom's banks are working to expand their geographic footprint, both within the country and throughout the MENA region. Bahrain, which is centrally located and boasts one of the strongest financial regulatory regimes in the Gulf, is well positioned to serve as a banking hub for the Middle East as a whole. These diversification and expansion efforts have the potential to drastically alter the contours of the local banking sector.

CONSOLIDATION: At the end of the first quarter of 2011 Bahrain was home to more than 400 financial institutions, including around 160 banks and other banking-related entities. The country had 15 local retail banks, 15 foreign retail bank branches, 26 representative offices of foreign banks, 27 sharia-compliant banks and 77 wholesale banks.

Many of the wholesale institutions were launched in the mid-2000s with the goal of investing in the region's real estate sector. The Gulf property market, flush with oil wealth and catering to inflated demand for luxury villas and other high-end developments, attracted huge amounts of investment from 2003 to early 2008. When the international downturn swept through the region in early 2008, however, the bottom dropped out of the market, and it became apparent that what had initially appeared to be substantial demand from end-users was mostly interest from real estate developers and investors looking to "flip" property and turn a quick profit. When the downturn hit Bahrain in 2008, many of the wholesale banks that had been set up in this period held investment portfolios that were 70-80%

In early 2011 the sector featured 15 local retail banks, 15 foreign retail branches, 26 representative offices of foreign banks, 27 sharia-compliant banks and 77 wholesale firms.

Consolidation is expected, with some larger retail banks well placed to acquire smaller wholesale firms

leveraged in property. "Many local investment banks started as private equity firms, which at the time meant almost exclusively real estate," said Jithesh Gopi, the head of research at local financial services group Securities and Investment Company. "This was a weak model, and it became clear that many of these firms were more like property investment companies than investment banks."

A number of real estate projects in the region were put on hold due to the sudden drop in demand and financing. Many of the wholesale banks that had invested heavily in property followed suit, putting their dealings on ice in the hope that their holdings would regain some value.

In early 2011 profitability had returned to a number of segments, though the high-end real estate market remained down. As a consequence, many of the Kingdom's wholesale banks continued to post losses. Market-watchers feel the Kingdom is on the verge of a period of consolidation, with larger retail (and some of the better-diversified wholesale) banks well situated to acquire smaller wholesale institutions.

Similarly, Bahrain's wholesale banks represent potentially lucrative acquisition targets for major multinational financial institutions looking to break into the Gulf market.

The sector has already seen consolidation in recent years. In early 2009 sharia-compliant Al Salam Bank, which was incorporated in the Kingdom in 2006, paid $72m for Bahrain Saudi Bank (BSB), a conventional bank that has been active in Bahrain since the early 1980s and had a six-branch local network. BSB was converted into an Islamic institution after the takeover. Al Salam, which has fared well since the downturn, has said that it is in the market for other acquisitions in the region. In April 2010 Ithmaar Bank, a local wholesale institution, merged with its own subsidiary, Shamil Bank, an Islamic firm. The resulting bank, still called Ithmaar, is sharia-compliant and has seven branches in the Kingdom.

Having fared relatively well in the face of the economic downturn, Islamic banks are expected to play a central role in the upcoming period of mergers and acquisitions.

NEW SEGMENTS: The high-end property segment, which delivered huge returns for local banks during the rapid regional growth in real estate in the mid-2000s, slowed as a result of the downturn. Consequently, Bahrain's financial institutions are working to move into a number of new segments, including affordable housing, Islamic financial services, infrastructure, industrial development and education, among others. Diversification has become a watchword among local players eager to avoid repeating the mistakes that led to the recent losses.

The Central Bank of Bahrain (CBB), the government's financial regulator, is also working to encourage banks to diversify their holdings. The state has been pushing a number of segments, including affordable housing – which is expected to undergo substantial development in the coming years – and industrial development, which has the potential to be a major economic driver in the coming years due to the government's support.

Islamic institutions, many of which have fared relatively well in the face of the economic downturn, are expected to play a central role in the upcoming period of mergers and acquisitions in Bahrain. Islamic financial services are in high demand around the world, and Bahrain is considered to be an international leader in the segment. The Kingdom is well placed to take advantage of the fact that many conventional retail and wholesale institutions would like to move into the sharia-compliant market.

EXPANSION: As banks continue to grow, either as a result of consolidation or the knock-on effects of the improving economic environment, many will work to expand their international presence.

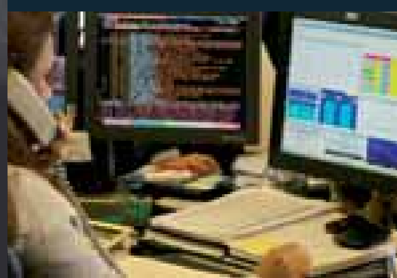
Bahrain has been a regional centre for financial services since the local banking industry became established in the 1970s. Today, the Kingdom is better situated than ever to serve as a home base for banks looking to launch services throughout the MENA region. The CBB is widely regarded as a leading financial regulator in the area, and the Kingdom is home to a large population of well-educated and highly capable financial workers.

A number of local institutions have launched foreign operations in recent years. Elaf Bank, an Islamic wholesale institution that set up in Bahrain in 2007, recently won a licence to operate in Malaysia, for example, giving the firm access to the two largest markets for Islamic financial services in the world. Elaf plans to act as a bridge between the two countries, offering Islamic bond issuances and other sharia-compliant products in both markets.

Other local institutions that are either in the process of incorporating branches in foreign markets or have announced that they plan to do so include Arab Banking Corporation, Bahrain's largest wholesale bank, which is set to launch a subsidiary in Russia. In addition, National Bank of Bahrain, one of the Kingdom's largest retail institutions, has plans to expand its existing networks in Abu Dhabi and Saudi Arabia, and launch a new subsidiary in Qatar.

Capital Markets

New bourse takes the place of former stock exchange
Financial services companies continue to dominate
Mutual fund investments on the rise
Attempting to create a more balanced market
Divestment should create more listings and IPOs



Financial regulations currently in place are among the best in the Gulf

Trading up

A new exchange and solid fundamentals are expected to contribute to future growth

There have been major strides forward in local capital markets in recent years. In 2010 Bahrain's investors welcomed the launch of a second bourse, which will eventually offer a full complement of financial products, widening the Kingdom's capital markets offerings substantially. At the same time, the Central Bank of Bahrain (CBB) has worked to deepen the market with a wide variety of initiatives, including a comprehensive regulatory reform programme and a project to encourage new initial public offerings (IPOs). These changes are in line with Bahrain's reputation as a regional leader in financial services and capital markets and are expected to burnish its status in these areas.

That said, the country's capital markets face a number of challenges. Steadily increasing competition from exchanges in Qatar, Dubai and Saudi Arabia mean that Bahrain cannot afford to rest on its laurels. With this in mind, attracting new listings in order to further deepen both of its bourses is an essential component of the country's ongoing capital markets development plan. A substantial amount of new capital markets business could eventually come from the privatisation of a handful of major state-owned firms. Based on the successful listing of the government-controlled Aluminium Bahrain (Alba) in late October 2010, there is significant potential for future growth in this area.

Despite these challenges, the Kingdom is still relatively well positioned to maintain its status as a leading financial centre in the Gulf. The Bahrain Bourse (BHB), which was known as the Bahrain Stock Exchange (BSE) until it underwent corporatisation and a rebranding effort in 2010, has benefitted from a number of new IPOs over the past few years, and the Bahrain Financial Exchange (BFX), the Kingdom's new bourse, is steadily ramping up activity. With the CBB at the helm, the Kingdom will likely be recognised as a regional capital markets leader for some time to come.

POST-CRISIS DEVELOPMENT: The international economic downturn that swept through the Gulf region in late 2008 and 2009 had a negative effect on the bourse, though Bahrain's capital markets fared better than those of some of its neighbours. "Like all exchanges in the region, we were down as a result of the downturn," said Ebrahim Jaffar Al Aradi, the head of trading and members affairs at the BHB. "But we did better than some others in the region. The index fell by around 20%, compared to 30-35% on other exchanges."

The market was better insulated from the effects of the downturn for a number of reasons. Bahraini investors did not have any involvement with the complex financial instruments that kicked off the crisis in the US. Additionally, the BHB remains a fairly localised, low-volume market, which has been a challenge in some ways but was an advantage during the downturn. "The crisis had limited consequences here," said Liam Richard Gibbon, a capital markets advisor at the CBB's Capital Markets Supervision Directorate (CMSD). "This is due to the economy's strong fundamentals, preventative measures and careful oversight by market regulators."

Since the downturn, as liquidity has declined around the world, many firms in Bahrain have worked to alter their development trajectories, moving away from short-term debt instruments and interbank loans from international financial institutions. Instead, they are increasingly looking to the local market for long-term financing. This bodes well for the BHB and the BFX.

OVERSIGHT AND REGULATION: The financial regulations currently in place in Bahrain are widely regarded as among the best in the Gulf. The CBB has served as the Kingdom's financial regulator since it was launched in 2006. Prior to that, the bourse was overseen by the Ministry of Commerce (until 2002) and by the Bahrain Monetary Agency, which was set up in 1973 and replaced by the CBB in 2006.

The CBB is responsible for regulating all aspects of the financial sector, including conventional and Islamic banks, insurance and investment firms, brokers and capital markets. The CMSD, the central bank's capital markets arm, has worked to ensure that the local regulatory regime is in line with a variety of international

The Bahrain Bourse was better insulated from the effects of the international financial crisis than exchanges in neighbouring countries, as it is fairly localised and was not involved in the risky instruments prevalent in the US. Careful oversight and strong fundamentals also helped.

The BHB was introduced in 2010 to replace the BSE, which had been in operation since 1987

standards, including the International Organisation of Securities Commissions. The CMSD has a mandate to regulate the two licensed exchanges, clearing houses and depositories, as well as approve the issuing, offering and listing of securities. It also develops efficient market regulation, enforces existing capital markets legislation, and educates investors and other market players in sound financial and trading practices.

In 2010 the CBB introduced a number of major initiatives and regulatory changes, including licensing the BFX, which was subsequently launched in February 2011; reforming the capital markets rulebook; and corporatising and rebranding the BHB. Major new regulations introduced in 2010 include the introduction of new rules for brokerage firms, legislation surrounding dispute resolution and, in conjunction with the Ministry of Industry and Commerce, a new corporate governance code, among others.

THE ESTABLISHED PLAYER: The BHB was launched in 2010 to replace the BSE, which had been the Kingdom's sole exchange since 1987. However, Bahrain has been home to some form of capital markets since 1957, when shares of public companies were traded on the Al Jowhara Market, a local informal exchange. The launch of the BSE was the result of a feasibility study carried out by the state in conjunction with the International Finance Corporation, the World Bank's private sector development arm. The exchange saw trading commence in June 1989, with 29 local firms listed. Electronic trading was put in place in 1999, and in 2006 the CBB took over the supervision of the bourse. Most recently, in 2010 the bourse was corporatised and rebranded as the BHB in an effort to boost competitiveness and efficiency. While the government owns the exchange, it is set up to function independently.

Three indices track the BHB: the Bahrain All Share Index, the benchmark; the Dow Jones Bahrain Index, which lists all firms registered in the Kingdom; and the Esterad Index, a smaller collection of firms.

As of the end of the first quarter of 2011, the BHB was home to 49 listed companies, 35 mutual funds and 12 bonds, eight of which were Islamic bonds, or *sukuks*. Market capitalisation at the end of the first quarter was BD7.51bn ($20.03bn), up 15.4% from BD6.51bn ($17.36bn) during the same period the previous year. The financial sector accounted for around 66% of the 2011 market cap, with commercial banks valued at BD2.69bn ($7.17bn), almost 36% of total market cap; investment firms at BD2.1bn ($5.6bn), or 28%; and insurance companies at BD181.1m ($482.9m), or 2.5%. Other major players included the services sector, with BD1bn ($2.67bn), making up 13%; the industrial sector with BD1.3bn ($3.47bn), or 17%; and the tourism sector with BD227.5m ($606.73m), or 3.5%.

As of the end of March 2011, Ahli United Bank was the single largest stock listed on the BHB, with a market cap of BD1.34bn ($3.57bn), or 17.9% of the value of the total exchange. In second place was Alba, with BD1.29bn ($3.44bn, 17%), followed by the Bahrain Telecommunications Company (Batelco), with BD699.8m ($1.87bn, 9.3%); the Arab Banking Corporation, with BD668.3m ($1.78bn, 8.9%); and the National Bank of Bahrain, with BD560.3m ($1.49bn, 7.5%).

BENCHMARKS: Three indices track the BHB, including the Bahrain All Share Index, which serves as a benchmark; the Dow Jones Bahrain Index, which lists firms that are registered in the Kingdom; and the Esterad Index, which is overseen by Esterad Investment, a local company, and comprises a selected collection of 22 firms that have been chosen in accordance with specific criteria, including market capitalisation and liquidity. The All Share Index ended the first quarter of 2011 at 1424.64 points, down around 8% from 1547.13 points in the same period in 2010. Dow Jones Bahrain fell around 7% during the same period, from 130.2 points in 2010 to 121.18 points in 2011. Finally, the Esterad Index ended the first quarter of 2011 at 1521.51 points, down 4% on 1584.24 in 2010.

As of March 2011 there were 11 active brokers involved with the BHB. The Securities and Investment Company (SICO), which has been the dominant broker for the past decade, controlled around 52% of the brokerage market during this period, or around BD23.1m ($61.6m). Other major brokers on the exchange include Gulf Securities, with BD6.4m ($17m), or 14.5% and Al Ahlia Securities, with BD6.1m ($16.2m), or 13.8%.

While activity on the BHB has fallen off over the past year, the exchange has performed better than bourses in Kuwait and Dubai. Still, the Kingdom's regulators and major players face a number of issues in the coming years. For one, listings on the exchange are not in line with the economy at large. The oil and gas sector, for example, which accounts for around 25% of GDP in the Kingdom, is simply not represented on the BHB. Conversely, financial services firms are somewhat overrepresented on the exchange in comparison to their overall economic contribution. While the CBB is working to improve the balance of the exchange, primarily by pulling in new companies from different sectors, for the foreseeable future growth will likely continue to be driven by solid performances in the financial services sector, and particularly among major banks.

THE UPSTART: Located just next door to the BHB at Bahrain Financial Harbour is the BFX, the Kingdom's primary financial centre. The BFX is a subsidiary of the

Financial Technologies Group (FTG), an international financial technology company. FTG oversees a network of 10 exchanges around the world, including the top commodities exchange in India and other major bourses in Botswana, Singapore and Mauritius. It is as yet unclear how the launch of the BFX will impact business on the BHB in the long term. While the new exchange has been designed to complement its predecessor and (initially, at least) its product offerings will not overlap with those on offer at the BHB, it could potentially become a competitor in the future, especially if it is successful at attracting a wide range of listings and investors.

SPECIALISATION: While stocks dominate at the BHB, the BFX is focusing on other asset classes, including cash instruments, derivatives and, perhaps most importantly, sharia-compliant products. Bahrain is one of the largest Islamic financial services centres in the region. The Kingdom boasts the highest concentration of sharia-compliant companies anywhere on earth, and it is home to a number of major Islamic standards bodies (see Islamic Financial Services chapter). In an effort to take advantage of this situation, on February 7, 2011 the BFX launched Bait Al Bursa, the first dedicated trading platform for Islamic securities in the region. With an international advisory board that includes sharia scholars from Saudi Arabia, Syria and Canada, the bourse will offer a wide variety of products based on the concept of *murabaha*, a non-interest-bearing form of credit that is in line with Islamic law. Bait Al Bursa is powered by e-Tayseer, a fully automated trading platform purpose-built to handle sharia-compliant products. Trading on e-Tayseer has been ongoing since its inception, however the conventional launch of the system has been postponed for a later time. Executives were hopeful at the time of printing that the exchange would be able to begin operations by mid-2011.

NEW ISSUES: In the wake of the international financial downturn in 2009 and 2010, the BHB experienced a dearth of IPOs, in line with regional trends. More recently, however, as balance sheets have started to improve and firms have once again begun to look for new financing, listings have picked up somewhat. In late October 2010 the Alba IPO was launched by Mumtalakat, a government-owned investment firm that owns 69% of the aluminium producer.

The offering, which saw 10% of the firm listed on the market, brought in $338m, and was widely considered to be both a success and a solid indication of economic recovery. Since then, a number of local companies have announced that they plan to launch IPOs in the near future, including Bahrain Air, a relatively young low-cost airline; Gulf International Bank; and Zain Bahrain, a major telecommunications company.

Mumtalakat is expected to launch a number of new listings in the coming years. The firm, which was created in 2006 by royal decree, inherited 29 state-owned companies that were previously managed by the Ministry of Finance. Today, Mumtalakat has either a majority or a minority stake in 35 firms, including the Bahrain Airport Company, which oversees Bahrain International Airport; Bahrain International Circuit, which is responsible for the annual Formula One race in the Kingdom; Batelco, the leading telecoms firm; and Gulf Air, the national carrier, among others. In total, Mumtalakat's holdings are valued at around BD3.4bn ($9.07bn). Under Bahrain's Economic Vision 2030, the government's long-term economic development plan, the state plans to divest itself of many of these firms. "Alba was the first big IPO in recent years," said Gibbon. "It might also be the start of a government privatisation programme."

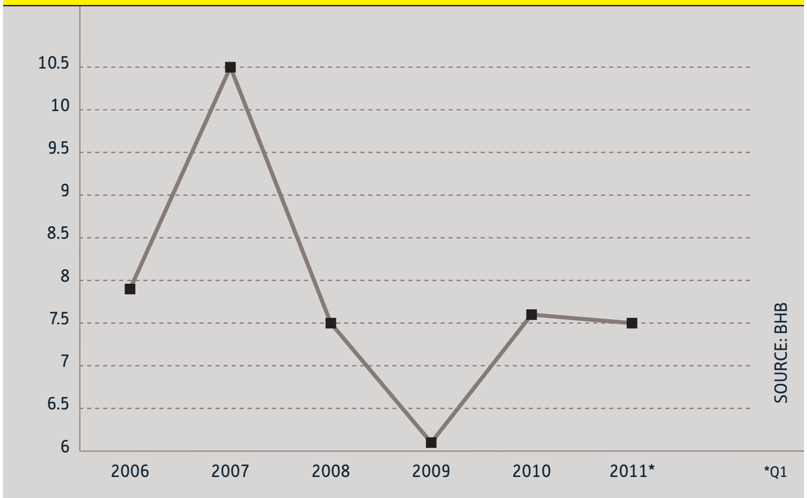
As the states divests its firms, more IPOs are expected in the future

DEBT MARKET: The debt market has been active in recent years. The government issued the Kingdom's first convertible bonds in 2010, and the CBB's regular short-term bond issues have been oversubscribed by a substantial amount. In the first quarter of 2011, for example, the CBB's three-month treasury bills (T-bills) saw a subscription rate of 283% and the bank's six-month T-bills saw a rate of 340%. Subscription rates for the CBB's sharia-compliant three- and six-month securities topped 500% during the same period.

Additionally, medium-term issuances have been popular in recent years, as evidenced by a 12-month T-bill recently issued by the CBB that saw a subscription rate

The new Bahrain Financial Exchange is focusing on asset classes including cash instruments, derivatives and sharia-compliant products. The latter is a growth area for the Kingdom as it is home to one of the largest Islamic financial services centres in the region.

BHB market capitalisation, 2006-11* (BD bn)




There is a highly trained local capital markets workforce

The BHB would benefit from a few changes, such as additional listings of firms in sectors other than financial services and the privatisation of major government-owned companies.

An expected forthcoming series of mergers and acquisitions would boost confidence in the bourse and, as a result, increase activity.

of 211%. In total the government issued six bonds in the first quarter of 2011, worth around $179.4m in all. The central bank also saw strong demand for an April 2011 issue of a five-year *ijara* sukuk, or real-estate linked Islamic bond, with a total value of BD200m ($533.4m) and a return of 5.5%. While the government has moved forward with a handful of issuances, the 2009 economic downturn and political unrest in the Kingdom early in 2011 have had a negative effect on the bond market. In early 2010 Esterad decided to withdraw a BD7bn ($18.67bn) issue at the last minute due to worries about undersubscription. Similarly, the government postponed the issuance of a planned $1bn sovereign bond in February 2011, citing the ongoing political rest as motivation. At the same time, however, a number of successful corporate bond issues have taken place recently. In October 2010, for example, BBK (formerly the Bank of Bahrain and Kuwait), a major local retail bank, successfully released a $500m bond after postponing the issuance from earlier in the year.

MUTUAL FUNDS IN FOCUS: The Kingdom has been a regional centre for mutual funds since 1992, when the government introduced formal regulations for the products. As of the end of 2010, investments in funds totalled around $9.2bn, up from $8.7bn at the end of 2009. Institutional investors accounted for 74% of this total, while the remaining 26% was ascribed to individual investors, primarily high-net-worth individuals. The largest institutional investor in Bahrain by a substantial degree is the Social Insurance Organisation, which was formed in 2008 as a result of the private and public pension funds merging (see analysis).

HUMAN RESOURCES: Bahrain benefits from the most highly trained capital markets workforce in the region, according to most major players. The Kingdom has been active in the financial services sector since the 1970s, and it is home to a substantial number of financial training programmes and education institutions. The Bahrain Institute of Banking and Finance (BIBF), which was established in 1981, is currently one of the premier financial training centres in the Gulf. The institute, which is funded by local financial institutions, offers a wide variety of training and accreditation programmes in both Arabic and English. In 2011 the BIBF was working to develop new programmes to cater to the rapidly expanding Islamic financial services segment.

VIEW OF INVESTMENT OPPORTUNITIES: The sector faces a number of challenges in the coming years. The BHB would benefit from additional listings of firms in sectors other than financial services, for example. The privatisation of major government-owned companies, such as Batelco and Gulf Air, would boost the market substantially. At the same time, the financial services sector, which was negatively affected by the downturn, will likely undergo a series of mergers and acquisitions at some point in the next decade or so. "Banks are facing liquidity challenges at the moment," said Hussain Al Sharaf, the director of the CBB's Islamic Financial Institutions Supervision Directorate. "The sector would benefit greatly from mergers and acquisitions." A round of consolidation has the potential to boost confidence in the sector, which could, in turn, result in increased activity at the local exchanges. "The capital markets in Bahrain are not quite deep enough yet," said Rohit Chawdhry, a senior manager of treasury and investment at Bahrain Islamic Bank, a local financial services firm. "That said, there is great potential here."

Investors looking to move into the Gulf are faced with many options these days. In addition to the BHB and BFX, they could potentially buy into a number of other exchanges in the region, including NASDAQ Dubai, the Qatar Exchange in Doha, and the Saudi Stock Exchange. Bahrain, with its long history in capital markets and top-notch regulatory regime, stands out from this crowd in a number of ways, though the CBB is working to widen the gap further. The launch of the BFX represents a step in the right direction.

OUTLOOK: Despite rising competition from neighbouring markets and the ongoing effects of the international economic downturn, Bahrain's capital markets are expected to grow dramatically in the coming years. While the aforementioned challenges could dampen expansion in the short term, the BHB and the BFX are both well set for long-term growth. Upcoming government privatisations represent a major potential influx of capital on the exchanges. Its reputation as a centre for Islamic finance puts the Kingdom in good stead for attracting sharia-compliant listings to the Bait Al Bursa in coming years. Bahrain is thus expected to remain a leading destination for investors in the Gulf.

Sectors by BHB market cap (BD)

	2010 Q1	2011 Q1
Commercial banks	2.5bn	2.7bn
Investment	2.4bn	2.1bn
Insurance	182m	181.1m
Services	1.2bn	1bn
Industrial	16m	1.3bn
Hotels & tourism	178.7m	227.6m

SOURCE: BHB

Fouad Rashid, Director, Bahrain Bourse

Market expansion

OBG talks to Fouad Rashid, Director, Bahrain Bourse (BHB)

How will the change of the stock exchange into a closed shareholding company affect operations?

RASHID: This important development will allow BHB to further introduce and develop initiatives that relate to its current offerings and activities, which will hopefully increase and diversify its sources of income. The change was one of the steps that the Kingdom of Bahrain had identified to further develop the capital markets sector and enhance its competitiveness.

Do you expect new initial public offerings (IPOs) in the short term? How does the BHB support listings?

RASHID: Looking at the IPO market in the region over the past two years, we have noticed that only a few IPOs were offered. One of the most important IPOs for Bahrain and the region was that of Aluminium Bahrain (Alba), which was listed on the bourse during November 2010. The reason for the low number of IPOs can largely be attributed to the global financial crisis, which adversely affected stock markets worldwide. New IPOs will be offered once the performance of financial markets begins to improve.

In addition, BHB's new rulebook, which will be issued in the coming months, will include flexible listing requirements. This change will hopefully encourage more companies to list on the exchange and benefit from its services and facilities. There are several companies that have already shown interest and inquired as to listing on the BHB. Currently a large number of potential listings are waiting for the right market conditions to proceed with the process.

What is your outlook for the listing of conventional bonds and sukuk (Islamic bonds) on the bourse?

RASHID: Many investors who were looking for fixed-income instruments have been investing in equities rather than bonds and sukuks. This was due to the limited issuance of bonds and sukuks, as well as the fact that retail investors had limited access to the bond market. Therefore, we have been trying to create a more active and accessible fixed-income market for all investors. There are currently 13 conventional bonds and sukuk listed on the bourse, totalling roughly $4.69bn.

A very small number of family businesses and closed companies are listed on the bourse. What are the bourse's plans to persuade them to list?

RASHID: Family businesses and closed companies are very important components of the Kingdom's economy. Since very few of them are listed on the bourse, BHB's new strategy is to work more closely with family businesses and companies to discuss any issues or concerns that they might have related to listing.

Ultimately, we would like to eliminate all obstacles that might be associated with their listing, without violating the rules and regulations relating to transparency and corporate governance.

How do you assess the bourse's overall performance in 2010, and where do you see potential in 2011?

RASHID: The BHB ended the year 2010 with a decline of 1.78% in the Bahrain All Share Index. However, the market capitalisation was up by 23.35%, increasing from BD6.13bn ($16.35bn) in 2009 to BD7.56bn ($20.16bn) in 2010. The main reason for this increase in market capitalisation was the listing of Alba that took place during November 2010.

However, the value and volume of shares traded decreased by 39% and 28%, respectively, at the end of 2010 compared to these same figures reported at the end of 2009. The trading results of 2010 clearly indicate that investors were still suffering from the consequences of the global financial crisis, in line with the performance of other stock markets in the region.

We hope that the turnover will show improvement throughout 2011, given the strong financial results announced in December 2010 by the BHB's listed companies. The Kingdom's well-regulated non-tax environment that allows up to 100% of foreign ownership should also encourage further activity in the future.

Arshad Khan, Managing Director and CEO, Bahrain Financial Exchange

A single platform

OBG talks to Arshad Khan, Managing Director and CEO, Bahrain Financial Exchange (BFX)

What new instruments are you offering to attract greater foreign participation in the market?

KHAN: The BFX is a multi-asset exchange. This makes it unique among exchanges in the region. Other exchanges deal in one or two asset classes, but there is no single platform that offers everything to an investor. The BFX offers the advantage of trading in different asset classes, either in the derivatives market, our Islamic platform or our cash platform, to trade conventional products like stocks, bonds and exchange-traded funds.

Having a multi-asset exchange licence allows us to offer innovative instruments to attract foreign investors to our market. Over the past two years people have changed the way that they invest in capital markets. Traditionally, investors invested in one asset class and a lot of them were severely affected by the global economic crisis. Analysis shows that if an investor has hedged their portfolio into different asset classes their return is greater than for those investing in a single asset class.

On the derivatives platform we have introduced innovative products such as index products, as well as commodities and currencies that address both investment and hedging purposes.

What role do you envisage sharia-compliant financial instruments playing in Bahrain?

KHAN: One issue in the industry that is not addressed by the existing capital markets in the region at present is the lack of financial instruments for the Islamic finance market. There are simple products such as sharia-compliant securities and sharia-compliant exchange-traded funds, and then there is another side of Islamic finance that is more structured and specialised, such as structured products like murabaha. The area in which the industry still needs additional innovation and automation is in murabaha products. On a daily basis there are billions of dollars traded in murabaha alone, making it one of the most actively traded products in Islamic financial markets. Trading of this product is performed on a completely manual basis, which brings disadvantages due to time, transfer issues and resource costs.

Bait Al Bursa, our Islamic division, is focused on automating the Islamic finance market. The first product that we launched was e-Tayseer, which is a platform where complete automation of murabaha transactions occurs, eliminating errors and improving transaction efficiency in the process.

Islamic finance has continued to grow and it now needs support from markets such as the BFX. A separate platform is now required to address the issues that are associated with Islamic finance, which include a lack of standardisation, transparency and high transaction costs.

Is sentiment still a major factor in market movements? If so, is this an indicator that a greater level of investor sophistication is needed?

KHAN: Anything to do with investing has a level of sentiment involved with it. To understand and interpret sentiment, it is important to educate investors. However, if end-users are not properly trained it affects the complete industry.

If you invest the right amount of energy, not only through an exchange but through your members and brokers, you can create the right medium for expressing sentiments in the market.

A greater level of investor sophistication is needed. If you compare markets in the Middle East with markets in the West, there is no comparison. Markets in the West were established hundreds of years ago, whereas markets in the Middle East were established just 15 years back.

The markets in the Middle East region have advanced tremendously since their establishment and they have invested heavily in increasing investor sophistication. However, they are still relatively new compared to the world's more longstanding markets.

Institutional investors account for some 74% of total fund holdings

Mutually beneficial

Rapid growth seen in mutual and other fund schemes

The country's reputation as a regional destination for funds of all kinds has resulted in a rapidly growing segment over the past two and a half decades, which has benefitted the local capital markets and Bahrain's larger financial services sector. Indeed, at the annual Fund Forum Middle East conference, which was held in Manama in October 2010, Sheikh Mohammed bin Essa Al Khalifa, the chief executive of the Economic Development Board (EDB), highlighted the strength of Bahrain's mutual fund market and the importance of mutual funds to the Kingdom's ongoing economic development. "This is the right time and the right place for fund managers who want new ways to generate better returns," he said.

The first offshore funds were listed in Bahrain in the early 1980s, and in 1984 a number of locally domiciled funds were launched. The industry benefitted from the implementation of formal government regulations in 1992, and since then it has shown exponential growth. In 2007 the Central Bank of Bahrain (CBB) rolled out a new regulatory regime for funds. In addition to bringing the segment in line with international standards, the new regulations opened the door for so-called "expert" schemes, including more complex arrangements such as hedge funds.

BY THE NUMBERS: As of the end of 2010 there were 2767 mutual funds in the Kingdom, up from 2711 in 2009 and 2199 in 2006. The number of mutual funds has grown steadily despite the international economic downturn's sweep through the region in 2008 and 2009, which is a sign of the sector's strength.

Overall investments in funds reached $9.2bn at the end of 2010, up from $8.7bn at the end of 2009, but were down substantially from $15.6bn in 2007 and $10.7bn in 2008. This post-crisis decline can be attributed almost entirely to funds that were registered offshore. Locally incorporated funds, which account for the largest percentage of total fund investments in Bahrain, were valued at $4.5bn at the end of 2007, $5.7bn at the end of 2008, $5.2bn at the end of 2009 and $5.6bn at the end of 2010. Institutional investors accounted for around 74% ($6.8bn) of total fund holdings at the end of 2010, while individuals – primarily high-net-worth individuals and their representatives – accounted for the remaining 26% ($2.3bn).

Islamic financing instruments are also taking off: sharia-compliant funds have posted solid growth in recent years, rising from just $752m at the end of 2006 to $1.6bn at the end of 2010. At the end of 2010, the Kingdom was hosting 129 locally incorporated funds, with the remainder incorporated offshore.

MAJOR PLAYERS: The single largest investor in mutual funds in Bahrain is the Social Insurance Organisation (SIO), the government entity that oversees public and private pension plans in Bahrain. Created in early 2008 as a result of a merger between the country's public and private pension plans, at the end of 2009 (the most recent year for which statistics were available at the time of press) the SIO controlled just more than $9bn in assets. Around 45,000 people rely on the organisation to manage their pension funds.

The SIO posted profits of BD34m ($90.68m) in 2009, compared to the BD126m ($336.04m) loss the previous year. The institution holds major stakes in a handful of the leading companies in the Kingdom, including the Bank of Bahrain and Kuwait and the Bahrain Telecommunications Company. In 2009 the SIO saw a 73% increase in its foreign investment portfolios, which is in line with the management's long-term plan to increase investments in markets abroad, including China, India, the US and the EU.

A number of additional funds are active in Bahrain. In August 2010 the Securities and Investment Company (SICO), a local investment bank, established a new money market fund on the Bahrain Bourse, which was previously known as the Bahrain Stock Exchange. The company's $20m SICO Money Market Fund is the first locally managed money market fund in the Kingdom and will invest primarily in corporate paper, government vehicles and domestic banking products.

The number of mutual funds has grown steadily despite the international financial crisis, and their overall investments were up at the end of 2010.

The single largest investor in mutual funds is the Social Insurance Organisation, which oversees public and private pension plans.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Islamic Financial Services

Maintaining dominance as a leader in Islamic banking
Home to the most qualified workforce in the region
Focusing on developing sharia-compliant products
Efforts to branch out into different economic sectors

Sharia-compliant finance was worth $1.14trn worldwide in mid-2011

Golden opportunity

The sharia-compliant finance industry is poised for a sea change

The Kingdom was the first in the region to create a fully fledged Islamic financial services market, formed with careful government oversight and assertive planning practices throughout the 1990s and 2000s.

The local Islamic financial services sector has reached a crossroads. On the one hand, the young industry is more vibrant than ever. Some of the world's top Islamic financial institutions call the Kingdom home, and the country hosts a number of the industry's major regulatory, ratings and oversight organisations, including the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), which is considered to be the leading standard-setting organisation for the international Islamic finance industry,

SUCCESSES & CHALLENGES: With its long history in Islamic financial services and numerous major institutions, Bahrain serves as one of the world's leading examples of a well-implemented sharia-compliant financial framework. The Kingdom is expected to continue to play a central role in ongoing international discussions about how best to further merge sharia standards with increasingly complex financial instruments.

Still, the industry has faced some challenges during the past few years. Local sharia-compliant banks were affected by the international economic downturn in 2009 and 2010, and while the sector as a whole has experienced some growth since that time, some institutions, especially Islamic investment banks, have yet to recover fully due to worldwide economic conditions and lack of investment opportunities.

Concurrently, Bahrain's reputation as the long-time centre of Islamic financial services in the Gulf has been challenged by a number of emerging markets in neighbouring countries, including Dubai, Qatar and Saudi Arabia. The sector is also relatively immature, and is continuing to develop and improve its data collection facilities and analytical tools. There is also a need for greater differentiation among products.

The industry is expected to benefit from a number of new products and services, while various regulatory and advisory bodies continue to assert their influence both locally and on the international stage.

TURNING POINT: With these issues in mind, many local players believe the sector has reached a turning point. A period of consolidation and diversification is expected in the coming years, as a handful of major entities work to firm up their business models, and smaller firms, many of which were hit hard by the downturn, give in to economic and regulatory pressure to shore up their balance sheets. At the same time, as operators look to differentiate themselves from the conventional financial sector and each other, the industry is expected to benefit from an increasing number of new products and innovative financial vehicles.

The oversight framework surrounding the industry is expected to undergo a number of significant changes in the coming years, as the Kingdom's various regulatory and advisory institutions continue to jostle for position and influence, both in the domestic forum and on the international stage. These developments have the potential to boost Bahrain's status as one of the world's leading Islamic financial markets.

HISTORY: Bahrain boasts one of the oldest banking sectors in the region – the Kingdom began developing the industry in the early 1970s as a means of diversifying away from oil income. Islamic finance began to catch on around the world in the mid-1970s as a result of the emergence of a handful of young Muslim economists who argued that the conventional banking system was both integral to modern economic development and not in line with sharia law. One of the first major steps toward setting up the Islamic financial services sector in the Gulf was the establishment of the Islamic Development Bank (IDB) in 1973. The institution, which was launched as a joint project by the member countries of the Organisation of the Islamic Conference, has played a major role in the development of the international framework surrounding the sector.

While Bahrain was not the first country in the region to host Islamic banking institutions – it trailed both Dubai and Kuwait, in fact – it was the first to make the conceptual and operational jump from a handful of institutions to a fully fledged industry. The formalisation of the sector in the Kingdom through the 1990s and 2000s was largely a result of careful government oversight and assertive planning practices.

By mid-2011 the worldwide sharia-compliant financial sector was worth around $1.14trn and was growing at an annual rate of 10%, according to the 2011 Global Islamic Finance Report. Bahrain and Malaysia are widely acknowledged to be the leading international centres for the expanding industry.

OVERSIGHT AND REGULATION: A wide variety of government, private and non-governmental organisations are involved in regulating the industry. The regulator is the Central Bank of Bahrain (CBB), which supervises all aspects of the Kingdom's financial sectors. Prior to the launch of the CBB in 2006, the Bahrain Monetary Agency served as a financial regulator. Islamic finance is overseen by the CBB's Islamic Financial Institutions Supervision Directorate (IFISD), which maintains an Islamic banking regulatory regime that is widely regarded as among the best in the world. "We meet with every Islamic institution on a regular basis, which allows us to keep a close watch on the sector," said Hussain Ali Sharaf, the director of the IFISD.

The standards framework developed by AAOIFI, an international Islamic finance industry body based in Manama, has become the benchmark for Islamic financial firms and central banks. With around 200 members from 45 countries, the organisation's sharia, accounting, auditing, ethics and governance standards serve to inform the official regulatory requirements and guidelines of Islamic financial institutions in leading Islamic finance markets around the world. While its regulations are already widespread, AAOIFI faces challenges in achieving wider adoption of its Islamic finance accounting standards in jurisdictions that follow only the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board.

OTHER PLAYERS: A number of other organisations are involved in standardising and regulating the local industry as well. The Islamic International Rating Agency, launched in the Kingdom in 2005, provides risk ratings for Islamic financial entities and products in the vein of conventional credit ratings firms Fitch, Moody's and Standard & Poor's. The International Islamic Financial Market, which was founded in 2002 by Bahrain and five other governments with the IDB, is a leading standardisation body for Islamic capital and money markets around the world. Finally, the General Council for Islamic Banks and Financial Institutions (GCIBFI), which was launched in May 2001 as a joint project of the IDB and a number of other international Islamic financial institutions and has members in 25 countries, works to increase awareness of sharia financial standards and further develop the sector. Finally, the Bahrain Association of Banks serves as a professional organisation for financial institutions in the Kingdom. Launched in 1979 and re-registered with the CBB in 2010, the association boasts more than 100 members.

Selected Islamic banks by assets, 2007-09 ($ bn)

	2007	2008	2009
Arcapita Bank	3.8	5.1	4.4
Kuwait Finance House	1.9	3.4	3.7
Shamil Bank*	2	2.9	2.8
Bahrain Islamic Bank	1.7	2.3	2.4
Al Salam Bank	1	1.5	2.1

SOURCE: GCIBFI *Then a wholly owned subsidiary of Ithmaar Bank

The CBB supervises all banking activity, but the IFISD maintains and enforces sharia compliance

THE BANKING SECTOR: As of the end of the first quarter of 2011 the Islamic banking sector in Bahrain was composed of 31 banks and financing companies, including seven retail banks , 21 wholesale banks, two financing companies and one representative bank. The sector is divided into retail and wholesale banks. Retail institutions serve the local market, offering standard banking services for Bahrainis and expatriates living in the Kingdom. Wholesale banks, on the other hand, are allowed limited access to the local economy, and primarily function as offshore investment entities.

According to the CBB's first-quarter 2011 report, as of the end of March 2011 the Islamic banking sector had total assets amounting to $24.6bn, which is equal to around 12.36% of the Kingdom's total banking assets of $199bn. A substantial number of the Islamic wholesale players were set up in the mid-2000s, when the regional property boom fuelled growth of more than 25% in the conventional banking sector. In 2004 local Islamic banks had an asset base of $5.4bn; this number jumped to $8bn by 2005, $12.2bn by 2006, $16bn by 2007 and, finally, $24.6bn in 2008.

When the international financial downturn hit Bahrain's banking sector in late 2008, Islamic financial institutions initially appeared to be better insulated than their conventional counterparts. Islamic financial institutions were first thought to have avoided the crisis entirely until 2009, when the investment side of the sector – and particularly *sukuks*, or Islamic bonds – began to slow down substantially. This was largely the result of an overreliance on real estate, particularly by among Islamic investment firms. From 2008 to early 2011, asset growth in the Kingdom was negligible – the total asset base was approximately $25bn.

MARKET STRUCTURE: The Kingdom has the highest concentration of Islamic banks in the world. Institutions currently operating in Bahrain include Al Baraka Banking Group, Al Salam Bank, Bahrain Islamic Bank (BIsB),

The local Islamic banking sector was composed of 27 banks, including eight retail and 19 wholesale institutions, as of early 2011. It had total assets of $24.6bn, or around 11.5% of banking assets.


Several organisations have worked to define and standardise how Islamic instruments should function

Ithmaar Bank, Khaleeji Commercial Bank, Gulf Finance House, Kuwait Finance House, ABC Islamic Bank, Arcapita Bank, Citi Islamic Investment Bank, Elaf Bank, the International Investment Bank, Unicorn Investment Bank, GBCorp and Capinnova Investment Bank.

At the end of 2009, according to a 2010 GCIBFI report, the largest Islamic financial institutions in the country in terms of assets were Arcapita Bank, with total holdings of $4.4bn, Kuwait Finance House, with $3.7bn, Ithmaar Bank, with $6.7bn, BIsB, with $2.4bn and Al Salam Bank, with $2.1bn.

The Kingdom is also host to a number of Islamic windows at conventional banks, including Standard Chartered, Ahli United Bank, BMI bank, ESkan Bank, Bahrain Development Bank, PNB Paribas, GIB, Gulf One Investment Bank, Investcorp, The Arab Investment Company, and HSBC. In early 2011, in an effort to boost the number of Islamic banks in the sector, the Qatari government instructed conventional banks in that country to shut down their Islamic windows or spin them off into standalone Islamic banks. Following the announcement in Qatar, Rasheed Mohammed Al Maraj, the governor of the CBB, announced that Bahrain would not follow suit, and conventional banks would be allowed to continue operating Islamic windows, which the CBB considers to be an important source of competition.

RISING PROFITS: Based on recent returns posted by some institutions in late 2010 and early 2011, it appears that the sector is beginning to pick up once again. Al Baraka Islamic Bank's net operating income hit $1.81m in the first quarter of 2011, up nearly 152% from a loss of $0.60 in the first quarter of 2010. During the first quarter of 2011, ABC Islamic Bank reported profits of $3m, up 66% from $1.8m during the same period the previous year. Finally, BIsB posted a profit of BD1.5m ($4m) in the first quarter of 2011, up 25% from BD1.2m ($3.2m) during the first three months of 2010.

With 52 Islamic financial institutions and 27 active Islamic banks in 2010, Bahrain is home to half of the GCC's total sharia-compliant institutions. Islamic windows at conventional banks add to the available services.

At the end of 2009, there were a total of 211 fully fledged Islamic financial institutions in GCC member countries and 37 Islamic windows at conventional banks, according to a 2010 report published by the GCIBFI. Financing and investment companies (wholesale banks in the local parlance) account for 38% of this total, followed by *takaful* (Islamic insurance) companies with 26%, banks with 21%, and Islamic windows with 15%.

Bahrain is home to 52 Islamic financial institutions, – 21% of the Gulf total after Kuwait, with 74 institutions (30%), and Saudi Arabia, with 65 institutions (26%). With 27 active Islamic banks in 2010, Bahrain is home to half the GCC total. Banks can be successful by setting themselves apart via services. "The market is too saturated to compete simply as a retail bank so you have to create a niche in the market to survive. Banks have to identify the opportunities that exist within the market and put different products in place that suit the needs of the consumer," said Mohammed Bucheerei, the CEO and member of the board of Ithmaar Bank.

INVESTMENT PRODUCTS: The local sukuk market was hit hard by the economic downturn in 2009. Global sukuk issuance topped out at $13.8bn in 2007, then dropped to $2.14bn in 2008, $7.45bn in 2009 and $5.35bn in 2010. Bahrain was the world's fifth-largest sukuk market in 2010, with total volume of $680m, behind Malaysia ($35.5bn), Saudi Arabia ($2.05bn), Indonesia ($1.82bn) and Pakistan ($1.02bn). Before the downturn the majority of sukuk issues in Bahrain came from corporate entities; after the crisis most new sukuk issues have been on a sovereign or semi-sovereign basis.

Sukuks are often described as Islamic bonds, but this explanation is not quite accurate. In reality, sukuks are complex sharia-compliant financial instruments that fuse aspects of equity and debt products and are issued in a variety of flavours, each of which has its own strengths and weaknesses. For example, in recent years *ijara* sukuks have been the financial instrument of choice for funding real estate projects in the Gulf. Ijara is a type of leasing agreement in which a financial institution purchases an asset and then leases it out for a predetermined price and time period. Ijara schemes were used to finance the mid-2000s' Gulf property boom. When the market crashed in late 2008, investor confidence in ijara and other types of sukuks went with it.

In recent years, however, a number of organisations, such as the AAOIFI, have worked to more clearly define how sukuks should function. This increased standardisation has given investors some renewed confidence, and as of mid-2011 the market seemed to be picking up again. As of the end of the first quarter of 2011, the Bahrain Bourse (BHB), which was known as the Bahrain Stock Exchange until a rebranding exercise in 2010, listed nine sukuks, including two medium-term instruments issued in 2009 and a five-year, BD200m ($533.4m) ijara sukuk issued by the government in April 2011 (see Capital Markets chapter).

Unlike conventional bonds, sukuks are generally bought and held until maturity. In an effort to boost the segment, the government is working to encourage secondary trading. The creation of the Bahrain Financial Exchange (BFX) in early 2011 bodes well for increased sukuk trading (see Capital Markets chapter). The BFX, the second exchange, will focus on complex and niche financial instruments that are unavailable on the BHB. In February 2011 the BFX launched Bait Al Bursa, the region's first trading platform dedicated exclusively to sharia-compliant instruments. Once trading begins, this bourse has the potential to boost secondary sukuk trading dramatically.

TAKAFUL: Islamic insurance is a growth segment in Bahrain. As of the end of 2009, the most recent year for which statistics from the GCIBFI are available, the Kingdom was home to eight takaful firms, including Allianz Takaful, Chartis Takaful, Solidarity, Takaful International and T'azur. Additionally, two retakaful firms – namely ACR Retakaful and Hannover Retakaful – are active in the country. The takaful segment brought in gross premiums of BD32.67m ($87.1m) in 2009, up 22% from BD26.75m ($71.3m) the previous year. The 2009 figure was equal to around 16% of total insurance sector gross premiums of BD200.6m ($534.6m) that year. Total assets at takaful companies increased by 10% in the same period, from BD90.18m ($240.5m) in 2008 to BD99.41m ($265.1m) in 2009.

With overall penetration of just 2.5%, the Kingdom is expected to see substantial growth of both conventional and Islamic insurance products in the coming years. "There is currently huge potential in the takaful market," said Rohit Chawdry, the senior manager of treasury and investment at BIsB. "We expect the Islamic insurance segment to grow quickly in the coming years." (see Insurance chapter)

CHALLENGES: The industry faces a number of issues. Like those in Islamic financial markets around the world, the majority of the products currently on offer in the Kingdom's sharia-compliant segment are simply conventional instruments stripped of their interest-bearing features, as interest is not allowed under sharia law. Copying conventional financial instruments has been an essential tool as the Islamic segment has developed, but increasingly investors are calling for new, custom-designed financial products. Developing new products within an Islamic framework is not a simple task – in this respect, adoption of AAOIFI's internationally-recognised standards on Sharia for Islamic finance can help development of new financial instruments and ensure global acceptability by Sharia scholars and the industry at large. Indeed, diversifying Islamic financial offerings appears to be the way forward. A number of local entities have been working to develop new Islamic products in recent years. The BFX's Islamic product development working group, for example, plans to eventually turn the exchange into a destination for new products. "Islamic financial institutions are at a real fork in the road," Patrick J Gallagher, the CEO of HSBC Bahrain, told OBG. "They can either spend the next 20 years ripping off conventional products, or they can develop new products of their own."

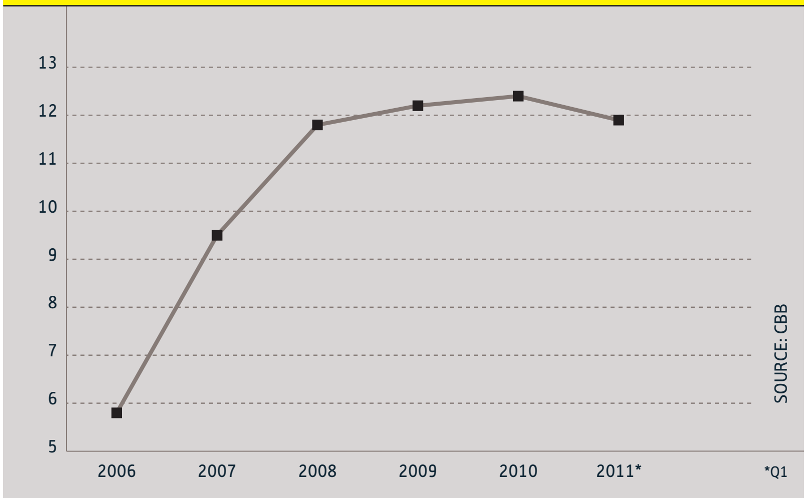
Human resources present another challenge. Bahrain has one of the largest and most highly qualified financial workforces in the Gulf. Like every other Islamic financial market, however, the Kingdom suffers from a shortage of sharia scholars, the experts in sharia law and finance who oversee every Islamic financial institution in the country. As of early 2010 there were around 200 properly qualified sharia scholars in Bahrain, many of them sitting on multiple boards. Several training and development programmes have been established in the Kingdom to produce a workforce that is well-versed in sharia-compliant financial practices – an essential step in maintaining Bahrain's reputation.

Expansion is expected in Islamic insurance products

Diversifying Islamic financial products will be a focus for the industry in the next few years. Instead of copying conventional financial instruments, Islamic bankers are being encouraged to develop new products within an Islamic framework.

OUTLOOK: Bahrain faces growing competition from some rapidly expanding Islamic financial centres around the world, but the local sector's history and regulatory regime stand it in good stead in terms of maintaining the Kingdom's reputation as a regional leader in Islamic finance for the foreseeable future. As the market recovers from the global economic downturn, the sector's contribution to GDP has the potential to show a marked increase. In addition to generating economic growth in the Kingdom, the sector has the potential to attract a greater flow of foreign investment in the future. "We could certainly make good use of additional international investment," said Sharaf. Regardless, the local Islamic financial sector is expected to be an increasingly important contributor to development in Bahrain.

Total domestic assets at Islamic banks, 2006-11* ($ bn)



Diversifying into more sectors will ensure long-term growth

Paradigm shift

Branching out to increase stability and market depth

The Central Bank of Bahrain is encouraging banks to invest in the development of new products not based on a pre-existing conventional model. This should help sustainability in the sector while also boosting confidence in overall services.

In the keynote speech at the 17th annual World Islamic Banking Conference (WIBC), held in Bahrain in November 2010, Rasheed Mohammed Al Maraj, the governor of the Central Bank of Bahrain (CBB), called on the Kingdom's Islamic financial institutions to reinvent themselves in the coming years. "The aftermath of the financial crisis presents the Islamic financial industry with both an opportunity and a challenge," he said.

NOT SO DIFFERENT: Indeed, the industry in Bahrain is at a junction. During the early and mid-2000s, local Islamic banks reaped massive profits, primarily by investing in large-scale real estate projects, just like conventional banks. While Islamic financial institutions differed from their conventional counterparts in a number of ways, they also had much in common. In general, both segments were prone to funding long-term assets – major property development projects, for example – with short-term funding, such as three- and six-month bonds or *sukuks* (sharia-compliant debt instruments that resemble bonds). Islamic banks boosted their balance sheets substantially during the 2004-07 period, but, like their conventional siblings, much of this capital was subsequently distributed among shareholders and staff members in the form of dividends and bonuses.

Finally, both Islamic and conventional banks were seriously overleveraged in real estate; in some institutions property accounted for more than 70% of overall investments. Considering these shared practices and missteps, it is not surprising that Islamic financial institutions and conventional banks suffered the same fate in the aftermath of the global economic downturn. In 2009 both segments saw growth peter out and stagnation – or, in some cases, decline – set in.

NEW DIRECTIONS: As of early 2011 this situation showed signs of improving. In April 2011, for example, the government successfully issued a five-year, BD200m ($533.4m) *ijara* sukuk on the Bahrain Bourse, the country's recently rebranded stock exchange. According to a report issued at the 2010 WIBC, the Islamic financial services sector in the Gulf is expected to recover more rapidly than the conventional sector in the coming years. While the CBB is working to take advantage of these short-term growth prospects, it is also encouraging local players to focus on implementing long-term, sustainable business practices.

Boosting sustainability in the sector will likely take place in a number of ways. In addition to general recommendations, such as increasing transparency and oversight, the CBB has encouraged banks to diversify the products they offer and to venture into new development segments. While sharia-compliant institutions account for an increasingly important part of the local financial services sector, most Islamic institutions offer only a handful of products, the majority of which overlap with the products on offer at every other Islamic institution in the country. According to the Bahrain Association of Banks, a local professional organisation, less than half of the Islamic banks in Bahrain offer more than six products, and only 15% offer more than 10.

NEW DEVELOPMENTS: Additionally, the products on offer are mostly sharia-compliant copies of existing conventional instruments. In an effort to expand their offerings, banks are being encouraged to invest in the development of completely new products, and specifically those that are not based on any pre-existing conventional model. This advice has been taken to heart at the Bahrain Financial Exchange, which officially opened its doors in February 2011 but had yet to begin trading at the time of press. One of the exchange's first actions was to launch an Islamic product development group to create new Islamic financial instruments for eventual inclusion on the market.

In addition to diversifying the product mix, the CBB is working to encourage institutions to venture into new segments and niche areas. "More diversification is needed," said Hussain Ali Sharaf, the director of the CBB's Islamic Financial Institutions Supervision Directorate. "Local sharia-compliant institutions would benefit from looking into new sectors, such as industry, health care, education and maybe even agriculture."

Abdulhakeem Alkhayyat, Managing Director and CEO, Kuwait Finance House Bahrain

Ready for the future

OBG talks to Abdulhakeem Alkhayyat, Managing Director and CEO, Kuwait Finance House (KFH) Bahrain

Do you believe previous growth rates achieved in Bahrain's Islamic banking industry are sustainable?

ALKHAYYAT: Islamic bank assets in Bahrain reached $24.6bn in 2008, $25.5bn in 2009 and, according to the latest numbers released by the Central Bank of Bahrain, $25.4bn at end-October 2010. The stagnation witnessed over the last two years is a direct consequence of the economic crisis, but these statistics may obscure unique qualities among Islamic banks. Many Islamic financial institutions (IFIs) with investment banking business models faced asset reductions while retail banks, including KFH, continued to grow, albeit moderately, throughout 2009 and 2010.

At the end of 2004 Islamic banking assets in the Kingdom stood at $5.4bn. Between 2004 and 2008, our industry experienced an average annual growth of 45%. Even without the crisis, we would have certainly seen a decrease in growth. That said, all the ingredients are here to see growth continue alongside economic recovery. There is no doubt that we will see further steady growth in Bahrain's Islamic banking industry, although at a more reasonable pace.

What steps is the private sector taking to promote standardisation in the Islamic finance industry?

ALKHAYYAT: Islamic banks are very active in industry bodies such as the Accounting and Auditing Organisation for Islamic Financial Institutions, International Islamic Financial Market (IIFM) and Islamic Financial Services Board. The private sector's collaboration with regulators is important to the establishment of accounting and documentation standards. You cannot impose standardisation. Regulations need to be understood and accepted in order to be implemented. It is crucial to ensure that Islamic banks are actively participating in the development of standards.

In our treasury operations today, we favour IIFM standard *murabaha* (cost-plus financing) documentation and the *tahawwut* (hedging) master agreement launched by IIFM and the International Swaps and Derivatives Association in 2010. However, standardisation should not be synonymous with rigidity that could risk stifling innovation.

As traditional asset classes become saturated, what areas offer the greatest potential for expansion?

ALKHAYYAT: Between 2004 and 2008, Islamic banks became very active in real estate. Having an actual asset underlying finance is one of the core principles of Islamic banking, so it is natural that IFIs invest in real estate, especially at a time when this form of asset was increasing in value. Since 2008, the real estate market has been correcting itself, and we should see some recovery in coming years. Indeed, we believe that the worst is certainly behind us. Although real estate will retain its role as a main component of Islamic banking assets, diversification is very important.

To that end, new markets in Bahrain offer strong potential for growth. Small and medium-sized enterprise financing, industrial ventures and Islamic asset management are all expected to be growth areas for the banking sector in the future.

How likely is consolidation among Islamic banks?

ALKHAYYAT: Fragmentation in our industry is an issue that goes beyond Bahrain. Total Islamic assets globally are forecast to surpass $1trn in 2010, which sounds like a big number, but we should bear in mind that even after the global financial crisis, the world's Top 20 banks each had assets in excess of $1trn. Consolidation of the sector is necessary for IFIs to compete on a global scale. With six Islamic retail banks and 21 Islamic investment banks in Bahrain, it is difficult to believe that there will not be any consolidation in our industry sooner or later. The shareholding structure of different Islamic banks has limited the appetite for mergers, but this can be overcome. Also, many institutions have similar business models. We need bigger players in Bahrain. To encourage growth, regulators and the government need to better incentivise and facilitate mergers.

Insurance

Rapid expansion in the takaful and retakaful markets
Life segment is the largest contributor to the industry
Penetration rates remain above regional averages
Local reinsurance expected to grow in the long term

New initiatives are raising awareness of the benefits of insurance

Well covered

Maintaining growth in spite of difficult times

As the economic crisis of 2008-09 disrupted financial activities around the globe, the Bahraini insurance market maintained growth by focusing less on investment activity and more on core business.

The rapid expansion of segments such as life insurance, *takaful* (Islamic insurance) and medical insurance has helped Bahrain's insurance sector to maintain steady growth in recent years. In 2009, the most recent year for which figures are available, the industry posted overall asset growth of 21%, up substantially from just 2% in 2008. Given the industry's continued growth in the face of the global economic downturn, which hit the Kingdom's financial institutions in 2008 and 2009, the sector has displayed a high level of stability and, in turn, long-term potential for growth.

PRESENT CHALLENGES: Though they have fared relatively well, insurers and insurance-related companies face a number of challenges in the coming years. While overall revenues have not suffered in the wake of the downturn, companies have had to make some adjustments to maintain profitability. Investment income has dropped off substantially, for example, which has forced companies to build up their core business in order to increase technical revenues.

Additionally, the market is somewhat crowded with small and medium-sized players, which has resulted in a highly competitive environment. As leading firms look to expand over the coming decade, the sector is expected to see a round of mergers and acquisitions. While consolidation could be a hurdle for smaller firms, it will likely benefit the industry in the long term.

Despite these challenges, the sector is well positioned to maintain its reputation as a regional leader in insurance for the foreseeable future. The Central Bank of Bahrain (CBB), which regulates the insurance industry, in addition to the country's other financial sectors, is widely acknowledged as one of the top oversight bodies in the region. Local players have worked to shore up their balance sheets, roll out new products and tap into niche segments. A number of ongoing public and private initiatives have also been put in place to address the lack of awareness about insurance among the general population – arguably the largest hurdle the industry must face in the coming years.

SUSTAINED GROWTH: Bahrain's financial sector is a major contributor to the economy, accounting for around 25% of GDP and employing a substantial percentage of the workforce. In general, the sector fared relatively well in the wake of the international economic downturn, though the investment banking segment saw losses in 2008 and 2009, mostly due to its involvement in the regional real estate boom that swept through the Gulf in the early and mid-2000s. The segment had yet to fully recover as of early 2011 (see Capital Markets and Banking chapters).

Insurance has been one of Bahrain's post-crisis economic success stories. Local insurers have seen gross premium growth in excess of 5% per annum since 2005, right through the economic downturn. This is not to suggest that the industry as a whole was in some way more responsible than other financial segments during the mid-2000s. Local insurers, like their counterparts in banking and capital markets, overextended themselves in some ways, including offering policies at prices that were not risk-commensurate in order to collect premiums that were put to work in the thriving capital markets. This focus on investment pulled the sector away from its core business, resulting in firms losing sight of proper risk management practices and an overreliance on reinsurance.

STRATEGY FOR SUCCESS: In 2008 the CBB pushed insurers to focus on their core business as a way of overcoming investment losses. This proved to be good advice – as investment incomes began to fall off in 2008, there was a marked rise in policy uptake. Overall underwriting activity increased by around 150% in 2008, compensating for the drop in investment activity.

It is as yet unclear how the sector fared in 2010 and early 2011, as financials have yet to be released. Anecdotal evidence suggests that growth continued in 2010, primarily on the back of rapidly increasing premium intake from a number of segments, including life, medical and takaful. However, some players have expressed doubts about continued expansion through 2010.

OVERSIGHT & REGULATION: The insurance industry is overseen by the CBB, which regulates all aspects of the sector. The legal framework for the insurance sector was put in place in 2003-04 by the Bahrain Monetary Agency (BMA), which was the regulator of the financial sector until the CBB was launched in 2006. The initial version of the insurance rulebook was based on standards developed by the International Association of Insurance Supervisors (IAIS), a Switzerland-based organisation that promotes cooperation among insurance regulators around the world.

The CBB has been at the cutting edge of insurance regulation in the region since it was set up in 2006. The bank was responsible for introducing the region's first comprehensive regulatory framework for the takaful and retakaful segment, for example. In 2010 the CBB pioneered regulation for the captive insurance segment, which is on the rise in the Kingdom.

The CBB has also worked to encourage local insurers to improve their risk management standards. "We update the insurance rulebook every quarter," said Sana Hashim Al Alawi, the head of conventional insurance and reinsurance firms at the CBB's Insurance Supervision Directorate. "We work constantly to keep Bahrain in line with international standards." In January 2011 the CBB was named a member of the IAIS's executive committee. A representative from the bank will serve a two-year term at the organisation, which oversees 97% of global insurance premiums.

BY THE NUMBERS: At the end of 2010, Bahrain's domestic insurance market comprised 27 Bahraini insurance firms and 11 overseas insurance firms (branches of foreign companies) carrying on direct business in the Kingdom of Bahrain. Additionally, the country is home to five reinsurance firms and two retakaful firms. There are also around 41 insurance companies restricted to business outside Bahrain, five representative offices, 33 insurance brokers, 25 actuaries, 11 loss adjusters and 5 insurance consultants.

In 2009 gross premium income among insurers reached BD200.6m ($535m), up 7.5% from BD186.6m ($497.7m) the previous year. The life insurance segment was responsible for BD57.3m ($152.8m), or around 29% of the 2009 total, up 11% from BD51.6m ($137.6m), or 28% of the total, in 2008. Gross claims reached BD13.8m ($36.8m) in 2009, down substantially from BD21.5m ($57.3m) the previous year. After life insurance, the largest contributors in terms of gross premiums in 2009 were the motor segment, at BD57m ($152m), or 28% of the total; fire property and liability coverage, at BD32.5m ($86.7m, or 16%); medical coverage, at BD27m ($72m, or 13%); engineering policies, at BD10.5m ($28m, or 5%); marine and aviation coverage, at BD7.9m ($21m, or 4%); and other types of insurance, with around BD8.3m ($22m, or 5%).

The Kingdom's insurers held total assets of BD1.15bn ($3.07bn) in 2009, up 21% from BD949.6m ($2.5bn) in 2008. Local conventional insurance firms were responsible for 73% of this total, or BD841.6m ($2.24bn). Takaful firms chipped in around 9% ($265m) and foreign insurers contributed the remaining 18% ($556.9m).

Insurers held total assets of $3.07bn in 2009, a 21% y-o-y increase

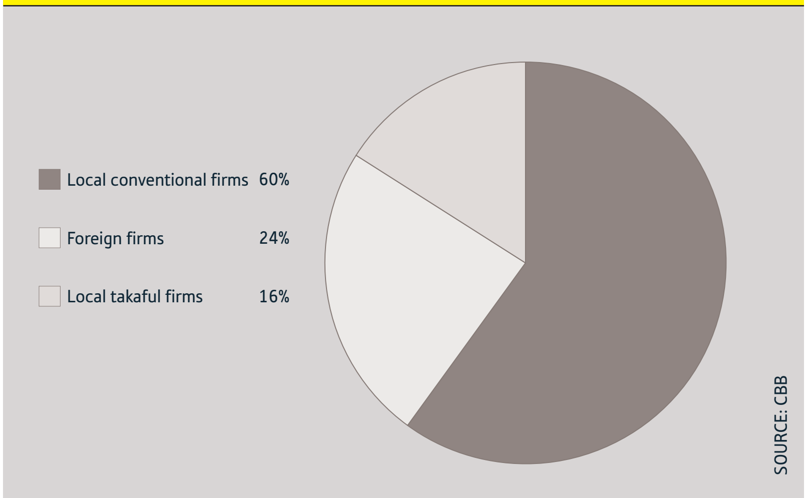
Insurance penetration in Bahrain stood around 2.6% as of early 2010, up from around 2.3% in 2008. This is well above the MENA average of 0.8%, but much lower than the world average of 7%. Bahrain is one of only a few countries in the region with a penetration rate higher than 2%, according to a late-2010 World Bank report on the insurance sector in the region. In 2009 total assets in the industry were equal to 12.1% of GDP. This number is substantially higher than the GCC average of 4.4% and the MENA average of 5.3%.

Similarly, non-life premiums in 2009 were equal to 1.43% of GDP and life premiums were equal to 0.7% of GDP, compared to 0.87% and 0.23% in the GCC and 0.97% and 0.28% in MENA, respectively. "The difference in the Middle East is that consumers must secure their basic needs first and then they will buy insurance, as opposed to the West where insurance is a basic need," said Walid El Hout, the deputy general manager of Medgulf, a Lebanese insurance company that serves many countries in the region, including Bahrain.

MAJOR PLAYERS: Based on receipts from 2009, the latest year for which comprehensive data is available,

Around 29% of the total $535m in gross premiums earned by the insurance industry went toward the life segment. Automobile insurance was a close second, with 28%.

Breakdown of market share, 2009



There are currently 46 offshore insurance companies in Bahrain. These cannot sell policies within the Kingdom, but tend to serve other Gulf markets.

Bahrain's top insurer is the Bahrain-Kuwait Insurance Company (BKI), with BD24.3m ($64.8m) in gross written premiums (GWPs) for the year, up from BD23.3m ($62.14m) the previous year. These figures reflect BKI's business in Bahrain. BKI was founded in December 1975 as a joint venture between investors in Bahrain and Kuwait and is registered as a national insurer in both countries. Kuwait's Gulf Insurance Company is the dominant shareholder, with around 56% of the shares, while Warba Insurance Company, also a Kuwaiti firm, holds around 14%. BBK (formerly the Bank of Bahrain and Kuwait) owns 7% and 18% of the firm is listed on the Bahrain Bourse. BKI offers a variety of products, including life, health, motor, marine and property coverage.

In second place in 2009 was the Life Insurance Corporation (LIC), which posted GWPs of BD21.1m ($56.27m) for the year, down slightly from BD21.3m ($56.8m) in 2008. Around 98% of LIC, which has been active in Bahrain since 1989, is owned by the Indian government; the International Agencies Company, a Bahraini firm, owns the remaining 2%. The firm offers a wide array of life and life-related products, including endowment, term assurance and health plans.

The third largest contributor in 2009 in terms of GWPs was Bahrain National Insurance Company (BNI), with BD17.5m ($46.7m), down from BD21.4m ($57m) the previous year, although both these figures are for Bahrain business only. The firm is a subsidiary of the Bahrain National Holding Company (BNH), which has been active in the Kingdom since December 1998, and currently holds partial or full stakes in a number of insurance and insurance-related local firms. Around 77% of BNH is listed on the Bahrain Bourse. At the end of 2010 the company posted a market capitalisation of BD46.1m ($122.9m). In April 2011 BNH's chief executive, Mahmood Al Soufi, announced that the company had plans to enter the takaful segment and expand its business into other GCC markets, including the UAE, Qatar and Kuwait, potentially through acquisitions.

Other major conventional players include Al Ahlia Insurance, which has been operating in Bahrain since August 1976; AXA Insurance Gulf, a subsidiary of French multinational AXA, which serves the region from its base in Bahrain; and the Gulf Union Insurance and Reinsurance Company, a local firm launched in June 1995.

THE OFFSHORE MARKET: In 2009 the Kingdom was home to 46 offshore insurance companies, down substantially from 53 in 2007, 50 in 2005 and 84 in 2003. The majority of the offshore insurance firms in Bahrain have traditionally serviced Saudi Arabia. In 2006 the Saudi Arabian Monetary Agency introduced new legislation requiring insurance companies that serve clients in Saudi to be based there. This caused difficulties for Bahrain's offshoring segment – some firms left the Kingdom to re-register in Saudi in order to continue serving clients there, while others closed up shop entirely or re-registered locally, attempting to break into the already crowded Bahraini market. Many of the firms that currently hold offshore licences in the Kingdom are focused on the takaful segment, which is expanding rapidly in a number of Gulf markets. With a solid regulatory environment, a liberal economy and a favourable foreign investment regime, Bahrain is an ideal location for insurers looking to enter the regional market.

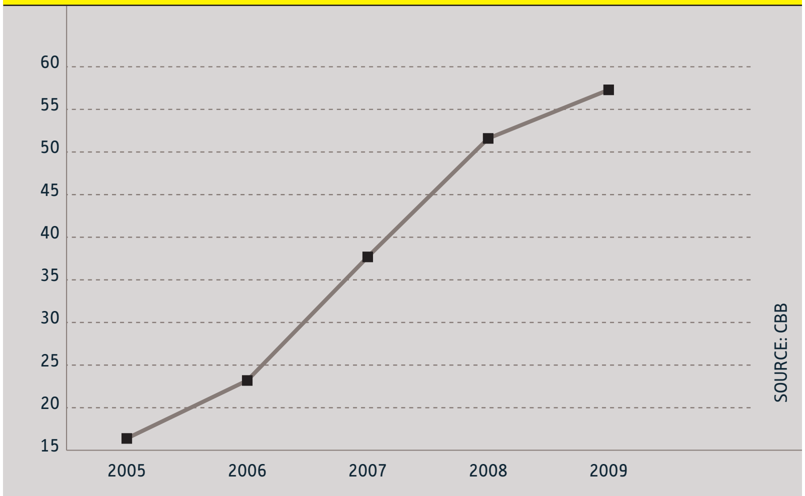
THE TAKAFUL SEGMENT: Bahrain is a major player in the Islamic financial services industry, which is growing rapidly around the world. Takaful has played an increasingly important role in recent years as many of the country's predominantly Muslim population are beginning to take advantage of Islamic banking options. In 2009 takaful companies posted GWPs of BD32.67m ($87m), up some 22% from BD26.7m ($71.2m) in 2008. Gross premiums in the takaful segment accounted for 16% of total gross premiums in 2009, up from 14% the previous year. Total assets in the segment jumped to BD99.41m ($265.12m) in 2009, up 10% year-on-year.

In 2009 the top takaful firm in Bahrain in terms of GWPs was Takaful International, with BD14.3m ($38.1m), up from BD14m ($37.3m) in 2008. The firm was launched in April 1989 and known as the Bahrain Islamic Insurance Company until 1998, when it was rebranded. Nearly 18% of the firm is traded on the Bahrain Bourse. Other major shareholders include Bahrain Islamic Bank, Investors Bank, the Gulf Monetary Group and a handful of Kuwaiti firms. Additional major takaful companies active in Bahrain include Chartis Takaful and the T'azur Company, in addition to the takaful arms of multinational insurers Allianz and Solidarity.

Despite large potential for future growth, the local takaful segment faces a number of challenges in the coming years. The Islamic insurance industry is not yet as developed as the conventional sector. Some takaful companies have struggled to invest their profits in sharia-compliant securities on the Bahrain Bourse, for example. The launch of the Bahrain Financial Exchange, a new bourse that will focus on sharia-compliant products, among other securities, could be a boon for the takaful segment. Trading at the new exchange is expected to begin in mid-2011 (see Capital Markets).

REINSURANCE: Bahrain has seen a steadily increasing number of reinsurance and retakaful firms open up shop in recent years. The Kingdom is home to five reinsurers and two retakaful players. In 2009 GWPs in the reinsurance segment reached BD242.5m ($646.74m),

Gross premiums for long-term insurance, 2005-09 (BD m)



Motor was the largest segment after life in 2009, representing around 28% of the market

The government has drawn up a new health plan to be offered in two phases: the first will require all expatriates to sign up for insurance and the second will extend the policy to Bahrainis.

up from BD219.4m ($585.1m) the previous year, while GWPs in the retakaful segment reached BD50.5m ($134.7m), up substantially from just BD15.9m ($42.4m) the previous year (see analysis).

TRENDS: Over the past five years the number of firms in the Kingdom has more than doubled. In 2005 the country was home to just 12 local insurers; by 2006 this had jumped to 19 and by 2009 there were 27. This growth can be attributed primarily to the success of the financial services sector in the mid-2000s. In the wake of the downturn, however, firms have seen revenues from investments fall off dramatically and have subsequently worked to expand their core underwriting business, resulting in increased competition. With this in mind, consolidation is expected at some point in the coming decade, as there is not enough available capital to support the current number of firms.

MAJOR SEGMENTS: Life insurance is a major growth segment, posting GWPs of BD57.3m ($152.8m) in 2009, up 11% from BD51.6m ($137.6m) the previous year. In 2009 life coverage represented around 29% of total GWPs. The segment has seen massive expansion in recent years – in 2005 gross premiums totalled BD16.4m ($43.7m) – due largely to rapidly rising public awareness of the importance of life coverage (see analysis).

Third-part liability (TPL) motor insurance is mandatory in Bahrain, and accounts for a substantial percentage of many companies' balance sheets. In 2009 the segment posted GWPs of BD57m ($152m), up 4.2% from BD54.7m ($145.9m) in 2008. Motor insurance premiums represented around 28% of the total in 2009.

Until very recently, private medical insurance in Bahrain was non-existent, as the state offered free health care for citizens and expatriates alike at state hospitals and clinics. In an effort to shift the financial burden of paying for health care to the private sector, however, the state has been working to implement a health insurance scheme over the past few years. While it had yet to be finalised as of early 2011, the plan is expected to be rolled out in two phases. Phase one will require all expatriates in the Kingdom to sign up for health insurance, and phase two will extend to locals.

In preparation for the institution of the health initiative, insurers have been working to build their medical segments. In 2009 GWPs for health reached BD27m ($72m), up 27% from BD21.2m ($56.5m) the previous year, accounting for around 14% of total GWPs.

Some major Bahrain-based corporations have been experimenting with captive insurance. As opposed to buying a conventional insurance plan from an established insurer, some large companies have found it makes sense for them to develop their own insurance subsidiary, which can then deal directly with reinsurers. This is known as "captive" insurance because the insurer is owned by the company it is insuring. The CBB recently put in place regulations for captive insurance, which is a sure sign that the practice is catching on.

HUMAN RESOURCES: Bahrain has a reputation for producing highly skilled workers. In 2009 insurers and insurance-related firms employed 1566 individuals, 61% of whom were Bahraini, up from 1394 in 2008, according to CBB figures. "Bahrain has the best insurance labour force in the Gulf," said Ashraf Bseisu, the CEO of Solidarity Group, a Manama-based Islamic financial services company. "In fact in recent years some Bahrainis have left the Kingdom to take upper management positions in firms abroad."

The well-trained workforce is largely the result of numerous training programmes and initiatives. Chief among these is the Bahrain Institute of Banking and Finance (BIBF), which was set up in 1981 by local financial institutions, and is widely recognised as one of the top financial training centres in the Middle East. The institute is funded by income from a 1% levy that is paid by all financial firms in the Kingdom. The BIBF's centre for insurance offers certificate and diploma programmes in insurance and risk management.

The Gulf Insurance Institute (GII), which was launched in Bahrain in 2007 by BNH and a handful of other investors from the MENA area, was developed in order to offer training for employees of insurers in the region. The institute offers accreditation courses in a wide variety of insurance-related topics, including risk management, financial planning, wealth management, talent development and sales.

OUTLOOK: In addition to having one of the best quality insurance training regimes in the region, Bahrain possesses solid fundamentals, a renowned regulator and, importantly, growing awareness among the general population of the overall value of insurance. With one of the highest penetration rates in the region, the country is seen as an example by its neighbours.

At the same time, the local insurance sector has room to grow and a plan in place to do so. Consolidation, which is expected to take place in the next few years, will be hard on smaller players, but will benefit the industry as a whole. The life segment is expected to continue to see substantial growth in the coming years, and the institution of a compulsory health insurance policy for expatriates – and eventually for locals – will result in growing revenues for Bahrain's insurers.

Sheikh Mohammed bin Isa Al Khalifa, CEO, Social Insurance Organisation

Safety first

OBG talks to Sheikh Mohammed bin Isa Al Khalifa, CEO, Social Insurance Organisation (SIO)

To what extent has the global economic downturn affected the SIO's assets?

SHEIKH MOHAMMED: In 2007 we started to see the effect of the global economic crisis on our international portfolios. When public equity markets lost some 20-30% of their value, we experienced the same drop in many of our own equity portfolios.

However, we have also been prudent in allocating to fixed income, which helped dampen the decline in our international portfolios through interest income. We also have a large allocation of funds in cash deposits, and this strategy continues to support the portfolio, protecting it from risk.

Our worst year was 2008, when our returns dropped significantly, though we still maintained a profit for the year overall. In 2009 positive performance returned as the international markets regained their momentum. We have witnessed continued growth following this in 2010 as well.

Looking forward, there is growing concern over inflation in global markets. Oil prices today are at high levels, with this trend driven mainly by the political tensions in Middle Eastern markets.

However, if these tensions subside in the near future we expect oil prices to come down and growth to continue in a positive trend in global markets. This will benefit our portfolio in terms of giving us a reason to start allocating more funds on the international market, in order to capture more gains and achieve our target rate of return of 6%. This will also allow us to continue to diversify our portfolio.

How would you describe the internal investment strategy, and what areas do you think offer the greatest potential for the fund?

SHEIKH MOHAMMED: Today we hold almost 80% of our assets in the local market. The majority of these assets are sitting as cash deposits, earning us the London interbank offered rate and a few basis points above that. We also have strategic holdings in some of the larger firms operating in Bahrain's financial and telecoms sectors. We participate in the tourism sector through our holdings in National Hotels Company and Bahrain Tourism Company.

There are also opportunities within the industrial sector, and we recently participated in the Arabian Sugar project. We are also continually looking at any opportunities that may arise that could allow us to take advantage of Bahrain's geographic position and the country's free trade agreements. However, these are considered private equity, and we have to look at the overall portfolio in terms of how much we can allocate to these ventures.

How is the issue of unemployment being addressed, and what schemes does the SIO have in place to tackle this issue?

SHEIKH MOHAMMED: In 2007 Bahrain became the first country in the Arab world to introduce a scheme that addresses with the issue of unemployment. Although this programme falls under the Social Insurance Law, responsibility is shared with the Ministry of Labour, as it operates the unemployment office.

We cooperate in registering everyone who is unemployed. The unemployment office takes care of training and preparing them to enter the workforce. Our role is to collect the insurance premiums, which are paid by both public and private sector employees.

We have created a sizeable fund that will ensure we have enough assets to support the unemployed, even if numbers increase dramatically in the future. Unemployed high school graduates seeking jobs receive a payment of BD120 ($320) per month for a period of six months, provided that, if they are offered two jobs, they accept one of them. Unemployed college graduates receive BD150 ($400) per month. Individuals made redundant because of the economic downturn receive 60% of their last salary. It is our responsibility to supply a safety net, not only for Bahraini nationals but also for expatriates.

Many insurance companies rely on reinsurance for risk management

Realigning reinsurance

Domestic firms are taking a greater share of the market

Around 53% of total non-life premiums in the GCC were ceded to foreign reinsurers in 2005. This decreased to 52% in 2006 and 49% in 2007.

As in the rest of the Gulf, insurance companies in Bahrain have come to rely heavily on reinsurance as a means of risk management, as most firms are not large enough to carry substantial amounts of risk by themselves. This has been a major challenge in the region – GCC insurers as a whole ceded around 46% of their non-life premium income to foreign reinsurers in 2009, according to a January 2011 report released by the Qatar Financial Centre. This is one of the highest cession rates in the world. Reinsurance business coming out of the GCC was valued at around $5bn for the year, with the majority of this going to reinsurers in Europe and Bermuda.

The long-term view of the sector is encouraging. Locally incorporated reinsurance firms have been pulling in a growing percentage of reinsurance premiums. In 2005 around 53% of total non-life premiums in the GCC were ceded to foreign reinsurers. This dropped to 52% in 2006 and 49% in 2007, in part the result of an increase in the number of locally registered reinsurance firms.

THE LOCAL MARKET: The Central Bank of Bahrain (CBB) is widely considered to be one of the best financial regulators in the Gulf. For this reason, the Kingdom is often at the cutting edge of regional financial developments. Such has been the case with reinsurance, which has grown exponentially in recent years. There are currently five conventional reinsurance firms and two *retakaful* (Islamic reinsurance) firms in Bahrain. As of the end of 2009, according to statistics from the central bank, the Kingdom's reinsurance and retakaful segment pulled in gross written premiums (GWPs) worth BD292.9m ($781.2m), up from BD235.3m ($627.5m) the previous year, retaining premiums of BD231.3m ($616.9m), or approximately 79% of the total.

THE MAJOR PLAYERS: Bahrain's leading reinsurer is the Arab Insurance Group (Arig), which was launched in 1980 as a joint venture by a number of Arab governments and is active in both the life and non-life segments. In 2009 the firm accounted for around 36% of GWPs in the Bahraini reinsurance market, reporting premiums of BD105.3m ($280.8m), down from BD105.8m ($282.2m) the previous year.

Around 35% of the firm is listed on stock exchanges in the Gulf, including those in Bahrain, Kuwait and Dubai. The remainder is controlled by state-owned and private organisations in the region. The UAE government owns approximately 31% of Arig, while the Libyan government holds around 16% and the Kuwaiti government around 9%.

Trust Re has been Bahrain-based since 1989, with a paid-up capital of $100m. The company is active in all classes of non-life reinsurance, covering Asia, Africa, Russia and CIS countries. Trust Re has branches in Cyprus and Malaysia, with subsidiaries spread throughout Asia, the Middle East, North America and Europe. As at Dec 2010, its equity stood at $206.2m with a gross turnover of $301.9m. Hannover Re Bahrain, a subsidiary of the German reinsurance giant, posted GWPs of BD26.7m ($71.2m) in 2009, up substantially from BD18.1m ($48.2m) the previous year. The Malaysian firm Labuan Reinsurance and New Hampshire Insurance, a subsidiary of the US-based Chartis Group, round out the market.

RETAKAFUL: There has been expanding demand for retakaful services over the past decade, as the takaful segment has grown and Islamic policyholders have required increasingly higher standards of conformity to sharia law. Previously, takaful firms would pass on their risk to conventional reinsurance firms. In recent years, however, local and international Islamic standards issuers, such as the Bahrain-based Accounting and Auditing Organisation for Islamic Financial Institutions, have encouraged takaful firms to use sharia-compliant reinsurers.

This has resulted in growing demand for retakaful services in the Gulf and other Islamic Insurance markets around the world. "There is huge growth potential in the retakaful industry," said Fadi Abunahl, the CEO of Trust Re. "As Islamic banks increase financing the demand for retakaful will increase as well."

Due to the growing demand for sharia-compliant services, the retakaful segment is expected to experience substantial expansion in the coming years. "The growth of retakaful will be higher than that of conventional reinsurance," said Mahomed Akoob, the managing director of Hannover Re's operations in Bahrain. "A majority of real estate projects are financed by Islamic banks, for example, and they will require takaful and retakaful insurance."

At the end of 2009 there were two retakaful firms in Bahrain. The Middle East operations of ACR Retakaful, a Singaporean firm and one of the largest Islamic reinsurance companies in the world, have been based in Bahrain since 2008. Another active participant in the market is Hannover Retakaful, a wholly-owned subsidiary of the German firm.

REGIONAL TRENDS: As of late 2010 GCC reinsurance rates were low compared to more developed global markets. This can be attributed to excess reinsurance capacity, as multinational companies have recently moved to get in on the ground floor. As demand continues growing and insurance penetration increases, reinsurance firms can be expected to raise their prices. At the same time, the regional market will likely continue to experience a surplus of capacity in the immediate future as new reinsurance firms expand their businesses into the GCC.

The early months of 2011 were a challenging time for insurers and reinsurers around the world. Severe earthquakes in Japan and New Zealand, flooding in Australia and ongoing political unrest in numerous countries in the MENA region strained the industry. Indeed, when Arig released its first quarter financial results in April 2011, it noted the difficult climate that prevailed in the industry. Despite these challenges, the company reported a profit of $0.6m for the first quarter of 2011. This was, however, a decline from the same period in 2010, when its profits amounted to $4.5m. Similarly, GWPs fell to $132m for the quarter, compared to $141.7m during the same period the previous year. However, the company has been posting regular growth, and it is expected to continue to expand. Arig has also agreed to abide by the UN sanctions levied against the Libyan government, a founding member and a major shareholder of the company, and they are not expected to affect the firm's long-term growth.

Arig's potential growth in coming years is in line with projections for the sector as a whole. While continued expansion bodes well for the reinsurance sector, perhaps more important is the fact that a growing percentage of local reinsurance concessions are expected to stay in the Middle East, particularly in the Gulf. As regional reinsurance and retakaful firms continue expanding, they will be able to cover more of the local reinsurance business.

An increased demand for sharia-compliant banking services has also led to the rise of the retakaful segment, which is expected to expand at a quicker rate than the conventional reinsurance industry.

Penetration in the life segment stood at 0.6% in 2009

Expanding the life market

The long-term segment has experienced rapid growth

Long-term policies made up approximately 29% of total premiums in 2009, making the segment the largest contributor to the insurance industry.

Despite the lingering effects of the international economic crisis in 2008-09, Bahrain's insurance sector has continued to grow across the board in recent years. While a number of segments have driven this development, perhaps none has been more central to the recent expansion than the life segment, which has posted massive growth over the past few years. From 2005 through 2009 gross written premiums (GWPs) from live underwriting nearly quadrupled. While the Central Bank of Bahrain (CBB), the Kingdom's financial regulator, has not yet compiled statistics for 2010 or the first few months of 2011, anecdotal and other evidence suggests that this growth has continued apace.

ON YOUR MARK, GET SET: The American Life Insurance Company (Alico), which was a subsidiary of the American International Group (AIG) at the time, was the first life insurance firm to register in the Kingdom, in 1961. The company hoped to use Bahrain as a starting point for launching business in a number of markets in the region. However, growth in the life segment remained minimal until the late 2000s.

Before the central bank was formed, the Bahrain Monetary Agency (BMA), the CBB's predecessor, oversaw the sector. In 2006 the CBB replaced the BMA as the country's primary financial regulator and overhauled Bahrain's insurance rulebook, designing a regulatory framework which is in effect today.

SOLID NUMBERS: Conventional life coverage in Bahrain falls under the CBB's "long-term" category, which includes group life, group credit life, level and decreasing term assurance, unit-linked assurance, profit policy participation and children's education policies. In 2009 the long-term insurance sector brought in GWPs of BD57.3m ($152.8m), up 11% from BD51.6m ($137.6m) the previous year. While 11% growth would be considered massive in most markets, in Bahrain it was the lowest the life segment has posted over the past five years. In 2008 the segment posted expansion of around 37%, growth for 2007 came in at 62%, and growth in 2006 was around 41%. These numbers can be attributed primarily to the segment's start from a relatively low base; in 2005 the sector posted GWPs of BD16.4m ($43.7m).

In 2009 long-term policies were responsible for around 29% of total premiums, making the segment the single largest contributor to the industry that year. In 2009 insurers in the segment paid claims valued at BD13.8m ($36.8m) in total, down around 36% from BD21.5m ($57.3m) in 2008. The fact that premiums increased and claims decreased in 2009 was a boon for the sector, with firms pulling in substantially higher revenues than in 2008. Life insurance penetration stood at just 0.6% in 2009, according to Swiss Re. The low penetration rate presents both a challenge and a major opportunity for local life insurance firms.

MAJOR PLAYERS: The largest life insurer in terms of GWPs in 2009 was the Life Insurance Corporation International Bahrain (LIC), which pulled in BD21.1m ($56.3m), down from BD21.3m ($56.8m) the previous year. The 2009 figure translates to a 37% share of the market, down from around 41% in 2008. LIC issued 60,038 policies in 2009, up from 57,993 in 2008. The company was the second-largest insurer overall in 2009, just behind the Bahrain-Kuwait Insurance Company.

LIC is a joint venture between the Indian state-owned insurance firm Life Insurance Corporation, which owns around 98% of the Bahraini subsidiary, and the International Agencies Company, a major Bahraini shipping company, which owns the remaining 2%. LIC has been active in Bahrain since July 1989 and caters to Indians living and working in the Kingdom, as well as Bahraini citizens. LIC offers a wide variety of products, including endowments, children's education plans, whole life and joint life plans, term assurance, health care plans and pension plans. According to local news reports, as of the end of 2010 the firm was considering setting up a *takaful*, or Islamic insurance, subsidiary to tap into the rapidly expanding takaful market in the Gulf. It was also in the process of starting operations in the US.

The second-largest life firm in terms of GWPs was MetLife Alico Bahrain, with BD11.9m ($31.7m) in 2009, giving the company a 21% market share, up from up from BD9.9m ($26.4m) the previous year. MetLife Alico Bahrain took on its current structure when MetLife, the largest life insurance company in the US, acquired Alico from AIG in a $15.5bn deal in March 2010. MetLife Alico Bahrain offers life insurance, savings plans, retirement planning, accident coverage, health coverage and travel insurance in the Kingdom.

The third-largest life firm in the Kingdom was Zurich International Life (ZIL), which posted GWPs of BD11.5m ($30.7m) in 2009, down from BD13m ($34.7m) in 2008. The firm issued 9131 policies in 2009, a slight decrease from 9209 the previous year.

ZIL has carried out regional offshore business from Bahrain as a subsidiary of Zurich Financial Services, a Swiss company, since 1986. In early 2010 it was awarded a licence by the CBB to operate in the Kingdom. Since then, it has taken an aggressive position in terms of expanding in the region. In December 2010 it acquired 99.99% of Compagnie Libanaise D'Assurances, a major Lebanese insurer that boasts a large regional network, including branches in the UAE, Kuwait and Oman. According to local media reports, as of early April 2011 ZIL was considering launching a takaful firm to cater to the growing Saudi Arabian insurance market.

In fourth place in terms of GWPs in the long-term segment is Legal and General Gulf, with BD5.4m ($14.4m) in 2009. The firm was set up in February 2009 as a joint venture between British insurer Legal and General and Ahli United Bank, a local financial institution. The remaining two conventional life insurers in Bahrain are Bahrain National Life, which had a market share of around 3% in 2009, and Arabia Insurance, with a market share of around 0.2% that year.

ISLAMIC INSURANCE: The remaining BD5.7m in long-term premiums (around 9.9% of the market, down from 10.6% the previous year) came from takaful companies, three of which offer life products in Bahrain. The takaful market has grown substantially in recent years, in line with the Islamic financial services sector in general both in Bahrain and the Gulf as a whole. The top player in the takaful segment in terms of GWPs in 2009 was Solidarity Family Takaful (SFT), a subsidiary of Solidarity Group Holding, a local firm that was launched in the Kingdom in 2003 and oversees a number of insurance and insurance-related subsidiaries in Bahrain and throughout the MENA region. SFT posted premiums of BD3.3m ($8.8m) in 2009, which represents a total share of around 6% of the long-term insurance segment, up from BD1.9m ($5m) the previous year.


The CBB updates the insurance industry rulebook each quarter

Around 9.6% of long-term premiums in 2009 were from takaful companies, of which there are three offering life products in the Kingdom.

Takaful International, a local firm that was known as the Bahrain Islamic Insurance Company until 1998, held the second spot in the takaful life segment in 2009. The firm posted GWPs of BD1.6m ($4.2m) for the year, or around 2.8% of the total, up from BD1.4m ($3.7m) in 2008. Takaful International launched the first sharia-compliant life insurance policy in the Kingdom in 2001. Finally, Allianz Takaful, a subsidiary of German multinational Allianz, pulled in GWPs worth BD562,000 ($1.5m), or around 1% of the total market, down from BD658,000 ($1.75m) and approximately 1.2% the previous year.

Energy

Exploration efforts under way for oil and gas
New council focusing on renewables and nuclear power
LNG imports a viable solution to need for natural gas
Enhanced techniques hoped to treble oil output
Independent producers to meet electricity demand

Over $20bn will be invested in the sector over the next two decades

Transformation initiative

Focus turns to maximising local supply and considering imports

The hydrocarbons industry in Bahrain is the oldest in the Gulf. The Kingdom discovered oil in 1932, six years before neighbouring Saudi Arabia. Four years later, in 1936, it built the region's first refinery. Since then, oil and to a lesser degree natural gas have played a major role in the country's economy.

Supplies of both are dwindling, however. From the sector's heyday in the 1970s, when it produced roughly 75,000 barrels of oil per day (bpd), output has fallen by more than half, to 32,192 bpd in 2009 and 30,576 bpd in the first half of 2010. That downward trend is now changing, thanks to renewed investment and the application of enhanced oil recovery (EOR) methods. Nevertheless, with proven reserves of only 130m barrels of crude oil and 92bn cu metres of natural gas, Bahrain's hydrocarbons sector is bound to remain small in comparison to those of its neighbours.

DIVERSIFICATION: Having realised that it cannot rely on oil and gas for its future prosperity, Bahrain has been working for decades to diversify its economy. One of the ways it has done so is by leveraging its hydrocarbons wealth, which provides a supply of energy and feedstock, to develop more labour-intensive industries such as aluminium smelting and the manufacturing of fertilisers, plastics and other petrochemicals. Yet that model of development is no longer sustainable without further supplies of hydrocarbons, both as raw materials and in order to generate electricity. Thus, Bahrain is working to identify alternative suppliers and to develop its own natural assets more intensively.

The cornerstone of Bahrain's energy programme is an unprecedented expansion of oil and gas exploration as well as production activities. According to Abdul Hussain bin Ali Mirza, the minister of energy, Bahrain intends to invest more than $20bn in developing its energy sector over the next two decades. Of that $20bn, $5bn will be used for modernising and improving the country's flagship refinery in Sitra, while the remaining $15bn will go towards further development of the existing Bahrain Field. The expectation is that, with the application of EOR methods, output can be boosted to 100,000 bpd by 2020 (see analysis).

At the same time, Bahrain has recommenced offshore exploration in its 7652 sq km of territorial waters. Although past attempts to find commercially viable quantities of oil and gas in these areas have been unsuccessful, there is hope that new technologies will prove more fruitful. In a similar vein, as of early 2011, the Kingdom has also launched an ambitious deep-gas exploration and extraction programme. Whether or not these efforts pay off, the development of the existing onshore industry will make the single biggest contribution to the growth of business investment and capital goods importation over the next decade, according to the Economic Development Board (EDB).

SECTOR STRUCTURE: The hydrocarbons industry is regulated by NOGA, which was established in 2005. It replaced the Supreme Oil Council, the Gas Committee and the Ministry of Oil, whose overlapping jurisdictions had led to some confusion. NOGA is charged with organising, supervising and developing the oil and gas sector as well as related industries. Overall energy policy is formulated by the Supreme Committee for Energy, which is chaired by the Crown Prince and includes the ministers of defence, interior, foreign affairs, finance, health the energy, as well as the CE of the EDB. The committee is tasked with promoting the sector as a whole, developing strategies for investment, optimising resource use, and studying alternative sources of energy to meet the country's growing needs.

The Oil and Gas Holding Company (nogaholding) was established in 2007 to serve as the investment and development arm of the National Oil and Gas Authority (NOGA). Through it, NOGA oversees the operations of eight companies: the Bahrain Petroleum Company (BAPCO), the Bahrain National Gas Company (BANAGAS), BANAGAS Expansion, the Gulf Petrochemical Industries Company (GPIC), the Bahrain Aviation Fuelling Company (BAFCO), the Bahrain Lube Base Oil Company (BLBOC), Tatweer Petroleum and Skaugen Gulf

The Kingdom has spent decades leveraging its hydrocarbons wealth to develop more labour-intensive industries and is now working to identify alternative fuel suppliers and develop its own resources to maximise production.

The National Oil and Gas Authority is charged with organising, supervising and developing the oil and gas sector, as well as related industries, while overall energy policy is decided by the Supreme Committee for Energy.

The majority of natural gas production is consumed domestically

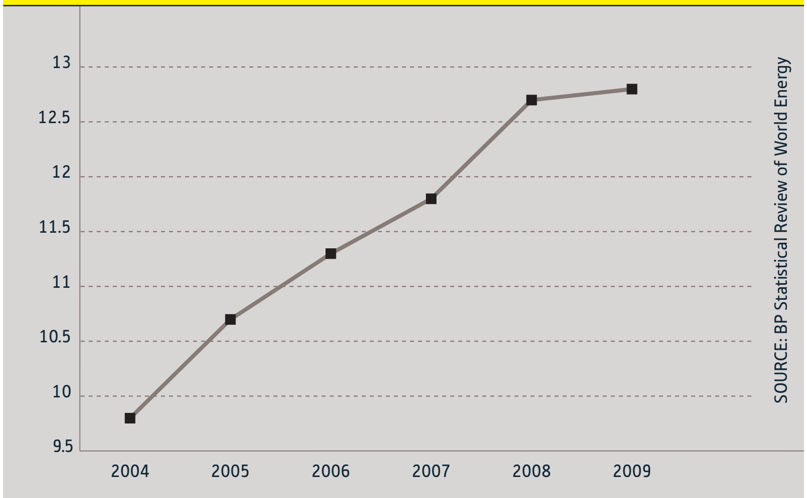
Though the global economic crisis reduced demand for products made with methanol, it also presented an opportunity for expansion in fertilisers due to a widespread shift towards biofuels.

Petrochem Carriers. BAPCO and BANAGAS Expansion are state owned, while the rest are joint ventures: the state holds 75% of BANAGAS, 33.3% of GPIC, 60% of BAFCO, 55% of BLBOC, 51% of Tatweer and 35% of Skaugen Gulf Petrochem.

LEADING PRODUCER: BAPCO has been the Kingdom's leading oil and gas producer since 1929, when it inherited Gulf Oil's interests in eastern Saudi Arabia and Bahrain. It is an integrated upstream and downstream petroleum company, responsible for all the country's oil and non-associated gas production at the Bahrain Field as well as the country's refining and export trade.

BAPCO owns and operates a 14m-barrel storage facility and a 265,000-bpd refinery that produces naphtha, gasoline, kerosene, aviation turbine fuel, ultra-low-sulphur diesel, heavy lube distillate, fuel oil and asphalt. About 95% of its refined products are exported. In 2008, the company had daily production of 32,900 barrels from the Bahrain Field and roughly 150,000 barrels from Saudi Arabia's Abu Safa field, as well as 167,000 barrel equivalents of natural gas, all of which is consumed locally. BANAGAS and BANAGAS Expansion, the

Natural gas production, 2004-09 (bn cu metres)



former of which is owned 12.5% by Chevron Bahrain and 12.5% by the Arab Petroleum Investment Corporation, are focused exclusively on the exploitation of associated natural gas from the onshore Bahrain Field.

BAFCO is a joint partnership between nogaholding, Chevron (27%) and British Petroleum Middle East (13%). It is responsible for all refuelling operations at Bahrain International Airport, though each of the partners markets and sells aviation fuel to individual airlines on its own behalf. BAFCO expects to expand its facilities in the coming years to keep up with demand as the airport undergoes a $4.7bn project that will increase its capacity to 27m passengers per year and make Manama a busier transit hub. It is currently seeking a plot of land to move its operations air-side, so that planes will no longer have to be fuelled by hydrant trucks, which are a relatively slow and inefficient means of delivery. Once the land is available, it plans to construct new facilities at a cost of BD20m ($53.34m).

EXPANSION OPPORTUNITY: GPIC was established in 1979 as a joint venture with the Bahraini government, Saudi Arabia's state-run Basic Industries Corporation and Kuwait's state-run Petrochemical Industries Company, each of which owns a one-third share.

The firm uses natural gas as feedstock to produce fertilisers and petrochemicals. Originally it consisted of two plants: one for manufacturing ammonia and one for methanol. Each has a capacity of 1200 metric tonnes per day. In 1998 the company expanded its operations and added a urea plant with a daily capacity of 1700 metric tonnes. GPIC's total annual output is currently more than 1.46m metric tonnes.

The global economic downturn of 2009 cut into GPIC's bottom line, but it also presented the company with an opportunity for expansion. "Global demand for products made using methanol was reduced during the crisis due to a slowdown in construction activity," GPIC's general manager, Abdulrahman Jawahery, told OBG. "Fertilisers are a very good business to be in because of a growing global population and a drive towards biofuel. Now is a good time to expand because it is possible to exploit favourable market conditions thanks to eager contractors." Over the next 12 months, GPIC plans to break ground on a new plant that will expand its production capacity of methanol by 120 metric tonnes per day and of urea by 80 metric tonnes per day. The company already has the necessary land and is now trying to secure the requisite feedstock.

Established in 2009, BLBOC is a joint venture among nogaholding (27.5%), BAPCO (27.5%) and Finland's Neste Oil Corporation (45%). The company is building, and will soon operate, Bahrain's first lubricating base oil plant (LBOP) at the refinery in Sitra. The LBOP, scheduled to come on-line in late 2011, will have the capacity to produce 8600 bpd of very high viscosity index (VHVI) Group III base oils suitable for blending in top-of-the-line automotive lubricants (see analysis).

Tatweer Petroleum is a joint venture between California-based Occidental Petroleum (Oxy, 48%), UAE-based Mubadala Development (32%) and nogaholding (20%). In 2010, Tatweer was put in charge of upstream activities at the Bahrain Field, with the mandate of raising both oil and natural gas output through the application of EOR techniques (see analysis). Oxy was chosen because of its experience in extracting heavy oil from fields that have already passed through primary and secondary phases of production.

Tatweer's aim is to raise the Bahrain Field's production to 100,000 bpd of oil and 2.7m cu ft per day of natural gas over the next decade. That is a heady goal, but not one without precedent: working together at the Mukhaizna Field in Oman, Oxy and Mubadala managed to improve production from less than 8000 bpd to 120,000 bpd in only five years.

Data from the first half of 2010 indicated that the Bahrain Field's production actually decreased to 30,576 bpd from 32,192 bpd the year before, but NOGA attributes that decline to routine maintenance that required certain production units to stop rather than any larger trend. Although year-end data are not yet available, Tatweer reports that, by the end of 2010, it managed not only to stem the production decline, but indeed to register a 25% increase—the field's first in 33 years.

The sector's newest entrant is Skaugen Gulf Petrochem Carriers, a joint venture with Skaugen Middle East (35%) — a subsidiary of Norway's marine transportation company, I M Skaugen — and Bahrain's Capital Management House (30%), an Islamic investment bank. The company, which was formed in December 2010, will purchase and rent ships to transport olefins, liquefied natural gas (LNG) and liquefied petroleum gas (LPG) from production centres in the Middle East to high-consumption markets in South-east Asia and China. Presently, the firm operates two ships, though it intends to expand its fleet to meet the region's growing demand for petrochemicals shipping capacity.

NEW EXPLORATION EFFORTS: Since its initial strike at Awali in 1932, Bahrain has not made any new discoveries of oil or natural gas. There have been 22 completed attempts over the years — the most recent by Chevron in 2002 — but none of them has turned up commercially viable quantities. That may soon change, if the current efforts at both on- and offshore exploration pan out as hoped. In addition to applying EOR techniques to existing parts of the Bahrain Field, NOGA intends to explore the areas along the field's flank to see whether they offer any commercial possibilities, Faisal Al Mahroos, the CE of BAPCO, told OBG. Towards that end it plans to offer a new block for exploration to international oil companies in 2012. Bahrain also plans

BANAGAS – output & exports, 1H 2010 (000 MT)

Production	1828.88
Propane	494.84
Butane	454.05
Naptha	879.99
Exports	1666.92
Propane	356.87
Butane	309.26
Naptha	1000.8

SOURCE: NOGA

Exploration efforts at the edges of the Bahrain Field are hoped to turn up viable commercial deposits

to dig deeper in search of natural gas, in the hope of augmenting its 92bn cu metres of proven Permian reserves with reservoirs in the underlying Paleozoic formations. Thus, in 2007, the government issued a tender for deep-gas exploration in the Bahrain Field. Oxy and Canadian Natural Resources both submitted bids, and in early 2011, the former was selected to carry out the project, which promises to be ambitious in scope. Preliminary prospecting at depths of up to 20,000 ft has revealed tight hydrocarbons reservoirs, but it is not yet clear whether they are viable. Mirza estimates capital investment of $170m for the project, though that figure could increase by an order of magnitude if viable deposits are found.

BLOCK PARTY: The Kingdom has also recommitted itself to offshore oil and gas exploration. In 2009, NOGA apportioned the country's territorial waters into four blocks, ranging from north to south, which it offered for tender. Oxy was awarded an exploration and production-sharing agreement (EPSA) for blocks 1, 3 and 4, which cover 2858 sq km, 1088 sq km and 1478 sq km, respectively, while the Petroleum Authority of Thailand (PTT) won an EPSA for the 2228-sq-km block 2. All four agreements are for six years. According to their terms, the companies must conduct seismic studies and drill at least two exploratory wells in each block, at their own expense, during the first three years. In order to aid their efforts, they have been provided with digital data on all previous exploration attempts.

Geochemical surveys of blocks 1, 3 and 4 have already been completed, as has a three-dimensional survey of block 4, to the west of Bahrain's main island. These are now being processed and interpreted to determine the best locations for wildcat drilling. In 2010, Oxy drilled its first well in block 4 on the basis of old seismic data. While the well revealed hydrocarbons, analysis indicated that they are not commercially viable. Oxy has now commissioned China's BGP to conduct further seismic studies in block 4 to determine where to drill the second well, which is scheduled for the first quar-

A tender issued in 2007 for deep-gas exploration in the Bahrain Field is expected to see capital investment of $170m, though that figure could increase substantially if viable deposits are discovered.

Domestic producers of natural gas are working hard to keep up with increasing demand from a growing population and industrial base, but options such as imports are on the table.

ter of 2012. Drilling in Oxy's other blocks should commence in the third or fourth quarter of 2011.

Exploration of block 2 is proceeding at a slower pace. A two-dimensional seismic survey has been completed at a cost of $7.3m, but wildcat well drilling has not yet begun. According to Mirza, PTT has asked for a six-month extension to continue its studies so it can make a more informed decision about how and where to proceed. At this stage, it is too early to determine whether either Oxy's or PTT's offshore explorations will bear fruit. There is reason to hope for discoveries in the shallow Cretaceous and Jurassic formations, as well as in the gas-bearing Khuff formations. But whether they turn out to be significant, or even commercially viable, is an open question.

DEMAND FOR GAS: Bahrain's burgeoning population and increasing industrial development are driving up demand for natural gas and domestic production is working hard to keep pace. From 2008 to 2009, total natural gas production in the Kingdom increased from 538.23bn cu ft to 543.43bn cu ft, or less than 1%.

Things picked up in the first six months of 2010, as total production increased 3.5% over the same period the year before, from 257.32bn cu ft to 266.30bn cu ft. Yet demand has been growing even more quickly: in recent years, it has averaged 4% to 6%. According to Sheikh Mohamed bin Khalifa Al Khalifa, the general manager of BANAGAS, "The government wants to increase the amount of gas either through importation or build on reserves through exploration in the field," he told OBG. "Approximately 50% of the gas is used for heavy and medium industries and that percentage is expected to increase. Additionally, about 10% is used for residential use and that amount is expected to increase as the population continues to grow as well."

MIND THE GAP: With consumption rising to close the gap with production, NOGA is keen to develop other sources of natural gas, be they far below Bahrain Field or located undersea and offshore. Yet since the prospects of exploration are so uncertain, the country has also sought outside sources of supply, several options for which are now on the table. While Bahrain exports most of its oil, either as crude or as refined products, a growing percentage of its natural gas capacity is consumed domestically.

In 2009, according to NOGA, 37% of the country's gas went to the Electricity and Water Authority (EWA) for power generation, 17% was re-injected into depleted oilfields in order to boost their output, and the rest went directly to Aluminium Bahrain (24%), BAPCO (9%), GPIC (8%) and other industrial concerns (5%) to meet their power and feedstock needs. The government has estimated that the difference between capacity and consumption could be nonexistent by 2024, but NOGA is preparing for this possibility.

To head off the possibility of future shortfalls in production capacity and supply, the Kingdom is pursuing several options to increase output. By boosting their production and exploring more, NOGA is attempting to increase output from its existing reserves. BAPCO is near the end of a three-year, $200m programme, during which it worked over five wells and drilled eight new deep Khuff wells in the Bahrain Field, which it expects to increase daily gas production by 500m cubic metres. Moreover, as Tatweer further develops the country's onshore oil reserves, associated natural gas volumes may increase by as much as 5% over the next five to eight years, Al Khalifa said.

IMPORT POTENTIAL: Even so, Bahrain's growing demand for gas-fired electric power is likely to require substantial imports. In 2008, Bahrain signed a memorandum of understanding (MoU) with Iran to import up to 1bn cu ft of natural gas per day from the latter's massive South Pars field. The two countries began negotiations about constructing a pipeline between them, which would be operated as a joint venture in which each took an equal stake. Discussions continued throughout 2010, but halted in early 2011.

The project to import Iranian gas has currently been shelved because of alleged Iranian interference in Bahraini domestic politics, Bahrain's minister of foreign affairs, Sheikh Khalid bin Ahmed bin Mohammed Al Khalifa, told the media. Bahrain has also engaged in discussions with its neighbour Qatar about importing natural gas, but no deal has yet been ratified. Such an arrangement remains a possibility, though not for the foreseeable future, as Qatar currently has a moratorium on new natural gas exportation until 2013.

Another possible supplier is Russia. In late 2010, Bahrain signed a MoU with Moscow-based Gazprom for the importation of natural gas, though details of the envisioned arrangement have yet to be worked out. In this scenario, too, a pipeline is a possibility.

In any case, gas delivery via a pipeline is unlikely to meet Bahrain's immediate needs, since there would be a lag due to construction. "Considering the time element in the pipeline approach, we realise that we need another source just to make sure that we are never short of gas," Al Mahroos told OBG. The logical answer is LNG imports, which would allow Bahrain to meet its needs on the spot market, if necessary. "Import facilities can be built in a reasonable amount of time," Al Mahroos said. "We can then import LNG matching the demand. Even if we have a pipeline in the future, the LNG import capability will give us flexibility and insurance."

The Bahraini government has already issued a tender for the construction of an LNG import terminal,

GPIC – production & exports, 1H 2010 (000 MT)	
Production	672.75
Ammonia	193.63
Methanol	192.35
Urea	286.77
Exports	468.71
Ammonia	24.91
Methanol	187.2
Urea	256.6
SOURCE: NOGA	

Discussions are under way with multiple countries on importing natural gas to meet domestic demand

which will have a re-gasification capacity of 4.13bn cu metres and could later be doubled to 8.26bn cu metres. A total of 21 international oil companies expressed interest and 14 of those were shortlisted for further consideration. Final bids from those 14 companies were originally due in February 2011, but the date has been pushed back. The awarding of a contract, originally scheduled for the third quarter, could also be delayed. The terminal will likely be located east of the Khalifa bin Salman Port and is scheduled to come on stream in late 2014, but 2015 may be more realistic. Once the terminal is up and running, Bahrain will be able to import Russian gas via tankers, and if necessary turn to the spot market to meet its immediate needs.

ELECTRICITY & WATER: One of the advantages of being a small country is that space does not present an impediment to the development of infrastructure. A beneficiary of this fact, Bahrain is 100% electrified; there is no region of the island Kingdom lacking access to power. Nor, it seems, is there any region that is not ravenous for it: in 2010, the country's summertime peak load grew 11% and its overall demand for electricity grew 12%, Abdulmajeed Ali Al Awadhi, the chief executive of EWA, told OBG. Al Awadhi also expects demand to grow at a similarly high rate in 2011.

In 2010, Bahrain had a total generating capacity of 3150 MW against a peak load of 2708 MW. In 2011 its capacity will increase to 4000 MW over the forecast peak load of 3000 MW, as the country's new flagship power plant – Al Dur – becomes fully operational. This plant, which will have a capacity of 1234 MW, is the latest manifestation of a recent and continuing trend towards privatisation in the sector.

Until 2006, EWA was responsible for the generation, transmission and distribution of all power in the Kingdom. Since then, it has privatised one of its power generation plants, the 1000-MW Al Hidd, and commissioned the 950-MW Al Ezzel, which was completed in 2007, as well as Al Dur, which started producing 400 MW in 2010. EWA continues to operate two power

A tender has already been issued for the construction of a $600m LNG import terminal. With an initial re-gasification capacity of 4.13bn cu metres, the terminal could open in 2015.

In 2010 demand for water reached 150m gallons, a 6% increase over 2009, and 100% of production

plants on its own, one in Riffa and one in Sitra, which together have a generating capacity of 825 MW. Aluminium Bahrain, the country's giant aluminium smelter, also has its own dedicated 1500-MW power plant. EWA is working on plans to commission three more independent power plants by 2020, bringing the country's total capacity to some 7775 MW.

WATER RESOURCES: EWA has pursued a similar course in regard to its other responsibility: the provision of water. Indeed, in Bahrain, the provision of water and electricity are inextricable, because the country depends on desalination for 90% of its drinking water, with only 10% coming from underground aquifers. (The two supplies are mixed to ensure the proper distribution of salts.) Since 2006, when it embarked on its privatisation drive, half of the projects EWA has commissioned are for joint power and water schemes: the newly-independent Al Hidd increased its desalination capacity by 200% to 90m gallons per day (gpd) while the soon-to-be-completed Al Dur will have a capacity of 48m gpd.

In 2010, demand for water was 150m gallons, which was a 6% increase over 2009 – and estimated to be 100% of the country's production. Assuming further growth of 6% per year, Al Dur's extra 48m gpd will suffice for just under five years. But they may have to be stretched through 2017, when the next of EWA's planned power and water plants is scheduled to come on stream with another 52m gpd. In the meantime, EWA plans to spend BD180m ($480.05m) on storage tanks, pipelines and pumping stations. A few contracts have already been awarded for these projects, however, most will be tendered in the second half of 2011.

Bahrain has already begun to benefit from electrical linkages with the GCC: in 2010 it signed an agreement allowing it to import 600 MW a day from the unified grid and up to 1200 MW in times of emergency.

All of Bahrain's power plants are gas-fired, as are those it has planned for the coming years. Given its declining supply of domestic natural gas and its as yet incomplete plans to secure alternative sources of supply, the Kingdom has begun exploring other ways of addressing its growing electricity needs. One of these is pursuing renewable energy projects and limiting consumption through education efforts (see analysis). "On the consumer level, when the cost of energy is low, people can be wasteful," Chevron's country chairman, Majeed Shafea, told OBG.

REGIONAL COOPERATION: Another option, which is bound to have greater effect over the short to medium term, is pursuing interconnection with its neighbours and partners in the GCC.

Since 2001, Bahrain has been a partner in the GCC Interconnection Authority (GCCIA), along with Saudi Arabia, Kuwait, Qatar, the UAE, and Oman. The goal of the GCCIA is to connect all of its member states in a unified power grid in order to create a regional energy market. In addition to commercial benefits, member states will gain energy security – without having to generate as much power on their own. Al Awadhi estimates that, once they have pooled their electricity, each member can safely reduce its spare capacity by up to 50%, since they will all be able to draw on each other's excess production in times of need.

The GCCIA outlined plans for the Gulf-wide grid in 2004 and completed its first phase in 2009, linking the grids of Bahrain, Kuwait, Qatar and Saudi Arabia at a cost of $1.2bn. Phase two, which has also been completed, linked Oman's and the UAE's grids to each other. The third phase, in which the two networks will be brought together, has been halfway completed, as the UAE has been linked to its northern neighbours since April 2010. Oman's project should be tendered soon, and is expected to link up in 2012.

In the meantime, Bahrain has already begun to benefit from its linkage to its neighbours. In March 2010, Bahrain signed a power supply agreement enabling it to import 600 MW a day from the unified grid, and up to 1200 MW in times of emergency. Seven months later, it concluded a bilateral deal with Doha, whereby Qatar will supply it with 150 MW of electricity from 3pm to 5pm. In October, the Kuwait Fund for Arab Economic Development gave Bahrain a KD15m ($54m) loan to enlarge and improve its electrical network.

OUTLOOK: Bahrain's energy sector is in the midst of a transformative period, as it embarks on an ambitious programme of development and exploration. It is of course too soon to say how either will turn out, but on the development front at least, there have been promising signs, as the country experienced its first rise in oil production in a generation. Bahrain may be justified in feeling optimistic. Whether its efforts at offshore exploration pay off or not, it seems safe to bet that the Kingdom will be pumping more oil in the years ahead.

The picture when it comes to natural gas is somewhat less rosy, as the country's further economic development is for the time being dependent on gas-fired electricity generation and its supply of the resource is dwindling. However, with an LNG import terminal set to come on-line in the next few years, and Russia a willing supplier, the situation is far from dire – particularly in light of the impending completion of the GCC electrical grid. With fewer hydrocarbons resources than most of its neighbours, Bahrain faces challenges unique in the region. But thanks to new technologies and wise planning, the Kingdom seems poised to meet them.

Chairman, National Oil & Gas Authority; Chairman, Bahrain Petroleum Company; and Chairman, Tatweer Petroleum

Taking the initiative

OBG talks to Abdul Hussain bin Ali Mirza, Minister of Energy; Chairman, National Oil & Gas Authority (NOGA); Chairman, Bahrain Petroleum Company (BAPCO); and Chairman, Tatweer Petroleum

What progress has there been in offshore exploration since the blocks were tendered in 2009?

MIRZA: We tendered four offshore blocks and all of them were awarded. Blocks One, Three and Four were awarded to Occidental Petroleum and Block Two was awarded to Thailand's state-owned petroleum company PTT. Subsequent to the blocks being awarded, these companies have been actively carrying out their seismic surveys and studies, and processing the data that has been accumulated over the years.

Occidental Petroleum recently commissioned the Chinese firm BGP to do a study in Block Four by laying cables in the sea, with the aim of carrying out a three-dimensional seismic survey to further define where they can drill. They will be drilling the second well in Block Four by the first quarter of 2012. Occidental Petroleum will begin drilling one well in each of both Blocks One and Three in the last quarter of 2011. PTT has asked for an extension of six months to continue their studies, after which they will decide how to proceed with drilling.

The agreements state that the exploration period is six years for each block. In the first three years, each company must drill one exploratory well in each block, at a cost of around $10m, along with the cost of the seismic studies. The firms will bear all costs associated with exploration and if they do not discover hydrocarbons, they must absorb the costs.

Tatweer Petroleum is aiming to double Bahrain Field's production capacity within 20 years. Will enhanced oil recovery (EOR) play a part in this?

MIRZA: Tatweer Petroleum is using EOR techniques to increase production at Bahrain Field, which is 78 years old and has been seeing declining production. Tatweer will use EOR to first halt the decline and then increase production from the field. An increase in production has already started. The idea is to use water flooding, gas injection and steam injection to help increase production. Tatweer Petroleum will also be assessing the heavy oil in the field for extraction to make it commercially viable. In 2010, 25 new development wells were drilled and the plan is to drill 145 more in 2011. Tatweer will drill 3600 wells in total over the 20 years, and it is on track so far.

What measures are being taken by the government to secure additional gas from abroad?

MIRZA: Securing gas supply from abroad is one of the initiatives being undertaken by NOGA. We are also planning to install a liquefied natural gas import facility. We have tendered for a strategic partner and 21 international oil companies have expressed interest. We have shortlisted the best 14. We will award the tender before the third quarter of 2011.

Another initiative involves negotiating gas supply from Russia with Gazprom. We are making good progress with Gazprom and negotiations are currently moving forward. We are also negotiating gas supplies from Qatar and Iran. Qatar has placed a moratorium on exporting additional gas, but has stated that once the study is concluded they will give priority to Bahrain. We have been in negotiation with Iran for some time and it will take time.

How will the lube base oil project contribute to the BAPCO refinery? What further synergies of this kind might be explored in the future?

MIRZA: The project will produce group three lube base oil, a high quality lube that is in great demand. It will produce around 400,000 tonnes per year. We planned to commission the project in the second half of 2011. This project will give us a very attractive rate of return, greater even than our hurdle rate. Additionally, it adds value to our operations because we will be able to use the output from the hydrocracker as feedstock for the lube base oil plant. The project also opens opportunities to create a Bapco brand of very high quality lube oil, while opening up other synergistic possibilities with our partner, Neste Oil.

The country has estimated oil reserves of 130m barrels

Optimising output

Enhanced techniques are hoped to drastically increase oil production

A well drilled in the onshore Bahrain Field began gushing 9600 barrels per day (bpd) of light crude in 1932. A year later, commercial extraction was well under way, and the field has been producing consistently ever since. For several decades, its output increased, and it was not until the mid-1970s that output peaked at around 75,000 bpd – at which point the field reached maturity and production began to slide. By 2009, its output had more than halved, to 32,192 bpd.

In the 79 years since its first strike, Bahrain has tried 22 times to discover new oil deposits, both on- and offshore, thus far without success. Pockets of hydrocarbons have been found but never in commercially viable locations and quantities.

The Kingdom's most recent attempt, a programme of offshore exploration that began in 2009, is only in its early stages at present; it may yet bear fruit. However, for the time being the Bahrain Field remains the country's only source of oil, with proven reserves of approximately 130m barrels, according to the US Energy Information Administration.

AIMING HIGHER: Even as it holds out hope of making new discoveries, the Kingdom has embarked on an ambitious programme to boost production in the Bahrain Field by more than 300%, to a new all-time high of 100,000 bpd before 2020.

Towards that end, Bahrain intends to invest more than $20bn to develop its energy sector over the next two decades, according to Abdul Hussain bin Ali Mirza, the chairman of the country's National Oil and Gas Authority (NOGA). One-quarter of that amount will be spent modernising the refinery in Sitra, which produces all of the country's petroleum by-products (see analysis), while three-quarters, or around $15bn, will be used to develop the Bahrain Field.

The centrepiece of Bahrain's oil development programme is Tatweer Petroleum, a joint venture between NOGA's subsidiary holding company, nogaholding; California's Occidental Petroleum (Oxy); and Abu Dhabi's Mubadala Development Company. Oxy and Mubadala have 48% and 32% shares, respectively, while nogaholding maintains a 20% share in the enterprise.

The latter two have worked together before on similar projects in Oman, where since 2005 they have been engaged in an intensive oil extraction programme at the enormous Mukhaizna Field and more recently have become involved in gas exploration and development. The plan is for Tatweer to boost output by applying a range of enhanced oil recovery (EOR) techniques, which can extend the productive life and increase the viable reserves of legacy fields, such as Bahrain's, that have begun to exhaust primary and secondary methods of recovery.

RECOVERY TECHNIQUES: During a field's primary recovery phase, oil is driven to the surface by natural pressure or gravity, combined with artificial lift techniques, such as pumps. Around 10% of a field's oil can be extracted in this way before pressure diminishes to the extent that extraction is no longer practical.

Secondary recovery involves the injection of gas or water into the depleted reservoir in order to maintain pressure and displace the oil into the wellbore. Depending on the characteristics of a given field, these techniques can extract anywhere from 20% to 40% of a field's oil before the wells begin to discharge considerable amounts of the injected fluids themselves and production becomes uneconomical.

EOR, or tertiary recovery, techniques are similar to but more technologically advanced than secondary ones. Like the latter, they involve injection of fluids into the reservoir. But their aim is not merely to restore pressure; it is to alter the oil's very properties in order to improve its flow. This can be done in three main ways. The first is thermal recovery, which uses heat, usually introduced through the injection of steam, to lower the viscosity of, or thin, a reservoir's remaining heavy oils, which can be as thick as molasses. The second is miscible displacement, in which gases that are soluble in oil are injected into the reservoir, again to thin its contents. The third is chemical injection, which uses

The Kingdom hopes to boost oil production to 100,00 barrels per day, up from the current 31,000 barrels per day. About $15bn will be spent on the Bahrain Field.

Production is expected to surge in 2011 with the commissioning of 25 new wells

polymers to increase the effectiveness of water-flooding or surfactants to lower the oil's surface tension and cohesion. The best technique to use in any given situation depends on a number of factors, including temperature, pressure, depth, permeability, porosity and various fluid properties. Under the right circumstances and with the optimal mix of EOR techniques, it is possible to extract 60% or more of a field's oil.

NOTABLE EXPERTISE: NOGA chose Oxy as its partner in Tatweer because the US company has enjoyed notable success with EOR techniques. In the Permian Basin that stretches across West Texas and south-east New Mexico, where Oxy is the main oil producer, 60% of its output comes from fields that employ carbon dioxide injection; by implementing the technique, it expects to recover an additional 1bn to 3bn barrels of oil.

More relevant, from Bahrain's perspective, is the fact that Oxy has enjoyed similar success in Oman, where, as a partner in another joint venture with Mubadala, it employed steam injection to increase the Mukhaizna Field's oil output by an astonishing 1400% between 2005 and 2010 – and where it expects further significant gains through 2013.

In 2010, Tatweer was put in charge of all of the Kingdom's upstream activities, with the goal of raising the country's oil production from 32,192 bpd to 100,000 bpd – in other words, more than trebling it – within 10 years. By applying EOR techniques to the much-depleted Bahrain Field, the company is expected to recover previously unextractable deposits of heavy oil, transition zone oil and tight oil, thereby increasing the field's reserves by 300m barrels. Initial results have been encouraging: Tatweer reports that by the end of 2010 it had managed not only to stem the field's long-running decline, but indeed to register the field's first output increase in 33 years – a healthy 25%.

Enhanced oil recovery pilot testing began in 2011, including water-flooding and steam-injection tests, to determine exactly what type of widespread drilling the complex Bahrain Field can handle.

That number is all the more impressive when one considers that production actually declined by more than 10% over the first six months of the year, due to plant stoppages necessitated by routine maintenance.

The Bahrain Field's production increase is attributable to two main factors: the conversion of more than 100 pre-existing wells from gas-lift to beam-pumping units, and the drilling and commissioning of 25 new wells. If the latter are any indication, production should surge even further in 2011, when 125 more wells are scheduled for drilling – not to mention the next 20 years, over the course of which up to 3600 wells may come on stream, according to Mirza. Indeed, based on what it has seen so far, Tatweer is already predicting output of 70,000 bpd to 75,000 bpd of oil by 2014.

TESTS & RECOVERY: In addition to drilling more wells, Tatweer will also begin conducting EOR pilot projects in 2011. According to industry press reports, the company plans to conduct water-flooding tests in five different reservoirs to gauge the potential for augmenting light oil production, as well as a steam-injection test in a shallow heavy-oil zone.

These tests are necessary because the Bahrain Field is relatively complex; its multiple reservoirs exist at different depths and have various rock characteristics and oil properties. Studies have already been conducted to determine which EOR techniques are appropriate for which reservoirs, but pilot tests are necessary to confirm their findings before widespread drilling commences – especially since, as Tatweer's CEO Edward Hanley has said, the company will "be applying EOR techniques on a larger scale than has been applied anywhere in the world".

If everything goes as planned, steam-injection operations should be rolled out in multiple reservoirs during 2012, said Mirza. That technique, which Oxy used to great effect in Oman, is considered one of the best, most efficient methods for recovering heavy oil from carbonate reservoirs like Bahrain's. Since the Kingdom is thought to contain more than 1bn barrels of untapped heavy oil, the widespread use of steam-injection may well allow the country to meet its goal of increasing its reserves by more than threefold. In any case, thus far, one thing is certain: Bahrain's most ambitious petroleum project in a generation had a good first year.

The Bahrain Field saw its first output increase in 33 years in 2010

The Kingdom is heavily dependent on hydrocarbons sales

From the source

Continuous upgrades are expanding oil-based product offerings

In Bahrain's relatively diversified economy, the oil and gas sector plays less of a role than in most other Gulf states. Nevertheless, because the Kingdom levies no corporate or individual income taxes, it depends heavily on revenues derived from hydrocarbons sales to finance its budget. In 2008 oil and gas accounted for BD2.3bn ($6.13bn), or 85%, of the government's total income of BD2.7bn ($7.2bn). Total revenues dropped in 2009 to BD1.7bn ($4.53bn), though the share of oil and gas remained more or less steady, at 83%, with sales of BD1.4bn ($3.73bn).

The 2010 figures are likely to show a similar proportion: in its budget for fiscal years 2011 and 2012, the Ministry of Finance projects that net oil and gas revenue will account for 87% of the state's income.

EXPORTS ABROAD: Domestic consumption accounts for only a fraction of Bahrain's oil and gas revenue; the vast majority comes from export. This is partly due to the fact that, while the state receives full price for its petroleum products on the international market, it subsidises those products at home, and heavily: BD801m ($2.13bn) has been set aside for this purpose in the 2011 fiscal year and BD841m ($2.24bn) in 2012. In larger part, though, it is simply a matter of scale: whereas Bahrain consumed 9m barrels of petroleum products in 2009, it exported 92.4m.

Of Bahrain's 2009 petrochemicals exports, 3.58m barrels were gas liquids, 7.5m were petrochemicals and 81.34m were refined products. Diesel accounted for the biggest share of the latter, with 29.6m barrels, while jet fuel and fuel oil came in second and third, with 16.4m barrels and 15.6m barrels, respectively.

Naphtha was the fourth-largest export, with 14.1m barrels, followed by asphalt, with 2.6m barrels, and gasoline, with 1.8m barrels. Exported in much lower quantities were sulphur, with 433,000 barrels; butane, with 339,000 barrels; propane, with 229,000 barrels; and kerosene, with 209,000 barrels.

Year-end statistics for 2010 were not available at time of press, but according to a report released by Bahrain's National Oil and Gas Authority (NOGA), the Kingdom's oil and gas exports grew rapidly over the first half of the year. By-product sales from January to June of 2010 were up more than 10%, to 42.1m barrels, over the same period in 2009, when they were 38.4m barrels. The daily average of by-product exports rose from 211,935 barrels in the first half of 2009 to 232,987 barrels in the first half of 2010.

SINGLE SOURCE: All of Bahrain's refined oil products – which is to say, the lion's share of its petroleum exports – are produced at a single complex in Sitra. The heart of that complex is the Bahrain Refinery, which was established in 1936, making it the oldest in the Gulf. Since 1997, when it was nationalised, the refinery has been operated by the state-owned Bahrain Petroleum Company (BAPCO). Over that time, it has undergone a number of upgrades to modernise its operations and expand capacity, which currently stands at 265,000 barrels per day (bpd).

The first of BAPCO's improvements, in 1998, was an $800m programme to upgrade the Sitra refinery that allowed it to produce unleaded gasoline. Three years later, in 2001, the complex added kerosene Merox processing units. Then, in 2005, BAPCO awarded contracts for two further expansions. The first contract, worth $430m, went to Japan's JCG for upgrading the plant and enlarging its hydrocracking facilities.

The second contract, for $89.9m, went to Greece's Consolidated Contractors to build an ultra-low-sulphur diesel production plant at the refinery. This plant, which has a capacity of 100,000 bpd, has allowed BAPCO to reduce the sulphur content of its diesel to less than 10 parts per million, in accordance with the highest international standards.

LUBE BASE OIL PLANT: In June 2009, BAPCO, nogaholding, and Finland's Neste Oil Corporation formed a joint venture (JV) to build the Kingdom's first lube base oil plant (LBOP). The JV, known as the Bahrain Lube Base Oil Company (BLBOC), is owned 27.5% by BAPCO, 27.5% by nogaholding and 45% by Neste Oil. When its oper-

Domestic consumption accounts for only a small portion of oil and gas revenue; the vast majority comes from exports. The Kingdom consumed 9m barrels of petroleum products in 2009, but it exported 92.4m barrels.

The lion's share of petroleum exports are produced at a complex in Sitra that includes the Bahrain Refinery, which has seen numerous upgrades over the years. Its current capacity stands at 265,000 barrels per day.

Construction has begun on a new pipeline to transfer light crude from Saudi Arabia to the refinery

The ability to process new products at the Bahrain Refinery means the Kingdom can tap into new export markets, such as Europe and North America, where demand is growing for lubricant base oils.

ations commence, BAPCO will be in charge of running and maintaining the plant, while Neste Oil will be responsible for marketing its products.

The LBOP, which is estimated to cost $430m, will consist of a process unit, eight storage tanks with a capacity of 10,000 cu metres each, wharf modifications and interconnecting pipelines. It will be located within the Sitra refinery complex and make use of its existing infrastructure. South Korea's Samsung Engineering was awarded an engineering, procurement and construction contract for the project, which is now approximately 90% complete, according to BAPCO's chief executive, Faisal Al Mahroos. BLBOC's focus has now shifted towards pre-commissioning and commissioning activities. "Construction work is now fully under way and on track the plant coming on stream during autumn 2011," Ilkka Iittiläinen, the managing director of Neste Oil Bahrain, told OBG.

Once it is completed, the LBOP will have the capacity to manufacture 400,000 tonnes per year (approximately 8600 bpd) of very high viscosity index (VHVI) Group III lubricant base oils. That will make it one of the world's largest VHVI base oil plants, according to Iittiläinen. Ultra-low-sulphur unconverted oil from the hydrocracker bottoms commissioned in 2007 will serve as feedstock for the new plant. Its products, which will be manufactured using catalytic iso-dewaxing technology from Chevron Lummus Global, will have a viscosity index greater than 120, making them suitable for blending in top-tier automotive lubricants. Neste Oil plans to market and distribute these VHVI Group III oils under its Nexbase brand. "There is clear potential in this group, as the product is more efficient" than less-advanced oils, Iittiläinen told OBG. "However, there is also increasing competition as it has moved from being quite niche market to a more common product."

EXPANSION READY: The addition of ultra-low-sulphur diesel and lubricant base oil plants is part of BAPCO's larger strategy of improving its operating margins by producing higher-value products, Al Mahroos said. The new products may also help Bahrain tap into new export markets in Europe and North America, where demand for Group III lubricants is growing. At present, 75% of BAPCO's refined petroleum products are exported to countries in the Middle East, Africa and Asia.

The Sitra complex is set for even more expansion in the coming years. "The objective is to turn BAPCO into a top-class, very competitive refinery," Al Mahroos said. Towards that end, the company has recently completed a major study to develop a concept for the refinery's future development. Analysis and planning will continue throughout 2011; engineering for the new project should start in 2012. According to the chairman of NOGA, Abdul Hussain bin Ali Mirza, $5bn has already been allocated for the programme.

FEEDING THE SOURCE: As its capacity expands and demand for its high-quality petroleum by-products grows, the Bahrain Refinery will require more oil as feedstock. At present, roughly one-sixth of its crude originates from Bahrain's own onshore reserves. While the Kingdom is in the midst of a push to treble its domestic output through the application of enhanced oil recovery techniques, that effort will take time – and Bahrain's proven reserves are limited, in any case. Thus, the refinery is beginning to rely even more heavily on its other, already larger supplier: Saudi Arabia.

The Bahrain Refinery has traditionally drawn about five-sixths of its input from Saudi Arabia's Abu Safa field, in which both countries hold an equal stake, but that figure is now increasing. Over the first half of 2010, imports from Saudi Arabia rose 10.8% from 213,000 bpd to 236,000 bpd, and that is only a taste of things to come. At present, Saudi Arabian light crude is pumped from Abu Safa to Sitra via the AB-1 subsea pipeline, which is now nearing full capacity. Construction has begun on a new pipeline, which will run 114 km from Saudi Arabia's Abqaiq oil processing centre to the Bahrain Refinery. This New Arabia pipeline, which is scheduled to come on stream in 2011, will have a capacity of 350,000 bpd, allowing Saudi Arabia to raise output at Abu Safa and increase its crude exports to Bahrain. If need be, down the line, its capacity can even be expanded to 450,000 bpd.

With a steady supply of crude at the ready for the Bahrain Refinery, there is no reason why the Kingdom's refined oil exports cannot continue to grow — especially as the LBOP and other upgrades come on stream. "Refinery is an old industry and being successful in it comes down to advancing from simple operations to more complicated processes," Iittiläinen said. "Overall, it is a question of optimisation."

BAPCO – key indicators, 2008-09

	2008	2009
Refined product exports (m barrels)	81.3	80.9
Crude oil exports (m barrels)	54.5	55.5
Avg. price for Abu Safah crude ($ per barrel)	91	61
Crude production from Bahrain Field (bpd)	32,861	32,192
Avg. refinery crude run (bpd)	257,400	255,900

SOURCE: BAPCO

Total energy demand has grown some 12% per annum in recent years

Power supply

Focus shifts to independent producers to meet electricity demand

Over the past few years, Bahrain's rapidly growing economy and burgeoning population have led to a surge in demand for electricity. In this respect, as in so many others, it resembles the rest of the Gulf, but Bahrain's case is particularly acute.

With a relatively diversified economy, featuring several large, energy-intensive industrial concerns, most notably Aluminium Bahrain (Alba), one of the world's largest aluminium smelters, the Kingdom is especially in need of electricity.

In 2011, for the first time in recent memory, Bahrain is poised to generate an ample surplus. Nevertheless, the country cannot afford to rest on its laurels. Additional power stations, and a more robust electricity transmission infrastructure, are needed to cope with a growing appetite for power.

GROWING DEMAND: For almost half a century, from 1957, when Bahrain's electrical grid came on stream, to 2007, when the Al Ezzel Power Plant was commissioned as the country's first independent power project (IPP), the state was the sole provider of power. The move towards independent electricity generation over the past five years was in some respects a natural outgrowth of the Kingdom's larger trend towards privatisation, deregulation and economic reform, but it was also a calculated move on the government's part to harness foreign investment to provide for increasing energy needs. The decision came at an opportune time, for electricity demand had just begun to spike.

During the first half of the 2000s, electrical demand grew at an average rate of 6% per annum, according to Abdulmajeed Ali Al Awadhi, the chief executive of the Electricity and Water Authority (EWA). That rate already presented a challenge for the industry. Then, in 2006, it accelerated. Driven by a mix of industrial, household and commercial demand, growth rates over the next four years varied from 6.5% to 12%, where they seem to have more or less settled. In 2010, total energy demand grew 12% while peak load demand grew 11%. Based on what the EWA has seen since, Al Awadhi predicted that growth would continue at an equally high rate in 2011, due to soaring demand from construction, industry, tourism and other high-growth sectors. "We expect a similar increase this year," he said, "and to cope with that we have to improve in several areas: generation, transmission and distribution."

POWER STATION: Bahrain is set to receive a boost in electrical generation as its new flagship power plant, Al Dur, becomes fully operational in 2011. The Ministry of Finance awarded a contract for Al Dur, which is classified as an independent water and power project (IWPP), to a consortium led by Gulf Investment Corporation and SUEZ Energy International in 2008. The plant, which cost $2.1bn, was developed on a build-own-operate-transfer (BOOT) basis, with a term of 25 years. Its combined-cycle gas turbines have a capacity of 1234 MW, which means that Al Dur will become Bahrain's biggest single supplier of electricity. The EWA, which is still responsible for power transmission and distribution, has signed an agreement to purchase its entire output, at a price of BD0.1396 ($0.37) per KWh for a 20-year period beginning in June 2011. Al Dur began operating at partial capacity in 2010, during which it produced 400 MW of power.

Until Al Dur becomes fully operational, Al Hidd remains Bahrain's largest electricity supplier, with a generating capacity of 1000 MW per year. The EWA owned and operated the plant until 2006, when it was privatised and commissioned as an IWPP. A consortium consisting of Sumitomo Corporation (30%), Suez-Tractebel (30%) and International Power (40%) purchased the original facilities for $738m, then spent another $462m augmenting their water desalination capacity. The next-largest producer is the aforementioned Al Ezzel, Bahrain's first newly built IPP, completed in 2007. The plant, which cost $500m, is operated by the Al Ezzel Power Company, a joint

Until 2007, the state was the Kingdom's sole provider of electricity. Since then, however, a greater push towards independent electricity generation has brought in foreign investment to meet increasing demand.

The Kingdom's flagship power plant, Al Dur, is expected to become fully operational in 2011 after having produced some 400 MW of electricity in 2010. The plant's combined-cycle gas turbines have a capacity of more than 1200 MW per year.

In 2010 total electricity generation capacity reached 3175 MW and peak usage totalled 2708 MW

venture established by SUEZ Energy International (45%), the Gulf Investment Corporation (45%) and the Pension Fund Commission for the Kingdom of Bahrain (10%). Al Ezzel began generating 470 MW in 2006 and added another 480 MW in 2007. Like Al Dur, both Al Ezzel and Al Hidd were developed on a BOOT basis and have signed 20-year power purchase agreements with EWA.

Privately owned and operated IPPs and IWPPs generate most of Bahrain's electricity today, and they are the state's preferred model of development going forward. However, at least for the time being, EWA continues to operate two plants on its own: one in Riffa and one in Sitra. Together, they have a generating capacity of 825 MW. Alba also has its own dedicated 1500-MW power plant at its aluminium smelter. In the past, during the peak summer months, it has contributed 275 MW to the national grid.

FUTURE PREPARATIONS: During 2010, Bahrain had a total generation capacity of 3175 MW and peak usage of 2708 MW. In 2011, thanks to the completion of Al Dur, the Kingdom will have a total capacity of 4009 MW against an expected peak load of 3000 MW during the summer. That will mark the first time the country has an excess capacity of 1000 MW. Al Awadhi predicts that surplus will be sufficient for another three or four years, at which point additional capacity may be needed. Thus, the EWA is already laying the groundwork for future expansion.

By 2020, Bahrain plans to add three more plants at Al Dur. The first, an IPP, will be tendered in 2012. Construction will begin the following year and the plant will come on stream in 2014 or 2015. The second, an IWPP, will be tendered in 2015, built in 2016 and commissioned in 2017. The third will be another IPP, tendered in 2018, so it can come on stream in 2020. Once the plants are completed, the Al Dur complex will have a 5000-MW generating capacity.

DISTRIBUTION: Electricity generation is only part of the equation, however. Bahrain must also bolster its transmission and distribution network to cope with and make use of its newfound capacity. Towards that end, EWA has already awarded contracts worth BD320m ($853.43m) for the construction of both 220-KV and 66-KV transmission lines and transformers. Those projects, which will be completed by the end of 2011, are sufficient for the time being. But to cope with higher fault levels arising from increased production as the second, third and fourth plants at Al Dur come on-line, it will have to upgrade its entire national network to a 400-KV standard.

The EWA plans to have those higher-voltage lines in place by 2013 or 2014 and expects them to suffice through at least 2030. It is also preparing to build a new electricity control centre, Al Awadhi told OBG. That project is still in the planning stage, but the EWA hopes to tender it in late 2011, so the centre can be ready by 2013, when it will be needed.

Bahrain is also spending BD72m ($192.02m) to expand its network of distribution stations. It has recently completed two new 330-KV stations, one in Al Dur and one in A'ali, as well as eight new 66-KV stations, one each in Al Louzy, eastern Sanad, Manama Port, Suwaifiya, Prince Khalifa Port, Wadi Al Sail, Wadi Umm Al Nassan and Sitra.

It has also built three of a planned 16 distribution networks – in Maqabah, Salmabad and north of A'ali – at a cost of BD15m ($40m), and allowed three private electricity distribution networks to be established, north of Bahrain Bay, south of Marsa Al Seef and in Tabreed. Other projects undertaken in 2011 include the replacement of two 220-KV stations and seven 66-KV stations, at a cost of BD5.3m ($14.13m), and the construction and improvement of numerous substations, at a cost of BD41m ($109.35m). The only problem to be solved in realising the EWA's plans is securing an adequate supply of feedstock. Bahrain has recently embarked on a new deep-gas exploration programme and it is discussing several options for importing more of the resource, either through pipelines or in liquefied form. However, if for any reason those efforts fall through, the Kingdom will have to look towards alternative sources of electricity generation to ensure future prosperity.

In addition to building generation capacity, the Electricity and Water Authority is aware that an improved transmission and distribution network will be needed. To that end, additional transmission lines, transformers and distribution stations are in the works.

Electricity generation & peak load, 2009 (MW)

Month	Peak load	Generation capacity
January	1096	1860
February	1054	1712
March	1122	1765
April	1771	2219
May	2251	2717
June	2339	2626
July	2225	2766
August	2438	2935
September	2258	2912
October	1898	2712
November	1769	2457
December	1122	2459

SOURCE: Electricity and Water Authority

Much of the Kingdom's electricity is fuelled by domestic gas sources

Clear directive

A new council is tasked with maximising non-conventional potential

For decades, it made sense for Bahrain to depend on gas-fired electricity: even though it had been blessed with fewer hydrocarbons than its neighbours, the Kingdom had an ample supply to provide for its own needs.

As the country began to diversify its economy in the 1970s, it was only natural that it would leverage its supply of oil and gas to provide feedstock and electricity for its nascent metallurgical and petrochemical industries. Indeed, given the vast natural gas holdings of some of its neighbours, it makes sense even today, provided Bahrain can come to an agreement with them on the terms of import, as it likely will eventually.

ALTERNATIVES: However, given its own dwindling supplies of gas, and its increasing economic diversification, it also makes sense for the Kingdom to explore alternative methods of electricity generation – and conservation – if only to hedge its bets.

Bahrain's most visible, and publicised, alternative energy project is undoubtedly the wind generator in Manama's Bahrain World Trade Centre. When these landmark twin skyscrapers were completed in 2008, they were the first of their kind, an environmental as well as an architectural statement, built to channel sea breezes between then so as to turn three 225-KW wind turbines and generate up to 15% of the buildings' electricity. But striking and symbolic as the structure may be, it will remain little more than a novelty if Bahrain does not devise a national alternative energy strategy – and that will require both vision at the top and coordination among the Kingdom's agencies.

WIDENING THE PARAMETERS: There is now a body in place that is charged with that very task. The newly formed Supreme Committee for Energy, which is chaired by the Crown Prince and includes the ministers of defence, interior, foreign affairs, finance, health, electricity and water affairs, in addition to the chairman of the National Oil and Gas Authority (NOGA) and the CE of the Economic Development Board, has been given a mandate not only to oversee the sector as a whole and devise its overall strategy, but more specifically to consider non-conventional sources of energy, including renewables and nuclear power.

The latter option is unlikely to play a role in Bahrain, at least not in the near future nor directly. The committee is coordinating its efforts with the GCC Secretariat and the UN International Atomic Energy Agency to conduct feasibility studies about nuclear power in Bahrain, but the project is still only in the planning stage, and it is not a sure sign of things to come. In fact, it is difficult to locate an appropriate site for a nuclear facility in Bahrain, owing to the country's small size. If nuclear energy is to play a role in the Kingdom's future, it is mostly likely to do it secondhand, through the GCC Interconnection Authority, when the UAE moves forward with its own nuclear energy programme.

RENEWABLES: Bahrain is more likely to move forward with renewable energy projects, particularly in wind and solar power. The Electricity & Water Authority (EWA) is currently leading a national committee that is looking into these prospects. A Japanese company has already concluded tests on wind velocity to see whether the former might be feasible, while the US company Petra Solar has been engaged to explore the latter. In early 2011, EWA signed a contract with Fichtner, a German engineering consultancy, for a one-year project to devise a pilot plan, most likely for a hybrid solar- and wind-power project. If Fichtner's findings are favourable, the EWA is hoping to tender the project by the end of 2011 so construction can begin in 2012.

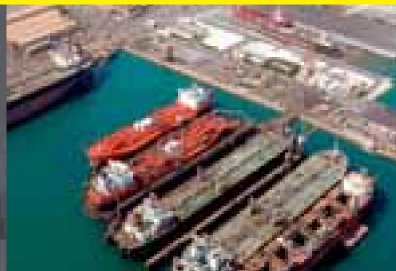
According to Abdul Hussain bin Ali Mirza, the chairman of NOGA, the project would cost $8m and consist of two hybrid plants, each of which would produce 5 MW of electricity. If the project is successful and proves to be economically feasible, then the EWA will decide whether to proceed on a larger scale. Also, Bahrain's National Committee for Energy Conservation, established in 2006, is working with the EWA and other governmental agencies to devise ways to limit energy consumption. Shifting focus to renewables and reducing consumption are clearly long-term areas of interest.

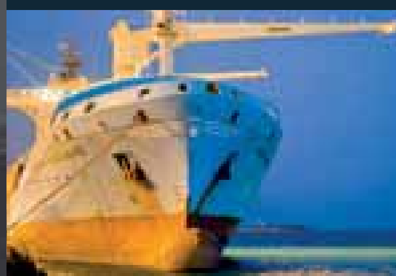
The Supreme Committee for Energy has been given a mandate to not only oversee the entire sector but to focus particularly on alternative sources of energy such as renewables and nuclear power.

The Electricity and Water Authority is leading a national committee in looking into wind and solar power projects. Depending on the results of a feasibility study, the tender for a hybrid solar- and wind-powered project could go out in 2011.

Transport

Port traffic and container activity is increasing
Setting up as a centre for regional trade
Frequency of flights and routes set to rise
Planned road work to improve local connections





Many roads and causeways are scheduled for expansion or upgrades

Linking up

Connections and services are expanding

Owing to Bahrain's long history as a trading centre, it comes as no surprise that the Kingdom is becoming an important transport nexus in the region. The industry's steady expansion has not gone unnoticed, and government authorities have highlighted the development of transport links and infrastructure efficiency as a key component to the nation's overarching economic strategy known as Vision 2030. Upgraded connections to international markets are expected to further advance Bahrain's reputation as a base for commerce.

Once famous as a centre of pearl trading during the 19th century, Manama has also been long known for its oil exports, after petroleum was first discovered there in the 1930s. Bahrain now maintains a more diverse trade market, as goods such as perishable foods, stainless steel, aluminium, containers, automotive parts and oil products move in and out of the country.

SECTOR UPDATE: Transport and communications made up 5.7% of the Kingdom's GDP during 2008, at BD478.6m ($1.28bn), and rose to 7.1% of GDP to BD515.7m ($1.38bn) in 2009 at current prices, according to Bahrain's Central Informatics Organisation (CIO). The most recent data available indicates that GDP contribution by the transport and communications industries fell slightly by the third quarter of 2010, making up an estimated 6.8% of GDP at current prices.

The industry's strength is more apparent, however, when analysed in real terms. According to the CIO, transport and communications grew from BD386.4m ($1.03bn) in 2008, representing 8.2% of the nation's GDP, to BD431.3m ($1.15bn), or 8.8% of GDP, in 2009. Contribution to GDP rose again by the third quarter of 2010, providing an estimated 9% of Bahrain's GDP in real terms. Positive signals are also coming from the trade industry. Although overall trade dropped by 15.5% in 2009, the sector grew by an estimated 7.8% in 2010, and further growth of 5.4% is predicted for 2011, as measured by current prices. The Economic Development Board has forecast that imports will increase by 41% in 2011, falling to 11% in 2012 and 5% for 2013-15. Exports are expected to grow by 50% in 2011, slowing in 2012 and 2013 to 5%, followed by 2% in 2014-15.

GROUND LINKS: According to the CIO, a total of 4122 km of road stretches throughout the Kingdom as of 2010, with 3392 km of surfaced roads and 576 km of causeways. Essential to Bahrain's road network is the King Fahd Causeway, which connects the country with its western neighbour, Saudi Arabia. The causeway carries a significant load of vehicles annually, with approximately 6.8m crossing the bridge during 2009.

The causeway is due for an upgrade, however, as congestion problems have increased, leading to delays. In an attempt to ease the heavy volumes of traffic, remodelling plans for the bridge were released in August 2010 (see analysis). Initial construction for the project is scheduled to be completed by 2015, and capacity is expected to eventually increase by 167%.

In June 2010 the Kingdom announced further plans to improve the flow of traffic in Bahrain by building a new causeway between Muharraq and Manama. Stretching 2.42 km over three bridges and comprising six lanes, the North Manama Causeway will connect commuters with both the Bahrain Bay and the Bahrain Financial Harbour. The project is scheduled for completion in 2013 and will carry a $265m price tag.

Plans have also been made to link Bahrain and Qatar with a $3-5bn, 40-km causeway to include a high-speed rail service. Qatar's winning bid to host the 2022 World Cup seems to have given the project a needed boost, and the causeway is hoped to be completed by 2015.

REDUCING CONGESTION: "Although road congestion still presents problems in Bahrain, the government has improved the situation substantially," Iain Rawlinson, the chief commercial officer of APM Terminals, which operates the Khalifa Bin Salman Port (KBSP) in the Kingdom, told OBG. "By and large, traffic conditions today are vastly better than they were two years ago."

Road congestion will be eased further through public transport services. Covering 184.2 km, the proposed network will include a monorail, trams, light rail and a

A new causeway between Muharraq and Manama, another between Bahrain and Qatar that will include a high-speed rail service, and increased public transportation options are all expected to increase ground movement.

Bus Rapid Transport service. The Kingdom should begin work on the BD3bn ($8bn) network before end-2011.

SEA LINKS: Bahrain is well suited to serve ocean transport links. In fact, the Kingdom has the potential to become a major trans-shipment centre in the region due to a number of advantages such as convenient proximity and access to large Saudi markets, a growing road network and an expanding number of local logistics services. In recognition of the country's trans-shipment potential, a new port was recently built. Opening in 2009, KBSP is Bahrain's newest general cargo and container port and is operated by APM Terminals, a division of A P Moller - Maersk Group, which has a 25-year concession to run the facility. The port and accompanying industrial area were built on the north-eastern tip of Bahrain in Hidd and cover 800 ha of land.

Versatility and efficiency are some of KBSP's greatest assets. The BD136.4m ($363.78m) port has a maximum depth at quayside of 15 metres, permitting KBSP to handle most of the largest container ships. With an average performance of 35.2 moves per crane per hour in 2010, KBSP has the highest crane productivity of any port in the Gulf, according to APM Terminals. According to the General Organisation of Sea Ports (GOP), gross crane productivity and berth productivity rose by 42% in 2010 compared to 2009. Gate turn time decreased by 20% between 2009 and 2010, and container volumes grew by 31% over the same period.

The port's location makes up another significant advantage for KBSP. Busy Saudi markets to the west have been a key component of Bahrain's transport industry, however, Iraq's emerging economy could further increase the number of ships calling at KBSP. Iraq's surplus market is expected to drive demand for container shipment between Iraq and Saudi Arabia, making KBSP a key port to handle the anticipated climb in trade. Hassan Al Majed, the director-general of the GOP, said KBSP "provides easy access and shortest transfer time to the markets in the northern Gulf, namely, Saudi Arabia, Kuwait, Qatar, Iraq and Northern Iran."

While discussing the industry's potential, Rawlinson compared the country to another small yet productive island: "Bahrain sits at the doorstep of Saudi Arabia, just like Hong Kong sits at the doorstep of China," he said. "Given Bahrain's business-friendly policies and liberal markets, [it] has the ability to capitalise on its strategic location and become to Saudi Arabia what Hong Kong has become to China. Bahrain can cater to Saudi markets better than any other country in the region."

FINANCIAL CRISIS: Bahrain's port began operations in April 2009 during an economic low point for the Kingdom. The financial downturn had significant effects on shipping, resulting in a number of changes for KBSP, including a notable shift in transport modality from general cargo to containers. The shift can be attributed to liquidity issues. Containerisation allows companies to ship much smaller volumes on consignment, rather than risk the build up of large stockpiles of unused material shipped through general cargo methods.

As a consequence of the new trend, KBSP has seen a rise in container volumes, handling 367,589 twenty-

Shipbuilding firms have diversified into oil rig and military ship repairs

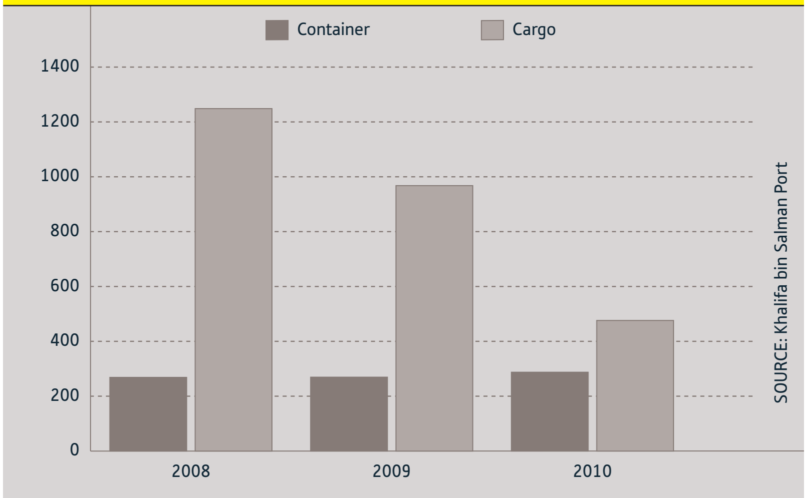
foot equivalent units (TEUs) in 2010, compared to 280,060 TEUs in 2009. Rising container volumes, largely resulting from an increase in the trans-shipment business, were accompanied by a reduction in general cargo. Building materials in particular fell substantially due to the recession. Limited amounts of steel came through the port during 2009, with only slightly higher volumes of timber over the same period. Clinker and limestone shipments dried up completely. Overall, general cargo volumes dropped approximately 55% during 2010, according to APM Terminals.

Despite this slump in shipments, KBSP has weathered the financial storm well. The most important development for the port in 2010 came with the addition of a new direct service from Asia which makes weekly calls at KBSP. The port is also connected by feeder networks to Kuwait and Iraq. Likewise, government spending on infrastructure upgrades throughout the region has dampened the impact of reduced cargo shipping due to troubled construction projects.

MAKING ADJUSTMENTS: Like many other industries connected to the transport sector, the shipbuilding

Opened in 2009, the Khalifa Bin Salman Port has the highest crane productivity of any port in the Gulf. According to the General Organisation of Sea Ports, berth productivity and container volumes increased significantly from 2009 to 2010.

Container & cargo traffic, 2008-10 (TEUs 000)



The ship repair market suffered from the global financial crisis as shipowners focused only on critical repairs. Now that the economy is growing again, ship repair companies are looking forward as owners undertake previously postponed work.

and repair market suffered from the financial downturn as ship owners focused on only critical repairs, putting off issues that did not need immediate attention. The main player in the industry, Arab Shipbuilding and Repair Yard Company (ASRY), has felt some of the effects of recent economic belt-tightening. Although it increased ship repairs from 133 in 2008 to 168 in 2009, revenue still dropped by 37% from $207.49m in 2008 to $131.36m in 2009 as the average ticket value per ship fell, according to ASRY data. Despite the revenue reduction, ASRY still turned a profit in 2009.

Much of this resilience is due to diversifying into oil rig repair and rig storage. With roughly 120-150 rigs in the Gulf, ASRY tapped into a large market when it launched its offshore operations in 2008. The new division has a range of services for jack-up drilling rigs, cable and pipe laying vessels, semi-submersibles and drill ships. "We have redirected our focus and are targeting offshore and military ship repairs. The naval market represents a huge opportunity for growth in the company," said Chris Potter, the chief executive of ASRY.

ASRY is also in the process of expanding its yard. The company is building a 1.4-km repair key, with a water depth of 12 metres. An additional 200,000-sq-metre fabrication area with the ability to hold 3000 tonnes of end loading is under construction.

Although the ship repair industry is not expected to see substantial growth in the near future, ASRY has been able to effectively diversify and adapt to the recent economic conditions. "We are not expecting 2011 to be exceptionally different from 2010 – the market is not changing that quickly," Chris Potter, the chief executive at ASRY, told OBG. "However, we do expect to see continued and steady growth as large numbers of ship owners must now go beyond the essential repairs and undertake previously postponed work. Overall, the forecast for 2011 is quite positive."

IN THE AIR: The Kingdom has long been a regional leader in the aviation industry. In 1932 it welcomed the first scheduled flight to Bahrain when an aircraft carrying 24 passengers touched down on its way from London to Delhi. More scheduled flights followed, and eventually Bahrain became the first country in the Gulf to operate an international airport. In 1976, Bahrain International Airport (BIA) began to host regular supersonic flights as the Concord flew between Manama and London, and a new terminal completed in 1994 raised the airport's passenger capacity to 9m per annum.

The aviation industry has continued to expand and has contributed to the state's objectives for the transport industry. The BIA is currently operated by the Bahrain Airport Company (BAC) which undertook management of the airport in March 2010. Set up in 2008, the BAC is wholly owned by Mumtalakat, a Bahraini holding company. The new management company hopes to increase BIA exposure, manage effective relationships with airlines, improve facilities and infrastructure and increase and diversify BIA's revenue streams.

Aviation in Bahrain is monitored by the Civil Aviation Affairs (CAA) regulatory body. The CAA's responsibilities include approving flight schedules, allowing landing and over-flight patterns, authorising all operational permits, regulating the carriage of hazardous cargo and ensuring that the industry adheres to international security and safety benchmarks. It also focuses on keeping Bahrain's skies as open as possible.

INDUSTRY UPDATE: Recent financial troubles have had a limited impact on the Middle East's aviation sector. For instance, the number of passengers at BIA still grew by about 3% in 2009. The European aviation sector, by comparison, contracted by 5-10% over the same period, according to the BAC.

Although the total number of BIA passengers reached approximately 8.76m in 2008 and rose to around 9.05m in 2009, this fell slightly to about 8.9m in 2010. Total cargo passing through BIA peaked in 2007 at 341,630 tonnes but has since gradually declined, falling to 298,135 tonnes in 2010, according to the CAA. Yet the BAC expects positive results in 2011, with underlying growth averaging 4-6% for the year. The management company is also adding one to two new carriers along with five to 10 new routes annually. Among the newcomers, United Airlines began flying to Manama from Washington DC in April 2010. According to the CAA, some 46 airlines operated to and from the BIA in 2010.

The BIA should also benefit from a change in strategy for Gulf Air, one of Bahrain's largest carriers. Already providing passengers with a wide range of connections throughout the Middle East, Gulf Air is going to focus on the Middle East and North Africa region further by increasing the frequency of flights and the number of routes. As of October 2010 the airline had extended the frequency of existing routes to two and three times daily and added five new routes to Bahrain.

LOOKING AHEAD: Expanding quickly enough to meet growing market demands is one of the most significant challenges facing the airport. The sector has expanded at a rate faster than expected which has caused some problems with transfer times. Yet the BIA is attempting to keep up with the pace of demand by expanding its facilities. By the end of 2013 the airport's capacity will increase from a tight 9m passengers annually to 13.5m and the company has long-term plans focusing on the construction of a new airport north of the BIA.

Despite some growing pains, the BIA is benefitting substantially from the aviation industry's growth. Indeed, the BAC anticipates that 2011 will be the airport's first year to turn a profit. "This year should be a real turning point for the airport," said Gordon Dewar, the CEO of BAC, in an interview with OBG. "Although the financial crisis has had some negative effects on our bottom line, we have made tremendous progress recently and expect to see further growth in 2011."

MAKING CONNECTIONS: Bahrain's ground, sea and air links are increasingly connected, as companies such as DHL, Aramex and Agility are facilitating transport industry growth by providing logistics services. Bahrain's proximity to Saudi Arabia and relatively trouble-free Customs duties and regulations on the Bahraini-Saudi border are a boon to logistics players. "The oil and gas industry in the Eastern Province of Saudi Arabia presents a huge opportunity for the transportation and logistics sector in Bahrain," said Jeremy Skyrme, the country manager for shipping company TNT Express.

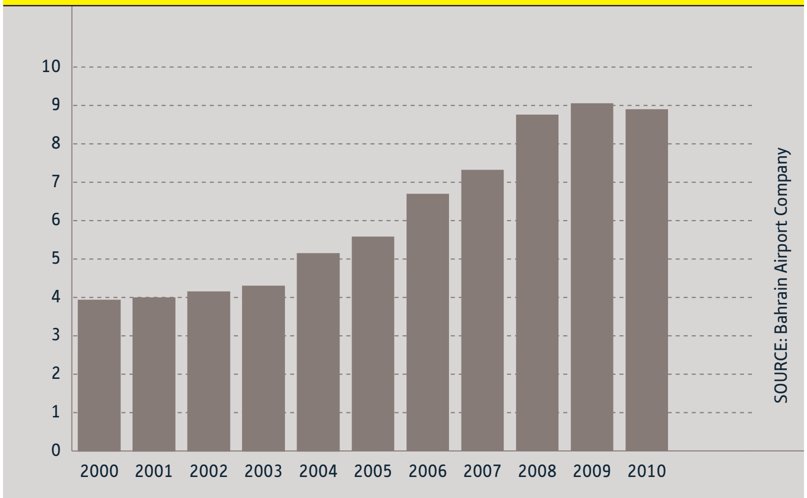
Five to 10 new air routes will be added at the BIA annually

A division of the GOP, the Bahrain Logistics Zone will be an important player in the Kingdom's logistics industry when it becomes operational in the fourth quarter of 2011. It is located within 1 km of KBSP and 40 km of Saudi Arabia via the King Fahd Causeway, with space and storage facilities to carry out logistics details.

OUTLOOK: Despite some challenges, the Kingdom's transport sector is growing and evolving. Government authorities are investing substantial sums of money into Bahrain's expanding road network, creating more effective ground links. The country's newest commercial port entered the market at a difficult time, yet KBSP has pulled through while increasing efficiency at the same time. Likewise, Bahrain's airport has hit some financial hurdles but is expecting a record-breaking year in 2011. An expanding logistics industry is also bringing additional strength to the transport sector.

Positive results are expected for the BIA in 2011, with 4.6% growth anticipated for the year. New carriers and routes, plus an increase in air passengers, will benefit from plans to expand facilities.

BIA passenger traffic, 2000-10 (m)



Given its depth, KBSP can handle the largest container ships

Steady flow

Establishing a transit nexus for the logistics industry

The growing economies of Saudi Arabia, Qatar and Iraq are providing increasing opportunities for the Kingdom to establish itself as a regional trans-shipment centre.

As the global economy becomes increasingly connected, demand is rising for faster and more efficient transfer of goods. Possessing a number of significant assets and advantages in this area, Bahrain has the potential to effectively meet the growing demand for logistics services within the northern Gulf.

Bahrain's logistics industry is bolstered by the strong transport sector. Supported by an expanding road network, efficient sea connections through the new Khalifa Bin Salman Port (KBSP) and increasing air traffic at the Bahrain International Airport (BIA), Bahrain's growing transport industry provides logistics firms with a range of options for transferring goods and delivering cargo to other markets. With the potential to create more collaborative and mutually beneficial relationships in the future, the success of both the transport and logistics industries is closely related.

THE SAUDI EFFECT: The Kingdom's location is another key contributor to its growing logistics sector. Separated by the narrow Gulf of Bahrain and connected by a 26-km causeway, Bahrain sits next to Saudi Arabia, which is the largest market in the Middle East and North Africa region. With a nominal GDP estimated at $434.6bn in 2010, Saudi Arabia has been ranked the 23rd biggest economy in the world, according to the IMF. In May 2011 the IMF forecasted that Saudi Arabia's GDP would rise by 6.5% in 2011.

Accessing Saudi markets is only getting easier for local logistics firms. The King Fahd Causeway connecting the two countries is scheduled for an upgrade, including significant lane expansion in an effort to ease the heavy traffic (see analysis). This project has been coupled with streamlined Customs duties and regulations, further increasing accessibility of Saudi markets. "Customs authorities have significantly improved the regulations in the country. The major area for improvement within the industry would be designating 3 to 4 lanes on the King Fahad Causeway and increasing the cooperation between Bahraini and Saudi customs officials to decrease transit time," said Luai Alagha, the country manager of Aramex, a global provider of logistics and transportation solutions.

Streamlined Customs duties and regulations have increased accessibility to regional markets, as have upgrades and lane expansions to local causeways.

Although goods flow both directions over the causeway, Saudi Arabia is increasing its exports, which should provide more opportunities for Bahrain's logistics industry. "As exports in Saudi Arabia grow, we should see more Saudi goods shipped out of Bahrain through KBSP, due to Saudi Arabia's overcrowded ports," Hamad Fakhro, the assistant director general of the Bahrain Logistics Zone (BLZ), told OBG. "Higher cargo and container volumes through KBSP will result in higher demand for logistics services such as storing and packaging."

OTHER MARKETS: Although the largest, Saudi Arabia is not the only attractive market for regional logistics companies. Qatar's economy is rapidly expanding. The country's GDP grew at an estimated rate of 15.9% during 2010 and one forecast predicts even higher GDP growth in 2011 of 17.2% year-on-year, according to December 2010 figures. The country has also allocated a staggering $50bn for infrastructure improvements to be completed before 2022, when it will host the World Cup. In addition, Qatar's port does not currently have the capacity to process the significantly higher volumes of building materials that will be required for Qatar's expansion plans. It appears that Bahraini logistics firms will have opportunities to fill this gap.

Iraq makes up another growing economy in the northern Gulf. With a coalition government in place and a recent uptick in Iraqi oil output, the country's economy is expected to grow by 6.3% on average per annum from 2011 to 2015, according to March 2011 statistics. In real terms, Iraq's construction industry has expanded by 5.4% y-o-y in 2010, and is widely forecast to grow by another 6% in 2011. Infrastructure spending is also on the rise. In Baghdad, for instance, plans are being made to construct a $3bn metro system.

Increased infrastructure projects should result in more imports, providing Bahrain with significant, multimodal transport opportunities. "Reconstruction of Iraq means big business for Bahrain's transport industry," said Iain Rawlinson, the chief commercial officer of APM Terminals, which operates KBSP.

LOGISTICS ZONE: A division of the General Organisation of Sea Ports (GOP), the BLZ, set to become operational by the end of 2011, will provide logistics firms with an operational base near the airport and KBSP. The facility covers 100 ha. "The BLZ is a dedicated logistics area catering to local, regional and international firms whose activities revolve around re-export and value-added logistics services," Hassan Al Majed, the GOP's director-general, told OBG. "It has its own round-the-clock Customs services and fully serviced warehouses. It has been designed to enable firms to fully leverage the benefit of its proximity to KBSP."

The zone is expected to generate some 2400 direct jobs and draw BD100m ($266.7m) in investment, and *Foreign Direct Investment* magazine rated the BLZ ninth out of the top 25 upcoming free zones in June 2010. Scheduled to be operational in late 2011, the facility is 13 km from BIA and around 40 km from the Saudi border via the King Fahd Causeway. It has plots of land available for lease and there are plans to eventually add another 1.5 sq km to the zone.

An additional project in the pipeline is a multi-level car park. With capacity for 4000 vehicles, the car park will serve as a storage centre for imported cars before re-exportation or local distribution. The project will provide significant investment opportunities, and has potential to make Bahrain a regional auto centre.

MULTINATIONAL PRESENCE: The Kingdom's logistics industry has already attracted significant international investment. Agility, for example, entered Bahrain in 2004 and has a number of offices throughout the country. A Kuwaiti company formed in 1979, the firm offers freight forwarding, warehousing, transport and logistics services. Agility delivers a large part of its clients' goods to Saudi markets, making Bahrain a convenient base from which to operate. Improved regulations and Customs duties at the King Fahd Causeway adds additional incentive for working out of Bahrain.

Aramex is another large, international logistics firm with a heavy local presence. The company offers a range of services in Bahrain including express, freight, domestic, shop-and-ship and logistics services. It operates out of three warehouses and has plans to build a fourth facility measuring 4000 sq metres.

Similarly, global courier DHL has its Middle East aviation hub based at BIA. The largest and only automated facility in the region, DHL uses this hub to provide express, freight, logistics, transport and courier services, serving the Middle East, Eastern Europe and Africa.

The Kingdom has a number of natural, strategic advantages such as its close proximity to the region's largest market and the growing economies of nearby Qatar and Iraq. Several logistics firms are operating successfully, utilising Bahrain's increasingly effective transport facilities and infrastructure. More investment should follow when the BLZ opens in late 2011.

The Bahrain Logistics Zone, scheduled to become operational in late 2011, will cater to companies whose activities include re-export and value-added logistical services. The zone is expected to attract $267m in investments.

Growing numbers of lorries and cars are lining the highways

Improved connections

Large infrastructure projects are upgrading the road network

The first phase of the Ministry of Works' plan to overhaul the road network is to upgrade congestion-prone junctions with flyovers, overpasses, bridges and tunnels.

The transport industry has a number of natural advantages, including the country's location and relatively small size, which allow for quick and efficient ground transport between shipping points or to larger markets such as Saudi Arabia. As the industry expands and increasing numbers of vehicles ply the roads, however, the ground network has become less efficient due to growing traffic congestion. Government authorities have recognised the problem and are investing substantially to improve current conditions. Overseeing the construction is the Ministry of Works (MOW), which has a directive to improve infrastructure in accordance with Bahrain's economic strategy, known as Vision 2030.

BIG PLANS: Findings from the Kingdom's most recent traffic modelling study, which was conducted in 2002, were used to prepare the MOW's current master plan for improving Bahrain's road network. The master plan attempts to support further economic growth and alleviate traffic concerns by accommodating the number of vehicles using Bahrain's roads. Phase One focuses on immediate upgrades to congestion-prone junctions. Among several projects in this phase, the Bahrain Map Junction was transformed into a two-level junction along with a flyover. In July 2010 a flyover across the Umm Al Hassam Junction was also completed.

The Mina Salman Junction represents a third upgrade proposal, with bidding for the project taking place in the third quarter of 2010. Scheduled to be completed in 2013, the project will include an overpass providing vehicles with direct access from the Sheikh Isa Bin Salman Highway to Al Fateh Street. A tunnel will also be built from the Sheikh Isa Bin Salman Bridge leading towards Hidd and the Khalifa Bin Salman Port (KBSP).

Phase two focuses on road development, and three roads have been targeted for work: construction of the Jerdab Road to connect Jaber Al Ahmed Highway with East Isa Town, improvements on the Sheikh Jaber Al Ahmed Al Sabah Highway, and construction of Road 42 to connect the North of Sitra with the Mina Salman Industrial Area. The third phase of the master plan concentrates on long-term developments, including, for example, the upgrading of the Al Fateh Road.

According to 2010 Central Informatics Organisation (CIO) data, the Kingdom contains 4122 km of roads, with highways measuring 576 km and surfaced roads stretching a total of 3392 km. Since 2004 the Kingdom has added 519 km of new roads, all of them surfaced, and expanded highways by 135 km.

SAUDI LINKS: One major component to Bahrain's growing ground network is the King Fahd Causeway, which stretches 26 km to the west, connecting Bahrain with Saudi Arabia. Built in 1986 and costing $1.2bn, the causeway carries a substantial number of vehicles over the Gulf of Bahrain every day. According to the CIO, approximately 6.8m vehicles drove over the bridge in 2009. This represents a slight decrease in traffic from 2008, when roughly 7.6m vehicles crossed the bridge. Approximately 416,000 lorries crossed the causeway in 2009, down from 439,000 in 2008.

The dip in traffic, particularly from lorries, can be attributed in part to heavy congestion causing delays and ultimately reducing the causeway's efficiency as a transport route. Expansive remodelling plans for the causeway were announced in early August 2010. The project aims to increase vehicle capacity by 167% while decreasing commuting times as well. Expected to cost around $4bn, the undertaking should permit up to 100m passengers to cross between Bahrain and Saudi Arabia every year, compared to the approximately 17.6m passengers crossing the causeway in 2009. Although initial construction is scheduled to be completed by the end of 2015, it could take another 25 years to hit all of the capacity targets.

While many roads have been targeted for work, the King Fahd Causeway to Saudi Arabia is receiving special attention, and extensive remodelling plans for it were announced in August 2010.

"Bahrain's economic success has meant there are some road traffic congestion challenges at times," said Gordon Dewar, the CEO of the Bahrain Airport Company. "Road congestion is often a by-product of economic growth. However, the current works and future plans for road investment are addressing that and the airport will benefit from this improved infrastructure."

Sheikh Daij bin Salman Al Khalifa, Chairman, General Organisation of Sea Ports and Chairman, ASRY

In position

OBG talks to Sheikh Daij bin Salman Al Khalifa, Chairman, General Organisation of Sea Ports and Chairman, ASRY

What role do you envision Iraq playing in the future of Bahrain's trans-shipment sector?

SHEIKH DAIJ: Iraq has always been an important market in the region and the Kingdom of Bahrain's vision for creating the new Khalifa Bin Salman Port (KBSP) involves turning it into a trans-shipment hub for the whole Northern Gulf region, with Iraq as one of the target countries. Development and reconstruction of Iraq's economy will no doubt lead to greater activity at KBSP, both in terms of trans-shipment and re-export from Bahrain to the Iraqi market.

The trans-shipment business began in early 2010 and I see it as the beginning of a long-term commitment that will significantly benefit the economy of the Kingdom of Bahrain, through KBSP, in the future. It is also worth noting that Iraq, until recently, only possessed a limited number of cargo ships and has recently embarked on a massive expansion of its cargo fleet. In September 2010 the Iraqi government signed a deal with an international company to operate 66 ships, representing a major step towards restoring the country's cargo transport capacity.

Iraq is a huge market and rebuilding its economy will bring forth a number of profitable business opportunities. Bahrain sits in a very strategic position and offers an ideal gateway and trans-shipment hub for the Northern Gulf, providing an efficient and cost-effective solution to Iraq's plans for rebuilding.

In what ways does Bahrain Logistics Zone (BLZ) operate in conjunction with the KBSP and the greater Salman Industrial Area?

SHEIKH DAIJ: The BLZ is a complementary project to KBSP, and is conveniently located within the new industrial area at Hidd in northern Bahrain. The zone is technically a Customs-free, value-added logistics park, which offers integrated services for commercial, import, export and re-export activities.

The logistics gateway will serve to boost Bahrain's viability as a logistics hub and will function under the General Organisation of Sea Ports. BLZ's strategic location in close proximity to the KBSP – which is only 3 km away – will allow streamlined movement of logistics traffic and easy access to Saudi Arabia, the upper Gulf and the Indian subcontinent.

With international, regional and local companies setting up their manufacturing facilities in the Salman Industrial City, BLZ provides an opportunity for those companies to set up their own distribution and logistics facilities in the BLZ or to be serviced by the companies in the zone with a multitude of value-added services and logistics solutions.

Where do you see the greatest potential for growth in the ship repair industry?

SHEIKH DAIJ: The ship repair industry has been very closely linked to the tanker and cargo ship segment, and for that reason is very sensitive to the volatility of the shipping industry. The year 2008 was regarded as overwhelmingly successful, particularly for Bahrain's ship repair industry. However, following the global economic crisis and the subsequent decline in trade volumes, the shipping industry suffered heavily as cargo volumes and freight rates declined. This, in turn, severely affected the ship repair industry as a number of ship owners postponed major repairs or began laying off older vessels without replacing them. The situation did begin improving in 2010 and I hope 2011 will witness significant recovery in both the shipping and ship repair industries.

With specific consideration of the shipping industry in Bahrain, the leading ship repair company, Arab Shipbuilding and Repair Yard Company (ASRY), began diversifying into several new areas of business in recent times, including offshore services for the oil and gas industry, as well as the repair of naval vessels, which are highly sophisticated. ASRY has plans in place that will continue to strengthen its position both regionally and internationally, and I am very optimistic regarding the outlook of this vital industry.

Gordon Dewar, CEO, Bahrain Airport Company

Expanding connections

OBG talks to Gordon Dewar, CEO, Bahrain Airport Company

What impact has the global economic crisis had on the aviation industry in the Middle East, particularly in terms of demand?

DEWAR: Clearly the economic crisis has had a negative effect on the industry, but the Middle East has fared better than many other regions in the world. If you compare the Middle Eastern aviation industry to that of Europe, the performance in the Middle East appears spectacular. Even in the most trying part of the downturn, Bahrain International Airport (BIA) still managed to achieve 3% growth. Meanwhile, Europe witnessed a 5-10% decline.

Air traffic has been fairly consistent in spite of the crisis. BIA is a major transfer airport, so there have been fluctuations as a result of airlines' choices of routes, but the traffic from Bahrain itself has maintained steady growth. We witnessed a reduction in flights in 2009, but we largely maintained passenger numbers. Econometric modelling undertaken by the airport suggests that we will be able to sustain the historic pattern of 4-6% growth over the coming years.

From the perspective of the airport, the main issue is ensuring that our development takes place fast enough to accommodate the continued demand. We are now finalising our long-term master plan, which will define not only how we want to grow in the long term, but also how we are going to attract early investment to maintain the rising demand. BIA's track record, as it stands, shows the airport attracting, on average, about one or two new carriers and adding between five and 10 new routes each year.

How are expansion plans for the airport's facilities being developed to meet growing demand?

DEWAR: The long-term plan envisions the construction of a new airport to the north of the current airport on reclaimed land. However, this will inevitably take time. This means there is an established plan that has both the ambition and government support necessary to achieve such a feat. It also gives us the clarity that we need to invest for the future in the existing facilities as we try to reach a capacity of between 13m and 15m passengers before the new facility opens. We will be installing additional capacity at the existing airport that will allow us to accommodate for growth over the next 10 years.

What are BIA's major defined objectives and to what degree do individual airline strategies influence the direction of the airport's plans?

DEWAR: The main focus of any airport should be on satisfying the airlines and passenger service is a big part of that. Fundamentally, we are here to make the airlines successful and to share the benefits of their growth and success. In this relationship, individual airlines play an important role. Gulf Air is currently developing a unique strategy to further improve its connectivity in the Middle East, which is already particularly strong. It will be focusing on delivering twice-a-day and thrice-a-day flight schedules to important Middle East cities and regions.

Additionally, Gulf Air will also be strengthening its interconnectivity through Bahrain in order to provide for those routes that would not traditionally host point-to-point traffic. They are building on the fact that the airline already has many partners and an extensive network in the Middle East.

At the same time, other carriers in the Middle East are looking toward intercontinental markets. In turn, Gulf Air has been increasing the frequency of flights serving its core markets and is establishing new routes to other markets that are either less well served or not served at all. These include flights to Addis Ababa, Isfahan, Colombo and Aden.

We can take advantage of the fact that Bahrain is ideally positioned as an air and sea centre for transport to other countries in the region. We have also launched the first direct flight to North America from Bahrain with the introduction of a United Airlines route serving Washington, DC from BIA.

Real Estate & Construction

Government infrastructure projects will benefit sector
State plans to expand supply of affordable housing
Cost of materials has stabilised and may rise in 2011
Land prices remain a barrier to additional development



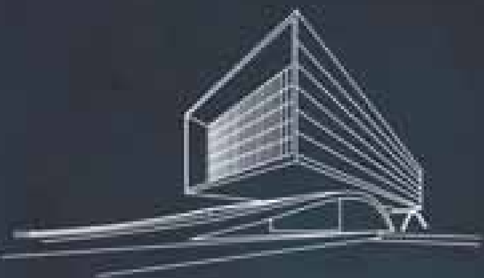


Bahrain Bay has been ideally positioned to succeed. Its track record, the commitment of the shareholders and the plan ahead, will guarantee its success.

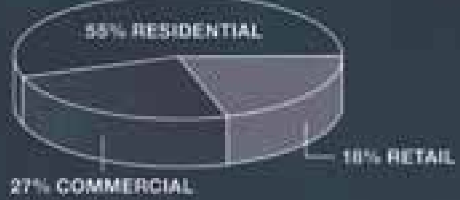
Bahrain Bay is committed to world leading best practice in construction delivery, urban design and environmental management.

Global investment: developers from the USA, France, India, Singapore, Kuwait, Saudi Arabia, the United Arab Emirates and Bahrain are committed to the project.

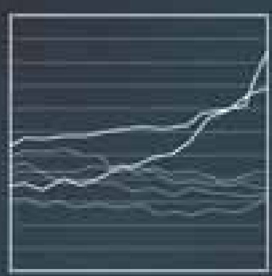
Over 70% of the land parcels have been sold within the $2.5 billion Bahrain Bay Development.



Arcapita Bank Headquarters completed and handed over in Q4 2010, with several other Third Party Developments underway.



A fully integrated mixed-use community designed to offer a wide variety of investment opportunities.



Bahrain has shown genuine economic resilience in a turbulent world economy and remains a leading performer in the region.

ON TRACK

BAHRAIN BAY

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In 2010 private sector players formed a professional association

Onward and upward

The sector looks to new segments for continued growth

Due primarily to proactive government investment, Bahrain's real estate sector is poised for expansion in 2011 and 2012. The sector has recovered a substantial percentage of the losses it suffered in the wake of the international economic downturn, and while revenues are unlikely to reach pre-crisis levels anytime soon, developers and property managers are expecting steady growth in the coming years.

However, property developers face a number of challenges. The financial sector, which had significant exposure to the real estate market when the downturn hit in 2008, has yet to resume lending on a regular basis. A number of real estate segments – in particular commercial space – are oversupplied, and in general purchase prices and rents are falling. "It will be a buyer's market at least for the next 12 to 24 months," said Bob Vincent, the CEO of Bahrain Bay, a major project being developed on reclaimed land next to downtown Manama. "The general perception right now is that the market has hit the bottom, and now we are on the way back up."

OVERSIGHT: A number of government organisations and private companies are active in the real estate sector. The Ministry of Municipalities Affairs and Urban Planning issues building permits, maintains the land registry, oversees reclamation work and cooperates with other institutions to develop policy. Other government bodies that are active in the sector include the Ministry of Works (MoW), the government's construction arm that is currently working on affordable housing schemes; the Ministry of Housing (MoH), which oversees the state-subsidised housing programme; the Ministry of Finance, which is in the process of rolling out a new mortgage scheme; and Eskan Bank, the government's official mortgage lender.

The private sector boasts a wide range of local and foreign developers. In 2010 a number of major players came together to form the Bahrain Property Development Association (BaPDA), a professional organisation that represents the Kingdom's real estate developers and acts as an intermediary between the government and individual firms. "Before we launched the association, none of the local developers interacted with each other," said Aaref Hejres, the chairman of BaPDA and CEO of Diyar Al Muharraq, a large-scale project being developed off the northern coast of the Kingdom. "Now that we are up and running, this is starting to change."

MAJOR DEVELOPMENTS: As of May 2011, the public protests had quietened, and the country was seeing a return to business as usual. In March 2011 the government announced that the Kingdom was on target to achieve GDP growth of 4.5% in 2011. That same month, the Kingdom also cancelled the 2011 Bahrain Grand Prix. This has had a considerable impact on the hospitality sector, which counts on the racing event to bring in a substantial percentage of annual revenues. According to CB Richard Ellis Bahrain, some hotel developers that had planned to open new properties in time for the race have pushed back their launch dates.

However, the government also announced several economic initiatives in the early part of 2011 that are likely to benefit local developers. These included a one-time payment of BD1000 ($2667) to all local families, the creation of 20,000 new jobs under the Ministry of Interior and a BD2.5bn ($6.67bn) project to construct 50,000 new affordable homes over the course of the next three years.

Additionally, in March 2011 the GCC announced the creation of a $10bn fund to help develop certain initiatives in Bahrain. The fund, which is being administered by Saudi Arabia, will likely be put toward new social housing projects in the Kingdom.

SMALLER AND HEALTHIER: In the three years since the economic downturn hit the real estate market in 2008, the industry has undergone a sea change. During the heady pre-crisis years, developers were focused almost exclusively on luxury and prestige

In early 2011 the government announced a BD2.5bn ($6.67bn) project to construct 50,000 new affordable homes over the next three years.

There is substantial demand for affordable housing. Both the government and the private sector are working to resolve this, with some 60,000 units expected to be built by 2014.

projects in the residential and office segments. Now, with expanding oversupply of high-end product throughout the market, companies are realigning their business models to focus on smaller projects. In this transitional environment, a number of new trends have moved centre stage.

The government has taken a leading role in boosting the industry in recent years. The state has focused on developing a number of key sectors, including affordable housing, industry and infrastructure. Sustainable development practices are increasingly popular in Bahrain. In 2008 the government launched the Bahrain Green Building Council in conjunction with local developer RealCapita, and in May 2010 the Kingdom hosted the first Green Building Forum at the Bahrain International Exhibition Centre. Additionally, a number of large-scale residential developments have made sustainability a selling point, which a growing trend across the region.

RESIDENTIAL DEVELOPMENT: At the time of press, it was reported that the residential market had not been very active so far in 2011. Disruption in the first quarter unsurprisingly led to a reduction in overall transactions, with potential tenants and purchasers monitoring the situation carefully. Most residential property in Bahrain is aimed at the middle- and high-end segments. This is largely a result of years of luxury development before the financial downturn in 2008. New high-end real estate projects have continued to open in Manama's upscale neighbourhoods despite faltering demand and falling prices in recent years. According to an April 2011 report from Cluttons Bahrain, the local branch of the UK-based real estate firm, average rental rates for a two-bedroom apartment in Manama decreased from around BD760 ($2027) in the first half of 2009 to just over BD500 ($1333) in the early months of 2011. Similarly, sales rates in Juffair, an area of Manama popular among Western expatriates, fell from just under BD800 ($2134) per sq metre in the third quarter of 2010 to around BD715 ($1907) per sq metre in the first quarter of 2011. Sales rates in Seef, one of the capital's business districts, declined from around BD1050 ($2800) per sq metre to BD1000 ($2667) per sq metre in the same period.

AFFORDABLE HOMES: While the luxury and high-end segments are down, business in other areas is looking up. Affordable housing – generally defined as any property priced at BD100,000 ($266,697) or below – is expected to be a key area of development ahead. Although affordable housing has been a major focus in the Kingdom for years, supply has not been sufficient to meet demand. However, with the recent spotlight on the sector, this may soon change (see analysis). Both the government and the private sector are working to resolve the situation. As of the end of 2010, around 60,000 new affordable residential units were expected to be built by 2014, more than half of which were part of state-sponsored programmes. Since then, the government has allocated an additional BD2.5bn ($6.67bn) for public housing initiatives over the next five years.

A number of firms have rolled out projects in this segment in recent years. Initial plans for Diyar Al Muharraq, a $3.2bn mixed-use development that was launched in 2005, included some affordable units. In April 2011, the developers announced that they planned to spend some $500m to expand the project's affordable component. The project as a whole is expected to house about 100,000 people.

Alargan Gulf Real Estate Company, a Kuwaiti firm that was launched in 2007, is building 450 affordable homes, while Manara Developments, which was established in Bahrain in 2006, has shifted focus to low- and middle-income projects. By 2015 it plans to have rolled out just under 4000 affordable housing units, some priced as low as BD85,000 ($226,692).

OTHER SEGMENTS: As the high-end residential market has fallen off in recent years, developers have moved into other niche segments. The government, which continues to be the main player in the sector, has been a major source of business since 2008. State-sponsored infrastructure projects are expected to offer developers a substantial amount of new business in the coming years. In addition to the Qatar-Bahrain Causeway, new developments in this area include work at Bahrain International Airport plus several large-scale road expansion initiatives.

As part of a long-term plan to diversify the economy away from oil and gas revenues, the state is also working to expand the industrial sector. The Kingdom has targeted industrial investment growth of 20% for 2011, according to a report from Cluttons Bahrain. As of the first quarter of 2011, demand for industrial property stood at around 5.5m sq metres, with current supply meeting only 10% of this figure. Consequently, the state is working to allocate more land for industrial development. Existing projects in this segment include the Bahrain Investment Wharf and Bahrain International Investment Park, both of which are almost entirely leased. Investment Gateway Bahrain, a project from Manara Developments that is expected to launch in 2011, will add 600,000 sq metres of light industrial space.

The office segment in Bahrain is oversupplied, which has resulted in declining rental prices. As of mid-April 2011 rates were down around 30% from 2008, when they peaked just before the global financial crisis. Consequently, the Kingdom is currently home to some of the best value office rental rates in the GCC, starting at around BD8 ($21) per sq metre per month for grade-A space and BD5 ($13) per sq metre per month for grade-B space. Rental rates are expected to remain low in the coming years as demand continues to lag behind supply.

EDAMAH: The Bahrain Real Estate Investment Company, the state-owned real estate management firm generally known as Edamah, is expected to play an increasingly important role in a number of market

Funds from the GCC are expected to be used for new housing projects

segments in coming years. The organisation was launched in December 2007 by the Bahrain Mumtalakat Holding Company, the Kingdom's investment management arm that oversees a portfolio that includes some 35 state-owned firms with a total value of around BD3.4bn ($9bn). Edamah was established with a mandate to manage, develop and invest in all government-owned real estate and land.

The company has three parts to its business: property management, which involves the management of government land that is under lease to third parties; asset management, which covers the management of income-generating building assets that it holds, such as the Souq Bab Al Bahrain; and real estate development. Edamah is at the pre-contract stage for a number of its projects, which include residential/mixed-use developments, office developments targeted to specific industry sectors and neighbourhood retail development.

Edamah has been providing project and development management services to the National Oil & Gas Authority (NOGA) for the potential develop-

With the decline in the high-end market, developers are focusing on other niches, such as infrastructure work and industrial ventures. Meanwhile, in the office segment, oversupply has translated into some of the best value rental costs in the GCC region.

Average residential rental rates, 2008-11 (BD per month)

Era Bahrain

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Era Tower, the tallest, 50 storey freehold Luxury residential tower, Developed by Bahrain-Based Era Projects, Is emplaced in the vibrant and plush Seef District.

The contemporary apartment layout comprises a commodious living room, dining room, and modern kitchen, ranging from 71 sqm to 176.4 sqm.

Recreational facilities includes gym,spa,swimming pools, jogging track, walkways, kid's play area and family picnic corners. More than 480 parking slots available.



ERA BUSINESS CENTER is a signature premium commercial project developed by ERA projects. The prestigious tower is located in diplomatic area, the prime commercial area in Bahrain.

: breathtaking views of the blue sea of the Bahrain marina and Bahrain financial harbor.
: 29 stories of tower with seven multiple carparks, one gym and recreation area.
: each typical floor office is subdivided into two offices of 163 sqm. each.



ment of a new landmark 46-level office development that would be located in the Bahrain Bay – Bahrain Financial Harbour area. If the project proceeds, the building would provide around 32,000 sq metres of net leasable area, of which Bahrain's energy sector is expected to occupy a large share. Construction would commence in early 2012 for completion early 2014. Edamah is also expected to take an investment position and act as developer for the project.

Designed by UK-based architecture firm RMJM, the building will sit on an 11,000-sq-metre plot between Bahrain Financial Harbour and Bahrain Bay. The project partners, NOGA and Edamah, are targeting to meet the gold-level environmental standards of LEED, the global green building certification system. The building's design features a "second skin" façade system that will absorb a substantial proportion of the heat load and thus reduce energy costs.

RMJM is also designing a new headquarters for the Bahrain Institute of Banking and Finance, a financial training institution that was launched in 1981. If approved, the building would sit close to the planned NOGA building, separated by a plaza space featuring restaurants and places for social interaction.

FINANCING: When the downturn hit, some investment banks had property portfolios that accounted for 60-80% of their investments. After suffering losses, many of these institutions put a hold on transactions, pausing business in the hopes that prices would begin to come back up. Consequently, large-scale investment at some institutions has slowed to a trickle over the past few years. As Saud Kanoo, chairman of Al Saraya Properties, told OBG, "A major issue affecting the market is the manner in which developers fund their projects. Legislation needs to be improved and the government needs to ease up on the loan process. Developers can no longer finance their projects from sales and have to finance their projects solely on the developer's cost."

The mortgage market was relatively stable in 2010 and 2011. By mid-2010 the segment was worth about $1.4bn, according to Sakana Holistic Housing Solutions, a private sector Islamic financing company that specialises in mortgages and is increasingly important in the sector. Founded in 2007 as a joint venture between BBK (formerly the Bank of Bahrain and Kuwait) and Ithmaar Bank, the company offers sharia-compliant financing options for Bahrainis looking to buy a home. "The market was challenging in 2010," said R Lakshmanan, Sakana's CEO. "But now it seems like liquidity is starting to come back."

However, mortgages may not be sufficient to meet the needs of all potential homeowners. Loans are capped at BD30,000 ($80,009), which is below the BD100,000 ($266,697) level that is generally considered affordable housing. Moreover, because of high land prices, units are unlikely to be sold for less than BD70,000-85,000 ($186,688-$226,692). This is a major challenge for the state and private lenders.

CHALLENGES: The real estate market is likely to face a number of challenges other than financing

The limited supply of land remains a challenge for local property developers

issues in the coming years. Land pricing is a significant issue. Many developers purchased land in 2006 and 2007, planning to sell it for a profit as the market continued to expand. When the downturn swept through the industry in 2008 and 2009, however, land prices dropped substantially. Consequently, a substantial number of developers are sitting on their land, in the hopes that prices will go back up in the near future. This is a major issue in Bahrain, a relatively small island with a very limited supply of land.

Lending to homebuyers was relatively stable in 2010 and 2011. The total value of mortgages reached about $1.4bn by mid-2010.

Developers that are looking to get into the affordable housing segment also face a number of barriers. Convincing Bahrainis to move into apartments remains a major challenge, as the local market has historically been centred around multiple-storey houses and villas. This is largely a cultural issue that both private sector developers and the government are trying to address. "We are working to change the culture here," said Hejres, the chairman of BaPDA. "Small does not necessarily mean poor quality."

Ironically, a speeding up of the affordable housing programme, which is currently on the agenda, would produce a double benefit – a fillip for the real estate industry and a mitigation of one of the issues that caused unrest in the first place.

OUTLOOK: Despite these issues, the local real estate sector appears poised for continued long-term recovery and ongoing expansion in the coming years. The market is underpinned by strong fundamentals, which bodes well for future growth prospects. The Qatar-Bahrain Causeway is expected to boost demand in both the residential and office segments. While growth in the coming years will not match the unchecked expansion seen in the years leading up to 2008, this is widely considered to be for the best. In general the government and private developers alike are focusing on more sustainable segments and factoring in lower margins. This careful development strategy is expected to result in long-term stability and steady profits in the coming years.

Luxury housing was the market focus prior to the 2008 downturn

A healthy change

The financial downturn has resulted in sector improvements

In the aftermath of the economic crisis, both the government and the private sector have worked to ensure that future growth in the real estate sector is sustainable.

When the international economic downturn swept through US financial markets in late 2008, Bahrain, like the rest of the world, was watching carefully. As a major financial centre in its own right, the Kingdom kept a close eye on the crisis as it unfolded around the world over the next few months.

With a few exceptions, the Gulf was fairly well insulated against the direct effects of the downturn. The secondary impact, however, began to play out over the last six months of 2009 and through 2010. In Bahrain, the downturn manifested itself primarily in the form of declining investor confidence in real estate projects, which up until that point had been the central focus of investors not only in the Kingdom, but also throughout the region. “It took a while for the crisis to hit Bahrain,” said Bob Vincent, the CEO of Bahrain Bay, a large-scale development going up on reclaimed land off downtown Manama. “But then it was exacerbated by negative perceptions of Middle East property markets in general.”

CAREFUL OVERSIGHT: While Bahrain felt the effects of the downturn, it was not hit nearly as hard as a number of its neighbours in the Gulf. This is at least in part due to prescient government leadership. Over the past few decades the Central Bank of Bahrain (CBB) has put in place a financial regulatory regime that has boosted the Kingdom’s reputation among financial services firms around the world.

A number of other factors contributed to the country’s sidestepping the financial downturn, as well. Perhaps most obviously, Bahrain simply did not have as much money invested in international and local real estate ventures as some of its neighbours. Additionally, the Kingdom had little involvement with the complex financial instruments – such as subprime loans, for example – that had a negative effect on a number of financial markets in late 2008.

The state’s focus on industrial development and movement away from hydrocarbons revenues will likely create opportunities for developers and other players in the sector.

RESET: The local real estate market was never as out of hand as in Dubai, for example, where speculation-fuelled deals pushed up prices. As Vincent told OBG, “Bahrain was not driven by sovereign wealth investment, like some of the other markets in the region.”

However, Bahraini developers and investment banks were certainly caught up in the region-wide property bubble in the early 2000s. In the aftermath of the downturn, the government and local developers have worked together to ensure that future expansion in real estate is sustainable. With this in mind, a number of new segments have taken centre stage over the past few years, including infrastructure, affordable housing, industry, health care and education. Compared to the luxury-housing segment, which was the focus of development for several years before the downturn hit, these areas offer smaller margins and longer turnaround times. That said, they also carry much less risk than the high-end segment, which has suffered from falling demand since the crisis, and they are considered to be central to Bahrain’s future development.

In fact, 2011 and 2012 have the potential to be profitable years for real estate developers in Bahrain. The new focus on sustainable development in the segments listed above has sparked new momentum in the sector. In response to the recent political unrest, for example, the government has moved to speed up the development of social housing, which is expected to generate new projects for developers and other major real estate players.

At the same time, the government’s recent focus on industrial development will likely result in a number of long-term, large-scale real estate projects in the Kingdom. Increased industrial development will not only generate income for developers and other major players, but it also will contribute to the country’s long-term plan to move away from oil and gas income and towards more sustainable sources of revenue. In general, the Kingdom’s large-scale economic reform programme has the potential to be a long-term source of government-sponsored real estate projects that could well prove to be lucrative.

Basem bin Yacob Alhamer, Minister of Housing

Affordable housing options

OBG talks to Basem bin Yacob Alhamer, Minister of Housing

What measures are being taken to meet increasing demand for low- and middle-income housing?

ALHAMER: It is not a secret that applications for government-subsidised housing units are increasing by the day. This recent rise in applications has come about because of the rapid increase in the Kingdom's population along with the growing costs of renting and owning property. Today, the Ministry of Housing has more than 50,000 applications for social housing in progress.

In order to reduce the size of this list, the ministry has devised a two-prong strategy that should eliminate the waiting list of applications by 2014 and establish a maximum waiting period of five years. According to the plan, the ministry will continue to employ its yearly construction and maintenance projects' budget towards building improved traditional social housing units. These units will account for about 35% of the estimated housing needs. Construction of the remaining 65% will be shouldered through public-private partnerships (PPPs) that will soon be launched with the building of a number of large-scale, multi-phase projects including the 15,000 housing units of Northern Town.

Do you expect to see any changes in the type of housing projects being developed that would address the growing need for social housing?

ALHAMER: The Ministry of Housing strategy demands the involvement of large-scale development companies to cover the growing need for low-income and social housing in the Kingdom. There is clear evidence in property market trends that social housing is a sound investment, which is proving to be relatively economically sustainable. The Kingdom's property market has been saturated by luxury properties, while the majority of the local population is made up of limited-income citizens whose housing needs demand more affordable options.

Furthermore, the global economic downturn has complemented this shift. Property developers have already announced new lines of affordable and social housing products, which should help relieve demand.

What role will local contractors and engineers play in developing new housing projects?

ALHAMER: Many local contractors, construction companies and Ministry of Housing engineers have played an important role in achieving the government's main objective, which is to provide well-designed and adequate social housing for limited-income Bahrainis.

All of the housing projects that are included in the ministry's construction plans in 2011 have been tendered to local contractors. The ministry depends on both local and international contractors and consultancy firms to prepare feasibility, environmental and engineering studies of the allocated project areas to ensure their suitability for the housing market.

Government housing projects help support local employment. The local labour market is rich with skilled worker in the fields of contracting and construction. Local hires should be the preference as part of the efforts towards achieving a sustainable economy. Nevertheless, there is always a need for hiring non-Bahrainis as well, especially those with rare specialties.

What role does Eskan Bank play in the Ministry of Housing's efforts to ensure home financing options will be available to low-income Bahraini families?

ALHAMER: Eskan Bank was established in 1979 to provide financial housing services in the form of construction, purchase and maintenance loans. Once the ministry's Housing Services Directorate has allocated a loan service to eligible low-income Bahraini families, Eskan bank takes care of all financial transactions involved in delivering these housing loan services. Loan payments are stretched over a period of 30 years, with a flat rate of 3% to cover the cost of administrative services. Eskan bank also invests in different retail outlets to provide for the social and economic needs of the population in a given area. The bank is also involved in the construction of social housing under PPP in support of the ministry's efforts to shorten and eventually eliminate the long waiting list of eligible applicants.

The Ministry of Housing oversees the state-subsidised housing plan

Homeward bound

Developments under way to meet demand

Cultural preferences tend toward single-family homes. Developers find it a challenge to convince people to buy or rent units in large buildings.

The local housing market is expected to play an important part in Bahrain's development in the coming years. The Kingdom's population, which reached 1.2m in 2010, has been projected to double by 2030. Local contractors and developers stand to benefit from the numerous large-scale residential projects that have been scheduled to go up over the next decade to accommodate this population growth. Many of these developments have been launched directly by the government, but the private sector has also started to increase its participation in the affordable housing segment.

Over the past several years the Ministry of Works (MoW), the government's construction arm, and the Ministry of Housing (MoH), which oversees the state-subsidised housing programme, have worked to realign the sector, with an eye toward increasing the supply of affordable housing and boosting development in a handful of other niche segments. As the country's largest developer by a considerable degree, where the government leads the sector tends to follow. With this in mind, housing will likely be the primary growth driver through at least 2015.

HISTORY: While the government's current focus on housing has been stepped up recently, the state has been working to improve access to affordable homes for decades. The MoH was launched in 1975, with a mandate to provide housing to Bahraini families that could not afford to pay for a home of their own. The ministry functioned as an independent organ of the government until 2002, when an official reshuffle after parliamentary elections resulted in the MoH and MoW merging to form the Ministry of Works and Housing. In December 2007, an official decree divided the ministries once again.

Turning the MoH into an independent entity was largely a strategic move, designed to improve the ministry's standing in the country and highlight the government's commitment to providing housing for its citizens. Since then, the MoH has played a major role in Bahrain, launching a variety of large-scale projects and overseeing the construction of a substantial number of affordable housing units.

DEMAND FACTORS: With a total area of just 741 sq km, Bahrain has a population density that is among the highest in the world. The real estate boom in the early 2000s resulted in residential housing prices that were well out of range for most Bahrainis. With this in mind, it is no surprise that the official waiting list for government-sponsored housing grows by about 4000-5000 names every year.

A number of other factors have contributed to the rapidly rising demand for housing. Large villas and multi-storey houses are the norm in the region at large, and have been popular in Bahrain for years. This cultural preference is a challenge for developers, who find it hard to convince locals to buy or rent small and medium-sized units or even, in some cases, apartments in high-rise buildings. "The cultural issues surrounding affordable housing in Bahrain are a big challenge," said R Lakshmanan, CEO of Sakana Holistic Housing Solutions, a private sector Islamic financing company that specialises in mortgages. "People want townhouses here, but Bahrain is small. We need to go vertical."

According to a number of major industry players, however, as of early 2011 land prices represented the largest single obstacle in the country's housing market. During the pre-crisis boom, land in some high-value areas increased by as much as 500-600% over a four-year period. While prices dropped substantially after the downturn hit the property market, many developers and other landowners are still holding onto large plots of prime real estate, in the hopes that prices will go back up.

According to industry participants, land prices represent the greatest barrier to expanding the housing market. They typically represent about 40-50% of the total cost of a development.

"Land was traded like a commodity here," said Stefan Burch, the associate director of strategic consultancy at Cluttons Bahrain, the local branch of the UK-based real estate firm. "This was a huge problem – prices were three-to-four times what they should have been." Consequently, land generally accounts for around 40-50% of the final price of most developments in the country.

AFFORDABLE HOUSING: Demand for affordable housing is huge. As of 2010 around 80% of Bahraini nationals earned less than BD1200 ($3200) per month. A Gallup poll carried out in late 2010 indicated that 41% of nationals and Arab expatriates had been unable to afford adequate shelter or housing at least once in the previous year.

The swelling demand for social housing can be attributed to Bahrain's growing population as well as market rental rates that are still much higher than many people in the country can afford. In fact, even at properties that are classified as low-income, rental costs have increased. According to Gulshan Properties, an Indian company, there was a 25% increase in the price of low-income accommodation during the first few months of 2011.

As of March 2011, the waiting list for government housing had around 55,000 names on it. Subsidised housing is available to Bahraini nationals at different income brackets, starting with those who earn less than BD400 ($1067) per month, with this group having access to the greatest amount of funding. As of 2010, around 80% of citizens earned less than BD1200 ($3200) per month. Hasan Al Bastaki, the managing director of Manara Developments, a local real estate firm, estimated that 10-20% of the applicants on the waiting list are seeking relatively small amounts to cover mortgage costs or a down payment on an apartment, for example. The rest of the applicants on the list need more support.

CONSTRUCTION WORK AHEAD: In 2002 the MoH announced that it would construct 75,000-100,000 affordable homes as part of the Northern Town project, which would include a mix of middle-income and affordable units. As of late 2010, the state had yet to break ground on the project, although it is expected to be completed by 2012. In early 2010 the MoH announced that the government would roll out 10,000 affordable units by the end of the year, and 38,000 more by 2014.

Additionally, near the end of 2010 the state announced that it planned to construct 4500 new affordable housing units in conjunction with private sector developers and construction firms. "[This] will be a first step in partnership between the public and private sectors," said Salman bin Hamad bin Isa Al Khalifa, the crown prince, in a statement released in conjunction with the announcement.

A TURNING POINT: The affordable housing segment is expected to benefit from massive investment in the coming years. In early 2011 the MoH announced that it would spend a total of some BD2.5bn ($6.67bn) to build 50,000 new affordable homes by 2016. In addition, part of the $10bn GCC fund for Bahrain unveiled in the spring will likely be used to finance the development of local housing projects.

The private sector is also working to take advantage of this growing market. In April 2011 the developer of Diyar Al Muharraq, a $3.2bn mixed-use project, announced that it planned to expand its affordable housing component by around $500m. The project as a whole is expected house around 100,000 residents in some 30,000 units upon completion.

High-end real estate projects continue to open in Manama

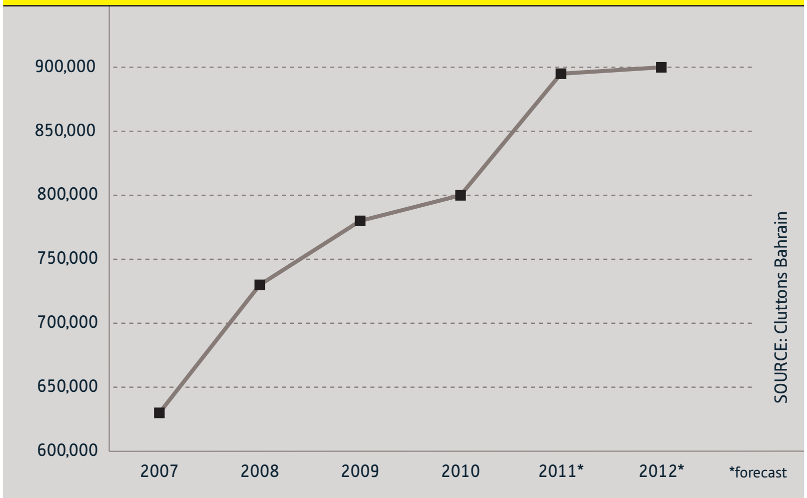
Subsidised housing is available to Bahrainis at different income levels, starting with those who earn less than BD400 ($1067) per month.

Manara Developments has shifted its business model to focus on two market segments: affordable housing and housing targeting the lower- and middle-income bracket. The firm is currently developing a number of residential projects, including Tubli Gardens, which will feature houses starting at around BD85,000 ($226,692).

Similarly, the Kuwait-based company Alargan Gulf Real Estate Company is currently constructing 450 affordable homes in the Kingdom as part of larger mixed-use projects. Additionally, Alargan has been working with the government to secure end-user financing for its projects, which will include townhouses starting at BD70,000 ($186,688).

"Margins are extremely tight at the moment," said Manara Development's Al Bastaki. "Still, affordable housing and infrastructure are segments to watch."

Commercial office supply, 2007-12 (sq metres)



The Ministry of Works focuses on large-scale infrastructure projects

Bricks and mortar

The move into new segments bodes well for future expansion

Bahrain's Vision 2030, the country's long-term economic plan, calls for a complete overhaul of the country's infrastructure. Already under way, this programme will create work for the sector.

Despite the lingering effects of the global economic downturn and the recent unrest in the Kingdom, Bahrain's contractors, property developers and other construction-related players are optimistic about the future. New buildings and large-scale projects have continued to go up over the past few years, despite a number of major challenges and constraints, which points to the fundamental strength of the market. While demand has fallen off in some segments, such as luxury residential and high-end office developments, it has grown substantially in other areas, including affordable housing, industrial development and infrastructure.

VISION: This shift from the high-end residential market to a handful of niche segments is in line with Vision 2030, the Kingdom's long-term economic development plan, which is overseen by the Economic Development Board (EDB). Among other things, the plan calls for a complete overhaul of the country's infrastructure, work which is currently under way and will likely supply local construction companies with work for years to come.

The government, which has been a major mover in the construction sector for years, has continued to invest heavily in a variety of developments, including transport projects, industrial zones and, perhaps most importantly, large-scale affordable housing projects. Ongoing work in these segments bodes well for the Kingdom's construction sector.

REGULATORY OVERSIGHT: A number of government bodies are involved in Bahrain's construction sector. The Ministry of Municipalities Affairs and Urban Planning acts as the industry regulator, overseeing land and property registration, issuing building and land reclamation permits and developing policy. The Ministry of Works (MoW), the government's construction arm, has launched numerous major transport projects in recent years.

"For the past few years we have focused on large-scale infrastructure expansion projects," Essam bin Abdulla Khalaf, the minister of works, told OBG. "In the coming years we will continue to play a major role in infrastructure development, and we will also work to implement projects that create jobs, in line with the government's plan to increase employment throughout the country."

The Ministry of Housing, which was part of the MoW until 2007, oversees the country's affordable housing programme, which supplies low-income Bahrainis with housing units. The EDB also plays an important role in the construction sector. Under Vision 2030, the board oversees the National Planning Development Strategy, a blueprint for future infrastructure development. Designed by the US-based architecture and engineering firm Skidmore, Owings and Merrill in 2007, the strategy outlines large-scale, sustainable infrastructure upgrades throughout the country and lays out a zoning policy for ongoing development in a number of areas.

However, some remain sceptical about the government's planning efforts. Mohamed Salahuddin, president of the board at Mohamed Salahuddin Consulting Engineering Bureau, a local engineering and architecture company, told OBG, "Bahrain has never been successful at urban design. There are no proper regulations to control building design. Architecture and urban layouts need to be managed. This involves better integrating the road network into the urban layout and enhancing transportation."

PROPERTY RISING: The construction industry in Bahrain, like the rest of the Gulf, was negatively affected by the downturn, which hit the region in mid-2009. By mid-2010 around 25% of the building projects under way in GCC countries had been shelved or cancelled entirely. Demand for high-end property, which rose substantially through the early and mid-2000s, fell off, as did prices for land and construction materials. Banks and other lending institutions, which played a major role in funding the pre-2008 property boom, quickly tightened their purse strings, instituting conservative lending requirements almost immediately. Between 2008 and 2009 the total value of new construction contracts in the country fell from $2.2bn to approximately $1.2bn, according to a report from Research and Markets.

BUFFERED: Bahrain fared better than many of its regional neighbours in this new climate. Developers in the Kingdom had only begun to experiment with the speculative practices that were already in widespread use in some markets when the crisis hit. Similarly, Bahrain's financial regulatory regime, which is widely regarded as one of the best in the region, insulated the country from most of the complex financial products that affected Wall Street and other markets in late 2008 and 2009.

Thanks in large part to these advantages, the Kingdom's property market began to see signs of improvement by late 2009. In December 2010, prior to the political disturbances, Research and Markets published a report projecting that new construction contracts awarded in the Kingdom would total $1.6bn in 2012. Since the events of early 2011, the government has announced that the country is on still track to post GDP growth of 3% in 2011.

Before the downturn, most construction firms were focused on the luxury villa and apartment segment. Today, however, most local developers have worked to realign their business towards middle- and low-income end-users. Additionally, many firms have begun to focus on a handful of other segments, including industry and education, both of which are key development areas under Vision 2030.

This realignment has paralleled a number of new building trends. While sustainability was important in development circles before the downturn hit, in the three years since 2008 it has become a central tenet at many firms. The importance of "green" building in the Kingdom was on display at the inaugural Green Building Forum, which was held in May 2010 at the Bahrain International Exhibition Centre.

"Green building technology is huge right now," said the MoW's Khalaf. "Green development has had a major impact on the construction sector over the past few years, and we only expect it to become more important in the future."

LARGE-SCALE PROJECTS: While Bahrain was more insulated from the downturn than other countries, a number of major construction projects were put on hold in the wake of the crisis, including Uptown Bahrain and Downtown Al Areen. At the same time, work at some large-scale projects has continued, although financing arrangements have been modified in certain cases. "The fact that some projects, such as Bahrain Bay, survived the downturn and some did not is related closely to the strength of individual developers and available revenue and equity," Bob Vincent, the CEO of Bahrain Bay, a mixed-use development located close to Manama's central business district, told OBG.

Construction permits by type, 2008-10

	2008	2009	2010
Addition	5187	5737	5156
Demolition	1128	650	732
Demolition & new construction	118	64	67
New construction	3840	2936	2493
Reclamation	35	9	12
Renovation	1234	984	879
Total	11,542	10,380	9339

SOURCE: Ministry of Municipalities Affairs & Urban Planning

Work on some large-scale developments continued despite the global financial crisis

INFRASTRUCTURE: As part of the government's National Planning Development Strategy, the state has rolled out a wide variety of large infrastructure projects in recent years. In 2010 the Kingdom budgeted BD152m ($405m) on road construction and maintenance, which included the completion of the Sitra Bridge and Umm Al Hassam interchange.

At the same time, other projects are ongoing, including efforts by the MoW in Mina Salman. Khalaf, the minister of works, told OBG, "Currently, the ministry is planning a road network upgrade in Mina Salman. This will be a 30-month project to build a three-level interchange, which will have a positive impact on traffic flows in a key area of Bahrain." Another major project under way is the North Manama Causeway, being developed by the MoW in conjunction with BESIX, the Belgian construction company, and the Haji Hassan Group. The causeway will link Bahrain Financial Harbour and Bahrain Bay with the Al Fateh highway.

Perhaps the most important road development in the coming decade is the Qatar-Bahrain Causeway, a $3-5bn bridge project that will connect the two countries via a 40-km, four-lane link. The project has been delayed a number of times since 2008, when it was first launched. As of April 2011, however, construction is expected to begin by the end of the year, and to be completed by 2015. Overseen by the Qatar-Bahrain Causeway Foundation, the project will be carried out by multiple international construction and

The government's budget for road development in 2010 amounted to more than $400m. Major projects included the Sitra Bridge and Umm Al Hassam interchange project.

Construction of the Qatar-Bahrain Causeway, a project valued at $5.5bn, is expected to begin by the end of 2011 and be completed by 2015.

Materials prices fell significantly in 2009. However, they stabilised in 2010 and may rise in 2011 as demand increases in Bahrain and regionally.

consulting firms, including COWI, Qatari Diar, Vinci Construction Grands Projets and Halcrow.

Other recently completed or ongoing developments include an airport expansion project, a sewage project, the $1bn Green Line monorail project and a new service zone at Khalifa bin Salman Port. "Infrastructure projects will be the driving force in the construction industry," said Hasan Al Bastaki, the managing director of Manara Developments, a local developer. "They add value to the country overall, create employment and are a much-needed asset."

HOUSING: The residential market, and specifically the affordable housing segment, represents a major growth area in the coming years. The official waiting list for state-subsidised housing had around 55,000 people on it as of the end of March 2011. The government has rolled out around 10,000 new affordable housing units annually over the past few years, but this has not been enough to meet the needs of the Kingdom's low-income residents, who account for a substantial percentage of the population. In early 2011 the government announced that it would spend BD2.5bn ($6.67bn) on new public sector housing programmes through 2016. A number of private companies have launched affordable housing initiatives as well, primarily as a component of larger mixed-use developments.

LAND RECLAMATION: Bahrain is a small island nation with a rapidly growing population. Consequently, for the past three decades land reclamation has been an important tool for developers, especially those planning large-scale projects. From 1981 to the end of 2008, the Kingdom increased in size by around 11.4%, or some 26 sq km, thanks to reclamation projects on the coasts.

However, land reclamation is controversial in Bahrain and the Gulf in general. As Brian Newman, the CEO of the Bahrain Real Estate Investment Company (Edamah), told OBG, "We need to focus on making the best use of the land we have instead of reclaiming new land. This involves upping densities and encouraging people to adopt a more urban lifestyle. This is a long-term process." In recent years the government has worked to implement new rules to regulate reclamation, which can be harmful to the underwater environment. In mid-2010 Adel Khalifa Al Zayani, the director-general of the Public Commission for the Protection of Marine Resources, Environment and Wildlife, called for stricter regulations on reclamation. In an effort to enforce the existing legislation surrounding the issue, which was passed in 2008, the Ministry of Municipalities Affairs and Urban Planning introduced a new law in February 2011 that will require dredging companies to install GPS systems on their boats, which will in turn be monitored to ensure that reclamation work is being carried out within legal limits. This is in line with Al Zayani's appeal to improve industry oversight.

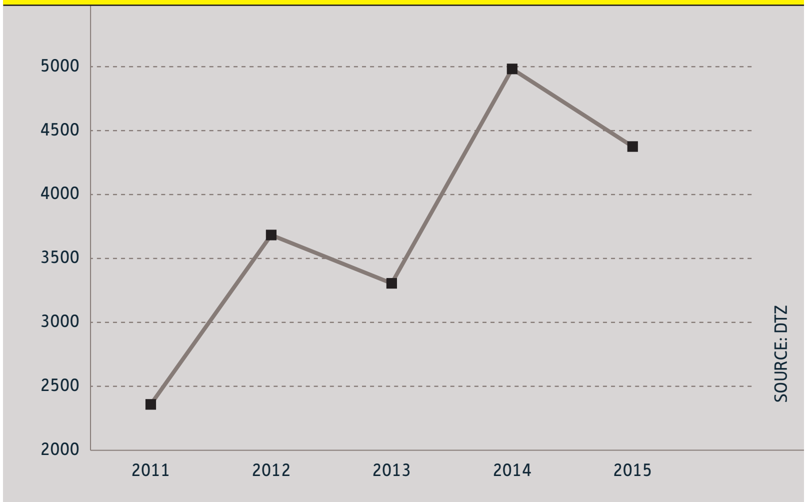
MATERIALS: When the downturn hit Bahrain in late 2008, the price of many construction materials was at an all-time high. In the years leading up to the crisis, steel prices doubled, for example, from BD300 ($800) to BD600 ($1600) per tonne. In late 2008, costs began to flatten, and in early 2009 they fell dramatically. Since then, prices have generally drifted up. According to Ali Al Tashani, the chairman of Al Tashani Holding, a local firm, "Prices have stabilised recently and are starting to improve."

During the first nine months of 2010, cement prices in the GCC averaged around $67.20 per tonne, down 13% from $77.30 per tonne during the same period the previous year. Perhaps in response to low prices, in early 2011 cement manufacturers attempted collectively to raise prices by 30%. However, before the price hike went into effect, the Ministry of Industry and Commerce intervened, announcing that it would not tolerate collusion. Nevertheless, market forces alone may be sufficient to increase prices in the near future. Growing demand for building materials in Saudi Arabia, which is the source of most of Bahrain's cement, could translate into rising prices for Bahrain as early as the second half of 2011.

In an effort to overcome the Kingdom's dependency on imports, in April 2011 Hassan Fakhro, the minister of industry and commerce, announced that the ministry planned to collaborate with the United Cement Company, a major local producer, on a feasibility study to form a new construction materials firm. The company, which would initially focus on cement production, could potentially post annual turnover of around $126bn within a decade.

OUTLOOK: Despite recent economic and political challenges, players in Bahrain's construction sector are optimistic about the potential for future growth in the country. Contractors and developers have worked to realign their business toward new niche growth segments, including infrastructure, housing and industry. While the high-end residential segment has fallen out of favour since the downturn hit, it could still play a role in future growth, according to some players. "Mixed-use real estate projects still have great potential," said Salahuddin. "If a developer can combine retail, residential, commercial and office space all in one location, they will find demand."

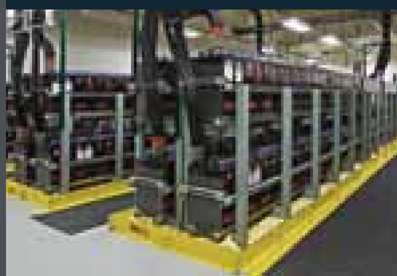
Residential apartment pipeline, 2011-15 (no. units)

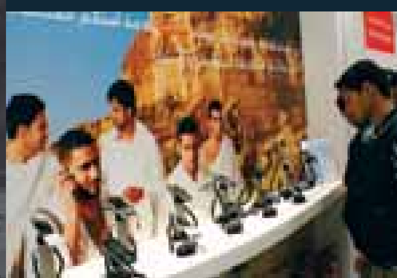


IT

E-government services a priority for the authorities
Hardware sales set for growth as connectivity expands
Addressing the skills shortage in the local workforce
Several foreign majors are active in the sector







Some 20% of internet users subscribe to mobile broadband services

Opening up

Growth and investment opportunities continue to multiply

Government authorities installed Bahrain's first computer in 1978. Private players soon followed suit, making IT investments of their own shortly after, and it was not long before the Kingdom had earned a strong reputation for innovative IT development. It has maintained that reputation, and remains a vibrant regional centre of technology.

IT infrastructure expansion has been propelled by the demands of Bahrain's strong financial industry, growth which has attracted more IT companies, such as Microsoft. The Kingdom's welcoming culture complements the business opportunities by providing expatriates with a comfortable place to work and live. "A range of successful telecoms and IT firms are now operating in Bahrain, using integrated systems and modern infrastructure," Sheikh Salah Ahmed Al Khalifa, the general manager of Bahrain Institute of Entrepreneurship and Technology, told OBG.

MARKET STRUCTURE: The Supreme Committee for ICT – a cabinet committee chaired by the deputy prime minister – is responsible for organising ICT development and leading e-government implementation, while the day-to-day operation of Bahrain's e-governance programme is managed by the eGovernment Authority (eGA). The Economic Development Board (EDB) promotes industry investment and is responsible for market liberalisation. More generally, however, the EDB is tasked with formulating and overseeing the country's economic development strategy and creating a business environment that is conducive to foreign investment.

INTERNET SERVICE PROVIDERS: Consumers have a total of 11 internet service providers (ISPs) to choose from at present. Bahrain Telecommunications Company (Batelco) is the largest, but is facing increased competition. Menatelecom, a subsidiary of Kuwait Finance House, and Zain Bahrain, a part of Zain Group, offer services through WiMAX networks. Other ISPs include Etisalcom, Kalaam Telecom, Kulacom Communications, Light Speed, North Star, Nuetel Communications, Orbit, and Rawabi Telecommunications and Software.

There are 188,000 internet subscribers in the Kingdom, all of whom use broadband, following the phasing out of dial-up services.

BY THE NUMBERS: Business Monitor International's (BMI) 2011 report on IT estimated the value of the Kingdom's IT market at some $314m in 2010, up from $280m in 2009. The industry is forecast to achieve a compound annual growth rate (CAGR) of 7% from 2010-15, according to BMI, as economic stability continues to increase, credit becomes more accessible and oil prices rise.

There were around 188,000 internet subscribers at the end of third-quarter 2010, all of whom used broadband due to the phasing out of dial-up. This represents a 19% rise on 2009, when there were around 162,000 subscribers, according to the TRA. Some 85% of households with an internet connection have fixed broadband, yet internet penetration was just 15% at the close of third-quarter 2010.

Residential subscriptions numbered just over 150,000 in 2009, up 46% from 103,000 in 2008. Significantly less growth occurred in corporate internet subscriptions, which increased by 1% between 2008 and 2009. Roughly 10,500 internet subscriptions came from businesses in 2009.

Within the broadband market, 43.6% of subscribers used wireless connections (WiMAX or satellite) by the end of the third quarter in 2010. ADSL networks, representing 36.9% of the market, was the second-largest type of subscription. The smallest segment, at 19.5% of internet users, was subscribers to mobile broadband services.

Users enjoy varying access speeds. In 2009 33% of broadband subscribers were connected at 256 KBps, while roughly 40% accessed the internet at speeds of 1 MBps or above. Average revenue per user (ARPU) for broadband was BD19.20 ($51) per month in 2009. Residential ARPU was BD15.10 ($40) and non-residential ARPU was 84.20 ($225) per month.

The average cost of a broadband connection has been dropping in recent years. However, standard

European prices are still much lower. According to the TRA, medium-speed business broadband (1-4 MBps) costs subscribers around four times more in Bahrain than the average price in Europe.

Compared to the rest of the world, fixed broadband penetration in the Kingdom is relatively high at 11.9%, with the global average 6.9%. Yet Bahrain still has some catching up to do regarding other developed countries which, on average, had a fixed broadband penetration rate of 22.2% in 2009.

ADJUSTMENTS: The global financial crisis had a major effect on Bahrain's technology sector, as many companies that used IT services went bankrupt. Some of the surviving firms also reduced spending on technology, making upgrades a lower priority. In addition, the quality of IT education took a hit as institutes and organisations reduced their budgets.

Yet not all technology firms suffered. Batelco, for example, profited from the downturn, as the financial crisis lowered the cost of buying companies, making it easier to expand through acquisitions. Government projects continued to provide a source of business, albeit at a lower level. Going forward, the Kingdom's growing capital markets sector and increasing status as a regional financial centre will likely lead to greater spending on IT services, providing opportunities for further expansion.

Trade liberalisation and economic reforms will likely drive both public and private sector organisations to increase their IT budgets to compete with international benchmarks. Demand for e-government and broadband services is also expected to be high. All in all, though the crisis may have stunted IT growth for a time, the industry has seen recent expansion and has multiple opportunities for further growth.

SERVICES: The IT services market is dominated by a few large firms, including Zayani Computer Systems, National Computer Services and Gulf Business Machines. Internationals such as Oracle, Cisco and Microsoft are also present. The market was valued at $70m in 2010, making up 22% of total IT spending in Bahrain. Further growth is expected as evolving markets encourage IT investment from telecoms companies. Business Monitor International forecasts a CAGR of 11% for the segment from 2010-15.

In July 2010 the Central Informatics Organisation signed an agreement with local firm Almoayyed Computers. The deal stipulates that Almoayyed provide Microsoft licences and services, as well as staffing and technical support, for three years to 58 government bodies and agencies. The company will also deliver training programmes for public employees. In October 2010 Channel Middle East, part of Dubai's ITP Publishing Group, awarded Almoayyed the Commercial and Small and Medium Business Reseller of the Year award, making it the Kingdom's first IT company to receive the honour.

SOFTWARE: The value of Bahrain's software market was estimated at around $38m in 2010, with CAGR forecast at 8% from 2010-15. Despite a slow 2009 – partly attributable to strained budgets – the

Fixed broadband penetration is well above the global average

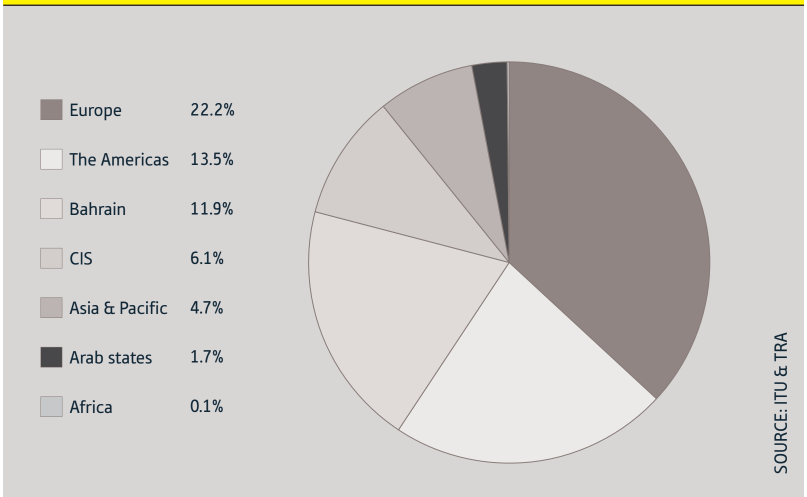
segment is expected to see stable expansion in coming years as local financial firms are boosted by a strong economy and increase IT spending to meet new regulatory requirements. Around 30% of software spending is expected to stem from enterprise applications, thanks to an unsaturated market for enterprise resource planning applications.

HARDWARE: Bahrain's hardware market has less local involvement than the software industry. A handful of international companies – including HP, Dell, Toshiba and Acer – control much of the market.

However, strong demand for laptops should lead to the creation of more partnerships with regional players. For example, HP and Metra Computer, an Egyptian company with branches in Bahrain, worked out an arrangement in 2009 which made Metra HP's newest distributor for imaging and printing and personal systems groups to Bahraini consumers. In addition, multinational PC giant Lenovo announced in October 2010 that it was considering the Kingdom as a base for regional expansion. The company already has a strong presence in Saudi Arabia and Dubai, and

The hardware segment has limited local involvement, with international firms controlling much of the market. However, strong demand for laptops should lead to the creation of more partnerships.

Fixed broadband penetration, 2009



The eGovernment Authority has allocated substantial resources to the issue of e-security

the Bahrain office would cater to Kuwait, Oman, Qatar and Bahrain. Lenovo had the fourth-largest share of the worldwide PC market as of 2010.

The Kingdom's hardware retail market is posting steady growth. Standing at around $150m in 2009, PC sales were predicted to reach $167m by the close of 2010. The PC industry is expected to expand by 6% per year from 2010-15. Some of this growth can be attributed to rising demand for laptops due to growing wireless access throughout Bahrain, infrastructure improvements and technology upgrades.

DIGITAL GOVERNANCE: The e-government programme is one of the public sector's most recent and most important contributions to the IT industry's development in Bahrain. Established in May 2007, the eGA delivers e-services through four channels: a mobile portal, an online portal, self-service kiosks and common service centres, and a nationwide freephone helpline number. The eGA's strategy for 2011-14 further targets intra-government projects and cooperation. Improved technology will be used to provide high-quality services and facilitate increased effectiveness at the administrative level. The strategy focuses on three primary streams: the IT environment, readiness and usage.

User rates are climbing as e-government services improve, and by January 2011 there had been more than 27m transactions on the system. With 203 services available, the eGA provides users with a wide range of time-saving options that have also been shown to reduce average transaction costs from BD3 ($8) to BD0.90 ($2.40).

CUSTOMER SERVICE: Much of the eGA's success has come as a result of the agency's relationship with its users. "Bahrain regards recipients of government services as customers and not beneficiaries, because they have unique requirements," said Mohammed Ali Al Qaed, the eGA's CEO. "Customers have choice and demand services based on their needs. The expectation of better services is fundamental. Citizens are not willing to pay for basic services that are generally seen as a responsibility of the government. Even when the government is able to extend the service's effectiveness through innovation, the willingness to pay is driven by value-for-money. This means government must be efficient. The Kingdom will need to continuously seek ways to reduce the cost of using government services," said Al Qaed.

Use of e-government options is increasing as services improve, and by January 2011 there had been more than 27m online transactions.

E-SECURITY MEASURES: One area in which the eGA has effectively focused resources is e-security. Adopting a proactive approach to digital fraud, the agency has developed a number of security controls in several government ministries.

The eGA has also created the National Authentication Framework, which should streamline the authentication procedure used when connecting to e-government services, as well as improve security by creating unified identity profiles for each user.

In recognition of the eGA's security achievements, the agency has been awarded ISO 27001 Information Security Certification, an international certificate for exceptional data protection.

"This award is a clear demonstration of the eGA's keenness to protect the security of information. Protecting sensitive information is a priority in our work and securing our clients' data is the measurement of our success," Al Qaed told OBG.

PROGRESS REPORT: A recently updated Telecommunications Regulatory Authority study, carried out by internet intelligence firm Renesys, has investigated the changing associations between ISPs and international telecoms carriers serving Bahrain and the wider region. After recognising the strengths and weaknesses of connectivity in the Kingdom, Renesys' July 2010 analysis concluded that internet connectivity was acceptable, though greater levels of diversity were needed, with a lack of access to diversified paths and relative isolation from crucial underwater cabling identified as areas for improvement.

Bahraini providers have a restricted set of international transit options, at least compared to their neighbours in the UAE. Domestic providers have three choices when it comes to international carriers: Tata, Flag and Emirates. Tata dominates the market, while Flag's only customer was Batelco until Lightspeed began using its capacity in August 2009 and Nuetel followed a month later.

Most local providers pick up transit from the Bahrain Internet Exchange, which purchases capacity from Tata and Emirates. Carrier variation is important as it can aid effective routing by domestic providers and thereby reduce performance hiccups, such as delays, for internet customers.

The Renesys report noted that Bahrain's internet ecosystem is expanding at around 30% per year. This closely resembled the rates of expansion being seen in Qatar and Saudi Arabia. "Connectivity markets are increasingly competitive and industry players, financial institutions and the government have to make critical decisions in order to ensure adequate, diverse and resilient international connectivity to Bahrain," Mohammed Mahmood, the technical and operations director at the TRA, told local press in August 2010. "Availability and affordability of internet services, capacity and local content will all be key elements in attracting inward investment and sustaining competitive growth in the Kingdom in the coming years."

NEW DEVELOPMENTS: The sector is set for a number of changes in the near future. Perhaps most notably, the development of a nanotechnology centre was announced in October 2010. The facility will produce high-tech products that will then be sold in the GCC region. These products include Striboil, which is designed to lubricate components of friction units of motor, air and water vehicles, and Agbion2, which is designed for a range of applications in the sanitary, medical and agricultural fields. Both the Talal Abu-Ghazaleh Organisation – an international holding company which operating 70 offices in the Middle East and North Africa, as well as branches in Europe, Asia and North America – and the Russian National Association of Nanoindustry are involved in the centre's development.

Efforts have also been made to increase recycling of unwanted equipment. Plans were announced by the Good Word Society in July 2010 for a new programme called Recycle IT. Besides motivating Bahrainis to increase recycling, the project has a parallel emphasis on IT training and recruitment, and intends to supply valuable IT training to 100 young people during its first year of operations. Programme planners hope that those who finish the training will be qualified for entry-level IT jobs.

A third, innovative development has come from a new online application, SocialTaggers.com. Launched by Bahraini firms H2M Solutions and Legend PAPI, the website distributes advertising through social media tools. Accessing the site through a Facebook or Twitter account, users are paid for sharing the ads they like with their friends. The application has created a new type of online advertising known as pay-per-tag. The launch has come at a good time, as the MENA region has seen rapid growth in the use of social media. As of May 2010 over 15m people in the region had a Facebook account, with roughly 1m users coming from the GCC.

TRAINING: As in neighbouring states, Bahrain's qualified IT workforce is not large enough to meet growing demand. Although the number of IT graduates is sufficient, many are under-trained and not qualified for entry-level positions. Employers are therefore required to provide further instruction upon hiring new graduates. "Economic troubles reduced the budgets of training institutions, and numerous institutes began diverting resources to marketing while also lowering tuition costs. Although this may have enabled them to attract more students, the quality of education has been reduced as a result of the shift in resources," said Al Khalifa.

Efforts are being made to correct the problem. Microsoft, for example, has partnered with Bahrain Mumtalakat Holding Company to launch a programme called Future IT Leaders. The University of Bahrain and Bahrain Internet Society are also working together on the project. The programme aims to qualify third-year students at the University of Bahrain through on-the-job training lasting six months with Microsoft partners.

There are a number of internet service providers to choose from

Additional training is needed to bring IT graduates up to speed with industry requirements, and measures are being undertaken to address this.

"Although specialised and costly, the Future IT Leaders programme enables students to become highly marketable," said Badea Esbai, Microsoft's country manager in Bahrain. "The programme also allows the private sector to play a valuable role in IT education by assisting in the development and shaping of the technology workforce." Launched in the spring of 2009, the programme is ongoing.

OUTLOOK: Bahrain has developed a strong IT sector that has tremendous potential for further growth. Alex Lightman, the director and chief technology officer at Fortune Nest Corporation, told delegates at the Bahrain World Economic Summit in November 2010 that the country is well suited to becoming a regional version of Silicon Valley in the US. "If you look at Silicon Valley's leading companies, such as Google, Yahoo, Cisco and HP, they were all funded by development capital," said Lightman. "Bahrain is the regional centre that can provide capital for the development of high-technology businesses."

A liberal economy, business-friendly policies and a central location in the Gulf region are all key advantages that can draw IT companies to set up in the Kingdom. The sector is performing strongly and is well positioned for sustained growth going forward.

Breakdown of internet subscribers, 2005-Q3 2010 (%)

	2005	2006	2007	2008	2009	Q3 2010
ADSL	42.6	64.3	83.4	66.9	46.9	36.9
Fixed wireless*	-	-	1.9	14.7	39.3	43.6
Mobile broadband	-	-	6.6	14.4	11.7	19.5
Dial-up	57.4	35.7	8	3.9	2.2	0

SOURCE: TRA

*Including WiMAX & satellite

Falling prices and product innovation are set to fuel growth

Buying time

Sales are climbing as the economy strengthens

Hardware sales are forecast to grow at a rate of 6% per annum through to 2015, when they are expected to have an annual value of some $243m.

Considering the emphasis placed on technology in Bahrain, it is no surprise that IT retail is growing. Although consumer electronics sales slumped in 2009, forecasts for 2010 were positive, and the industry is expected to be worth $522m by 2014.

The sluggish sales in 2009 can be attributed to a combination of factors, with rising unemployment and a drop in asset prices both contributing.

GROWTH DRIVERS: The segment's growth is expected to stem from falling retail prices and increased product innovation. Other factors include sustained development of the IT retail industry, rising demand for feature-rich electronics and the return of steady population growth. Consumer electronics sales are also expected to benefit from an increase in channel retail and seller flexibility.

Furthermore, the expanding IT retail market is indicative of improving economic conditions. One result of the financial crisis was a significant drop in IT spending. Many businesses made technology upgrades a low priority during the recession and shifted resources to more urgent concerns. Favourable economic conditions, however, seem to have since helped to correct this imbalance, as technology sales are up.

HARDWARE: Hardware plays a substantial role in Bahrain's IT retail market. In 2009 the segment made up 48% of consumer electronics sales and was valued at $150m. This figure increased in 2010, with hardware sales reaching $167m.

Growth is expected to continue, with Business Monitor International forecasting in 2011 that hardware sales will grow at a rate of around 6% per annum through 2015 to reach $243m.

With an increasing number of Bahrainis owning notebooks and PCs, it is likely that demand for broadband services will grow and connectivity throughout the Kingdom will expand.

This predicted rise can be at least partly attributed to rising demand for notebooks driven by expanding wireless access, infrastructure development and technological improvements.

As in other Gulf states, the Bahraini PC market is dominated by notebook retail, which is forecast to make up more than 60% of PC sales during 2010-15. Small- and medium-sized enterprises contribute 35% of IT spending regionally.

The rise in sales figures for IT hardware could also lead to greater amounts of retail space being dedicated to technology products over the coming years.

MAJOR IMPACT: As sales continue to rise, more IT products will arrive in the Kingdom and likely result in several significant changes in the industry.

For example, as greater numbers of Bahrainis own notebooks and PCs, demand for broadband services should increase and connectivity throughout the Kingdom is likely to expand. A 2010 report by internet intelligence firm Renesys noted that Bahrain's internet ecosystem is expanding at around 30% per year. This closely resembled the rates of expansion being seen in Qatar and Saudi Arabia

Likewise, as consumers make hardware upgrades, demand for upgraded broadband services at faster speeds and better prices is to be expected.

This fits in with Bahrain's Economic Vision 2030, which serves as the country's overarching economic strategy. One component of the plan is to develop improved infrastructure connections, including telecoms, that provide high-quality services at competitive prices, thereby creating a better environment for conducting business.

E-GOVERNMENT: Another area that is likely to benefit from the recent uptick in IT spending is the Kingdom's e-government programme. Established in 2007, the eGovernment Authority (eGA) provides citizens with more than 200 different online government services through a variety of access methods. With more hardware in use, the eGA will likely see increased demand for its services.

The impact of growing technology sales should be positive for the IT industry as a whole. Further growth is dependent on the continued upward trajectory of Bahrain's economy, among other factors, but the indicators are favourable for the expanding market.

HH Sheikh Mohammed bin Mubarak Al Khalifa, Deputy Prime Minister and Chairman, Supreme Committee for Information and Communication Technology

Building on past success

OBG talks to HH Sheikh Mohammed bin Mubarak Al Khalifa, Deputy Prime Minister and Chairman, Supreme Committee for Information and Communication Technology (SCICT)

Why were changes to the eGovernment Authority (eGA) 2011-14 strategy necessary?

SHEIKH MOHAMMED: The previous eGA strategy for 2007-10 set out a framework for ensuring the delivery of over 200 accessible and sophisticated electronic services, with the aim of making Bahrain a regional leader in e-government. Bahrain has surpassed the planned objectives, and gained regional and global recognition in this regard. The new e-government strategy for the years 2011-14 builds on the achievements of the previous strategy. It is more comprehensive, with a framework that enables the development of a comprehensive approach to e-government advancement. It focuses on three areas: the IT environment, a factor affecting the customer service; readiness, the ability to develop government infrastructure that supports services; and usage, designating efforts to enhance the user experience. The strategy is oriented toward government-to-government and intra-governmental projects. It will also improve administrative efficiency and effectiveness, ensure operational sustainability of intra-government collaboration, utilise best-fit technologies and continue the delivery of e-services on the four channels the previous strategy introduced.

What policies is the government developing to increase human capital in the IT sector?

SHEIKH MOHAMMED: IT literacy is essential to promoting the use of e-government services, and a capacity-building programme has been incorporated into the eGA strategy. In 2010 approximately 2000 citizens were trained as part of this programme. As specified in the 2011-12 plan, we aim to reach a total of roughly 15,000. In addition to direct training and awareness programmes, a number of ICT events are being organised in Bahrain to promote IT literacy. These activities were based on policies designed to both keep pace with new developments in ICT and spread IT literacy locally and regionally. The eGA is working with the Global Alliance for ICT and Development and the Arab Centre for e-Content Development to accelerate achievement of the Millennium Development Goals via technology.

What incentives are in place to encourage private sector participation in the IT industry?

SHEIKH MOHAMMED: The government has spent more than BD20m ($53.3m) on IT initiatives over the past three years. There is no doubt that the development of infrastructure and e-solutions will benefit all sectors and private industry can capitalise on the information society established by existing initiatives.

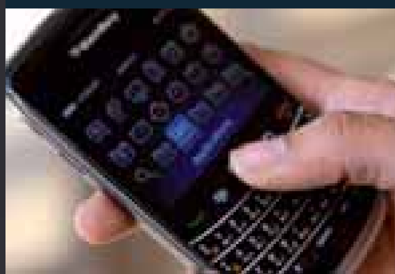
We have also introduced the eInvestor project, an initiative that will enhance transparency in government procedures, creating new opportunities for the private sector, enabling it to play a bigger role in delivering IT services. The eGA is working in partnership with private firms to finance and support initiatives that promote economic prosperity and create high-quality jobs. The eGA also supports the private sector by co-organising major international ICT events in the country, in addition to organising local and regional events.

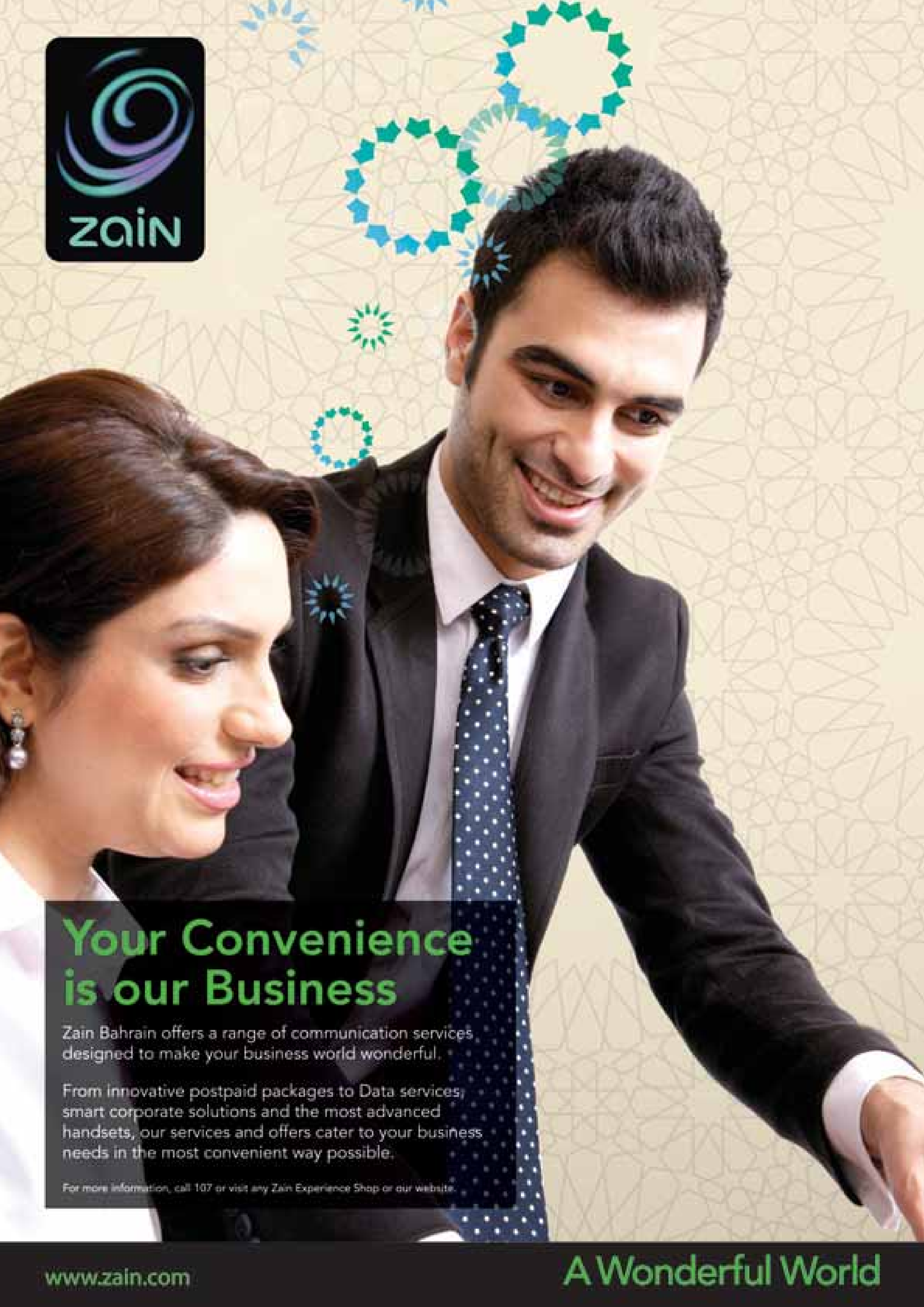
What measures need to be taken to position the Kingdom as a regional centre for ICT?

SHEIKH MOHAMMED: A number of measures are in place to secure Bahrain's position, including a focus on e-government initiatives that is supervised by the SCICT. Bahrain is one of the regional leaders in terms of mobile and internet penetration rates. It also enjoys a well-developed ICT infrastructure. Tapping into these advantages, the new e-government strategy focuses on recent international ICT trends, including open data platforms, mobile applications and the enhancement of public participation through the use of social media tools. Furthermore, the Kingdom has received international recognition for its efforts, most notably on the UN's "e-Government Readiness Index 2010", which ranked Bahrain first in the Gulf and Middle East and 13th worldwide. Our horizons are now set to position the Kingdom of Bahrain as an international ICT hub.

Telecoms

Number portability to come into effect in 2011
Local loop unbundling set to end existing monopoly
Regulator prioritises increased competition
A third provider enters the mobile market

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A Wonderful World

There are currently three operators in the mobile segment

Smooth operators

Heightened competition and new technology are driving the market

The local telecoms industry has a history of providing consumers with high-quality, innovative services. Indeed, the market has developed a reputation for being one of the region's most dynamic. Government authorities have recognised the industry's strength, and that connectivity is a key component for economic advancement in the Kingdom.

Despite a number of opportunities for growth, the industry is undergoing changes requiring adaptation for operators. Perhaps most importantly, the fixed-line market is expected to slow, with an eventual reduction in the penetration rate around 2015, according to Business Monitor International forecasts. Much of this downward trajectory is attributed to an uptick in mobile usage, with a marked emphasis on mobile data services. Further changes are occurring in the mobile segment, which recently expanded from two providers to three. Saudi Telecom entered the market in March 2010 with the launch of VIVA, and the addition has had notable effects on the mobile segment.

MARKET COMPOSITION: An independent oversight body, the Telecommunications Regulatory Authority (TRA), has been monitoring Bahrain's telecoms industry since 2002. Organised under Legislative Decree No. 48, the TRA's mission has two parts: to grow a competitive market that provides consumers with innovative services and to develop an ideal regulatory body. The agency mounted a campaign in 2003 to liberalise the industry, which has since resulted in significant market maturity.

Mohammed Al Amer, the chairman, commented on the results of the agency's efforts in a December 2010 TRA publication. "From the beginning of liberalisation we aimed to adopt international best practice and standards. Now we benchmark our prices against those in the region and OECD countries. While we are still able to identify gaps and shortfalls, the trends are encouraging and for many types of service we lead the region," Al Amer said.

As of December 2010 Bahrain had 10 fixed-line operators, 15 international call companies and 12 internet providers. In addition, there are eight operators providing leased-line services and six supplying other data services, such as national frame relay or international managed leased lines. The mobile market is composed of three operators, namely Bahrain Telecommunications Company (Batelco), Zain Bahrain (MTC Vodafone) and VIVA.

OPERATIONS: Batelco is the only company operating in all of these segments at present. However, Etisalcom provides consumers with every telecoms service except for mobile, while Zain operates in every segment except leased-line services. A number of operators such as Kalaam Telecom and Rawabi Telecommunications and Software also provide the same mix of national fixed, international calls, internet and leased line services.

The TRA has taken steps to ensure fair competition between operators and that the quality of services remains high. In November 2010 Batelco received a draft order from the regulator requiring it to permit other licensed operators to connect to the company's fixed copper line. Known as local loop unbundling, the TRA's draft order stipulated terms and conditions, as well as pricing, for what will be the wholesale offering of Batelco's fixed copper line.

Adel Darwish, the market and competition manager at the TRA, explained the agency's motivations behind the new draft order in a November 2010 press release. "Unlike mobile networks, the establishment of an alternative fixed network involves relatively high costs," he said. "With the introduction of the local loop unbundling service, the TRA hopes to see more competition arising in the provision of fixed services and the introduction of new, innovative and affordable fixed services."

NUMBERS: The telecoms industry experienced revenue growth of 11.6% between 2008 and 2009. With a compound annual growth rate (CAGR) of 8.2%

The sector is overseen by the Telecommunications Regulatory Authority, which is also tasked with expanding a market that provides consumers with innovative services. Liberalisation has been a central objective for the authority.

At end-2010 there were about 1.6m mobile subscribers

between 2004 and 2009, the sector has maintained a stable record of expansion. Telecoms revenues are a significant contributor to Bahrain's economy, constituting around 4.7% of the Kingdom's GDP in 2009, according to figures from the TRA.

FIXED-LINE: There were approximately 228,000 fixed lines at the end of 2010, a 4% decrease from 2009. Penetration also declined slightly over this period, from 20% to 18%. Monthly average revenue per user dropped to BD1.10 ($2.93) due to reductions in international direct-dial revenues, constant national call revenues and the rate of additional fixed lines. In the residential market, the percentage of households with a fixed line increased from 78% in 2008 to 83% in 2009.

MOBILE: The mobile market continues to play a critical role in the health of the industry, generating a majority of the telecoms sector revenues. At the end of 2010 there were about 1.6m mobile subscribers in the Kingdom, an increase over the 1.4m recorded in 2009. Mobile penetration as a percentage of total population also grew, from 119% in 2009 to 127% in 2010. This followed a dip in the penetration rate between 2008 and 2009. Prepaid subscribers represented about 80% of mobile subscribers in 2010. However, this ratio may be changing. The number of prepaid subscribers fell from 1.21m in 2008 to 1.16m in 2009, while post-paid subscribers rose from 230,619 in 2008 to 245,778 in 2009.

Increasing by 55% between 2008 and 2009, international phone call traffic continued to show a significant rate of growth. Calls made to South Asian countries – the Zone 2 region – accounted for 72% of total international minutes in 2009. However, the revenues stemming from calls made to the Zone 2 region in 2009 amounted to only 48% of total international call revenues. According to data published in December 2010 by the TRA, mobile phones were used for 85% of the total outgoing international minutes in 2009, with fixed lines making up the remaining 15%. Although slightly down from the 2008 level of 89% of total outgoing international minutes, mobile use for international calls still rose by 47% when compared to the previous year.

Around 200,000 subscribers made up the broadband market at the close of 2010, an increase of 27% from 158,000 in 2009. The broadband penetration rate has grown steadily over time, reaching 16% in 2010, compared to 7% in 2007, representing a CAGR of 32%. The number of mobile broadband subscribers doubled between the fourth quarter of 2009 and the third quarter of 2010, reaching 36,000. By comparison, as of the third quarter of 2010, nearly 83,000 broadband subscribers used fixed wireless services. On a household level, broadband penetration rates have also increased. The percentage of households with fixed broadband rose from 51% in 2008 to 85% in 2009. Dial-up service was phased out of the market completely in February 2010.

Growth for the telecoms industry has had a positive impact on the Kingdom's employment figures. According to the most recent data published by the TRA in December 2010, the sector added over 500 jobs to the economy between 2006 and 2009, employing a total staff of 2500 by the close of 2009. Employment in the industry has grown at a relatively steady rate for some time, increasing by 38% since the sector was liberalised in 2003.

Perhaps more significantly, as of 2009 the sector's workforce was 85% Bahraini – a high percentage when compared to other industries. For example, Bahraini employees made up around 67% of the banking and financial sector in 2009.

MAKING ADJUSTMENTS: The global economic downturn had a limited impact on Bahrain's telecoms industry. "Despite the financial crisis, the sector has continued to expand," Alex Serot, the TRA's marketing and competition director, told OBG. Similarly, Peter Kaliaropoulos, the group chief executive of Batelco, maintained that the downturn did not have a major effect. "Telecoms services are a basic necessity," he told OBG. "Economic troubles certainly may prompt consumers to cut back, but spending decreases will most likely take place in other areas of a consumer's budget before telecoms is impacted." Kaliaropoulos added that many of Batelco's recent challenges resulted more from the entrance of a third mobile provider rather than from the financial crisis. Batelco's net year-on-year profit fell by 17.4% over 2009, in part because of VIVA's arrival.

VIVA's entry has also had a noticeable impact on Zain and caused value erosion for the Kingdom's second mobile operator. In fact, both Batelco and Zain have lost subscribers since VIVA's launch in March 2010. Although the situation has not become alarming for Zain, the operator still worries that VIVA's entrance could lead to price wars and a deterioration of quality. At variance with this fear, the TRA maintains that VIVA adds an element of competition to the mobile market that will spur greater levels of innovation and operations efficiency. The consumer

With a CAGR of 8.2% between 2004 and 2009, the sector has maintained a stable record of expansion. Telecoms revenues are a significant contributor to the economy, constituting 4.7% of GDP in 2009.

will be given an enhanced set of choices as a result. Furthermore, subscription losses cannot be entirely attributed to VIVA. Inactive subscriptions and a shifting focus towards post-paid contracts have both contributed to declining numbers.

REGULATORY RESPONSIBILITIES: The decision to introduce a new mobile operator into the market was not a straightforward one for the TRA. "The role of the regulator is never going to be easy," noted the organisation's then-deputy general director, Rob Middlehurst, in a December 2010 TRA publication. "It requires treading a fine line between what would sometimes appear to be the conflicting demands of consumers, an incumbent operator and new service providers, while taking into account the government's public policy objectives and keeping abreast of advances in global telecommunications. The model we have developed is based on pragmatism, flexibility and transparency. Where necessary, difficult decisions have had to be taken to ensure the efficient working of the market and to keep on track so that the Kingdom realises its longer-term vision for the market and consumers."

The TRA has taken additional steps to improve services throughout Bahrain. Aiming to reduce the number of inactive prepaid subscriptions, it issued a directive in mid-August 2010 instructing Batelco, Zain and VIVA to ensure that mobile customers registered their personal prepaid account details.

REGISTRATION: The regulator noted in an August 2010 press release that SIM card registration would benefit subscribers to the service, attributing unregistered SIM cards as a cause of irritating and improper phone calls from unknown mobile numbers. "We have taken this step to support public safety and discourage illegitimate use of the mobile telecoms networks," said Al Amer in the press release.

The regulator warned that unregistered subscriptions would be suspended for a three-month period before permanent cancellation. A similar effort to ensure prepaid SIM card registration took place two years earlier in July 2008.

The industry experienced further adjustment in September 2010 when the TRA instructed internet providers to block two websites that were in violation of the Kingdom's telecoms law. The oversight body explained that the directive was needed in order to safeguard consumer interests, as well as to advance fair and beneficial competition between licensed service providers. One of the offending websites violated Bahraini law by offering internet users with unauthorised voice services. The other provided an illegal callback service, according to a TRA press release in September 2010.

The TRA turned its attention to number portability in early November 2010, announcing that the final technical details required for the implementation of fixed and mobile number portability had been published. The regulator gave mobile operators six months to make the necessary technical changes for number portability implementation. Fixed operators

Number portability will smooth the process of switching operators

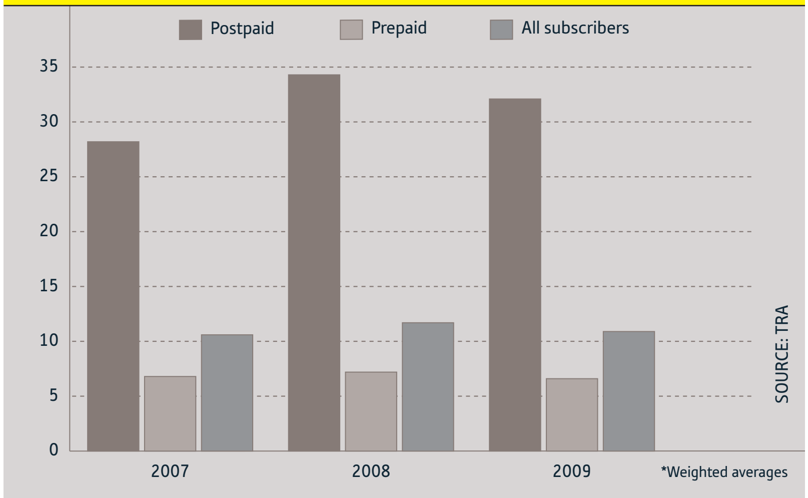
(including those who provided WiMAX services) were given eight months to comply.

Ahmed Aldoseri, the TRA's ICT director, explained the benefits of the new directive in a November 2010 press release. "Enabling number portability will give consumers greater flexibility and choice by being able to switch between different licensed operators without having to give up the number they are used to using. This should also provide the impetus for greater competition and creativity in product offerings as licensed operators vie to build consumer loyalty and attract new subscribers."

EXPANSION: Many industry leaders agree that mobile data services provide some of the greatest opportunities for further growth. Traditional voice services, on the other hand, appear to be less lucrative avenues for expansion. Fixed-line services made up only 6% of sector revenues in 2009. The total number of mobile subscribers rose by a CAGR of 16% between 2008 and 2009, according to the TRA, and the role of voice mobile service is declining in favour of mobile data. "The amount of young peo-

Aiming to reduce the number of inactive prepaid subscriptions, the TRA issued a directive in August 2010 instructing the three mobile operators to ensure that customers registered their personal prepaid account details.

Mobile ARPU, 2007-09 (BD per month)*



There is a great deal of potential to expand value-added services

The government is set to establish a national broadband network with the assistance of the Electricity and Water Authority, which will offer fibre-optic access on reasonable terms.

ple using value-added service devices is growing tremendously. Data services are continually being introduced and being offered at affordable and competitive rates. Competition among traditional voice providers is fierce and the market is saturated. The area for continued growth among tier-one operators will be value-added services," Mohammed Zainalabedin, the general manager of Zain, told OBG.

INFRASTRUCTURE INVESTMENT: As the industry continues to transform, operators must keep up, and this often requires IT upgrades. Indeed, many of Bahrain's telecoms firms have already invested heavily in IT infrastructure. Batelco, for example, was the first operator in the Kingdom to install an end-to-end national next-generation network, providing customers with voice, data and video services via a single line. Begun in April 2005, the project cost $57m and was completed in January 2009.

In the mobile market, Batelco offers consumers a 3.5G wireless network capable of 21 MBps. As of January 2011 the operator maintained around 250 base stations in the Kingdom, although this number rises almost continuously due to the ongoing construction of large buildings – which often lower the signal strength – throughout Bahrain. Batelco is deploying fibre-optic cabling, but only on an as-needed basis for the time being.

Other operators have also made significant investments in infrastructure. Zain entered the mobile market in April 2003 and in December that year launched its own 3G network. This was expanded in January 2005 to cover the whole of Bahrain, and in 2006 Zain introduced HSDPA telephony services. The company launched WiMAX services in September 2007 after being awarded one of two fixed wireless access (FWA) licences by the TRA.

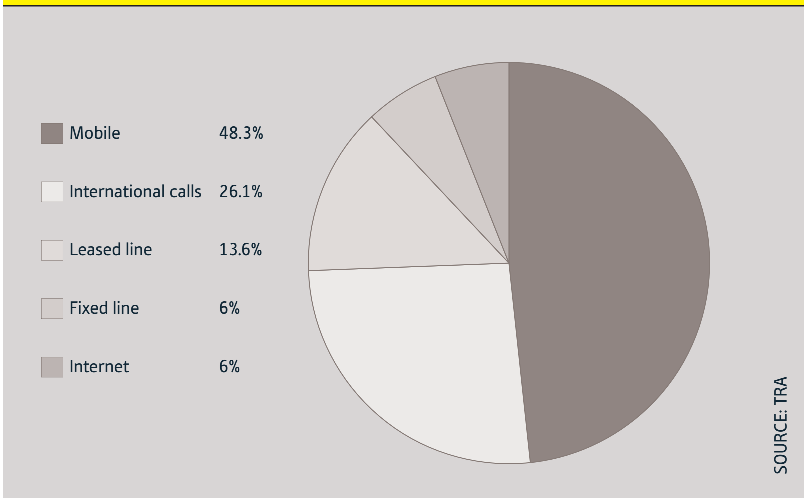
Menatelecom won the other FWA licence, and introduced its own WiMAX network about a year after Zain. Initially investing over $100m in the network, Menatelecom reported in November 2010 that active WiMAX subscribers had risen to 56,000; the operator began 2010 with 33,000 active WiMAX subscribers. With a 12.2% share of Bahrain's mobile market as of the second quarter in 2010, VIVA is quickly showing a strong presence and expanding its services. Shortly after launching in March 2010, the operator introduced VIVA TV, a mobile television service that offers customers over 20 channels. The service runs on 3G and Edge-enabled handsets. In May 2011, VIVA upgraded its wireless broadband network such that it can reach speeds of 42 Mbps.

Government authorities have also made plans to play a bigger role in upgrading infrastructure. In July 2010 the government announced its intention to set up a national broadband network (NBN) with the assistance of the Electricity and Water Authority (EWA). The EWA will make surplus capacity on their fibre-optic network available on reasonable terms. The Bahrain Internet Exchange has been instructed to oversee the Kingdom's NBN operations.

OUTLOOK: Although telecoms technology has already reached advanced levels in Bahrain, the industry continues to evolve. The market is also becoming increasingly competitive. "The ultimate beneficiary from the liberalisation of the sector and the development of competition is the consumer," said the TRA's Serot. "In terms of prices, quality and range of options for services, consumers are benefitting as technological improvements are implemented in the networks and competition intensifies." Further, as the industry continues to provide higher quality services for better prices, Bahrain's appeal as an international business centre will only increase.

However, consumers are not the only beneficiaries of the changing telecoms market. Operators also have considerable opportunities for expansion as Bahrain attracts greater numbers of businesses to operate in the country and as the authorities continue to support the industry's growth. "The move towards ubiquitous high-speed broadband connectivity also provides opportunities for operators to invest in and develop infrastructure," the TRA's Serot told OBG. "The potential for growth is tremendous."

Estimated telecoms revenues by segment, 2009



Mohammed Al Amer, Chairman, Telecommunications Regulatory Authority and President, Central Informatics Organisation

More choice

OBG talks to Mohammed Al Amer, Chairman, Telecommunications Regulatory Authority (TRA) and President, Central Informatics Organisation (CIO)

How will number portability (NP) be implemented and what fees will be associated with the service?

AL AMER: Mobile number portability (MNP) and fixed number portability (FNP) will both be introduced in July of 2011. A central database of all numbers must first be established, which will be formed and administered by the TRA. In addition, before NP is implemented in Bahrain, certain requirements must be met. We must ensure that the system is capable of coordinating and effectively handling porting requests; maintaining the database of ported numbers; updating licensees immediately upon the completion of porting; and measuring the performance of all licensees. There will be a charge of approximately BD4 ($11) for MNP, BD6 ($16) for FNP and BD10 ($27) for special premium services such as universal numbers.

Portability will empower consumers to select the licensed operator that best suits their needs for fixed or mobile services, which allows for greater flexibility in consumer choice. It will also encourage operators to improve service offerings to keep current customers as well as attract new customers. There will be no limitation on number porting and switching, which means that numbers can be ported as often as the subscriber wants. The system is also recipient-led, which means that subscribers only have to deal with the new operator when making a switch. This is also a “no win-back” policy, which stipulates that the old operator may not contact former subscribers for three months.

What affect will local loop unbundling (LLU) have on telecommunications companies and end-users?

AL AMER: In accordance with the telecoms law, regulatory obligations such as LLU can only be imposed on operators that have been found to be dominant in a relevant market. Because Batelco was found to be dominant in the fixed-line market, it is obliged to provide access to the copper local loop to other licensed operators on fair and reasonable terms. This will enable other operators, which do not own access networks, to provide competing services independently of Batelco. Currently there is competition in the mobile market but there is still a monopoly when it comes to the fixed-line market. By making copper networks available to other operators, we hope to see more competition in this area. We also expect LLU will bring additional competitive pressures to the broadband market as well as to services for business users.

Do you expect the presence of mobile virtual network operators (MVNOs) to expand?

AL AMER: Bahrain has three fully fledged mobile operators, with the entrance of VIVA in 2010 having increased competition among mobile service providers. MVNOs do not require licences from the TRA and can be launched through commercial negotiations with the current mobile operators. Because there is already fierce competition among the current mobile operators, the TRA does not see the need for a regulated solution. MVNOs have had the opportunity to develop here but have not become popular. I do not expect to see a lot of MVNOs in the near future and competition will remain between the core operators themselves.

To what degree does the affordability of WiMAX affect internet penetration in Bahrain?

AL AMER: Through the introduction of attractive offers to end-users, WiMAX operators have contributed to making broadband more affordable. Lower prices have in turn led to an increase in the number of subscribers and usage, as demand is elastic. We see also there is still an untapped demand in broadband penetration, which stood at 14% at the individual level and 85% at the household level, as of the end of 2009.

WiMAX is currently capturing a good percentage of broadband customers. However, we are seeing a lot of interest in LTE technology and most of the existing mobile operators will be moving from WiMAX to LTE. Broadband will move to LTE as it can provide higher bandwidth in comparison to WiMAX and fixed lines.

Lower prices and higher connection speeds may be on the way

In the loop

New measures should heighten the level of competition

A TRA draft order requires Batelco to permit other operators to have an unbundled or unmanaged connection to the fixed-line local loop.

Competition in Bahrain's telecoms market is set to increase in the wake of recent regulatory directives. One of the primary missions of the Telecommunications Regulatory Authority (TRA) – an independent oversight body established in 2002 – is to supply consumers with innovative services by ensuring that the market is competition-led. In November 2010 the authority took steps to expand competition by issuing a draft order requiring local loop unbundling (LLU) on Batelco's fixed copper line.

LLU will have a major impact on the telecoms sector. "This will increase the competitive supply of internet services, and should result in lower prices and faster broadband speeds," said Mohammed A Al Amer, the TRA's chairman and acting general director, in April 2010. "In line with the objectives of the Economic Vision 2030, such improvements will encourage businesses and consumers to make more use of internet and internet-based applications."

INCUMBENT ADVANTAGE: Batelco, the incumbent provider, owns the local loop – the last section of the network, which connects a customer's property with the exchange. The company has been providing other operators with access to the local loop, but only under managed control. Now the TRA's draft order requires Batelco to permit other licensed operators to have an unbundled or unmanaged connection to the local loop. These operators will therefore no longer be restricted to a specific combination of service packages that they can offer consumers. Competition is expected to increase as operators are able to provide more customised and innovative products.

BUILDING COMPETITION: The TRA said that to wait for operators to construct fixed copper networks of their own was not a realistic strategy for promoting competition. "Batelco, as the incumbent monopoly operator, has built the local loop over many years, and it is both impractical and uneconomic for other operators to build a full fixed access copper network through which to compete," the TRA's 2009 annual report stated. The decision to unbundle Batelco's local loop had been in the pipeline for some years.

In August 2007 the TRA worked with UK consultancy Indepen in an effort to determine how well LLU might work in the Kingdom. The regulator then announced in September 2009 that Bahrain would adopt LLU, and field tests took place the following April. The November 2010 draft order set the terms, conditions and pricing for what will become the wholesale offering of Batelco's fixed copper line.

NUMBER PORTABILITY: The TRA has taken additional measures to ensure competition among providers. In 2008 it began researching the feasibility of introducing number portability, which gives consumers the option of keeping their fixed-line or mobile telephone number when switching providers. The TRA ran a campaign called "I Love My Number" in 2009, requesting consumer feedback on the potential move. In November the following year, the organisation announced that number portability would apply to the mobile market within six months and to the fixed-line market – including WiMAX subscribers – within eight months from July 1, 2011.

Number portability is expected to have a notable impact on the telecoms industry and the overall business environment. It will give consumers greater flexibility and choice, enabling them to switch between different operators without having to give up their numbers. Heightened competition should also provide the impetus for more creativity in product offerings and packages, as operators vie to build consumer loyalty and attract new subscribers.

"Regulatory changes that increase competition in the telecoms sector are beneficial not only for the consumer, who is further empowered with more choice, but also for the overall sector because it motivates innovation," Ibrahim Al Omar, the CEO of VIVA, told OBG. As the industry adjusts to the changing market, it seems that both residential and business consumers are in for lower prices and additional options.

Industry

Real manufacturing output growing faster than GDP
Free zones specially designed for foreign firms
New methods to boost aluminium production
Land in export-oriented free zone is 75% allocated
Investor-friendly framework sets the tone





The sector's share of real GDP increased by 5% from 2000 to 2009

Success by design

A concerted shift in focus to manufacturing has paid off

The Kingdom has taken advantage of its reserves of natural gas and focused on its aluminium smelting and petrochemicals industries, whose export earnings have brought in a steady stream of revenue.

Over the past 40 years, Bahrain has transformed its economy from one based almost exclusively on the trade of natural resources – primarily oil, pearls and dates – to one that is increasingly industrialised. In the 1970s the Kingdom began using its reserves of natural gas, which provided a ready supply of energy and feedstock, to an aluminium smelting and a petrochemicals industry, whose export products earned it a steady stream of foreign currency.

ADVANTAGES: Since then, with the government's encouragement and guidance, the country's manufacturing sector has grown in size and diversity. By 2009, according to the Economic Development Board (EDB), the Bahraini agency charged with directing public policy, manufacturing had surpassed crude oil and gas extraction as a contributor to GDP. While aluminium and petroleum by-products still account for the lion's share of the sector, today they are joined by a range of other industries, some of the most notable of which are steel, shipbuilding and repair, fibreglass, garments and foodstuffs.

Bahrain's location in the heart of the Gulf has long been a significant asset for industrialists. With easy access to both the stable European and surging Asian markets, it is a convenient springboard for companies looking to serve a wide range of customers, and its membership in the GCC makes it an ideal base for those seeking duty-free access to the newer markets of Kuwait, Oman, Qatar, Saudi Arabia and the UAE. Those factors – along with its well-developed regulatory framework, efficient logistics systems, extremely favourable tax regime, and its free-trade agreement with the US – have made this small island Kingdom an increasingly popular destination for foreign investors.

The manufacturing sector's contribution to real GDP increased from 8.9% in 1980 to 17% in 2009 and saw the ratio of manufactured goods as a share of total exports exceed 23%.

GROWTH AND DIVERSIFICATION: The manufacturing sector has experienced robust growth in the past three decades. According to data from the Ministry of Industry and Commerce (MoIC), the sector's contribution to real GDP increased from 8.9% in 1980 to 17% in 2009. Non-oil industrial revenue grew by 27% over that period, while the ratio of manufactured goods as a share of total exports exceeded 23%.

The sector grew especially quickly during the first decade of the new millennium. Whereas the sector's share of real GDP increased by 3.1% between 1980 and 2000. Between 2000 and 2009, average annual growth for manufacturing was 5%, accoring to the EDB's analysis. The board's combined second- and third-quarter report for 2010, "Bahrain Economic Quarterly", indicates that real manufacturing output increased by 105% between 2001 and 2008 – almost double the average rate of real GDP growth – while nominal output grew 245%, from less than BD400m ($1.07bn) to BD1.3bn ($3.47bn).

Refined oil was the fastest-growing subsector, in nominal terms, with an increase of 510% over that seven-year period, followed by metal fabrication, with 477%, and mineral products, with 328%. Those figures are somewhat misleading, however, since the vast majority of refined oil's growth was due to increases in the commodity's price rather than expansion of its production volume.

NON-OIL SEGMENTS: In real terms, according to the EDB report, refined petroleum's output increased by 11% over that span. That is a significant amount, but several non-oil subsectors performed even better. As a result, refined petroleum's share of the overall real manufacturing output actually shrank by about 8% from 2001 to 2008, while the shares of various other industries increased.

Although real figures for each of the subsectors are not available, by taking the inflation rate of refined oil into account, the EDB was able to calculate that basic metals accounted for the largest share of real manufacturing output in 2008, with 29%. Chemicals came next, with 27%, while refined petroleum came in third, with 10%. Mineral products and food and beverages were tied for fourth place, with 7% each, followed by clothes and dyes, electric lamps, and fabricated metals, which represented 4% each. Ship repair accounted for 3%, while a miscellany of other industries accounted for the remaining 5%.

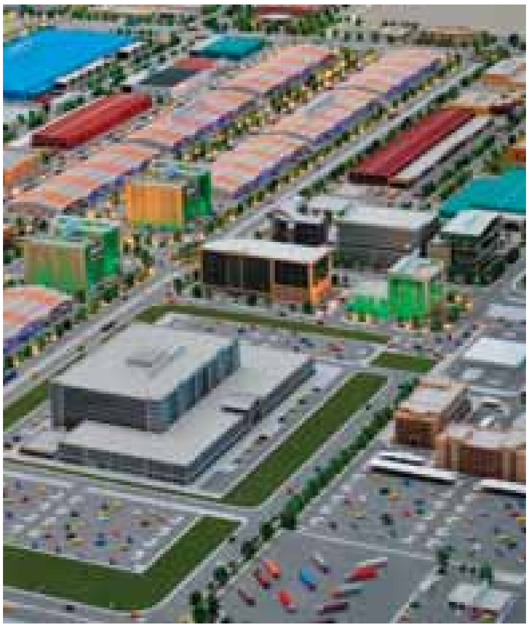
INDUSTRIAL PARKS: This economic transformation happened by design, not by chance. The fact that the Kingdom's manufacturing sector is now markedly bigger than the oil extraction sector, and that petroleum refining now counts for a smaller share of manufacturing than ever before, is a result of deliberate state policy, which is aimed at building an economy that is based on sustainability, diversity, knowledge and innovation, a target articulated in Bahrain's long-term development plan, Vision 2030. The Kingdom has recognised that it is more dependent on oil than it would like to be, but its recent progress, to which the numbers above attest, is proof that its policies are working.

In order to reach its aims of economic diversification and further industrialisation, the Bahraini government has adopted a number of policies to attract foreign direct investment and promote business development (see Analysis). One of its most effective innovations, particularly in recent years, has been the establishment of specially designed industrial parks and logistical zones. These areas, which are located near and integrated with the country's transportation infrastructure – including the Khalifa Bin Salman Port (KBSP), the King Fahd Causeway linking the island with neighbouring Saudi Arabia, and the expanding Bahrain International Airport (BIA) – are designed to attract new, and especially foreign, industrial firms by offering a number of incentives such as assistance in obtaining the necessary permits, dedicated on-site Customs-clearing units, and long leases at competitive rates.

COMPLEMENTARY EFFORTS: The focal point of these efforts is Salman Industrial City (SIC), which consists of four separate but complementary developments in and around Al Hidd: namely, the Hidd Industrial Area (HIA), the Bahrain Logistics Zone (BLZ), the Bahrain Investment Wharf (BIW) and the Bahrain International Investment Park (BIIP). These four entities were developed and continue to be administrated separately, but they work in unison, as each focuses on different businesses and segments of the marketplace, and all benefit from proximity to the adjacent KBSP.

The HIA is the oldest of SIC's four developments. Established by the MoIC in 1987 on 7.9m sq metres of industrial land, the HIA today contains a number of major industrial firms, including a steel mill, a pellet production facility and a ship repair yard. It also contains the Bahrain Business Incubator Centre, a subsidiary of the Bahrain Development Bank (BDB) designed to foster small and medium-sized enterprises and independent entrepreneurs.

The BLZ was developed by the Ministry of Finance on 100 ha of land just a few minutes by road from KBSP. Launched in 2008 as the region's first boutique logistics area, the BLZ is designed primarily to attract logistics firms targeting the Northern Gulf markets,



Salman Industrial City is composed of four separate developments

especially Saudi Arabia, Qatar and Iran, though it also welcomes distributors, retailers and other associated businesses. Its favoured activities include component assembly, labelling, packaging and repackaging, weighing and filling, kitting and palletising, and testing and repair.

Also established in 2008, the BIW is a 1.7m-sq-metre, mixed-use business park catering primarily to construction and real-estate companies. The BIW, which was privately developed though it sits on government land, consists of four separate parks, each of which is zoned for a different purpose. The industrial park sits on 800,000 sq metres and is geared towards small and medium-sized industries, while the 190,000-sq-metre logistics park focuses on warehousing, cold storage, redistribution and IT services. The wharf contains a 70,000-sq-metre business park featuring low-rise office blocks, a training centre, conference and exhibition halls, and a 640,000-sq-metre residential and service park featuring a hotel for the wharf's guests, apartments for its labourers, and retailers.

The BIIP has been developed by the MoIC on 247 ha of land near both BIA and KBSP. It is primarily targeted at local, regional and international investors looking to establish export-oriented manufacturing

The Kingdom's specially designed industrial parks and logistical zones are located near and integrated with its transport infrastructure. The developments are designed to attract foreign industrial firms with a number of incentives.

Breakdown of manufacturing by segment, 2004-08 (BD m)

	2004	2005	2006	2007	2008P
Food	45.1	54	60.8	67.5	81.5
Printing & paper	9.7	13.5	18.1	19.2	22
Oil industries	137.2	200.5	307.5	436.8	519.2
Other chemicals	14.7	22	22.2	23.2	31.6
Aluminium	126.3	135.6	198.1	263.3	302.2
Metal	57.1	90.3	97.8	115.2	148.1
Building materials	34.8	57.3	81.3	90.8	107.3
Other	32.2	39	39.5	46.9	54.4
Total	457	612	825.3	1062.80	1266.30

SOURCE: Ministry of Finance, CIO

A new aluminium line would greatly increase production, which is not currently meeting demand

Aluminium is still king when it comes to metals production, and the flagship manufacturer has an annual capacity of 860,000 tonnes. Increasing production would necessitate finding new sources of natural gas.

operations within Bahrain, though it also welcomes companies engaged in international trade and services. As of January 2011 the BIIP had allocated roughly 75% of its land to 74 different companies, 21 of which were already operational and the rest of which were in various stages of development, Brian Cogan, the BIIP's project director, told OBG. The park's companies manufacture a range of products, including foodstuffs, medical equipment, household products, electronics devices, packaging materials, electrical switchgear and architectural modelling tools. It also features companies offering such export-led services as insurance claims administration, software and advanced information systems development, and high-technology printing.

FILLING UP: Cogan said the idea behind the SIC is to be a high-tech, internationally competitive location giving companies in various sectors a means of access to the Gulf and beyond. By any measure, it is succeeding. *fDi Magazine* ranked the SIC among the top 25 of 700 industrial developments in its "Future Free Zones" report for 2010-11. Even more impressive than that ranking is the fact that the park is filling up, and quickly: according to Cogan, the BIIP expects its lots to be fully allocated by 2013, with investment totalling about BD407m ($1.09bn).

"Today, demand for industrial land exceeds supply by 10 times," Bahrain's minister of industry and commerce, Hassan Fakhro, announced in his keynote address at the Invest in Bahrain 2010 Forum, held in late September of that year. Thus, he said, the ministry is studying the possibility of developing "a Grand Industrial City" somewhere offshore.

Details of the project are still in the early stages of planning, although funds have reportedly been earmarked to finance feasibility studies. According to Fakhro, if the project comes to fruition, the futuristic industrial city would likely cost a total of several billion Bahraini dinars. "This will be the great project of the future, the biggest and the grandest ever planned in Bahrain," a local paper quoted him as saying later on at the forum.

ALUMINIUM: Industrial zones like the SIC and this planned offshore development may be driving innovation and growth in Bahrain's manufacturing sector. Nevertheless, for the time being, metals are still king, aluminium above all. Bahrain's aluminium industry dates to 1971, when Aluminium Bahrain (Alba) began smelting 120,000 tonnes of the metal per year (see Analysis). From that time forward, Alba has been the Kingdom's flagship manufacturer.

Today, thanks to a series of expansions, the company has an annual capacity of 860,000 tonnes, making it one of the world's largest aluminium smelters. With its own dedicated 2200-megawatt (MW) power plant, Alba is also one of the Kingdom's biggest generators of electricity, and hence one of its biggest natural gas consumers. In 2009, according to the National Oil and Gas Authority, Alba consumed 130.4bn cu ft of natural gas, or 24% of the country's entire output for the year.

Demand for Alba's products, which include rolling slabs, extrusion billets, ingots, T-ingots and liquid metal, already exceeds production and is expected to grow in the coming years as international demand intensifies. Thus, Alba is exploring two plans for expansion. The more ambitious plan would build a new production line and increase the company's output by 400,000 tonnes per year, or 46%, meaning it would require a lot more gas.

However, Bahrain is already consuming 100% of the natural gas it produces. It is currently pursuing a deep-gas exploration programme and attempting to ramp up production at its current fields; and it is pursuing foreign supplies of the commodity, both via pipelines and via the importation of ship-borne liquefied natural gas. Until one or more of those options pans out – or the country secures another source of electricity, perhaps from the increasingly-integrated GCC power grid – Alba may have to settle for the second option, an expansion plan, which depends on improving two of its existing lines, thereby ramping up their annual productivity by 80,000 tonnes over the course of three years.

In November 2010 Alba offered 10% of its shares in an initial public offering, which raised $339m for its largest shareholder, the state's sovereign wealth fund, the Mumtalakat Holding Company. In its offering memorandum, the company reported a first-half profit of $200m, beating its own forecast.

DOWNSTREAM PRODUCTION: Bahrain is also a major player in the downstream aluminium busi-

Selected exports & imports, 2004-08 (BD bn)

	2004	2005	2006	2007	2008P
Non-oil, non-service exports	0.79	0.96	1.17	1.13	1.39
as % of total exports	20.4	19.1	19.9	17.3	17.4
Non-oil, non-service imports	1.56	1.77	1.9	1.9	2.65
as % of total imports	50.9	45.7	43.7	40.1	43.3

SOURCE: Ministry of Finance, CIO

ness. In order to ensure optimal use of Alba's products, the has country established several secondary aluminium companies, beginning with Bahrain Atomisers International (BAI) in 1973. BAI, which is owned 51% by the BDB and 49% by Germany-based Eckart Werke, produces atomised aluminium powder and pellets used in manufacturing paints, vehicle spare parts and the steel industry. Its capacity is around 7000 tonnes per annum.

Established in 1977, the Bahrain Aluminium Extrusion Company (Balexco) is the oldest company of its kind in the Arabian Gulf region. At present, it has three extrusion lines, a powder-coating line, an anodising line, and a recycling and casting facility for re-melting scrap. With a total annual capacity of 25,000 tonnes, it serves not only the domestic market but also customers throughout the Middle East, Europe and Australia. According to local press reports, Balexco is adding a fourth extrusion line as well as a new anodising plant in 2011, thereby expanding its capacity to 33,000 tonnes per year.

Midal Cables was also established in 1977, as a 50:50 joint venture between Bahrain and Saudi Arabia to produce aluminium rods and electrical conductors. With a current annual capacity of 180,000 tonnes and offices in London, Toronto, Kuala Lumpur and Nairobi, Midal's products are distributed in more than 60 countries around the globe.

MEETING DEMAND: The Gulf Aluminium Rolling Mill Company (GARMCO) was established in 1986 as a joint venture among Bahrain (37.29%), the Saudi Basic Industries Corporation (30.4%), the Industrial Bank of Kuwait (16.98%), the Gulf Investment Corporation (5.9%), Iraq (4.71%), Oman (2.36%) and Qatar (2.36%). Today GARMCO has the capacity to produce 165,000 tonnes per year of cold-rolled aluminium coils, sheets, and circles, as well as 22,000 tonnes per year of foil, making it the largest downstream aluminium producer in the Gulf. With 23 global subsidiaries, GARMCO exports to a range of markets throughout the Middle East, East Asia, Europe, North America and Africa.

The CEO of GARMCO, Adel Hamad A Rahman Hamad, told OBG that the company would like to double its current production over the next 10 years. Towards that end, it is looking into the possibility of establishing a 100,000-tonne-per-year melting facility to reprocess scrap. It would also like to receive more aluminium from Alba. Both projects would require government-level participation: in the first instance, to establish an aluminium recycling programme; in the second, to secure new sources of energy so Alba can ramp up production.

Two more companies joined the sector in the 1990s. Aluwheel was established in 1993 as a joint venture between Midal and other Bahraini investors (51%) and Germany's BBS Kraftfahrzeugtechnik AG (49%). Today, using 20,000 tonnes of primary aluminium as feedstock, Aluwheel has an annual production capacity of roughly 750,000 wheels and 12,000 wheel alloys, which it exports to well-known carmakers in Europe and North America, including Audi, Citroen, Fiat, Honda, Opel, Peugeot, Rover, Saab, Volkswagen and Volvo. The Bahrain Alloy Manufacturing Company (BAMCO) was founded three years later as a joint venture between Bahraini and foreign investors to produce aluminium alloys for use in the production of vehicle spare parts and cast products. Currently, BAMCO has a total annual production capacity of 31,000 tonnes.

The dominant player in the steel segment produces 11m tonnes of iron oxide pellets yearly

Demand for aluminium could outstrip production by 2020, meaning that Middle Eastern producers will have to quadruple their production capacity over the next nine years to about 10m tonnes per year.

According to Mahmood Daylami, the general secretary of the Dubai-based Gulf Aluminium Council, demand for aluminium is set to outstrip production by 2020. Speaking at the 25th International Aluminium Conference in Manama in September 2010, he predicted that, if Middle Eastern producers want to keep up with and take full advantage of increasing worldwide demand, they will have to quadruple their production capacity over the next nine years to around 10m tonnes per annum. "This region is seeing a lot of expansion and more intense competition, but there is still a lot of room for more to come in," he said in the *Gulf Daily News* reporting. Based on their own expansion plans, Bahrain's aluminium producers clearly agree.

STEEL: In recent years, Bahrain has also begun to develop a significant ferrous (metals containing iron) industry. The dominant player in this subsector is the Gulf United Steel Company (Foulath), which will soon operate three different plants manufacturing everything from iron-ore pellets to finished steel products. At present, Foulath produces 11m tonnes of iron oxide pellets per annum through its Industrial Investment Company and some 100,000 tonnes per year of stainless steel flat products through its subsidiary the United Stainless Steel Company.

In 2010 Foulath formed a joint venture with Japan's Yamato Kogyo Company. The new entity, dubbed the United Steel Company, will operate a $1.2bn heavy-steel sections manufacturing project — the first of its kind in the Middle East — consisting of five dif-

ferent sections: a direct-reduction iron plant with an annual capacity of 1.5m tonnes, which can be increased to 1.8m tonnes; two melt shops with a combined annual capacity of 1.3m tonnes; and two section rolling mills, one for medium and heavy sections and the one for light to medium sections, each of which will have an annual capacity of 600,000 tonnes. Japan's Kobe Steel and the US's Midrex have been awarded a contract for constructing the first plant, and contracts for the other four have been awarded to Germany's SMS Meer and SMS Concast along with Korea's Samsung Engineering. The company has already secured the necessary electricity and natural gas, according to local press reports, and it expects to begin operations by mid-2012.

PETROCHEMICALS: After aluminium, petrochemicals manufacturing is Bahrain's next-biggest and next-oldest industry. The dominant company in this subsector is the Gulf Petrochemical Industries Company (GPIC), which was established in 1979 as a joint venture among Bahrain, Saudi Arabia and Kuwait.

GPIC uses natural gas as feedstock to produce 1.46m tonnes per year of ammonia, methanol and urea. The global economic crisis of 2009 predictably cut into its bottom line, as demand for its products declined, but the company decided to make the best of the situation by taking advantage of the consequent drop in construction prices to initiate. The expansion will add 2000 metric tonnes per day of ammonia and 3200 metric tonnes of urea to GPIC's current production. GPIC has already secured the necessary land for this and is now turning its attentions to acquiring the requisite feedstock.

OTHER INDUSTRIES: The Kingdom has a significant fibreglass industry. The Bahrain Fibreglass Company (BFG), established in 1975, operates five separate production sites in Bahrain and the Philippines, which comprise more than 30,000 sq metres of manufacturing space. According to Fakhro, its annual production forecast for 2010 was 20,000 tonnes.

In 2005 BFG was joined by a new entrant: Abahsain Fibreglass, which operates a 45,000-sq-metre facility at the BIIP with an annual production capacity of 60,000 tonnes. In 2010 Abahsain announced a joint venture with China's Chongqing Polycomp International Corporation to boost its existing output by 140,000 to 210,000 tonnes per year by constructing a new $200m-$300m plant, also at the BIIP. The new plant is expected to employ 1000 to 1200 people once completed.

OTHER INDUSTRIES: The Arab Shipbuilding and Repair Yard (ASRY) was formed in 1974 and inaugurated in 1977. Today its operations consist of 11 repair berths, a 500,000-deadweight-tonnage (dwt) dry dock, a 120,000-dwt floating dock and a 88,000-dwt floating dock. In 2010 it initiated an $188m expansion programme, which includes a new 1380-metre quay wall and an offshore fabrication area. The programme will be completed in 2012.

ASRY reported revenues of $106.35m from January to September 2010, during which period it

Securing additional supplies of natural gas to power production will be a challenge going forward

repaired 147 vessels. That marked a decline in sales over the year before, due to downsizing in the region's shipping industry. According to local press reports, the company is optimistic that the shipping and ship repair industries will recover their positions in 2011 and has a business plan in place to strengthen its share of the market if that should come to pass.

Bahrain also supports a garment and textiles manufacturing sector consisting of 10 factories, 85% of whose output is exported to the US, Canada and Europe, according to the MoIC. In recent years the foodstuffs processing industry has also grown in importance, attracting international heavyweights such as Kraft foods, which operates a $40m production plant at the BIIP. The EDB has predicted that, with food imports set to climb considerably in the coming years, this subsector will present additional growth opportunities in the near future.

OUTLOOK: After its best 10-year run in the country's history, the manufacturing sector is poised for further expansion. Rising demand and commodity prices bode well for its flagship aluminium and petrochemicals industries, while the country's – and the surrounding region's – increasing economic diversity and sophistication are opening up new markets for food and beverages, electrical machinery and fabricated metal products. The key challenge to overcome is the availability of natural gas to generate electricity. "Industrial growth in the future will depend on how much gas can be supplied to the market at competitive rates," Ankit Gupta, a senior analyst at Manama's Securities and Investment Company, said.

Natural gas plays such a large and strategic role in the country's economy that alternative sources of supply will have to be located soon under current energy plans. The opportunities in downstream industrial development for foreign investors and the Kingdom's citizens are significant. Bahrain's record of diversifying its revenue streams is well documented, and its momentum shows no signs of abating.

Petrochemicals is the largest industry after aluminium, with ammonia, methanol and urea all produced locally. Land has been found to expand facilities; now the requisite feedstock must be secured.

Esam Abdulla Fakhro, Chairman, Bahrain Chamber of Commerce & Industry

Embracing entrepreneurship

OBG talks to Esam Abdulla Fakhro, Chairman, Bahrain Chamber of Commerce & Industry (BCCI)

Small and medium-sized enterprises worldwide are prime generators of employment. How is SME growth being encouraged in Bahrain?

FAKHRO: SMEs are the pillars of economic and social development. As policymakers work to address the social problems generated by rising unemployment rates, SMEs will continue to play a major role in creating jobs. They provide an alternative way to improve standards of living and mitigate negative effects of unemployment, particularly for young people. With the BCCI's support, SMEs in Bahrain are set to achieve great success commercially and become a global model emulated by countries around the world.

The UN Industrial Development Organisation's (UNIDO) Enterprise Development and Investment Promotion (EDIP) Programme, known as "the Bahrain Model" due to its successful implementation in Bahrain, has already been adopted by 21 countries, including China, Egypt, Syria, Morocco and Libya. The programme aims to help potential entrepreneurs and investors translate their ideas into commercial ventures.

What is Bahrain doing to promote the growth of knowledge-based and high-tech industries?

FAKHRO: Bahrain is constantly seeking to increase its export capacity and reduce dependence on oil by diversifying its economy. We are honing the competitiveness of the industrial sector, especially in the field of high-tech industries. Government agencies have adopted a strategy that would provide an encouraging environment for industrial investments from both domestic and foreign sources. In line with its goal of achieving the sustainable economy outlined in the Bahrain Economic Vision 2030, the government has also adopted a programme targeting transfer technology in production processes, which could lead to enhanced prospects for exports manufactured by Bahraini companies.

The private sector also plays a major role in establishing and promoting industry through technological projects. A memorandum of understanding (MOU) was signed by the Economic Development Board and Kuwait Finance House-Bahrain to establish a $1bn "technology city" at Bahrain International Investment Park in Hidd. The project will focus on the manufacturing and assembly of computers, electronics, pharmaceuticals and medical supplies. It will also aim to embrace SMEs.

With finite gas reserves, is it still feasible for Bahrain's energy-intensive industries to expand?

FAKHRO: It is known that many industrial activities, particularly the aluminium industry, depend heavily on energy. Accounting for more than 25% of the sector, the aluminium industry is a focus of the government's broader programme of economic diversification. Gas is critical for this industry to function. In developing aluminium, the government can utilise gas by further developing value-added products in the industry, contributing to a greater benefit overall.

Despite their heavy reliance on hydrocarbons, continued investments in these sectors are critical due to their important role in the national economy. The issue of limited energy is certainly a concern, but efforts are under way to find and utilise economically feasible alternatives. The key is to facilitate the continued expansion of Bahrain's heavy industries.

Do you see the role of services expanding in the Kingdom's economy in the coming years?

FAKHRO: Data indicates that services currently account for 76% of GDP. According to the Central Agency of Information's third quarter 2010 Bulletin of National Accounts, the financial services sector contributes 25.3% of overall services in the Kingdom, with industrial services contributing 22.3%, transport and communications 9%, trade 7.1%, real estate 6.2%, hotel and restaurant services 3.5%, and the business services sector at 2.4%. The hotel and restaurant, communications and transportation service segments, for example, have all experienced growth in recent years and it seems that we will continue to see expansion in the coming years.

Firms can hire all staff without regard to nationality for five years

Fully serviced

One industrial zone specialises in multinational export-oriented firms

Bahrain International Investment Park (BIIP) is one of the latest and most successful, though probably not be the last, of the Kingdom's specially developed industrial zones. Designed to attract export-oriented companies – be they small local firms, medium-sized regional enterprises or large multinational corporations – primarily in manufacturing but also in internationally traded services, the BIIP is part of the Ministry of Industry and Commerce's (MoIC's) and the Economic Development Board's strategy of attracting inward investment in order to diversify the country's economy as a whole, improve its balance of trade, and create jobs for its burgeoning and increasingly engaged population.

Located on 247 ha in Al Hidd, the BIIP is part of the 12m-sq-metre Salman Industrial City (SIC), a conglomeration of it and two other similar industrial zones: namely, the Hidd Industrial Area, which dates back to 1987 and, like the BIIP, was developed by the MoIC; and the privately developed Bahrain Industrial Wharf, a mixed-use business park that caters primarily to construction companies and real estate developers. In addition to these industrial zones, the SIC contains the Bahrain Logistics Zone, a dedicated logistics, warehousing and distribution area upon which they can all draw.

The BIIP and other members of SIC all benefit from excellent access to the nearby Bahrain International Airport, which is working to more than triple its capacity by the end of 2013, as well as the recently completed Khalifa Bin Salman Port. They also have direct road access to Saudi Arabia via the 25-km King Fahd Causeway and within the next several years will have similar connectivity to Qatar via the planned Qatar-Bahrain Friendship Bridge.

SPECIAL INCENTIVES: In addition to its logistical benefits, the BIIP has numerous incentives to attract investors. All of its lots – which are fully serviced with the necessary roads, electricity, water, sewage, 24-hour security and gas – are available as renewable 50-year leases at the extremely competitive rate of BD0.50 ($1.33) per sq metre. Electricity is likewise affordable, with a rate of BD0.16 ($0.43) per kilowatt hour. The park also has a dedicated Customs unit to expedite the clearance process for all of its member firms, as well as a professional management team to assist them in obtaining the necessary start-up permits from the government.

Companies operating in the BIIP can be 100% foreign-owned, and there are no restrictions on their repatriation of capital. Moreover, since the BIIP is considered an integral part of Bahrain rather than a special, ring-fenced free zone, its foreign constituents receive all the benefits available to Bahraini firms, including the 0% corporate tax rate, an exemption from import duties on raw materials and equipment used for manufacturing, and unrestricted access to the GCC common market.

Thanks the latter, as well as Bahrain's numerous free-trade agreements, they have duty-free access to 16 countries, including Egypt, Kuwait, Oman, Qatar, Saudi Arabia, the UAE and the US. As a result, BIIP effectively gives companies a 5% margin over the various free zones operating in the GCC, since foreign firms working in those jurisdictions are obliged to pay Customs duties when exporting their products to other member-states of the council.

SUPERIOR OFFERINGS: The BIIP also offers two proprietary perquisites. In addition to all the benefits enjoyed by other Bahraini companies, firms operating under its aegis receive a 10-year guarantee against new corporate taxation, as well as a five-year waiver of the country's "Bahrainisation" policy. During that period, they may recruit workers without restriction or regard for nationality, although afterwards, 20% to 25% of their employees must be Bahraini. Brian Cogan, the BIIP's project director, told OBG that the BIIP's overall package of incentives at present surpasses that of any other zone in the region and is competitive on an international scale.

The Bahrain International Investment Park has numerous incentives for investors, including fully serviced lots, 100% foreign ownership, a 0% corporate tax rate, a dedicated Customs unit, and an exemption from import duties on raw materials and equipment used for manufacturing.

The BIIP is expected to be fully allocated by 2012; as of early 2011, 75% of its space had been taken

ELIGIBILITY: The BIIP prioritises high-value-added projects with an international focus. Cogan said the aim of the park is to provide a home to Bahrain's top exporting companies and thus attract foreign investment. Companies oriented towards the Bahraini domestic market, or which otherwise threaten to displace the country's existing manufacturing capacity and eliminate jobs will only be accepted if they demonstrate a clear strategy for growing the market as a whole and thereby contributing to the Kingdom's economic well-being. In order to be selected for placement in the park, projects must also demonstrate long-term sustainability.

Eligible activities at BIIP include, but are not limited to, light and medium manufacturing of such products as rubber, plastics, consumer goods, foodstuffs, garments, print and packaging, tools and machinery, generic pharmaceuticals, downstream aluminium products, chemicals, computers, and other electronic devices, and also knowledge-based businesses such as call centres, software development, design and engineering, and other technical services. The BIIP has established a One-Stop Shop to facilitate investment by assisting applicants through every stage of the process until they sign lease agreements and acquire building permits to construct their facilities. Preliminary industrial licenses are usually granted within 24 hours of application, and final decisions are usually made within two to four weeks, provided all the necessary documentation is in proper order.

MOVING TOWARD CAPACITY: Cogan told OBG that he expected the BIIP to be fully allocated by 2013. As of January 2011 75% of its 2.5m sq metres had already assigned to 74 different companies. Of those, 21 were already operational, 28 were in various stages of construction, nine had leases but were waiting for building permits and another 16 had been recently approved but had not yet signed leases. The companies ranged from small start-up firms to multinational corporations and came from 16 different countries in all. "These investments from a cross-section of leading global companies prove that Bahrain is now on the map as a credible competitor to Dubai and Saudi Arabia for international companies wishing to manufacture products for the GCC and Middle Eastern markets," Cogan told OBG.

Eligible activities include manufacturing of products such as rubber, plastics, consumer goods, foodstuffs, garments and generic pharmaceuticals. A variety of multinational companies have already set up in the park.

Kraft Foods Company, which with operations in 140 countries and 2009 sales of $40.4bn ranks as the world's second-largest food conglomerate, is the BIIP's biggest catch so far. Kraft has marketed its products in the Middle East and North Africa since the 1930s, and over the past decade it has starting producing there as well, first in Morocco and Egypt, and now in Bahrain. Kraft's 60,000-sq-metre, $40m facility in the BIIP, which it announced in 2006, was its first direct investment in the Gulf region. It produces Kraft cheese products and Tang powdered beverages both for Bahraini consumption and for export across the Middle East.

By moving into Bahrain, Kraft is poised to take advantage of the growing Gulf market, where demand for dairy products and soft drinks has been rising steadily. That is in keeping with the company's broader global strategy of focusing on developing markets with high growth potential, like the Middle East, instead of established markets that have already plateaued, such as Europe and North America.

Over the course of 2010 the BIIP added several more notable international projects. Siemens WLL Bahrain announced plans for a 25,000-sq-ft service centre, which will be the headquarters for a team of Bahraini and international technicians who will service aluminium and steel plants throughout the region, while BASF, the Germany-based chemical giant, announced it would build a plant for producing customer-specific antioxidant blends. The latter facility is expected to come on stream in late 2011 or 2012.

LARGE UPCOMING PROJECTS: While those facilities are notable because of their owners' international brand recognition, they are smaller in scale than a couple of other ventures. In January 2010 the Arabian Sugar Company received permission to build a BD56.7m ($151.22m), 585,000-tonne-per-year factory for the production of high-quality "Icumsa 45" white sugar, which will be the first of its kind in the country. Then in August 2010 Saudi Arabia's Saleh and Abahsain Company announced a joint venture with China's Chongqing Polycomp International Corporation to build a fibreglass plant. The facility, in which the former will hold a 30% stake and the latter will hold a 70% stake, will cost somewhere between $200m and $300m and will have an annual capacity of 140,000 to 210,000 tonnes.

"This is the largest investment to date in the BIIP and is a testament to Bahrain's competitiveness as an international manufacturing location," Bahrain's minister of industry and commerce, Hassan Fakhro, pointed out in a local paper. With the addition of a few more projects like this one, the BIIP will be filled up, and the race to build its successor will be on.

The biggest aluminium company operates at near full capacity

Aluminium assets

Production expansion is in the works for smelting operations

In the late 1960s the Bahraini government realised that it needed to diversify its economy away from a heavy reliance on petroleum extraction. The Kingdom had been the first country in the region to discover oil – it began commercial production in 1933 – but its reserves turned out to be relatively modest so it was also bound to be the first to run out. Thus, it began searching for an alternative. It needed an industry that would both provide valuable export earnings and be sustainable over the long term. It settled on aluminium smelting.

NECESSARY RESOURCES: Bahrain itself has no supply of bauxite, the mineral from which aluminium is derived, so it would have to import the raw materials. But its location was auspicious. Whereas some of the world's largest supplies of bauxite are in Australia, India and Brazil, some of the largest markets for aluminium are in Europe and Asia. "If you look at a world map, you see that Bahrain is at the centre of this network," Laurent Schmitt, the CEO of Aluminium Bahrain (Alba), said. "Bahrain is quite a good location for smelting, from a logistical standpoint."

Aluminium smelting is an energy-intensive industry; it requires massive supplies of electricity. Indeed, energy accounts for nearly 20% of the metal's production costs. Although Bahrain does not have a massive supply of gas like neighbouring Qatar, it had more than enough to supply its own needs at the time. Thus, it could generate the requisite electricity quite affordably, producing aluminium at competitive prices while still enjoying healthy margins.

MAIN PRODUCER: Alba was incorporated in 1968 and began production in 1971, with a capacity of 120,000 tonnes per annum. Ten years later, it underwent its first expansion, followed by others in 1990, 1992, 1997 and 2005. Today it has five production lines with a total annual capacity of 860,000 tonnes, making Alba the world's fourth-largest single-site smelter. Though routine maintenance and other factors require occasional shutdowns, the company typically operates near full capacity; over the past three years, production has averaged 860,000 tonnes per year. The company also produces 550,000 tonnes per year of calcined petroleum coke.

Alba's raw materials imports – alumina, green petroleum coke and pitch – are delivered to the company's own marine terminal 10 km away from the smelter. Its electricity needs are met by its own dedicated 2200-megawatt (MW) power plant, which uses combined-cycle technology for optimum efficiency. In essence, the waste heat given off by its main gas turbines is trapped and passed through heat-recovery boilers that power secondary steam turbines. During summer months, when electricity loads are at their peak, Alba's power plant can contribute 240 MW to the national electric grid.

The company's products include rolling slabs, extrusion billets, standard and T-ingots, and molten aluminium. Demand for them already exceeds production and is expected to grow further in the years ahead, Schmitt told OBG. In 2010 worldwide aluminium consumption was roughly 40m tonnes. According to forecasts by the Customer Research Unit (CRU), worldwide consumption should grow by around 8.5% per year over the next three years and 6% per year over the next decade. Europe, North America and China are all net importers, whereas the Middle East is a net exporter: it accounted for 4% of worldwide consumption and 8% of worldwide production in 2010. CRU expects the latter figure to grow to 15% by 2014, driven by demand in other markets.

EXPANSION OPTIONS: Alba would like to expand further in order to take advantage of these expected favourable market conditions and is currently exploring two ways of doing so. The first, more ambitious, plan is to build a new, sixth production line, which would increase the plant's capacity by 400,000 tonnes per annum, an astounding 46%. Alba conducted a pre-feasibility study of the project in 2010 and is currently in the midst of a full feasibility study, which

The main aluminium producer has five lines with a total annual capacity of 860,000 tonnes, making it the world's fourth-largest single-site smelter. It has its own marine terminal for raw materials imports and a dedicated 2200-MW power plant to generate electricity.

An additional source of energy will be required to execute one of two expansion plans under discussion

will be completed by the end of 2011, at which point the board will take a decision about whether or not to proceed with the project. The company has already selected a site for the new line; the main constraint is electricity, for Bahrain is now consuming its entire domestic gas production. There are several options for increasing the company's energy supply that Alba is discussing with the government, Schmitt told OBG. Inevitably, they must include some form of importation – be it of more gas to generate power at home or of electricity from the regional power grid that is nearing completion. If an additional source of energy is secured and the project goes forward, it should come on-stream in late 2014 or early 2015.

The second expansion plan involves improvements to the existing fourth and fifth lines, which account for roughly 70% of the plant's current capacity. Alba's board is expected to take a decision on this project by the end of 2011. If it decides to proceed, the lines' capacity will be ramped up progressively over three years, by the end of which output will be boosted by 80,000 tonnes per annum.

HIGHER-MARGIN PRODUCTION: In November 2010 Alba put 10% of its shares up for an initial public offering (IPO), which raised $339m. The proceeds of the sale went to Mumtalakat, Bahrain's sovereign wealth fund and Alba's majority shareholder; it intends to invest them in other ventures. According to the offering memorandum, which Schmitt cited to OBG, Alba turned a profit of $200m in the first half of 2010, which beat its own forecast. "Our strategy is to optimise and maximise the portion of high-value-added products such as extrusion billets, rolling slabs and foundry alloys," Schmitt told OBG. Those three products accounted for 63% of the company's first-half 2010 sales, according to the memorandum.

As of the end of 2010, 18% of output went to buyers in other Middle Eastern countries, 14% to Europe and 19% to Asia. The other 49% was consumed domestically. Much of this is taken up by downstream producers, which are keen to see upstream capacity increase.

In the coming years Schmitt said Alba aims for an even larger percentage of its sales to come from those higher-margin products. In the second half of 2010, it found at least one new major buyer. In September 2010, according to local press reports, Alba signed a multiyear contract with Sapa AB, the world's largest aluminium extruder, which operates around 45 plants in Europe, North America and China with a total annual capacity of 900,000 tonnes, to supply it with extrusion billets. Alba has not disclosed the exact value or volume of the deal, saying only that it was for "a significant quantity" of billets to be delivered over three years.

Broken down by region, during the second half of 2010, 18% of Alba's output went to buyers in other Middle Eastern countries, whereas 14% went to Europe and 19% went to Asia. The remaining 49% was consumed domestically. "In Bahrain, the aluminium value chain is highly integrated," Schmitt said.

DOWNSTREAM EXPANSION: Indeed, a full 27% of Alba's sales were liquid metal provided to the country's downstream aluminium producers, several of whose facilities immediately adjoin its own, which represents a tremendous competitive advantage for them. Those downstream companies are eager to see Alba to increase its capacity so they can increase their own. The Bahrain Aluminium Extrusion Company, which produces anodised and powder-coated surface treatments as well as extrusions for use in doors, window frames, and other products used in the construction industry, has plans to expand its current capacity from 25,000 to 33,000 tonnes per annum by building a fourth extrusion line, the company's CEO, Jassim Mohamed Seyadi, told the local media in December 2010. In addition to that project, which is scheduled to be completed by the end of 2011, it is also preparing a new anodising plant commissioned in the spring of 2011.

Meanwhile, the Gulf Aluminium Rolling Mill Company (GARMCO) has even more ambitious plans for expansion. With an annual capacity of 165,000 tonnes per year of cold-rolled aluminium coils, sheets, circles and foil, GARMCO is already the largest downstream aluminium producer in the Gulf region. But, as in Alba's case, demand for its products already outstrips its current production capacity, the company's CEO, Adel Hamad A Rahman Hamad, told OBG.

The company hopes to double its production over the next 10 years, but in order to justify doing so, it needs a bigger supply of aluminium slabs. The company has commissioned a study, which should be completed in June 2011, to determine the feasibility of producing a scrap-metal re-melting facility with a capacity of 78,000 tonnes per year. This will likely involve government participation in implementing a recycling programme. GARMCO is discussing such a project with the authorities and is hopeful it can be implemented in two years.

As the industry awaits either a recycling programme or an expansion at Alba, GARMCO may rely on more Saudi and Qatari suppliers in the meantime, Hamad said. In the future, Bahrain's aluminium sector will likely become more intertwined with those of its neighbours, if not for imports of aluminium, then for energy to produce more of its own.

The Kingdom's favourable tax regime is a draw for businesses

Favourable framework

Legal and tax benefits continue to pave the way for foreign investment

Bahrain's Vision 2030, the overarching economic strategy announced by the Economic Development Board in 2008, sets a number of targets, none more ambitious or important than transforming the economy from one built on the redistribution of oil wealth by a massive public sector to one based on "productive enterprises, engaged in high-value-added activities [that] offer attractive career opportunities to suitably skilled Bahrainis". In order to encourage the latter's development, the government has adopted a number of policies, many of which build upon the country's pre-existing strengths, to attract inward investment and promote industrialisation, particularly in the export-led sectors that can improve the country's balance of payments. The hope is that, by securing new flows of foreign currency for investment at home, the country can set off a virtuous cycle of growth, which will "ensure that every Bahraini has the means to live a secure and fulfilling life and reach their full potential".

LEGAL ADVANTAGES: Bahrain could not have embarked on such an ambitious endeavour if it did not already possess certain structural advantages upon which it could build and leverage, for example, its legal system. The Kingdom has a strong track record of protecting intellectual property rights, including patents and trademarks. It has signed both the Berne Convention for the Protection of Literary and Artistic Works and the Paris Convention for the Protection of Industrial Property, and it is currently in the process of passing new legislation that will bring it into compliance with the Agreement on Trade-Related Aspects of Intellectual Property Rights and the World Intellectual Property Organisation. Without such safeguards in place, few foreign investors would not feel comfortable investing in the kinds of knowledge-based enterprises the Kingdom is eager to encourage.

Bahrain's legal system also affords adequate protection for real property rights. Although the Kingdom does not yet possess a mortgage law, its land registry is well maintained and in recent years there have not been any reports of egregious expropriation. Bahraini and GCC nationals are permitted to own land in the Kingdom, and non-GCC nationals and foreign companies can own real estate in most newly developed areas. Moreover, Bahrain allows foreigners to own industrial projects outright and foreign companies to open representative offices without a local sponsor.

The Kingdom's system of commercial law is similarly robust, though it can occasionally prove slow in dispute resolution. In order to further streamline the process of law, in 2009 Bahrain passed legislation establishing a new Bahrain Chamber for Dispute Resolution (BCDR), before which parties can elect to settle their disputes in lieu of turning to the courts, provided they agree to do so in writing. Disputes settled by the BCDR will be governed by arbitration rules developed by the chamber in cooperation with the New-York based American Arbitration Association. This gives parties a new and more efficient mechanism for settling disputes, in which foreigners and locals alike can feel comfortable since neither has a proverbial home pitch advantage.

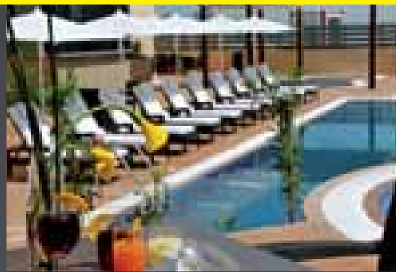
CLEAR REASONS: Bahrain also offers a highly favourable tax regime – the World Economic Forum judged it the fourth best in the world, out of 55 countries surveyed – with no personal income, withholding, sales, capital gains or corporate taxes. The one exception is oil companies, whose profits are taxed at a rate of 46%, though they are all majority state-owned. Nor does the Kingdom place any restrictions on currency exchange, capital flows, or profit and dividend repatriation. Those facts, in and of themselves, go a long way towards explaining the nation's success in creating robust financial and manufacturing sectors.

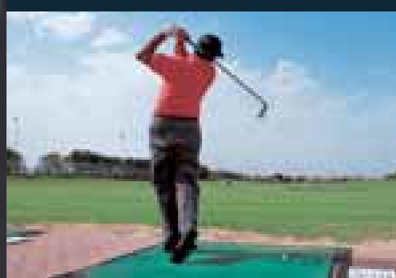
Combined with its access to the GCC common market and its free-trade agreement with the US, which allow Bahrain to serve as a conduit for trade between the massive North American and the growing Gulf markets, it is easy to see why Bahrain has tended to rank highly in international assessments and why it has been successful in attracting international investment.

The Kingdom offers many advantages for investors, including a strong track record on intellectual and real property rights, relatively liberal real estate ownership laws and a highly favourable tax regime rated fourth best in the world.

Tourism

Diversifying the sector's offerings to attract visitors
Further opportunities for collaboration across segments
Hotel infrastructure set to expand to build capacity
Developments to promote cruise stops on the agenda





Many of the Kingdom's tourists come from the Gulf region

New angles

Diversification in the sector aims to bring in a wider range of visitors

The Tourism Sector at the Ministry of Culture plays a major role in shaping the industry's policies, from marketing and promotion to planning strategy. Its efforts are improving relationships between private companies and public organisations.

Similar to its plans for the national economy, Bahrain has been strengthening its tourism sector through diversification. Government authorities and private firms have been working together in this effort, and increased collaboration has laid the groundwork for growth. Bahrain's reputation as a cruise destination has been enhanced over the past few years, and international sporting events have brought in record crowds. Cultural tourism and ecotourism have also been on the agenda to build and broaden the tourist base. Facilities for meetings, incentives, conferences and exhibitions (MICE) have been improved as well.

BUFFERED: Although the global financial crisis did affect growth, the impact was relatively low. One reason for this limited effect can be attributed to the Kingdom's overall lack of dependence on the international community for investment. "Bahrain has put an emphasis on local investment," Abdulla Siddiq, the deputy general manager of the Gulf Hotel, told OBG. "By limiting reliance on foreign investors, the Kingdom's tourist industry has been able to expand without the issue of financial instability inherited from wavering international backers."

The tourism industry was further protected from the economic crisis by its liberal culture relative to its neighbours, and the transport links which make it easy for regional tourists to visit. The Kingdom has long provided holidaymakers with a convenient place to relax and shop as a family. The King Fahd Causeway, which connects Saudi Arabia with Bahrain, facilitates easy access to the Kingdom's family-oriented shopping malls, restaurants and cinemas.

Many of the Kingdom's tourists come from the GCC region and much of Bahrain's current tourist infrastructure reflects its focus on this market segment. "Attracting greater numbers of international tourists will require new infrastructure," Nabeel Kanoo, the chairman of the Bahrain Chamber of Commerce and Industry's tourism committee, told OBG. "This presents tremendous opportunities for investors."

ORGANISATION: The Tourism Sector at the Ministry of Culture (MoC) plays a major role in shaping policies for the industry. In collaboration with other stakeholders, the agency is responsible for planning the Kingdom's tourism strategy. It is also in charge of issuing licences to hotels, tour guides, travel agencies and other related organisations that wish to operate in the country. Marketing and promotion, as well as data and research, similarly fall under the agency's area of responsibility.

The Economic Development Board (EDB) presides over these efforts. The EDB is responsible for the successful implementation of the Economic Vision 2030, which calls for diversified economic growth in an attempt to move the Kingdom away from an oil-dependent economy. A strong, sustainable tourism industry is one component of this strategy.

Kanoo Travel, the Bahrain Tourism Company, Al Gosaibi Travel, House of Travel and World Travel Services are among several private tourism firms operating in the Kingdom. Although there is still progress to be made in the relationship between private companies and public organisations within the sector, collaboration is increasing with positive results. "Further growth in the industry partly depends on stronger and more mature private-public partnerships," said Nada Ahmed Yaseen, the acting assistant undersecretary for tourism in the MoC. "Great strides have been made already, and greater levels of future cooperation are imperative."

NUMBERS: According to forecasts by the World Travel and Tourism Council (WTTC), the international association of travel industry executives, the travel and tourism sector's direct contribution to Bahrain's GDP was originally expected to be BD598m ($1.59bn), or 6.6% of total GDP, in 2011, rising by 4.4% per annum to BD921.1m ($2.46bn), or 6.9% in 2021 (in constant 2011 prices). Due to recent changes in the WTTC's methodology, it is not possible to compare the 2011 report with earlier ones. Investors are taking note of the country's growing potential for tourism. The WTTC estimated travel and tourism investment at BD241.4m ($643.8m), or 8.9% of total investment in 2011. It should rise by 4.4% per annum to reach BD369.7m ($985.98m), or 9.5% of total investment in 2021. The WTTC also expects the sector to boost employment over the next decade: the total contribution of travel and tourism to employment, including jobs indirectly supported by the industry, is forecast to rise by 3% per year from 79,000 jobs (16.9% of total employment) in 2011 to 106,000 jobs (18.2%) by 2021.

QUALITY NOT QUANTITY: The MoC has a focused set of objectives for the tourism sector. The ministry intends to foster an industry that can adapt to changing customer preferences in an innovative manner without ignoring business priorities or community concerns. Contributing to the Kingdom's socio-economic development is another priority for the sector. Rather than seeking to bring in a high volume of visitors, the emphasis has been placed on developing a quality offering across several segments.

The marketing and promotion directorate of the Tourism Sector at the MoC indicated in 2010 that a large marketing campaign specifically targeting European travellers was scheduled to be launched. In an effort to highlight the Kingdom's spread of natural and cultural attractions, one significant theme in the campaign would centre on the concept that "small is beautiful". However the Western media's reports of demonstrations in the capital in early 2011 inevitably put a dampener on the sector's plans, especially regarding the European market. By mid-May 2011, however, the thousands of Saudis who spend their weekends in Bahrain were flooding back into Manama, bringing back a key source of income.

CRUISE TOURISM: The development of Bahrain's cruise industry has been identified as a key component to the diversification of the sector. Cruise ships offer major opportunities for an array of Bahraini businesses and can make a significant contribution to the economy. "The potential for cruise tourism in Bahrain is almost endless," said the MoC's Yaseen. "A strong foundation is already in place, and it is our responsibility to build upon and improve what is already working well," she told OBG.

Some efforts have already been made to transform the Kingdom into a cruise destination. For example, government authorities have begun regulating taxi services running between the port and the city, which has facilitated easy transport for tourists making the trip. A duty free shop has also been established within the passenger cruise terminal, which provides visitors with shopping options as soon as they come ashore.

More work is needed, however, to generate greater levels of success in the segment. Yaseen notes that the existing promotional efforts highlighting the Kingdom as a cruise destination could be improved. Effective marketing would lead to more investment and consequently more synergistic partnerships.

Bahrain regularly hosts high-profile events like golf tournaments

SPORTS & LEISURE: A new genre of visitor has been attracted by a number of high-profile sporting events. Since 2004, the Kingdom has hosted Formula 1 races at the Bahrain International Circuit. These races are credited with drawing in a global television audience totalling more than 527m over the course of the 2010 season, according to Formula 1. The Kingdom has gained significant economic benefits from racing. "The development on the part of Bahrain to host this first-class event has been a massive component in its economic reforms and is having outstanding effects on building up the country's tourism industry," said Denis Johnson, the vice-president of sales and marketing for the Middle East and Africa for the InterContinental Hotels Group. "Staging the Grand Prix means that at least 15,000 spectators flock to the race and this has an amazing impact on our occupancy rates in the country," he said.

Bahrain also hosted the high-profile Volvo Golf Championship in late January 2011. The event took place on the Montgomerie course, an 18-hole, 72 par set of links at the Royal Golf Club in Riffa. Per Ericsson, the president of Volvo Event Management

The development of a cruise industry has been identified as a key growth area in the sector. Regulating taxi services between the port and city centre is one way the government is catering to cruise travellers.

Sector indicators, 2010 & 2020

	2010			2020		
	BD m	% total	Growth*	BD m	% total	Growth*
Personal travel & tourism	323.1	11.2	-1.2	586.2	12.6	5
Business travel	57.1	0.7	-3.4	87.9	0.6	3.3
Gov't expenditure	41.2	3.9	-1.8	68.8	4.1	4.2
Capital investment	157.8	6.1	-1.9	402	10.0	8.7
Visitor exports	707.2	9.7	1.9	1322.8	11.2	5.4
Other exports	61.7	0.8	26.1	100.7	0.9	3.9
T&T demand	1348	9.5	1.2	2568.4	11.5	5.6
Direct industry GDP	341.4	3.9	2.9	496.8	3.6	2.8
T&T economy GDP	751.4	8.6	3	1562.8	11.2	6.5
Direct industry jobs (000)	22.2	5	2	24.5	4.7	1
T&T economy jobs (000)	45.1	10.1	1.8	63.9	12.4	3.6

SOURCE: WTTC *Adjusted for inflation

Marketing campaigns use the concept that "small is beautiful" to attract visitors to the country

Sporting events bring in tourists, increase restaurant and hotel spending, encourage positive media coverage and highlight the country's distinct luxury profile.

(Golf), said the Kingdom's strategic location was a major factor in Volvo's decision to sponsor the 2011 tournament. "Bahrain is situated in between our biggest markets, Europe, and our fastest growing market, Asia, making it the ideal location to host our international clients," he said.

The Kingdom is hoping to draw in big crowds with the Bahrain Boat Show International (BBSI) in 2011. In its third year, the event is scheduled to span four days and take place at Amwaj Marina. The original April date was put off to later in the year, but specifics had not been announced at the time of press. Some 10,000 visitors and 50 exhibitors participated in the 2010 show. BBSI planners expect to see a surge in participants, with 15,000 visitors and 100 exhibitors expected to take part in the display of luxury.

The annual event brings a number of indirect economic benefits to the Kingdom. Besides increasing restaurant and hotel spending, BBSI planners calculate the show brings in the equivalent of $10m in positive public relations. A range of international, regional and local media cover the event, highlighting the Kingdom's distinct luxury profile. The BBSI also adds value to Bahrain's waterfront projects and helps to sustain the local boating industry. An uptick in employment opportunities is expected as this industry grows in future as the event is embedded.

ISLAND CULTURE: Bahrain is home to a rich culture with ancient origins. Proper preservation and promotion of its heritage is an important component of the tourism sector. "Bahrain's extraordinary history and culture provides tourists with something unique when they visit the Gulf," Noura Al Sayeh, the head of architectural affairs in the MoC, told OBG. "Our cultural heritage is one of our strongest assets in the tourism industry," she said.

Substantial effort has been put into the development of cultural tourism, with construction projects making up much of the work being done. For example, King Hamad bin Isa Al Khalifa is sponsoring the construction of the National Theatre, a BD20m ($53.33m) project. Its completion will furnish Bahrain's already flourishing theatre scene with a national stage. Another BD3m ($8m) was invested in a site museum at the Qalat Al Bahrain (Bahrain Fort), a World Heritage site. Ranked as the most important archaeological site in the Kingdom, Qalat Al Bahrain is a set of structures, including a fort. It is believed to have been the location of the capital of the Dilmun civilisation. The site was continuously inhabited by humans from 2300 BC to the 16th century and provides excavators and tourists alike with a unique insight into Bahraini history. The museum opened to visitors in February 2008.

A third project is the ongoing development of the Fort Arad site, including the construction of an accompanying information centre. The BD2m ($5.33m) project focuses on the fort's waterfront, with the aim to build a water link to the Bahrain National Museum. Water taxis and tourist boats will ferry visitors between the two attractions. Plans have been made to construct a BD40m ($106.68m) museum of modern art at a later date. Significant opportunities will exist for smaller investors who wish to build boutique hotels near cultural sites. Government authorities welcome this kind of construction as it can facilitate cultural tourism.

Challenges remain, however, for this segment. The Kingdom has a limited amount of available funding, and the financial crisis only aggravated this dilemma by further reducing what financing did exist for development and construction plans. Although this ultimately resulted in a number of tourism projects being delayed, trends were beginning to shift as regional economic activity improved.

"We are seeing a healthy and optimistic revival in cultural development projects," Al Sayeh told OBG. "Despite the recent financial downturn, I am confident Bahrain's rich heritage will continue to play an important role in the country's tourism industry."

ECOTOURISM: Named after a historic local Islamic leader, Sheikh Ebrahim bin Malik Island presents unique opportunities for ecotourism in Bahrain. The conveniently located island has a naturally rocky coastline, making it one of the nation's few islands without waterfront development.

The island's waters are filled with marine life. Pearl oysters, green and brown algae, gobies, sea urchins, bivalves, sea stars, gastropods and cuttlefish are among some of the organisms found in its coastal waters. The depth, slope and clarity of the biodiverse waters provide suitable snorkelling conditions. On land, ecotourists can also turn to bird-watching as an alternative activity. Although the island is not expected to bring in the number of international ecotourists as seen at the Hawar islands off the south-east coast of Bahrain, but the Sheikh Ebrahim bin Malik Island still has potential at a local level.

Al Areen Wildlife Park covers more than 8 sq km and is home to more than 50 animal, 90 bird and 80 desert plant species, many native to the Gulf region.

Dohat Arad on Muharraq Island is a natural sanctuary that attracts a large number of visiting and migrating birds in search of food and a warm climate.

MEETING IN BAHRAIN: The MICE sector presents further opportunities for growth. The segment had brought in a total of BD56m ($149.35m) by December 2010, and MoC's Yaseen announced then that it was expected to generate BD86m ($229.36m) in revenue over the coming two years, a major increase.

"The MICE sector is one where we can grow tremendously and figures we have prove we are on the right track," she said at a December 2010 event at the Bahrain International Exhibition and Convention Centre. Despite the global financial crisis, MICE tourism has done well, and Bahrain has recently hosted a number of key trade and business to business events, including the Gulf Industry Fair, the Middle East Financial and Technology Exhibition and Conference, as well as the Middle East Refining and Petrochemicals Conference and Exhibition.

As in most major cities in the world, there is a programme for upgrading infrastructure to keep the comparatively heavy traffic flowing. To capitalise on its good track record for MICE, Bahrain will need to invest in even bigger facilities as events and conferences continue to grow in scope and size. Alongside that, there is room for building additional three- and four-star hotels, to supplement the impressive expansion of the past few years.

NEW CAPACITY: Indeed, steps are being taken to improve and expand infrastructure, including a new "expo city", known as expo@bahrain. Totalling 145,000 sq metres of meeting and exhibit capacity, the indoor space will be equivalent to 21 football pitches. The facility will accommodate around 5000 delegates and up to 30,000 visitors daily.

Hotels in the three-, four- and five-star categories will also be built within walking distance of the conference centre, adding a total of 1200 rooms. Due for completion in 2013, expo@bahrain is estimated to have a BD115m ($306.7m) impact on the economy through increased MICE activity. A number of additional hotels are currently under construction, which will give business travellers more accommodation options when attending events at the expo@bahrain or elsewhere in the city.

The Bahrain Institute of Hospitality and Retail (BIHR) has plans to improve the quality of services in the tourism sector to match the new facilities. BIHR trains students for careers in hospitality and works on staff development for existing employees. In 2010 the institute completed the year-long Hospitality Today Programme, which provided free training for staff at every hotel in Bahrain.

The early results of the programme have been positive, according to Nigel Viegas, the director of academic relations at BIHR. He told OBG, "I am encouraged by the progress we have seen already and I believe the dynamic training that we have provided will give a real boost to Bahrain's hospitality industry." The Travel Academy at the Bahrain Training Institute, a vocational training centre established by the Ministry of Labour in 1992, also prepares nationals to work in the tourism sector.

New conference centres are being built to attract MICE business

OUTLOOK: As the sector continues to expand and diversify, more opportunities for growth and investment are emerging. A strong cruise industry is already developing. Sport in Bahrain has also gained worldwide attention, and investments in facilities for the MICE industry are expected to open up new avenues for hosting large-scale events. Meanwhile the Kingdom's cultural heritage and natural resources are beginning to play a major role in the sector.

"Bahrain has two significant advantages in the tourism industry," said Siddiq. "First, the Kingdom has an open and welcoming society. Second, Bahrain is conveniently located – travelling here is not a hassle." Government authorities, private investors and managers within the industry will seek to tap into these advantages to encourage sector growth.

Despite a number of challenges, the Kingdom has capitalised on its tourism potential by diversifying into new niches that will help it attract visitors to its small, but high-quality tourist offerings and events.

Training and professional development opportunities are being bolstered to support new and existing staff within the sector keep up with rising standards.

Middle East – tourism key indicators, 2010 & 2020

	2010			2020		
	BD bn	% total	Growth*	BD bn	% total	Growth*
Personal travel & tourism	75.85	9.8	0.6	167.16	10.2	4.2
Business travel	16.27	0.9	-1.7	33.59	0.9	4.3
Gov't expenditure	7.71	2.4	0.7	16.42	2.5	4.2
Capital investment	4.17	9.8	-12.4	112.48	12.1	6.1
Visitor exports	62.06	6.8	-4	126.75	5	4.3
Other exports	58.98	6.5	12.8	155.98	6.2	5.6
T&T demand	26.25	10.9	-0.3	612.39	10.8	4.8
Direct industry GDP	49.53	2.9	-2	112.03	2.9	4.7
T&T economy GDP	173.91	10.1	-0.1	429.86	11.2	5.2
Direct industry jobs (m)	1.88	3.4	1.3	2.44	3.5	2.6
T&T economy jobs (m)	5.27	9.6	1.9	6.93	9.9	2.8

SOURCE: WTTC *Adjusted for inflation

New hotels will offer both business and leisure facilities

Hospitality upgrade

Increasing hotel and resort infrastructure

Well known for its friendly and hospitable culture, Bahrain has a long tradition of welcoming outsiders. The Kingdom accommodates around 2m tourists a year who stay in a variety of hotels throughout the country. Such is the country's attraction that hotel infrastructure has had some trouble keeping up with the inflow of visitors in recent years. The market does not have a sufficient number of three- and four- star hotels, while five- star hotels are often completely booked at peak times.

UNDER CONSTRUCTION: Aiming to correct the issue, a number of large hotel construction projects are under way. For example, the Novotel Al Dana Resort in Muharraq, one of Bahrain's biggest resort hotels, is currently going through significant expansion. Due to be completed by the end of 2011 and costing BH22m ($58.7m), the project will include a 23-storey, twin-tower building that will house 146 rooms and 65 apartments. The existing property will also be given a luxury upgrade, bringing it up to "Pullman" class. It will be renamed the Pullman Bahrain in line with the classification policy of Accor Hotels, which operates the resort.

Bahrain Bay Development (BBD) is also making a large investment in hospitality infrastructure. BBD announced in December 2010 that construction on the Four Seasons Hotel – part of a $2.5bn landmark community on Manama's north shore waterfront – would soon begin. At a height of 201 metres, the 43-storey hotel will contain 260 rooms, adding a new and impressive feature to the city's skyline. The facility will cater to business and leisure visitors, with event space for meetings, incentives, conferences and exhibitions (MICE) tourists and a "Sky Pod" restaurant, located at the penthouse level, that will provide visitors with views of the island and the Gulf. Managed by BBD, the Four Seasons property is scheduled for completion by end-2013.

A large number of three-, four- and five-star hotels are under construction to make up for capacity shortfalls in these categories.

The new K Hotel, situated in Manama's Juffair neighbourhood, opened in January 2011. With 237 rooms and suites, the four-star hotel aims to provide the service of a five-star hotel at lower rates. It will cater to MICE tourism, with conference rooms accommodating 170 people.

Various other hospitality infrastructure projects dot the Kingdom as well. For example, the five-star Sofitel Bahrain Zallaq Thalassa Sea and Spa opened in February 2011 and provides tourists with 262 rooms. The hotel also has nine restaurants and a 2000-sq-metre spa complex offering a range of options such as wellness programmes and massage therapy. Marriott International is building the Renaissance Bahrain hotel on Amwaj Island. Set to open in 2011, the facility will contain a total of 323 rooms. The Hilton Hotels Corporation also has plans to complete a new luxury hotel in 2011. Its Conrad Bahrain will boast 250 rooms, as well as 50 apartments, and will sit on the recently built Reef Island near Manama.

SURGE: The completion of new four- and five-star hotels will add just under 1600 rooms or apartments to the existing stock. The surge in hotel expansion should be beneficial to the sector as a whole by driving up market competition and therefore increasing options for tourists.

Christopher Landais, Accor Hospitality's Middle East managing director, told the trade journal, *Hotelier Middle East*, "Although the country presents great opportunities, we have to bear in mind that it only has a population of 1m people."

The market has a number of strong points which off-set its size constraints. The Kingdom has maintained a stable economy despite volatile oil prices, and the government has emphasised tourism as a key driver for further economic growth, alongside its well-established financial sector.

To further sweeten the deal for international investors, the Kingdom has added several incentives to prospective hoteliers. The most significant are the lack of restrictions on foreign ownership and exemption for hotels from paying corporation tax.

Sheikha Mai bint Mohammed Al Khalifa, Minister of Culture

A rich heritage

OBG talks to Sheikha Mai bint Mohammed Al Khalifa, Minister of Culture

What is being done to help Bahrain compete with the region's established tourist destinations?

SHEIKHA MAI: Building a brand is the first and most important step that will be taken, in parallel with other activities and events to create a tourism identity.

The unique aspect of the GCC is that every country has its own selling points. Bahrain is known for its richness in culture and heritage, and is building further plans upon that. That does not exclude the variety of tourism products on offer, but it is where the Kingdom shines in comparison to the rest.

The countries of the GCC should not be competing against each other. Instead, they should look to complement each other by bringing together all their unique selling points and marketing the region internationally as one destination.

Which niches do you think offer the greatest investment potential, and how is the government encouraging investment in these segments?

SHEIKHA MAI: Cultural tourism has captured a great deal of attention and we have been working to develop this segment, as its culture is one of Bahrain's main assets. Bahrain Fort is a registered UN Educational, Scientific and Cultural Organisation (UNESCO) World Heritage Site, and additional projects are in the process of being registered with UNESCO, such as the "Pearling – testimony of an island economy" project. The Kingdom is ensuring that its culture is both preserved and promoted, which has led Manama being named the UNESCO Arab Culture Capital for 2012. It has also been nominated to be the Arab Tourism Capital in 2013.

We are also focusing on further developing the meetings, incentives, conferences and exhibitions (MICE) industry, working with other authorities to assist in their development. As for the cruise industry, all concerned parties in the country are working hard to further develop and attract more cruise companies, in the hope that they make Bahrain a hub for their future itineraries. We are working closely with the General Organisation of Sea Ports, the General Directorate of Immigration, Passports and Residence, the Ministry of Interior, APM Terminals and Bahrain Duty Free – as well as with the private sector – to further encourage investment in this segment. As for the MICE industry, Bahrain is ready to open expo@bahrain, a new venue to host MICE events. The project will provide all facilities, services and entertainment required by business visitors and their families.

What aspects of Bahrain's culture are the most appealing to an international audience?

SHEIKHA MAI: The fact that Bahrain has a history dating back thousands of years and was the capital of the Dilmun civilisation has always been a draw to the world. This ancient culture can be seen at the Bahrain Fort, which is now a UNESCO World Heritage Site, and throughout the country at several other attractions. It is also well documented at the Bahrain National Museum, which depicts the story of several eras of the country's rich history.

Bahrain is also well known for the unique nature and high quality of its pearls, which have attracted international tourists to our islands for centuries. They also drew the epic hero Gilgamesh to land on our shores thousands of years ago searching for them, and Jacques Cartier came here in the 1920s to collect Bahraini pearls for his jewellery line. The huge importance of the uniqueness of the pearling industry in Bahrain will also be emphasised in the "Pearling – testimony of an island economy" project, a potential UNESCO World Heritage Site. In addition to the culture of the past, tourists are drawn to the country's modern culture, which can be seen in Muharraq's traditional houses. These exemplify Bahraini traditions and culture, as well as the various handicrafts that Bahrain is renowned for and that are still practiced by talented young Bahrainis to this day.

Hassan Fakhro, Minister of Industry and Commerce, and Chairman, Bahrain Exhibition and Convention Authority

Organised development

OBG talks to Hassan Fakhro, Minister of Industry and Commerce, and Chairman, Bahrain Exhibition and Convention Authority (BECA)

What developments are planned to increase the supply of exhibition and conference space?

FAKHRO: A new facility is planned for development at Sakhir in the vicinity of the Formula 1 race track, which will cater to anticipated future demand. Expo@bahrain is planned to be developed in two phases, and will be 10 times the size of the existing Bahrain International Exhibition and Convention Centre in Sanabis. It will cost an estimated BD307m ($818.8m). The facility will be built on an area covering 150,000 sq metres. The first phase, which will comprise a 100,000-sq-metres purpose-built exhibition centre, is expected to be complete by 2013. A total of 75,000 sq metres will be demarcated for sub-divisible exhibition space, with a 25,000-sq-metre convention centre. A 50,000-sq-metre sub-divisible exhibition and convention centre will also be developed as part of phase two of the project.

How can the public sector position Bahrain as a regional centre for exhibitions and conferences?

FAKHRO: Exhibition organisers naturally gravitate towards locations that offer premier facilities and where there is a perceived demand. As the natural geographic centre of the region, Bahrain has connections to large population densities via the causeway that links Bahrain to Saudi Arabia. The planned causeway between Qatar and Bahrain will complete the link, and when coupled with a railway connection, Bahrain will have a naturally extended market. The addition of a new state-of-the-art facility in the form of expo@bahrain, along with the substantial transport links, means that all of the necessary infrastructure is in place to present Bahrain as a regional centre for exhibitions and conferences.

Another component adding to the attractiveness of a location for exhibitions and conferences is the leisure and tourism industry. The promotion of Bahrain as an international and regional destination for tourists is firmly on the government's agenda in the context of Economic Vision 2030. "Team Bahrain" is a new initiative of BECA to bring together all companies promoting Bahrain. It comprises more than 50 representatives from Bahrain's business and leisure tourism sectors and will spearhead the drive to enhance the capability and attractiveness of Bahrain as both a tourism and a meetings, incentives, conferences and exhibitions (MICE) destination.

How do you expect Bahrain to benefit from Qatar's recent win to host the 2022 FIFA World Cup?

FAKHRO: The 2022 FIFA World Cup is a triumph not only for Qatar but for the region as a whole. We anticipate that Bahrain in particular will benefit from this event. With the Bahrain-Qatar causeway anticipated to be constructed over the coming years, it is possible that Bahrain could host some of the events and fixtures and possibly could act as a venue for training camps for other countries' teams. The agile MICE industry in Bahrain will also take advantage of this opportunity to establish events to benefit from the influx of sports-related and leisure tourists.

Which specific industries and specialised events offer the best potential to attract the growing MICE industry to Bahrain?

FAKHRO: Bahrain is a net importing country that imports most of our requirements, as do our neighbouring countries. It is clear then that products, industries and services across the spectrum have potential to attract the MICE industry to Bahrain.

Sectors connected to knowledge-based industries, including high-tech products and services, as well as the education and health sectors, are particularly relevant. So too are events that cater to downstream production, tourism and the environment. Manufacturing industries and service providers in Bahrain and the region are continuously striving to develop their offerings, which is good for events that specialise in industry-specific technologies and products.

Some 70 ships dock during the cruise season from October to May

All aboard

Strengthening the economy as ships call at port

Cruises have become an integral part of Bahrain's tourism sector. Trends suggest the industry has a promising future, and much is being done to solidify this favourable trajectory. Government authorities have identified the segment as a profitable one that will help achieve its aim of further building and strengthening the tourism industry and, by extension, the entire economy. Private players have taken note of the sector as well. "Cruise tourism has already developed a solid track record of generating revenue for Bahrain, and possibilities for the industry's future growth are tremendous," said Nada Ahmed Yaseen told OBG in February 2011. Yaseen is the acting assistant undersecretary for tourism at the Kingdom's Ministry of Culture (MoC).

BY THE NUMBERS: Indeed, recent statistics are quite positive. According to the MoC, a passenger ship with 2000 tourists increases the sector's receipts by an average of $274 per passenger. As more than 70 ships could dock in Bahrain over the course of the cruise season, which runs from October to May, this could translate into a substantial figure. Figures for the first half of the 2010-11 season were also encouraging. As of mid-February 2011, the Kingdom had already welcomed 85,000 cruise tourists carried by around 35 ships, according to data from the MoC.

Going forward, the cruise segment will continue to be a priority for the Kingdom. "All concerned parties in the country are working hard to further develop and attract more cruise companies, in the hope that they make Bahrain a hub for their future itineraries," Sheikha Mai bint Mohammed Al Khalifa, the minister of culture, told OBG (see interview).

WORKING TOGETHER: The industry as a whole stands to benefit greatly by the increase in cruise tourists. Several new lines have signed up to call at Bahrain for the current season. The present line-up includes Aida, Costa, Silver, Europa and Spirit of Adventure. Other firms offering related activities have also climbed on board, including Kanoo Travel.

Working in partnership with the tourism sector and the MoC to promote tourism in the cruise season, Kanoo Travel organised local tours specifically designed for cruise passengers, including customised packages. The 2010-11 season (November-April) started with the inaugural visit of SAGA's Spirit of Adventure in December 2010. Inevitably, not all firms enjoyed the same success rate. Royal Caribbean International took Bahrain off its list of stops for the 2010-11 season, citing low demand. The cruise line and the MoC have not cut ties, however, and the possibility of adding Bahrain back to Royal Caribbean's itinerary is still on the table.

INITIATIVES: Speeding up arrival formalities and improving transport between the port and the city are other areas where the MoC has intervened to enhance visitor services. Yaseen said various authorities covering the port, passport control and traffic were coordinating activities to smooth passenger flows. After meetings with the taxi owners' association and the Arabian Taxi Company to solve visitor complaints about taxi fares, the government issued a directive requiring taxis to use meters.

The MoC is encouraging greater levels of hospitality by rewarding taxi drivers who epitomise Bahrain's welcoming culture. Yaseen spoke of a "mechanism to evaluate taxi drivers' performance and reward the outstanding ones".

Further plans are in the pipeline to translate relevant travel forms into several different languages, thereby catering to a wider range of tourists visiting the Kingdom. "The success of cruise tourism in Bahrain is partly dependent upon effective awareness campaigns," said Yaseen. "The two are very closely connected." Given the youth of cruise liner tourism in the Kingdom, it is remarkable that the country has already attracted so many visitors.

COLLABORATIVE POTENTIAL: In addition to wanting to further publicise the Kingdom's readiness as a cruise destination, the MoC would also like to

Further promotion and branding of the Kingdom as a cruise destination would go far in attracting more luxury liners and tourists to stop at the country.

Promoting and branding the country as a cruise destination should help to facilitate growth

attract more private sector participation, particularly in the form of public-private partnerships.

Indeed, the segment provides a prime environment for the creation of efficient partnerships between both public and private players. The MoC has initiated this effort by collaborating with a number of organisations. The ministry has worked with APM Terminals which operates Bahrain's newest sea port, Khalifa Bin Salman Port (KBSP), and the General Organisation of Sea Ports (GOP), which is the government body responsible for maritime activities. In addition to its discussions with the Passport Office and the Taxi Owners Association, the ministry has also worked with duty free merchandisers

The MoC's efforts are already yielding results. For example, APM Terminals has coordinated cruise ship arrivals in order to minimise delays at the port. Additionally, a duty free outlet has also been established within KBSP's passenger cruise terminal, providing shopping opportunities for cruise passengers almost as soon as they step off the ship.

A number of promising opportunities exist for new partnerships. For example, cruise arrivals could coincide with major sporting events, such as Formula 1 racing at the Bahrain International Circuit or golf tournaments similar to the recently held Volvo Golf Championship at the Royal Golf Club in Riffa.

Meetings, incentives, conferences and exhibitions (MICE) events could also be co-ordinated with scheduled cruise stops. Marketing partnerships could also be useful to explore new niches in the sector. For example, the promotion of Bahrain as a cruise destination before and at MICE events could prompt business travellers to consider the Kingdom for leisure tourism, returning on a cruise with their family.

Several promising opportunities exist for new partnerships, including coordination between cruise operators and major sporting events, business conferences and guided tours of the Kingdom.

The options for potential partnerships continues. According to the MoC, there are more than 900 tourist organisations operating in Bahrain, including institutions such as hotels, tour agencies and restaurants. Cruise tourism has the potential to create a range of partnerships between any number of these organisations. "The potential for greater levels of collaboration within the tourism industry is almost limitless," the MoC's Yaseen told OBG.

GUIDED TOURS: The area of guided tours for visitors is still on the process of being developed, and this could present another area for further expansion within the industry. The MoC is currently analysing the opportunity in an attempt to determine exactly what tourists want to see. Once the analysis is complete, new site development will need to be carried out and tours organised. Coordination with cruise schedules could dramatically increase the effectiveness of the guided tour industry.

DOCK INFRASTRUCTURE: At the moment, cruise liners calling at Bahrain share the KBSP with industrial ships, although there is a completely separate area at the port, dedicated exclusively for cruise liners. Made up of piers 1800 metres long and 15 metres wide, KBSP is a fully modern port, capable of accommodating the vessels commonly used in the region. The port is also outfitted with a cruise passenger terminal with room to hold a total of 2500 people, with duty free and shopping areas located in the complex. Although KBSP provides liners with excellent docking facilities, the industry in Bahrain may be able to attract more ships and passengers as the entire sector grows with the addition of a customised cruise terminal, such as those seen in other parts of the region. "A completely new port would elevate Bahrain's profile as a cruise destination," Nabeel Kanoo, the chairman of the Bahrain Chamber of Commerce and Industry's tourism committee, told OBG in a February 2011 interview with OBG.

THE FUTURE AHEAD: Having made its start in 2005, cruise tourism is still a relatively new industry in the GCC. Bahrain did not become a serious port of call until 2009. However, the Kingdom has embraced the growing regional trend and is rapidly developing its offering as a unique destination for cruise tourists. Although challenges still face the industry, as they do in other parts of the world, Bahrain has proven effective in handling many of these difficulties.

"The cruise industry has not come without its share of problems," said Kanoo. "There have been obstacles to manage and overcome, but significant progress has been made recently, and the sector is heading in the right direction."

As cruise tourism expands, the industry continues to provide profitable business opportunities including tie-ins with other events and attractions and the investment potential of constructing a new cruise terminal, when the sector reaches a critical mass that would justify such an undertaking.

And not just those closely involved in the expansion of the industry will reap the economic dividends. Transportation services, restaurants, hotels and shop owners would also benefit, as well as other leisure facilities provided for general tourists. Indeed, it appears that much of the Kingdom can benefit, whether directly or indirectly, as ships call at port.

Education

Matching provision with the needs of the economy
Expanding the number of vocational training courses
More research programmes are under way
Efforts to implement a knowledge-based economy
Assessment programmes maintain quality of institutions

There are 13 higher education institutions in the Kingdom

A careful study

Work to implement reforms to the system is under way

The nation's long-term economic development plan, Vision 2030, includes several goals for the sector, such as boosting Bahrainisation, matching education with business needs and diversifying the economy.

A regional leader in education provision for nearly a century, the government recently put in place a number of plans to expand upon this legacy. In line with the overarching goals of diversification and liberalisation outlined in Economic Vision 2030, the state's long-term economic development plan, Bahrain's educational institutions are expected to play an increasingly important role in coming years. In addition to improving the quality of education and boosting the Kingdom's economy, the sector hopes to position itself as a provider of education services to students from around the region. Central to this ambition is the National Education Reform Initiative (NERI), a key part of Vision 2030. Overseen by the Economic Development Board (EDB), the Higher Education Council (HEC) and the Ministry of Education (MoE), the NERI has made major inroads in terms of improving the sector since its launch in 2006.

CAREFUL OVERSIGHT: Bahrain was the first country in the Gulf to establish a formal public education system, in 1919. Initially, and until recently, the Kingdom's schools and universities focused primarily on rote learning and academic subjects, in accordance with traditional practices.

Since the NERI came into being, however, the government has been working to encourage instructors at primary and secondary schools to focus on engendering creative thinking skills in an effort to prepare students to compete for jobs on the international market. Similarly, universities are being encouraged to roll out new vocational programmes aimed at meeting the needs of local industries, including finance, information and communications technology (ICT), business and hospitality, among others.

The MoE oversees and operates the public school system, which consists of three stages, namely primary (ages 6-11), intermediate (ages 12-14) and secondary (ages 15-17). Schooling is compulsory and free for students at the primary and intermediate levels. While Arabic is the primary language of instruction in public schools, English is taught from the first year of primary school. Female and male students attend separate institutions in the public school system. The MoE acts as the primary regulator of the private school system, which consists of more than 50 institutions, as well as pre-school and kindergarten programmes. St. Christopher's School, for example, a private institution that opened in the Kingdom in 1961, is considered to be one of the top British-curriculum schools in the world.

Universities and higher educational institutions in Bahrain are overseen by the HEC, which is chaired by Majid bin Ali Al Nuaimi, the minister of education. The council is composed of a number of ministers, officials and heads of Bahrain's major universities. The national University of Bahrain (UoB), which was formed in 1986 as the result of the merger of Gulf Polytechnic and Bahrain University College, is the largest post-secondary institution in the country, with undergraduate enrolment of approximately 12,000 students. In addition to UoB, there are 12 private higher education institutions.

RECENT REFORM EFFORTS: The introduction of the NERI in 2006 has resulted in sweeping changes in Bahrain. The first stage, which is currently under way, involves four distinct projects. First, the NERI called for the creation of the Quality Assurance Authority for Education and Training (QAAET), which was established in 2008. The QAAET, which has a mandate to review all education and training institutions in Bahrain and to prepare and carry out the national examinations, is a central plank in the plan to improve quality in the sector. The second task carried out under the NERI was the creation of Bahrain Polytechnic in November 2008. A state-owned higher education institution with a focus on applied learning, the institution was developed to meet the labour needs of local industries. The third objective under the NERI involved increasing teacher training via the launch of Bahrain Teacher's College (BTC) in

2008. The final project involves boosting vocational education in an effort to increase the number of Bahrainis active in the workforce (see analysis).

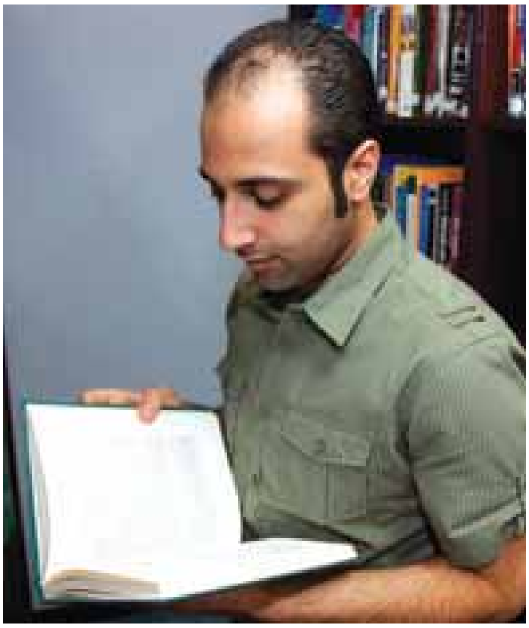
The NERI was designed to support Vision 2030, which includes a number of broad education-related goals, including increasing "Bahrainisation", the percentage of nationals employed in the country; matching the type of education on offer with economic needs; and diversifying the economy away from oil and gas incomes.

SCHOOL IMPROVEMENT PROGRAMME: In 2008 the MoE partnered with the Economic Development Board to introduce the school improvement programme (SIP), which set out to implement best practices in the educational system. The SIP focuses on several areas, including strategic planning, teaching methods and collecting data and statistics to inform self-analysis. "Initially we encountered resistance to the SIP among teachers and administrators," Hala Mustafa Amer, the chief of coordination and follow-up in the undersecretary of education's office at the MoE, said. "But now they are beginning to come to terms with it and even praise it."

As part of the SIP, the MoE has called for lengthening the school day, which would increase the number of instruction hours per year. The ministry first implemented the extended school day initiative on a pilot basis at the Muharraq Secondary Girls School in September 2009. The mechanics of the extension involved increasing the length of the lessons to 60 minutes (from the original 45) and reducing the number of lessons per day from seven to six. In real terms the length of the school day was increased by 45 minutes, giving an additional three hours and 45 minutes of instruction per week. This additional classroom time was devoted to Arabic, English, maths and science, in recognition of their importance.

The effect of increasing the school day at Muharraq has been significant on a number of fronts. For teachers, they now have more time to teach their lessons, which has enabled them to adopt more collaborative and interactive techniques. For students, they now enjoy greater opportunities for independent and class-based activities, such as discussion. Finally, the school's performance in the 2009/10 national examinations exhibited significant improvement over prior years. Compared to the previous year, the overall GPA rose by 3.2% and performance in 35 out of 48 examination courses improved.

BY THE NUMBERS: In early 2011 the government introduced the 2011-12 budget, which is the largest in Bahrain's history. Education figures heavily, as has been the case for government spending plans throughout the past decade. For 2011-12 the state allocated BD503m ($1.3bn) to the MoE, BD92m ($245.4m) to UoB, BD39m ($104m) to Bahrain Polytechnic, BD12m ($32m) to BTC and BD11m ($29.3m) to the QAAET. In total, approximately 12.5% of total expected government spending of BD5.3bn ($14.1bn) in 2011-12 will go toward education, up slightly from around 11% in 2010-11. During the



Some 12.5% of the 2011-12 budget will go toward education

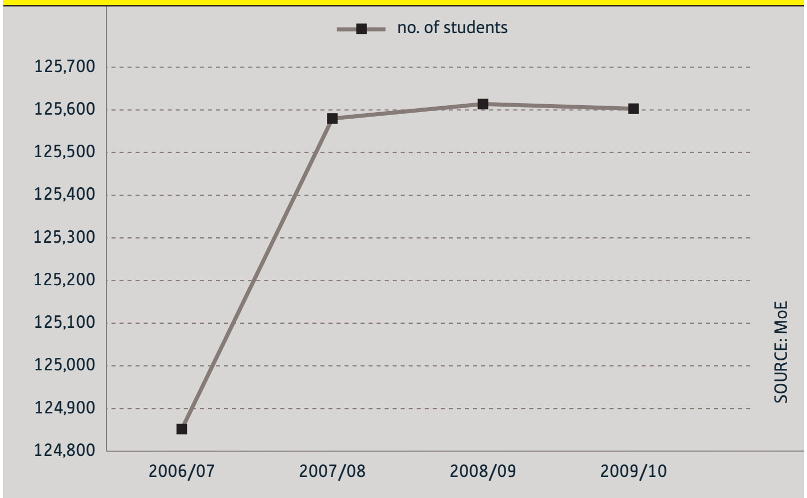
2009/10 academic year, there were 125,603 students enrolled in the country's public schools. These included 62,666 students at the primary level, 32,177 at the intermediate level and 30,760 at the secondary level. These numbers represent enrolment rates of above 95%, which are the highest in the region. The literacy rate in Bahrain, which hovers around 90%, is among the highest in the region.

Public sector higher education institutions – namely the UoB, Bahrain Polytechnic and the College of Health Sciences – are almost free for citizens. Private universities, on the other hand, charge tuition, although the government offers nationals a wide variety of opportunities to obtain funding. In 2001 Ahlia University began offering classes, becoming the first higher education institution in the Kingdom. Since then, 11 others have opened their doors.

ASSESSMENTS: Since it was founded in 2008, the QAAET has become a major player in the education sector. The authority consists of the schools review unit, the vocational review unit, the higher education review unit and the national examinations unit.

Exceeding 95% during the 2009/10 school year, enrolment rates are the highest in the region. With a rate of around 90% Bahrain is also at the top of the literacy league table.

Students at public schools, 2006-10




Vocational courses are increasingly important to the economy

Research is currently a relatively underdeveloped area of higher education in the region. Public and private institutions are setting up research facilities, which focus on key economic sectors.

Each division carries out regular assessments of their respective segment, posting the results on the QAAET's website and in local media.

As of early 2011, the school review unit had evaluated 202 public schools in the country. Of this total, 3% were rated as "outstanding", while 30% were rated "good", 47% were "satisfactory" and 20% were "inadequate". A new national examinations unit at the QAAET, which has introduced testing in primary, intermediate and secondary schools, is another means of raising standards in the system. As of early 2011 the higher education review unit had assessed 12 institutions on a three-tier scale. Of these, three universities were in the top tier, three were in the middle and six were in the bottom.

The QAAET has plans to evaluate every school, university and vocational training institution on a three-year rolling basis. When a university is reviewed poorly, the institution's administration submits an action plan to the authority on how to improve the situation. The QAAET publishes regular progress reports on the actions taken to improve performance. If progress is not made after a period of time, the HEC has the authority to take action.

HANDS-ON EDUCATION: Developing the country's vocational training capacity is an essential part of the NERI. Specifically, the reform initiative calls for the development of new training programmes that line up with Bahrain's existing labour needs, which include jobs in finance, the hospitality sector, ICT and business, among others. Currently there are two types of vocational schools in Bahrain – those operated by the Ministry of Education, which specialise in technical skills development and tend to focus on degree or certificate equivalency; and those operated by the Minister of Social Development, which are aimed at disabled students. The QAAET has evaluated 61 vocational training centres.

In addition to ministry-sponsored programmes and private players, vocational training is offered by Tamkeen, a government organisation that forms partnerships with private universities and other organisations to offer a variety of programmes. Tamkeen, which was previously known as the Labour Fund, is a major source of both grants and financial awards for students who enrol in training or education programmes in a handful of strategic sectors, including ICT and health care. Funding for these scholarships comes from the Labour Market Regulatory Authority, which collects fees from companies and business organisations in the Kingdom.

RESEARCH: Research is a relatively underdeveloped area of higher education in the Gulf. The MoE and a handful of private universities are working to change this situation, however. Until recently the oldest research institution in the Kingdom was the Bahrain Centre for Studies and Research, a government-operated think tank that was set up in 1981. In mid-2010, however, the centre was shut down by royal decree and a new research centre was established, the Bahrain Centre for Strategic and International Studies and Energy. This state-run operation has a mandate to focus on energy-related research that could have an impact on the Kingdom.

The UoB's Deanship of Scientific Research, established in December 1995, works on applied studies, the humanities, business and finance and molecular biology. A number of private institutions are also in the process of setting up research programmes. "We eventually want to strike a balance between teaching and research," said Abdulla Y Al Hawaj, the president of Ahlia University. "Consequently, we are working to launch research programmes in areas related to Bahrain's development."

Similarly, the Bahrain Institute of Banking and Finance (BIBF), a private training institute that focuses on the financial sector, is also in the process of establishing a research department. "There is a vacuum in Bahrain in terms of sharia scholarship," Mohammad Omar Farooq, the head of the centre for Islamic finance at the BIBF, told OBG. "We are working with the Central Bank of Bahrain to launch a sharia finance research programme."

OUTLOOK: The education sector faces a number of challenges. Perhaps the most pressing issue has to do with the quality of education currently on offer. In general, schools and universities are not yet operating at international standards. However, this is starting to change as state initiatives begin to have an effect. The MoE, for example, has targeted meeting international standards as part of its SIP. Indeed, with the MoE, HEC and QAAET at the helm, the Kingdom's education sector is poised for improvement.

Moreover, the most recent budget has underscored the government's commitment to the sector and its role in diversifying the economy. Taking into account existing initiatives, the state's ready embrace of sweeping improvement programmes and the expanding number of local education providers, Bahrain could well take a more prominent role in regional education provision in the coming years.

The National Youth Strategy is partly focusing on employment

Bridging the generation gap

The Kingdom's young people move into the spotlight

By mid-2011 the political unrest that had characterised Bahrain at the beginning of the year had mostly come to an end. The protests, which began in the Kingdom in February, have had several immediate effects on Bahraini society. Perhaps most importantly, they have focused attention on the country's large youth population that was central to the protest movement and, consequently, is currently at the centre of national and international discourse. In an effort to address the demands of the protestors and circumvent future grievances, the government is in the process of rolling out major new development programmes aimed at youth.

In early June 2011, the Kingdom announced that it would soon launch the second five-year National Youth Strategy (NYS) for the 2011-15 period. The initiative is expected to focus on increasing employment opportunities and training among youth, in an effort to improve incomes and, more generally, standards of living. The NYS 2011-15 will also likely include information and communications technology (ICT), language and cultural training elements. Finally, the programme is expected to include a strong citizenship component, in an effort to encourage the Kingdom's young citizens to become involved in public life.

LONG-TERM COMMITMENT: The state's focus on Bahrain's youth is not a recent phenomenon. Developing new opportunities for younger Bahrainis has been a government priority for the past 10 years. Like many other countries in the Gulf and throughout the Arab world, over the past decade Bahrain has experienced a "youth bulge", largely as a result of rapidly improving health and medical standards in the 1970s and 1980s. As of February 2011, young Bahrainis (ages 15-29) constituted around 27% of the total population; the median age in the Kingdom was 30.4, according to a recent report in *The Washington Post*. At the same time, youth unemployment – a major issue during the protests – was nearly 20% in early 2011.

The first NYS, which was launched in 2004 and carried out from 2005 to 2009, was developed largely as a response to the rapidly expanding youth population at the time. A joint project between the Kingdom's General Organisation for Youth and Sports (GOYS) and the UN Development Programme (UNDP), the first NYS was launched after a lengthy consultation and survey period, which included input from government entities, non-government organisations, leading private sector players and around 16,000 young people, who contributed their opinions through a series of small group discussion sessions and via a written survey. Additionally, around 100 youth leaders were closely involved in the coordination and implementation of the strategy.

A number of programmes were carried out under the umbrella of the first NYS, including the young Bahraini citizenship initiative, which focused on increasing participation in community life; the school-to-work transition project, which was aimed at aligning educational offerings with job requirements; the youth entrepreneurship initiative, promoting self-employment; the youth culture and leisure initiative, which focused on sports and recreation; and an ICT training programme.

THE NEW STRATEGY: The NYS 2011-15, like its predecessor, is a joint project between GOYS and the UNDP. The NYS is expected to build on these initiatives and will likely include new programmes to bring youth into the political process. Involving more young Bahrainis in public life is an essential part of reducing future unrest. "The changes in the Arab world [in early 2011] were led by young people, so it is time governments paid more attention to their development," Amal Al Dossari, a special advisor to GOYS and the director of the NYS 2011-15, told local press recently.

Like the first NYS, the new programme is being developed with input from some 10,000 young Bahrainis. According to GOYS, 800 of whom will be involved in planning and implementation. By increasing the involvement of young citizens, the government believes the NYS will address many of the root causes of unrest. It is hoped that by 2015, Bahrain's youth population will be actively engaged in public life in the Kingdom.

The country has a very young population. Roughly 27% of the population is between the ages of 15 and 29, and the average age in Bahrain is only 30.4.

The Kingdom is working to implement a knowledge-based economy

Supply and demand

Ensuring training matches the needs of the national economy

Over the past decade the government has introduced major education reform initiatives to improve the prospects of Bahrain's graduates. In addition to practical training, these plans have focused on developing a knowledge-based economy. For its part, the Ministry of Education has developed an education system to meet the needs of the local labour market by providing students with the right skills and competencies, covering basic, tertiary, higher and vocational education.

KNOWLEDGE-BASED: The country's continued development depends on moving away from hydrocarbons income and towards knowledge-based industries, such as information and communications technology (ICT), finance and business. Facilitating this transition is the overarching objective of Vision 2030, the government's long-term development plan, and it underlies the National Education Reform Initiative (NERI), the state's current education improvement scheme.

Instituting a knowledge-based economy in Bahrain is a two-tiered process. First of all, the government is working to encourage critical thinking skills at all levels of education, in an effort to boost entrepreneurship and innovation among the general population. Second, the state is focusing on improving "Bahrainisation" – the percentage of Bahrainis employed in the national work force, and particularly the private sector – in an effort to increase knowledge transfer, skills acquisition and general competence. The idea is that the local work force will simultaneously push the economy towards knowledge-based sectors and fill an increasing number of positions in those industries. With these aims in mind, the government has been working to develop vocational training programmes that support key local industries.

Major educational reforms have focused on instituting a knowledge-based economy and meeting the demands of the local labour market.

HELPING HAND: Tamkeen, a semi-autonomous government agency that until recently was known as the Labour Fund, has a mandate to develop the local workforce by investing in training and social services programmes. The organisation works hand-in-hand with the Labour Market Regulatory Authority (LMRA), which has the authority to regulate the labour market. In addition to processing permit applications and undertaking market research, the LMRA collects regular fees from businesses and professional organisations, which are then passed on to Tamkeen, to be spent on training and workforce development programmes.

In general, Tamkeen is working to achieve two specific objectives: turning Bahrainis into the employees of choice; and creating more jobs in private sector industries, with a growing focus on knowledge-based segments. The agency funds Bahraini students who are studying subjects that support national economic development, and oversees a range of vocational training programmes, with an eye on encouraging entrepreneurship and innovative business development.

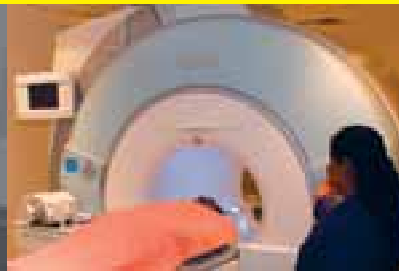
Tamkeen also is developing the Bahrain Qualifications Framework (BQF), a qualifications hierarchy that is meant to standardise expectations about qualification standards for students, educators, employers and employees. The BQF, which is expected to be launched at the end of 2011 as part of the QAAET, is being developed in conjunction with the Scottish Qualifications Authority. If the programme is successful, it could be expanded to other Gulf nations.

REGIONAL LEADER: Bahrain has many comparative advantages that will serve it well as it works to implement a knowledge-based economy in the coming years. Compared to many of its neighbours, a substantial percentage of Bahrainis are well educated and fluent in English. A number of knowledge-intensive segments are already established, including ICT and finance, both of which have a long history in the country.

Similarly, the Kingdom benefits from a wide variety of government- and private sector-sponsored vocational training centres. The country's existing education framework is well funded, carefully regulated and constantly improving, thanks to initiatives put in place over the past few decades. Building critical thinking skills and practice experience within educational system should bode well for graduates and the economy as a whole.

Health

The government is considering compulsory insurance
New public and private care facilities coming on-line
Health and wellness programmes get a dedicated island
Demographic indicators point to sustained potential



A new insurance scheme could provide a boost to the industry

Surging forward

Private providers are helping lead development

Between the public and private health care systems, there are 23 hospitals. The public system is primarily used by nationals while private facilities attract the expatriate population.

The health sector is poised for expansion in the coming years, thanks to government-led reform efforts and a substantial amount of private sector involvement over the past decade. The Kingdom's hospitals and clinics are considered to be among the best in the Gulf region, and with a number of major developments currently in the works, the sector's reputation is only expected to improve in the coming years.

The authorities are continuing their work to improve the sector and health care provision. Rapid population growth has resulted in steadily increasing demand for medical services. Over the past 10 years, Bahrain has seen a major rise in non-communicable, lifestyle-related illnesses, in line with other GCC countries.

The private sector is expected to play a major role in overcoming these issues in the coming years. Currently, private health care centres mostly cater to Bahrain's large expatriate population.

The launch of both a new health insurance scheme and regulatory regime in the near future, however, may potentially result in a substantial amount of new business at private facilities. The rise in demand could, in turn, boost foreign investment in the private health care sector. Increasing private sector participation is expected to play an important role in improving standards throughout the industry.

REGULATIONS: The Ministry of Health (MoH) is currently the primary service provider and the sector regulator. This is expected to change in the near future, however. In an effort to more effectively regulate the rapidly growing industry, the government recently announced the formation of the National Health Regulatory Authority (NHRA), which will be an independent body with a mandate to oversee all aspects of the health sector in the Kingdom.

In January 2011 the government announced that a $7m contract to set up the authority had been awarded to International Development Ireland (IDI), a multinational management and consultancy firm based in Dublin. Bahrain has an existing relationship with the Irish health care sector – the Royal College of Surgeons in Ireland-Medical University of Bahrain (RCSI-MUB), which is widely considered to be the leading medical university in the Kingdom. IDI has been active in Bahrain since 2004. The consultancy began work on the NHRA project in early 2011. Though it will be officially launched in the fourth quarter of 2011, it is already functioning.

THE PUBLIC SYSTEM: Bahraini citizens benefit from free health care at public clinics and hospitals, a system overseen by the MoH. As of the end of 2009, the ministry operated a network of 10 hospitals and 24 primary health centres (PHCs). A total of 1149 physicians were employed in MoH facilities as at the end of the year, in addition to 2804 nurses and 118 dentists. MoH hospitals and clinics served 4.1m outpatients and 54,380 inpatients over the course of the year. At the end of 2009 there were a total of 1360 beds in MoH facilities.

PHCs, which are located throughout the country, offer a variety of basic services, including preventative care, physiotherapy and immunisations. In 2009 some 72% of outpatient visits were recorded at PHCs. The busiest PHCs are in Muharraq, Isa Town, Sitra and Naim.

More complex secondary and tertiary services are administered primarily at the Salmaniya Medical Complex (SMC), which is the largest hospital in the country by a substantial degree, with 1022 beds in 2009. Services at SMC include cardiology, internal medicine, nephrology, oncology, a variety of surgical services, paediatrics, obstetrics and gynaecology, ophthalmology and dentistry, among others. SMC recorded 603,707 outpatient visits and 44,835 inpatient visits in 2009. Some 710 physicians worked at the hospital, in addition to 2308 nurses and 11 dentists.

BOOSTING CAPACITY: The MoH is currently developing a second major hospital – the King Hamad General Hospital (KHGH) – which, when completed, will boost capacity substantially. The 312-bed facility will be located in Muharraq, alongside the RCSI-MUB campus. KHGH, which will be a teaching hospital, is expected to benefit from the proximity of RCSI-MUB academic teaching staff and students. The first phase will open in September 2011 and it will be fully operational by mid-2012.

In addition to SMC, the MoH oversees a psychiatric hospital, a geriatric hospital and a handful of maternity hospitals spread across the country. Additionally, the Kingdom's armed forces operate the Bahraini Defence Force Hospital, which is technically public, though it is primarily intended to serve military personnel. The public system as a whole has 1702 beds.

PRIVATE PLAYERS: Bahrain's private health care system consists of 13 hospitals, with a total of 384 beds. Leading private institutions include the non-profit American Mission Hospital (AMH), the Bahrain Specialist Hospital (BSH) and Ibn Al Nafees Hospital (IAN). AMH, which was founded in 1902 by the Reformed Church in America, is the oldest hospital in the Middle East. Today, it is the largest and a highly respected private institution in the country – in 2009 AMH was responsible for almost 23% of total private sector outpatient visits. Around 40% of the patients at AMH are Bahrainis, while the remaining 60% are expatriates.

AMH has a range of departments, including obstetrics and gynaecology, internal medicine, paediatrics, orthopaedics, physiotherapy, dermatology, ophthalmology and dentistry. AMH currently has around 50 beds, though this number will rise substantially when the hospital completes work on a new BD12m ($32m) facility in the Riffa neighbourhood. The structure is expected to be completed by end-2014 (see analysis).

The 97-bed BSH, which was launched in October 2002, has become one of the top private sector facilities in Bahrain. In addition to the full range of standard departments, BSH is in the initial planning stages of setting up an oncology centre and an interventional cardiology centre. Bahrain is relatively underserved in terms of cancer treatment centres, in particular. Currently around 30-40% of the patients at the hospital are non-Bahrainis – the majority of the expatriate patients are from Qatar and Saudi Arabia. BSH also has a contract with the US Navy to treat personnel from its Fifth Fleet, which is based in Bahrain.

A number of other major private hospitals operate in Bahrain. IAN, for example, which was founded as a small clinic in 2002, has seen substantial growth over the past nine years. In 2009 the facility served 127,388 outpatients and 5064 inpatients, with a staff of 26 physicians and 82 nurses. Around 40% of IAN's patients are expatriates – primarily from Qatar, Saudi Arabia and Kuwait – and the hospital is working to expand its offerings to cater to the steadily expanding health tourism market in the Kingdom. A number of other private hospitals are active in Bahrain, including the International Hospital of Bahrain, Al Hilal Hospital, Al Amal Hospital, Al Kindi Specialised Hospital, the International Medical City Hospital and Awali Hospital.

ACCREDITATION: In an effort to boost their reputations and improve the quality of their offerings, many private hospitals in the Kingdom have sought out accreditation from foreign regulators. "Maintaining quality of care in this industry is extremely important," said Kasim Ardati, the CEO of BSH. "Accreditation plays a big role in attracting patients to a hospital." BSH is in the process of seeking accreditation from the US-based Joint Commission, for example, while AMH holds accreditation from the Australian Council on Healthcare Standards.

A number of private hospitals are accredited by international bodies

In late 2010 a number of the leading private hospitals in Bahrain came together to form the Private Hospitals Association, which is expected to eventually serve as an industry association for the segment. As of early 2011 details about the organisation's mandate and function were still being finalised.

PAYING FOR IT: In 2009 the MoH's total spending reached BD203m ($541.4m), around 2.6% of GDP. This number is expected to jump in the coming years, as the ministry works to provide services for the expanding population. According to government forecasts, MoH spending will reach BD486m ($1.3bn) by 2014, which represents a compound annual growth rate (CAGR) of 18.8% for the 2009-14 period.

In an effort to reduce the MoH's share of rising health care costs, the government is working to roll out a compulsory medical insurance scheme. Private health coverage has been increasing in recent years, especially

The Ministry of Health's spending is equal to 2.6% of GDP, or $541.4m. This figure is expected to see a CAGR of 18.8% for the 2009-14 period.

Private hospital indicators, 2009

	Outpatients	Inpatients	Beds	Physicians	Nurses	Dentists	Other
Int'l Hospital of Bahrain	78,855	3295	61	80	62	7	39
American Mission Hospital	217,899	3035	37	71	121	8	64
Awali Hospital	35,837	865	28	18	62	2	14
Gulf Dental Specialty Hospital	14,343	26	10	NA	18	12	4
Ibn Al Nafees Hospital	127,388	5064	24	26	82	NA	20
Bahrain Specialist Hospital	127,059	5438	69	45	79	4	53
Noor Specialist Hospital	...	1833	24	22	24	NA	3
Dr Tariq Hospital	11,817	167	22	9	26	NA	2
Al Hilal Hospital	119,173	2172	45	33	33	3	11
Al Baraka Fertility Hospital	9360	5580	12	3	7	NA	2
Al Amal Hospital	80,152	395	20	23	25	2	18
Al Kindi Specialised Hospital	28,809	952	17	26	55	6	9
Int'l Medical City Hospital	22,000	92	15	12	22	1	8

SOURCE: Ministry of Health

A new insurance scheme is likely to be rolled out in two phases, first to expatriates and then to nationals

among the Western expatriate population, but a substantial number of Bahrainis and non-Western expatriates still rely heavily on MoH services.

The details of the new insurance scheme have not yet been finalised, though it is expected to be rolled out in two phases. Phase I will require all expatriates – who comprise nearly half of the Kingdom's population – to obtain insurance, either through their employers or independently. Phase II will extend the requirement to Bahraini citizens, who will likely be given access to a government-operated insurance scheme. Citizens who cannot afford insurance are expected to be offered subsidised coverage by the state.

Depending on the details, the new scheme has the potential to drastically alter health care in the Kingdom. Bahrainis with insurance will be much more likely to seek care at private facilities, for example, which used to be too expensive for many of the uninsured middle- and lower-income population. Consequently, the private sector, which is smaller than the MoH's public health network in terms of patients, beds and facilities, is expected to see increased demand as a result of the plan, encouraging news for its long-term growth.

Over the past decade insurance coverage has increased substantially, primarily as a result of growing awareness among the population. When BSH was launched eight years ago, only 5-10% of the hospital's business came from insurance companies. As of early 2011, that figure had jumped to approximately 50%.

As insurance has become increasingly common, private hospitals have made an effort to develop close links with local insurers. "The relationship between insurers and private hospitals in Bahrain is good," said George Cheriyan, the CEO and chief medical officer at the AMH. "We have 92% collection rates from insurers. The main issue is maintaining high-quality services while keeping insurers happy at the same time." Achieving this balance could be a challenge for some local institutions.

The country imports the vast majority of its pharmaceuticals and the industry was valued at $114.7m in 2010. This is expected to rise to $144m by 2014 as the population continues to grow.

TRENDS AND DEVELOPMENTS: The unrest in February and March 2010 did have an impact on the health care sector, but as its residual effects subside the focus has turned to long-term issues. Health care providers face a number of challenges in the coming years. According to a recent MoH study, some 60% of the population age 20 and older is obese, one of the highest rates in the world. "The population is growing and the health of the population is changing," said Najeb Y Alhamer, the chief executive of Al Hamer Trading, a local firm that deals primarily in pharmaceuticals. "Heart disease, obesity and diabetes are lifestyle issues that are becoming more prevalent as the culture changes."

With communicable diseases under control, the government is focusing on non-communicable issues, including heart disease, obesity and diabetes. The MoH already operates several diabetes centres throughout the country and it plans to open new facilities aimed at a variety of non-communicable diseases in the coming years as well. For example, the ministry has outlined plans to build a specialised cancer treatment facility.

OPPORTUNITIES: The Kingdom's relatively small pharmaceuticals market is expected to grow substantially in the coming years, due primarily to increased demand for drugs on account of the rapidly expanding population. In 2009 the pharmaceuticals segment was valued at just BD43m ($114.7m), but this will likely rise to BD54m ($144m) by 2014, according to government forecasts. Local pharmaceuticals traders – all drugs are currently imported – face steadily rising prices. Pharmaceuticals imports are expected to increase from BD77.4m ($206.5) in 2009 to BD111.5m ($308.1m) by 2014, which represents a CAGR of 7.6%. "There are huge mark-ups on medicines in Bahrain," said Ebtisam Al Dallal, the CEO of Al Kindi Specialised Hospital. "Saudi Arabia pays less for medications because they have a huge population and buy products in bulk. Bahrain has a small population and buys smaller amounts of medicines, which has an effect on pricing."

Bahrain, like most countries around the world, has suffered from a shortage of nurses and other medical personnel in recent years. A number of local universities have medical training programmes of various sorts, including RCSI-MUB, Arabian Gulf University and the state-run College of Health Sciences. According to most local players, however, more health education is needed. "There are currently not enough opportunities in Bahrain for medical and nursing school," said BSH CEO Ardati. "The number of slots for students is minuscule compared to the number required to meet the demands of the sector. The College of Health Sciences and the RCSI-MUB only have 200 spaces for nurses annually, and last year they had over 600 applicants."

OUTLOOK: The health care sector is well situated for continuous growth in the coming years. The private sector, which is expected to grow exponentially as a result of the new insurance scheme and, more generally, the rising population, has the potential to serve as a major foreign investment draw. The eventual implementation of the NHRA will have a positive effect in terms of attracting investors. As the sector expands, the standards at clinics and hospitals in both the public and private sectors are expected to continue to improve.

Mohammed Khalil Alsayed, CEO, Ithmaar Development Company

Drawing a crowd

OBG talks to Mohammed Khalil Alsayed, CEO, Ithmaar Development Company

What can the government do to make Bahrain a more competitive destination for medical tourism?

ALSAYED: While consolidating its commendable achievements in providing universal public access to health care, the government could consider some more additional measures in this sector. Several steps are already being taken to develop a framework for the health care infrastructure in Bahrain. The authorities are working to redirect the focus of the Ministry of Health by dividing its provision and regulatory responsibilities between two separate entities.

To reach critical mass in medical tourism, sectors related to the industry should be given more attention. Medical tourism, for example, goes hand-in-hand with the core tourism sector. This includes developing places of interest and maintaining several leisure and recreation options. Additionally, the Economic Development Board should include health care in the agenda of its roadshows and promote it as a priority investment target. Adding the health care sector to its bouquet of priority sectors would provide it with greater traction.

Furthermore, active consideration should be given to making private sector health care projects eligible for regional soft loans. One point that would be of potential interest to regional Arab funding agencies is incentivising the health care/medical tourism sector for a defined period, perhaps eight to 10 years. The mechanism for providing incentives for investors can take many forms including preferential financing terms or soft lending programmes based on pre-determined criteria. This would also generate employment.

What sets Bahrain apart from other medical tourism destinations such as Thailand or Jordan?

ALSAYED: Bahrain has the geographical advantage of straddling the western and eastern hemispheres. This central location and excellent air travel connectivity make the country an ideal emerging destination. Although Thailand and Jordan are considered good, Bahrain's liberal lifestyle, cosmopolitan culture and excellent urban infrastructure distinguish it from other medical tourism locations. The mix of working professionals, ease of visa procedures for foreigners, and waterfront communities are also positive factors.

How can developments in medicine and health tourism affect other sectors of the economy?

ALSAYED: There are many ways in which Bahrain's economy can benefit from significant advancements in medical tourism. The most important variable in the medium term is the development of human capital. An influx of investment, new ideas and resources will further expose Bahraini medical professionals to cutting edge technology and new modes of thinking, creating the opportunity to learn about developments in various fields which may have otherwise taken longer to take root. In addition, a number of economic sectors would be favourably affected: airports would see greater capacity utilisation, and demand for hospitality and retail would increase as short- and long-stay patients and their families remain in the country.

What is your assessment of the planning and availability of medical professionals at different levels?

ALSAYED: Bahrain has invested heavily in health care infrastructure in the past several years. One of the major projects in the pipeline is the King Hamad University Hospital, while Ithmaar Development Company's flagship project, Dilmunia at Bahrain, is on course for its next phase, and the Dilmunia Health District will host a complex of medical facilities. Training Bahrainis to be doctors on par with international standards is a critical element of this programme. Reliance on foreign expertise will continue for some disciplines into the foreseeable future, but the Medical University of Bahrain and medical colleges will contribute growing numbers of professionals to the segment. However, there remains a need for a dedicated nursing school to teach high-demand nursing skills at a lower cost. This training would also lead to more employment opportunities.

The Ministry of Health has plans for 23 new primary care centres

Bricks and mortar

A number of health facilities are currently in the works

With the global health tourism industry expected to bring in $100bn by 2012, Bahrain is manoeuvring to attract a share of the market with the development of a "health care island".

The rapidly rising population and steadily increasing instances of non-communicable diseases foreshadow a rising demand for long-term health care in the country for some time to come. As the government and private sector organisations work to prepare to meet this demand, Bahrain's health care infrastructure is expected to change dramatically. A handful of major upcoming health-related projects and a substantial number of smaller developments will have a major impact on the sector in the coming decade.

PRIVATE SECTOR DEVELOPMENT: Perhaps the largest health care project currently under way in the Kingdom is the Dilmunia at Bahrain development, known colloquially as health care island. The $1.6bn project is being developed by Ithmaar Development Company (IDC), a subsidiary of Ithmaar Bank, a local financial firm. Located on a 125-ha, purpose-built reclaimed island off the north-west coast of the Kingdom, the project will feature a wide variety of health and wellness facilities as part of a mixed-use development. Dilmunia is one way in which Bahrain's is looking to capture a part of the global health tourism market, which is forecast to be worth more than $100bn by 2012, according to a recent report from Deloitte. The plans include housing for 12,000 to 15,000 short- and long-term residents, in addition to hotels, restaurants, shopping malls and other retail outlets. In addition to a general hospital, medical facilities on the island will include a wellness centre, a nutrition centre, a diabetes centre, an aesthetics centre (offering physical enhancement surgeries), a sports medicine centre and a separate hospital for women and children. In mid-June 2011 the IDC announced it had completed the first phase of the Dilmunia project, including reclamation work, master-planning and infrastructure design. The firm is expected to tender a contract for infrastructure construction before 2012.

A number of other private sector projects are under way in the Kingdom as well. The non-profit American Mission Hospital (AMH), the largest private medical institution in the country in terms of outpatient visits, is developing a new building in the Riffa area. The BD12m ($32m) project was announced in late 2010, and is expected to be completed near the end of 2014. It will include a new 100-bed hospital, which will supplement AMH's existing facilities in Manama, boosting the institution's capacity substantially.

On January 15, 2011 Royal Bahrain Hospital (RBH) opened its doors to patients for the first time. The BD6m ($16m) facility was developed by the Kerala Institute of Medical Sciences (KIMS), a leading Indian health care provider that operates hospitals in Oman, Qatar and Saudi Arabia. RBH is the second facility overseen by KIMS in the Kingdom – the firm has operated KIMS Bahrain Medical Centre since July 2004. The new hospital features 65 beds and boasts a wide variety of specialty departments, including cardiology, dermatology, cosmetic and plastic surgery, endocrinology, gastroenterology, neonatology, ophthalmology and urology.

PUBLIC SECTOR PROJECTS: The government plans to build several new facilities in the coming years. In mid-2010 the Ministry of Health announced 25 new projects, including a hospital in the Central Governorate, a cancer centre and 23 additional primary health centres. Some of the centres will be located in the neighbourhoods of Isa Town, Hidd, Barbar and Halat Abu Maher, according to the ministry. Additionally, the ministry is in the planning stages for a centre for genetic diseases at the Salmaniya Medical Complex, among several other projects that will aid the sector's growth.

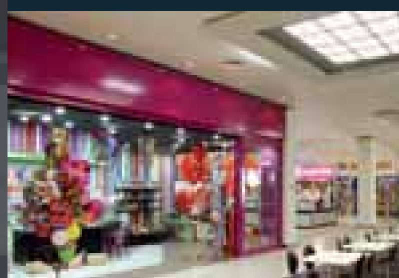
Hospitals & beds, 2009

Hospitals (gov't)	10
Hospitals (private)	13
Hospitals (total)	23
Beds (gov't)	1702
Beds (private)	384
Beds (total)	2086
Primary care units & centres	24

SOURCE: Ministry of Health

Retail

Shopping centres offer family-centred entertainment
Foreign firms bring added competition to the market
Increased food security will reduce reliance on imports
Rapid expansion in the automobile industry



The sector has recently welcomed several new foreign firms

Diverse and competitive

A shifting market and the entry of new players call for new strategies

Between 2007 and 2010, tourist arrivals rose by an average of 16% per year, with many of these visitors hitting local stores while in town. Tourists from the GCC are a particular focus.

Having weathered the economic crisis of 2008-09, Bahrain's retail industry has proven to be both resilient and dynamic. Heading into 2011 projections indicated that the sector would expand significantly in the near future. The industry maintains a dominant presence in the Kingdom and the market is diverse and competitive. Consumers can shop at a wide variety of retail outlets, from traditional souqs to large hypermarkets.

MARKET SHIFTS: Yet as economies throughout the world continue to adjust to the aftershock of the global financial downturn, Bahrain's retail market has been going through changes of its own. Not surprisingly, this has required some adaptation on the part of retailers. Perhaps most notably, 2009 marked a challenging period as several zealous retail developments – including a number of large shopping malls – jumped into the market just as demand began to decrease due to the economic crisis. Some observers concluded that the sector had become oversaturated as a result. However, numerous retailers have successfully repositioned themselves and increased market share.

The government has attempted to further improve retail conditions by subsidising necessities such as fuel, basic food products, water and electricity. By keeping inflation in check, government subsidies help channel more money into the economy for discretionary spending. "The average wage is relatively low compared to some other Gulf states, so the average worker's disposable income is limited," Robert Addison, general manager of Seef Properties, told OBG. "As a consequence, a slight rise in the rate of inflation can have a grave effect on the amount of money people have to spend, which ultimately weakens retail spending. However, the government has been fiscally prudent and also maintained subsidies on a range of goods."

A number of different factors are expected to influence future retail growth. Expansion in the tourism industry, for example, would drive up retail sales, and market conditions suggest that greater numbers of tourists will visit Bahrain in the coming years. Between 2007 and 2010, tourist arrivals rose by an average 16% per year, according to the Ministry of Culture and Information. Before the political unrest broke out in January 2011, tourism arrivals had been expected to rise an average of 2.5% per year through 2020, though a revised prediction has not yet been released.

Many of the Kingdom's retail outlets cater to tourists from the GCC region by providing them with a family-centred and relaxed setting in which to shop. Visitors from Saudi Arabia are particularly prevalent due to the 26-km King Fahd Causeway, which connects Bahrain and the Eastern Province of Saudi Arabia. During the recent political unrest, the number of Saudi visitors declined, having an impact on the local retail sector. However, since May, mall traffic has picked up, suggesting that the long-term effect many be minimal.

AUTOMOTIVES: One segment that appears to be doing particularly well is automotive retail. Though growth declined significantly in 2009, auto retail sales are expected to grow by as much as 13% by 2015, according to market research. Much of the market's positive trajectory has been propped up by steady economic growth, although companies like Nissan and Ford are supporting expansion as they award retailers with bonuses for auto sales (see analysis). "With the financial crisis behind us, consumers are spending more and auto sales are continuing to climb," said Mona Almoayyed, managing director at Y.K. Almoayyed & Sons, a diversified conglomerate operating in several retail segments, including the auto industry.

Bahrain's reputation as an investment destination for retailers is also growing. One notable newcomer is Indian jewellery chain Malabar Gold, which opened an outlet in the Kingdom in October 2010. The company has plans to open three more stores in the near future, eventually investing a total of $25m in Bahrain. Superdry, a UK fashion retailer, also plans to open a number of outlets in Bahrain. As of October 2010, UAE-based Danube Building Materials now has two stores in the Kingdom with the second outlet covering 6000 sq feet.

BY THE NUMBERS: The industry appears to have a promising future. According to Business Monitor International, retail spending could rise from BD820m ($2.19bn) in 2011 to BD1.09bn ($2.9bn) by 2015. Nominal GDP is expected to reach $33bn in 2011, with growth forecast at 1.9% for the year and rising to an average 5.4% annually between 2011 and 2015.

Although consumption as a percentage of GDP rose from 43.7% in 2008 to a provisional 50.3% in 2009, Bahrain's gross national disposable income (GNDI) has tapered off slightly, according to Central Bank of Bahrain (CBB) figures from June 2010. Listed as BD6.28bn ($16.75bn) in 2007, the nation's GNDI jumped to BD7.31bn ($19.5bn) in 2008, but slid to a tentative BD5.95bn ($15.87bn) in 2009, most likely a result of the financial crisis. Bahrain's average consumer price index (CPI) has climbed over the past several years. Increasing by 3.3% annually in 2007, the CPI rose again by 3.5% annually in 2008 and by 2.8% per annum in 2009, according to CBB figures.

Demographic figures also play a substantial role in driving retail sales. According to the 2010 National Census conducted by the Central Informatics Organisation (CIO), the population of Bahrain is 1.23m. The UN classified 71.2% of Bahrain's population in 2005 as economically active, putting 40.7% in the 20-44 age range, the group which has the most significant impact on retail spending. The economically active population is expected to rise slightly in 2010 to 72.7%. However, the 20-44 age range segment is predicted to drop to 39.9%. Bahrain also has a very urban population with more than 90% living in cities, according to 2005 UN calculations. This figure climbed to an estimated 91% in 2010, according to Business Monitor International.

MALLS: Providing customers with more than just places to shop and eat, Bahrain's malls have become the country's new social gathering centres. Shopping developments provide a relaxed, air-conditioned environment to escape the summer heat and enjoy time with friends and family. Yet malls have faced some recent challenges for a number of reasons. The global economic crisis negatively impacted the industry by slowing population growth and reducing the amount of disposable income. Although the economic downturn also forced a few new projects in the industry to fold, the market has nevertheless become more competitive, reducing margins for some retailers.

New malls have significantly increased competition. The Bahrain City Centre (BCC) mall, which opened in 2008, is one of the newest arrivals and has shaken up the sector, causing other malls to lose significant amounts of foot traffic and staff. The 140,000-sq-metre development provides shoppers with more than 300 stores, a 15,000-sq-metre indoor water park, a cinema with 20 screens, over 50 food court outlets and an entertainment centre for families.

Elsewhere, Lagoon Bahrain, located on the Amwaj Islands, is building the first outdoor mall. The first three of its retailers opened in August 2010. The entire project carries a $90m price tag. Soon to expand the market further, plans were recently announced for an additional mall project, which will be developed by a consortium led by Bahraini Al Salam bank, according to local press reports. Measuring 100,000 sq metres, the new mall will cost $100m and include a 30,000-sq-metre IKEA outlet. Developers predict that the furniture store alone will supply 450 jobs once the new shopping centre opens for business in 2014.

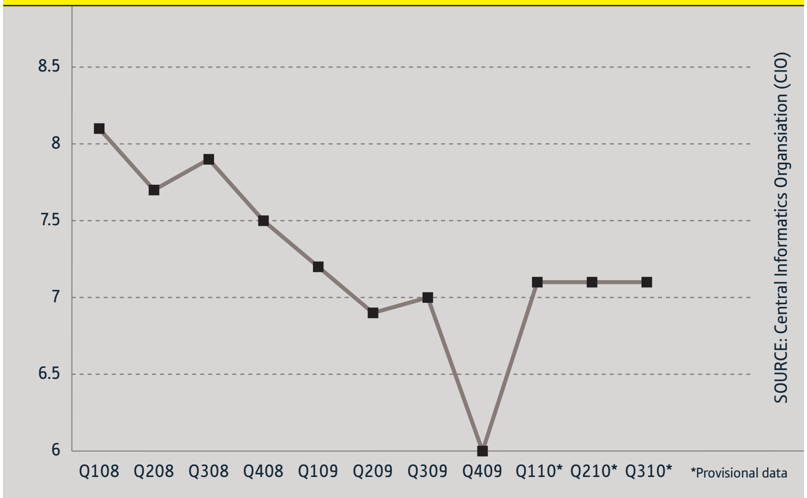
Retail spending is forecast to reach BD1.09bn by 2015

New shopping centres provide plenty of entertainment options, including cinemas, video arcades and even amusement parks.

NEW STRATEGIES: Located in Sanabis, Bahrain Mall has felt the rising competition and reported a 10% loss of foot traffic as well as a substantial decrease in its staff with the opening of BCC. The mall also lost 14 tenants in the latter half of 2010, though has since been able to fill 11 of the empty shops.

Similarly, Seef Mall, another incumbent in the industry, is also efficiently managing the heightened competition. It recently renegotiated many leases, creating win-win situations, including lowering rent for retail spaces, for both the mall and the tenants. Although the mall lost some retailers despite its flexibility on leases, only one store remained vacant in the facility as of early 2011. Seef Mall has also been able to expand retail space with an $8m refurbishment project. In addition,

Retail & wholesale trade, 2008-10 (% of GDP, real terms)



Food and beverage sales make up nearly 40% of total retail spending

The economic crisis, combined with increased competition, has led some malls to rewrite their leasing agreements and maintain longer opening hours in order to attract more retailers and customers.

the mall is effectively adjusting to consumer preferences. As many Bahrainis do their shopping in the evening, sometimes going out as late as 9pm, Seef Mall has changed its closing hours to 11pm on weekdays and to midnight on the weekends.

HYPERMARKETS: Reflecting the French retail model, many hypermarkets in the Kingdom are part of a mall. Although the combination of hypermarkets with malls has worked well in the past, hypermarkets have begun to pull customers away from other shops, forcing some retailers to go out of business.

Furthermore, the number of hypermarkets is increasing rapidly. The Lulu Hypermarket group, for example, has recently expanded with its third outlet in the Kingdom. Built at the Ramli Mall in A'ali, Lulu's newest outlet covers an area of 200,000 sq feet. The company has also announced plans to construct a fourth store in Bahrain with a 600,000-sq-foot facility in Hidd.

Although current conditions for expansion appear to be quite positive, the quick growth has nevertheless caused problems for a number of the nation's malls by significantly increasing competition. Effective e-commerce retailers offering low prices such as Amazon and ASOS have presented additional competition.

FOOD AND DRINK: Food sales in Bahrain are estimated to make up 39.6% of total retail spending, at a value of $740m in 2010. This figure is expected to fall slightly by 2014 to a level of 30.9% of the total, however, due to an increase in spending on non-food retail products. Food consumption as a percentage of GDP displays a similar trend. At 2.66% of GDP in 2009, this is expected to slowly decline to 1.42% by 2014. However, total per capita food consumption in Bahrain is predicted to rise from an estimated BD238.9 ($637.13) in 2010 to BD243 ($648) by 2015.

"Although there was relatively little change in the food industry between 2009 and 2010, I am much more optimistic about 2011," said V Sundar Rajan, the group general manager of TRAFCO, a Bahrain-based holding company which imports and distributes food and non-food products. The overall impact of the financial crisis on the food and drink industry was relatively mild as economic anxiety shifted consumer priorities, to some extent, from brand loyalty to lower prices. TRAFCO's sales value, for example, only fell 7-10%. Despite the marginal effects, the company is looking to diversify its interests into packaging and distribution.

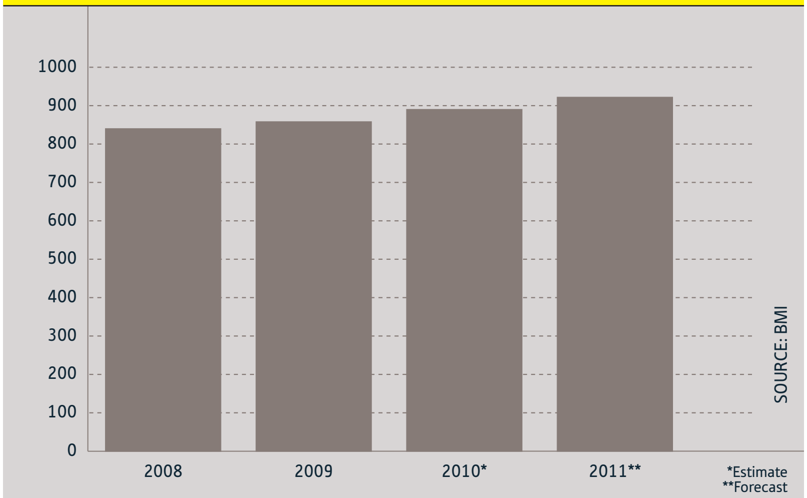
FOCUS ON FOOD SECURITY: The market is also changing in a number of areas. The sale of food products in hypermarkets and convenience stores is on the rise and the fruit and vegetable industry is becoming more competitive due to greater levels of supply.

Food security issues are having additional effects on the market. With an unfavourable climate for agriculture, Bahrain's local production capabilities are limited locally, leading to dependence on food and beverage imports. Government authorities and private investors are collaborating to mitigate the problem. Plans were announced in July 2010 for the development of a privately owned local poultry firm. Authorities anticipate the facility will produce as many as 10m chickens per year and carry a BD10m ($26.7m) price tag. Plans to increase food security by giving aid to small farmers and by building silos and storage facilities have also been discussed. The private sector is considering making investments in sugar processing, vegetable production in green houses and date processing.

OUTLOOK: As the economic downturn has faded and spending picks up, retail companies are successfully adjusting to a more competitive market. Foreign investors have recognised the Kingdom's favourable retail environment and are financing new stores.

Increased levels of tourism have driven further retail sales, though it remains to be seen how the tourism industry will fare following the political unrest of early 2011. The automotive industry in particular is seeing notable growth, and many shopping malls have been able to effectively manoeuvre increased competition. The food and beverage industry is also adapting to a changing market as consumers opt for lower prices over brand loyalty. The retail sector, having proven its ability to withstand difficult conditions, is well placed to experience greater levels of growth and expansion.

Automotive retail revenue, 2005-10 ($ m)



Robert Addison, General Manager, Seef Properties

Renewed normalcy

OBG talks to Robert Addison, General Manager, Seef Properties

How will the unrest that occurred at the beginning of 2011 affect the retail sector in the long term?

ADDISON: In the long term – and by that I mean at least five years – there will not be much impact on the retail market, because retail is quite resilient. Regardless of conditions, people have to eat and buy clothes. While in the short term they may cut back spending on luxury items, their spending will pick up again. Stability is key to consumer confidence. We are already witnessing consumer traffic rising to "pre-unrest" levels, as shopping malls play a vital role in the social fabric of the Kingdom. I am confident in the immediate and long-term futures of the industry. There has been a surge in interest from new tenants and new brands who want to enter Bahrain, so retailers are confident. We expect consumers to be so during the second half of 2011.

How do you see consumer spending developing?

ADDISON: The majority of people will be cautious about buying large ticket items. Rather, they will keep to necessities. There is a section of society that will buy luxury items regardless of the market sentiment, but outside of that segment, I believe consumer spending across the board will pick up from September 2011. Retailers have responded well to the slump in spending, with many offering significant discounts and sale prices. It is an obvious concern for a retailer, but I believe consumer spending will increase with parity pricing around the Gulf. In the age of internet shopping and regional brands, it is difficult to justify a price differential for the same goods in different GCC countries. However, given that Bahrain has the lowest cost base in the GCC, there is an argument that prices should be cheaper here.

How important is the Saudi market to the sector?

ADDISON: It was immediately apparent in the wake of the unrest just how dependent our retail sector is on tourists from Saudi Arabia and elsewhere in the GCC. The Saudis are regular visitors, rather than one-off tourists, which is important. With 7m plus visitors annually, the impact was evident. For our population, only about 100,000 sq metres of retail space is required, but Bahrain has far more than that because of the many tourists who access the market via the causeway.

How does the retail industry in Bahrain compare to those of neighbouring GCC countries?

ADDISON: Bahrain's retail market compares favourably to those of its neighbours. While many of the brands are available throughout the Gulf, it is the Kingdom's shopping environment that is a major attraction. Bahrain's malls have large leisure elements incorporated in them so that they are much more than a standard shopping trip. The cosmopolitan culture of Bahrain creates a friendly and relaxed shopping experience, and the compactness of the island means that travel distances are small – moving from one mall to another is easy. Customers do not just go to the malls to shop, as films, dining, socialising and escaping the heat are all common reasons for visiting malls.

Can the country's consumer base continue to support the amount of retail space in the Kingdom?

ADDISON: It can – but in a different way. It really has little to do with the unrest. There was a massive increase in the supply of retail floor space between 2000 and 2010, from 200,000 sq metres to 536,000 sq metres, on the back of a boom market. During this time, many retailers over expanded. Now, the financial crisis has forced many retailers to rethink their strategy of having a unit in every mall. They are now in the process of rationalisation and polarisation – that is, retailers are making the decision to close underperforming stores in weak malls, or to move their brand to major locations. In the medium term, other malls with less floor space than Seef mall or Bahrain City Centre will be developed to serve local communities. That way, consumers will have a wider choice of destinations for their daily shopping fix, with more leisurely, family shopping carried out at the major malls on the weekend.

The industry is expected to continue growing in the coming years

Revving up

Improving economic conditions lead to industry expansion

A high level of market saturation suggests that the future success of the industry will be tied to economic growth across the board.

Bahrain's automotive retail industry is now steadily expanding, with forecasts predicting a positive trajectory over the next several years, even in spite of posting poor sales figures in the recent past. A number of factors are driving this growth, with improving economic conditions being particularly significant. Due to high levels of market saturation, future auto growth is somewhat reliant on consumers growing wealthier from the economic uptick and buying new vehicles more often as a consequence.

After a 20% decrease in growth in 2009, the industry was expected to expand by 5% in 2010, according to figures reported in the local press in October 2010. Additionally Q1 2011 forecast on the auto industry by Business Monitor International predicted that sales of new autos will increase by around 15% in the 2010-2015 period, from $890m in 2010.

LUXURY CARS: One area performing particularly well is the luxury auto category. BMW, for example, recorded a 4% spike in Bahraini sales during first-half 2010. Representing the highest level of luxury cars, Rolls-Royce reported a 138% year-on-year surge in sales during the first 10 months of 2010. This pronounced increase in high-end auto purchases points to positive projections for the car retail industry as a whole. Similar to other states in the Gulf, luxury car sales in Bahrain represent an unusually large portion of the market and the recent expansion is indicative of returning consumer confidence.

Besides fading financial troubles, collaborative mother companies such as Ford and Nissan have helped spur sales by handing out bonuses once sales targets are met. These financial incentives make it possible for retailers to sell cars at a cost that Bahraini consumers are willing to pay while still making a profit and clearing inventory.

WHOLESALE: Selling to wholesalers has also presented new opportunities for growth. Y.K. Almoayyed & Sons, a diversified conglomerate operating in several of Bahrain's retail segments including the auto industry, currently sells many of their vehicles to wholesalers, offering monthly financing options.

"Although selling to wholesalers helps to move the stock, it's not an ideal source of sales revenue for us," Mona Almoayyed, managing director at Y.K. Almoayyed & Sons, told OBG. "We buy our cars in cash, but wholesale buyers pay us by the month, slowing our cash flow as a consequence," she said.

CHALLENGES: As auto retail continues to grow, the industry does face some challenges. Perhaps most notably, the Kingdom's road infrastructure has not kept up with the increasing number of cars in the country. Given the high levels of road congestion, some analysts predict the government may try to alleviate the problem by collecting a road tax or by focusing on the development of public transport – both factors that would likely impact sales.

Yet as of 2010, the government had set aside a road improvement budget of $403.5m. Authorities intend to use this money for reducing congestion on the King Fahd Causeway, which links Bahrain and Saudi Arabia. The construction will increase the Causeway's capacity by 167%, according to plans announced in August 2010. Plans have also been made to construct a road and rail causeway linking Bahrain with Qatar, which is scheduled to be opened in 2015. Assuming infrastructure investments are focused on road improvements rather than on public transport, the auto sales industry could benefit from increased rates of motor vehicle ownership.

Despite uncertainty over road congestion problems and potential public transport development, auto retail in Bahrain is growing steadily. With the support of a strong economy, current projections for industry performance are quite positive. "While it is true that the auto sales market is almost saturated and the opportunities for future growth are relatively modest, the industry itself is still growing and turning a profit nonetheless," Almoayyed said. "2011 is going to be a good year for the motor industry."

The government has set aside $403.5m for road improvement projects and intends to reduce traffic problems on the King Fahd Causeway.

Tax

Many double taxation treaties came into effect in 2010
Low tax regime likely to stay to encourage investment
International investment park differs from free zones
What it takes to attract and keep human capital

Social insurance contributions are payable at a rate of 15%

In brief

General overview of major taxation rules

In Bahrain there is no personal income tax; no tax on capital gains; no withholding tax; no restriction on repatriation of capital, profits or dividends; and very few indirect taxes. There is also no value-added tax, property tax or production tax. The only corporate income tax is a tax of 46% on the profits of companies in the oil sector, and a sales tax on gasoline is levied at 12%. Guests using hotel facilities are normally charged a government levy of 5%, and a 15% service charge is generally added to the total bill.

LABOUR TAXES: Social insurance contributions are payable for Bahraini employees at a rate of 15% of basic wages – the employer's contribution is 9% and the employee's is 6%. The employer pays an additional 3% of basic wages for Bahraini and expatriate employees to provide cover against injuries sustained during employment. Unemployment insurance at a rate of 1% is payable by all employees, capped at BD40 ($106.68) per month.

Each entity that is registered with the Labour Market Regulatory Authority is required to pay BD10 ($26.67) per month for every expatriate employee employed in Bahrain. Organisations with 50 or more employees are liable to pay a training levy at a rate of 4%. The base for the calculation of the training levy is the gross salary of expatriate employees who are registered with the General Organisation for Social Insurance but is limited to BD4000 ($10,668) per month per employee. This training levy applies only to salaries paid to expatriates.

CUSTOMS: Duty-free import of machinery and raw materials to be used in new industries for processing in Bahrain is offered. This includes machinery associated with direct operations, spare parts, packaging material and raw materials.

Currently, three free trade zones exist in Bahrain. Manufacturers in the free zones are exempt from Customs duties on the import of raw materials and capital equipment. There are no Customs tariffs on financial transactions or trade of locally manufactured goods between GCC member states under the following conditions: the producer of the goods must be at least 51% locally owned; and the value added in Bahrain must exceed 40%.

Bahrain has been a member of the World Trade Organisation since December 1993. Bahrain applies its Customs tariff according to the codes issued by the World Customs Organisation. This includes no duty on vegetables, fruits, fresh and frozen fish, meat, books, magazines and catalogues; a 5% duty on all other imported items such as clothes, cars, electronics and perfumes; a 100% duty on tobacco and tobacco related products; and a 125% duty on alcoholic beverages.

TAXATION TREATIES AND INCENTIVES: Bahrain has entered into double taxation treaties with several countries, most of which are now in force or pending (see analysis). Most of these treaties incorporate the latest Organisation for Economic Cooperation and Development provisions, a 0% rate of withholding tax on dividends (except for real estate investment trusts) and on royalties, and a 0% rate of withholding tax on interest (with a provision to ensure benefits of the interest article can only flow to residents of the other state).

A further incentive is the Bahrain International Investment Park (BIIP) which has been developed by the Ministry of Industry and Commerce. The BIIP offers unique incentives including 0% corporate tax with a 10-year guarantee, duty-free access to GCC markets and 100% repatriation of capital. Similar to free zones, Bahrain enjoys duty-free imports of raw materials and equipment for manufacturing. Products manufactured in a free zone are subject to a Customs duty of 5% when sold in the GCC and other Arab markets. However, as the BIIP is not a free zone but rather an integral part of the GCC, products manufactured in Bahrain and sold in the GCC and other Arab markets are free of import duties, providing a 5% margin against free zone locations.


Low income and corporate taxes attract valuable human resources

Attracting the best

Encouraging financial and human capital

Two of the strongest drivers for healthy and vibrant financial activity in a country are whether good quality people and good quality businesses wish to be located there. A large influence on this is tax, both personal and corporate. Bahrain scores very strongly on both these counts. Indeed, the 2010 Financial Development Report published by the World Economic Forum concluded that Bahrain has the fourth most favourable tax regime in the world, out of the 55 leading economies surveyed.

Looking at this from an individual's perspective, the absence of personal tax is a compelling incentive indeed. It encourages the best Bahraini talent to remain in the Kingdom and attracts expatriates, who are tired of the punitive levels of direct tax which they have to pay in their homelands, to come to Bahrain and hopefully pass on the benefit of their skills and experience to the Bahraini economy.

MAJOR INCENTIVES: When venture capitalists are asked about the most important things they look for in a potential investment, good management usually comes in at the top – it's all about the quality of the people. And a country will not attract high-quality people if those people are going to be subject to high taxes on their income and their capital gains.

There are equally strong incentives for corporate entities to be based in Bahrain. In the substantial majority of cases a corporation is going to pay no taxes on its profits at all. Clearly this is a major incentive for basing a company in Bahrain. Firms based here can use their well-earned profits to distribute dividends, strengthen their balance sheet and reinvest in the future of the business.

Bahrain offers a number of other attractive incentives for investors. and businesses. These include the duty-free import of machinery and raw materials, as well as low Customs tariffs and duties.

Additionally, there are initiatives such as the Bahrain International Investment Park (BIIP). The BIIP is a high-quality development which is located within minutes of the Bahrain International Airport and near the Saudi Causeway (and eventually the Qatar-Bahrain Friendship Bridge). What makes it even more attractive is the guarantee of no corporate tax for a 10-year period and duty-free access to the rest of the GCC. It also offers extremely affordable rents for office space and is a genuinely attractive and cost-effective environment for businesses looking to increase their export markets.

Add to these developments the increasing number of tax treaties into which Bahrain is entering with other countries and it is fair to conclude that the Kingdom has created an extremely fiscal-friendly environment for businesses.

ECONOMIC VISION: Of course, tax policy is only one of the country's attractive features. The future of Bahrain as an economic player is a complex matter involving a large number of variable financial and non-financial elements. The Economic Vision 2030 for Bahrain outlines the future path for the development of the Bahraini economy and sets out the aspirations for the economy, government and society in accordance with the guiding principles of sustainability, competitiveness and fairness.

The government is aware of the fact that leading international companies regard Bahrain as an ideal launching platform for accessing the trillion-dollar market of the Gulf due to the advantages of the current tax structure, the low operating costs and the transparent, stable banking system.

The government set up Tamkeen, an independent authority to support Bahraini employability, to support Bahrainis to become the employees of choice, and to support high-quality private sector job creation, but it is acknowledged that it will take a number of years before these objectives are fulfilled.

In the interim, therefore, the government should encourage individuals and firms to come to Bahrain, and there is no doubt that the paucity or lack of taxes will play a major part in making this happen.


Companies in Bahrain benefit from duty-free imports of raw materials

Country by country

Rules for free zones and double taxation treaties

Bahrain has the lowest corporate and personal taxes of all GCC countries. There is no personal income tax; no tax on capital gains; no withholding tax; no restriction on repatriation of capital, profits or dividends; and very few indirect taxes.

CORPORATE INCOME TAX: Corporate income tax on the profits of companies engaged in the exploration, production or refining of oil in Bahrain is levied at 46%. For these companies, tax is levied on net profits generated in Bahrain, which is calculated by subtracting business expenses from business income. Companies must file an estimated tax declaration by the 15th day of the third month of the calendar year. Tax is then paid in 12 monthly instalments. Trading losses can be carried forward indefinitely but cannot be carried back. Apart from this, there are no corporate taxes in Bahrain.

PERSONAL INCOME TAX: There are no personal income taxes in Bahrain, but workers must contribute to social insurance and unemployment funds.

MUNICIPAL TAX: A municipal tax is payable by individuals or companies renting property in Bahrain. The rate depends on whether the property is unfurnished or furnished residential property, or commercial property. There is a 1% land registration tax payable to the government on the transfer of real property.

END-OF-SERVICE BENEFIT: An end-of-service benefit is payable to expatriate employees at the completion of their employment contract in Bahrain, provided they have completed at least three years of continuous service with the same employer. It is calculated as follows:

- 15 days' salary for every year of service for the first three years of continuous service; and
- One month's salary for every year thereafter.

DUTY INCENTIVES: Duty-free import of machinery and raw materials to be used in new industries or for processing in Bahrain is offered. This includes machinery associated with direct operations, spare parts, packaging material, and raw materials. Bahrain Development Bank supports foreign investment and may offer attractive credit facilities to new investors (depending on the type of investment).

FREE ZONES: Currently, three free trade zones exist in Bahrain. Mina Salman, Bahrain's major port, provides a free transit zone to facilitate the duty-free import of equipment and machinery. Another free zone is located in the North Sitra Industrial Estate. The same facilities in the two free zones are used for the temporary import of goods for re-export. Hidd is the third industrial zone, where foreign investors may set up their operations.

Manufacturers in free zones are exempt from Customs duties on the import of raw materials and capital equipment. Leases run for 25 years and rentals are subject to re-adjustment every five years. In a government move to assist industry, ground rents in the industrial free zones are very low.

CUSTOMS DUTIES: The GCC countries announced the unification of Customs duties, effective from January 1, 2003. There are no Customs tariffs on financial transactions or trade in locally manufactured goods between GCC member states when the producing firm is at least 51% locally owned and value added in Bahrain of goods exceeds 40%.

TAX TREATIES: Bahrain has entered into a number of double taxation treaties which are now in effect with a number of countries, including Algeria, China, Egypt, France, Iran, Lebanon, Malaysia, Morocco, Pakistan, Philippines, Singapore, Syria, Thailand, Turkey and Yemen. Other taxation agreements have been signed with other countries but the treaties are not yet in effect. These countries include Austria, Belarus, Belgium, Brunei, Bulgaria, Ireland, Luxembourg, Netherlands, Sudan and Uzbekistan.

Recent developments include the following:

UK: The treaty was signed on March 10, 2010 and generally follows the Organisation for Economic Co-operation and Development (OECD) Model Double Taxation Convention. Important features include:

- The latest OECD provision on exchange of information;
- Zero-percent rate of withholding tax on dividends (except for real estate investment trusts) and on royalties; and
- Zero-percent rate of withholding tax on interest but with a provision to ensure the benefits of the interest article can only flow to residents of the other state.

This agreement has not yet entered into force. It will do so after both countries have completed their Parliamentary procedures and exchanged diplomatic notes.

Malta: A double taxation agreement (DTA) was signed between Malta and Bahrain on April 12, 2010. The DTA is designed to eliminate double payment on all forms of income taxes and includes the OECD's standard for the exchange of tax information.

Bermuda: A tax treaty with Bermuda was signed on April 22, 2010, on similar lines to the agreement with Malta.

Mexico: A convention was signed on October 11, 2010. The convention eliminates double taxation between the two countries and allows for the exchange of tax information in accordance with the standard created by the OECD. It applies to taxes on income imposed on behalf of each of the two countries, irrespective of how they are levied.

Malaysia: A Protocol to the Bahrain-Malaysia Agreement on the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income was signed on October 14, 2010 between Bahrain and Malaysia. The protocol amends the existing DTA by inserting a new article which allows the competent authorities in the two countries to exchange relevant tax information. The protocol ensures that the agreement complies with the standard on Exchange of Tax Information set by the OECD and endorsed by the G20.

Isle of Man: An Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and a Memorandum of Understanding on Economic, Trade and Technical Cooperation (MOU) were signed on February 3, 2011 between Bahrain and the Isle of Man.

The DTA will comprehensively address taxation issues arising in relation to the flow of business and any movement of people between Bahrain and the Isle of Man. It closely follows the model double taxation treaty published by the OECD.

BAHRAIN INTERNATIONAL INVESTMENT PARK (BIIP): The BIIP is a new, high quality, 247-ha business park that has been developed by the Ministry of Industry and Commerce. The park is conveniently located with excellent connectivity and access to both the Bahrain International Airport and the new Sheikh Khalifa Sea Port in Hidd. The BIIP enjoys direct motorway access to Saudi Arabia, via the 25-km Saudi-Bahrain King Fahd Causeway and will enjoy the same connectivity to Qatar via the Qatar-Bahrain Friendship Bridge once this has been constructed.

The BIIP is designed to attract export-oriented companies in manufacturing and internationally traded services, with high value projects that will contribute to creating quality local employment.

The BIIP offers unique incentives including:

- 0% corporate tax with a 10-year guarantee;
- Duty-free access to the markets of the GCC;
- 100% foreign ownership;
- Availability of serviced industrial land at extremely competitive rates;
- Renewable 50-year leases;
- No recruitment restrictions for the first five years;
- Exemption from import duties on raw materials and equipment;
- Free trade access to the US;
- 100% repatriation of capital; and
- No minimum capital required.

The BIIP targets local and international firms looking to develop manufacturing or international services operations. Projects from a wide range of sectors have already been approved for the park. These include food, medical technology, household products, electronics, packaging materials, electrical switchgear and architectural model manufacturing. Companies will also undertake activities in export-led services including insurance claims administration, advanced information systems, software application systems and high technology printing services.

THE FUTURE: It is well known that Parliament has been considering the introduction of certain taxes for some time. Indeed, in 2009 the International Monetary Fund commented that there was a need for Bahrain to diversify its revenue base, and supported the planned introduction of a value-added tax, corporate income tax, and excises to reduce the budget's dependence on oil revenue to ensure medium-term fiscal sustainability.

However, in 2010 Sheikh Mohammed bin Essa Al Khalifa, the chief executive of the Economic Development Board, said, "Our performance in the 2010 [World Economic Forum] Report shows the improvement, year-on-year, which Bahrain is demonstrating in the prudent and sustainable development of its financial system. An increasing number of leading international companies looking to access the trillion dollar market of the Gulf are recognising the business advantages of our tax structure, low operating costs and transparent, stable banking system backed by tried and tested regulation."

As dependence on revenue from hydrocarbons decreases, however, it is unclear exactly how the government will fund expenditures, and it would certainly be naive to expect that some forms of personal and corporate taxation will not play a part. For the time being, however, the comments above appear to underpin the Kingdom's strong commitment to a low tax regime to encourage both individuals and corporations to conduct business in the Kingdom.

OBG would like to thank *BDO Bahrain* for compiling these articles for **THE REPORT Bahrain 2011**.

Ali Jawad Habib, Head of Business Development, BDO

A regional competitor

OBG talks to Ali Jawad Habib, Head of Business Development, BDO

How competitive is Bahrain's tax environment for foreign investors compared to other GCC states?

HABIB: Bahrain has no corporate tax or personal income tax, and in addition to a low cost of living, the country's fiscal policies are highly beneficial for both individuals and corporations living and operating there. Unlike other jurisdictions, the issue of repatriating profits is straightforward in Bahrain, which is crucial. In places where taxes seem low, flexibility on corporate profits is often limited. Although the rates are nominally favourable, these restrictions act as a stealth tax.

In Bahrain there are taxes that apply in narrow contexts, but these are unlikely to have much bearing on foreign investors. For example there is a 5% tax on gross revenue for hotel services and entertainment. This rate still compares favourably to other tourism taxes in the GCC. Given that most of these assets are owned by Bahranis, this tax does not strongly affect foreign investors. There is also a 5% import duty on most products. For now, this law is set to remain, but given greater integration between the Gulf economies and growing acceptance of World Trade Organisation rules, it is likely that this tax will be reformed down the road.

It is also important to note that according to World Bank indicators, Bahrain performs quite positively in terms of governance and lack of corruption compared to other GCC states. Thus, investors have faith in the processes, laws and regulations of the country. This is particularly important since many countries advertise low taxes but have systems hindered by corruption and bureaucracy. This is not the case in Bahrain, which has ensured that standards in its civil and public services are akin to those of the developed world.

What are the most significant trends in Bahrain's current corporate finance environment?

HABIB: The current corporate finance environment in Bahrain is positive, representing a comparative advantage over its neighbours. As a country it has nurtured core competencies in attracting, hosting and helping to grow large overseas finance-based businesses. State agencies have also begun to leverage enormous sovereign wealth funds to invest internationally, showing that the country has the resources and the appetite for strategic investments. State agencies have also been instrumental in developing sharia-based products directed at the Muslim financial consumer. These products have opened a variety of opportunities for Western (and other) financial firms to generate revenues from a new and specifically non-Western source.

What needs to be done at a regulatory level to attract higher levels of foreign direct investment?

HABIB: Continued improvement in the legal and regulatory environment is critical. Labour regulations are progressive for states in the Gulf region; however, there is room for continued improvement on worker's rights. Supervision in the financial sector can also be improved.

Firstly, there are regulatory changes taking hold in Western financial environments in light of the credit crisis. Bahrain must embrace these changes in order to maintain credibility. A key weakness of Western regulatory agencies in the lead-up to the credit crisis was the fact that they could not stringently control a confident, dynamic, and global industry such as financial services. This is a very important lesson for policy makers involved in the regulatory sector in Bahrain. It is not sufficient to have merely adequate rules in place. The organisational culture and professional attributes on the part of regulators must be nurtured to ensure that the control of the sector is effective.

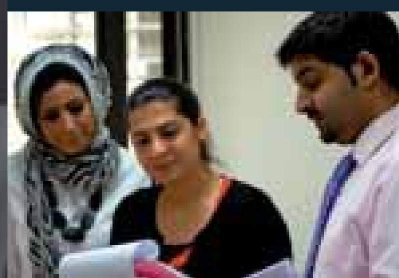
The emergence of Islamic finance is now an industry fixture rather than an anomaly. This is an area in which Bahrain can cultivate an advantage if it focuses on building an advanced regulatory infrastructure. A key disadvantage is the lack of a consistent framework in which sharia-compliant products are sanctioned. If Bahrain can develop a widely accepted set of standards, it could become a centre for global Islamic financial services and thereby attract further investment.

Legal Framework

New Corporate Governance Code effective from 2011
A look at management structure and committees
Enforceability of corporate governance regulations
Flexibility enabled by "comply or explain" principle








The code outlines nine key principles of corporate governance

Best practice

A detailed look at the new Code of Corporate Governance

Companies in Bahrain are regulated by the Ministry of Industry and Commerce (MOIC) and are generally governed by Commercial Companies Law (Decree Law No. 21 of 2001) (Companies Law) and Implementing Regulation (Ministerial Order No. 6 of 2002).

The MOIC has recently issued the Corporate Governance Code of the Kingdom of Bahrain (the code) for the purpose of establishing best-practice corporate governance principles in Bahrain and to provide protection for investors and other company stakeholders through compliance with the code.

While this code, as promulgated by the MOIC, follows best practice, it is nevertheless considered as the minimum standard to be adhered to.

Companies may either voluntarily adopt higher standards to better suit their objectives or be required to comply with additional or more stringent rules and regulations imposed by other regulatory authorities, such as the Central Bank of Bahrain or the Bahrain Bourse, depending on the nature of activity performed by the company.

EFFECTIVENESS AND APPLICABILITY: The code became effective as of January 1, 2011, and it supplements the Companies Law and the implementing regulation. In its initial form, the code will apply to public joint stock companies. Since the MOIC is expected to issue separate codes of corporate governance for other types of companies in due course, the code should be used as a model by all other companies to the extent applicable. All companies to which the code applies should be in complete compliance with the code by the end of 2011.

At every company's annual shareholder meeting held after January 1, 2011, corporate governance should be an item on the agenda for information and as an opportunity to address any questions from shareholders regarding the company's governance.

FUNDAMENTAL PRINCIPLES OF THE CODE: The code outlines nine fundamental principles of corporate governance, which companies are expected to uphold. These are followed by the directives relevant to the application of those principles.

Since these principles and directives are very broad in scope, every company under the code's jurisdiction is required to be in compliance with them.

The fundamental principles are as follows:

- The company shall be headed by an effective, collegial and informed board;
- The directors and officers shall have full loyalty to the company;
- The board shall have rigorous controls for financial audit and reporting, internal control and compliance with the law;
- The company shall have rigorous procedures for appointment, training and evaluation of the board;
- The company shall remunerate directors and officers fairly and responsibly;
- The board shall establish a clear and efficient management structure;
- The company shall communicate with shareholders, encourage their participation and respect their rights;
- The company shall disclose its corporate governance; and
- Companies that refer to themselves as "Islamic" must follow the principles of Islamic sharia.

The principles and directives are further supplemented with recommendations. Companies may not be in compliance with the recommendations to the extent that the same are not appropriate for application by such companies.

However, every company should either comply with those recommendations or explain why it does not because of its specific situation. This is known as the "comply or explain" principle, which requires listed companies to comply with the code's recommendations as often as is reasonable and to justify any departure based on its own particular circumstances.

COMPOSITION OF THE BOARD: According to the code, at least half of a company's board of directors

should be non-executive directors and at least three of those persons should be independent directors. However, in a company with a controlling shareholder, at least one-third of the board of directors should be comprised of independent directors.

The board of directors of the company should have no more than 15 members, and should regularly review its size and composition to assure that it is small enough for efficient decision making yet large enough to have members who can contribute from different specialties and viewpoints.

One person should not hold more than three directorships in companies with the provision that no conflict of interest may exist, and the board should not propose the election of any such director.

CONDUCT OF THE BOARD OF DIRECTORS: The code imposes several specific and general obligations on the board of directors in a company.

In particular, the principles, directives and recommendations contained in the code dictate the conducts of the directors in relation to:

- The board's role and responsibilities;
- The board's decision making process;
- The directors' independence of judgement;
- The board's representation of all shareholders;
- The directors' access to independent advice;
- The directors' communication with the management of the company;
- The board's responsibilities to establish specialised committees; and
- The evaluation of the board and each committee.

Additionally, the code provides detailed rules for the personal accountability of the directors and introduces procedures for avoidance and disclosure of conflicts of interest.

MANAGEMENT STRUCTURE: The code provides definitions and detailed descriptions of a variety of managerial positions, including those that the board shall fill by appointment. The officers shall include at a minimum:

- A chief executive officer (CEO);
- A chief financial officer (CFO);
- A corporate secretary;
- An internal auditor; and
- Such other officers as the board considers appropriate for its functioning.

THE APPOINTMENT OF CHAIRMAN: The chairman of the board of directors of the company should be an independent director and in any event should not be the same person as the CEO.

ESTABLISHMENT OF COMMITTEES: The corporate governance code requires the companies to establish an audit committee, a nomination committee and a remuneration committee.

The code also provides that the company may additionally establish an executive committee and a risk committee on a voluntary basis.

Moreover, the code also recommends that the companies establish a corporate governance committee. The precise scope of duties and responsibilities of these committees have been outlined below.

AUDIT COMMITTEE: The audit committee shall:

- Review the company's accounting and financial practices,
- Review the integrity of the company's financial and internal controls and financial statements;
- Review the company's compliance with legal requirements;
- Recommend the appointment of the internal auditor; and
- Recommend the appointment, compensation and oversight of the company's outside auditor.

NOMINATING COMMITTEE: The nominating committee shall:

- Identify persons qualified to become members of the board of directors or CEO, CFO, corporate secretary and any other officers of the company considered appropriate by the board. This excludes the appointment of the internal auditor, which shall be the responsibility of the audit committee, as outlined above;
- Make recommendations to the whole board of directors, such as nominations of candidates for board membership to be included by the board of directors on the agenda for the next annual shareholder meeting.

RECOMMENDATION COMMITTEE: The remuneration committee shall:

- Review the company's remuneration policies for the board of directors and senior management, which should be approved by the shareholders;
- Make recommendations regarding remuneration policies and amounts for specific persons to the whole board, taking account of total remuneration including salaries, fees, expenses and employee benefits; and
- Remunerate board members based on their attendance and performance.

EXECUTIVE COMMITTEE: The executive committee shall review and make recommendations to the whole board on company actions.

RISK COMMITTEE: The risk committee shall identify specific risks for company business and set out solutions to minimise these.

CORPORATE GOVERNANCE COMMITTEE: The corporate governance committee shall be responsible for developing and recommending changes from time to time in the company's corporate governance policy framework.

The corporate governance committee shall be empowered to:

- Oversee and monitor the implementation of the company's governance policy framework by working with the management, audit committee and SSB; and
- Provide the board of directors with reports and recommendations based on its findings in the exercise of its functions as defined above.

OBG would like to thank *Qays H. Zu'bi Attorneys & Legal Consultants* for compiling this article for THE REPORT Bahrain 2011

Qays H Zu'bi, Senior Partner, Qays H Zu'bi Attorneys & Legal Consultants

Comply or explain regime

Qays H Zu'bi, Senior Partner, Qays H Zu'bi Attorneys & Legal Consultants, on enforceability of the Corporate Governance Code

A code of corporate governance can be defined as a set of principles, standards or best practices issued by a regulatory body for the internal governance of corporations. The recently promulgated Corporate Governance Code of the Kingdom of Bahrain (the code) has been divided into three parts: principles, directives and recommendations. While every company in Bahrain has to comply with the broadly constructed principles and directives, recommendations may not be appropriate for some joint stock companies and the "comply or explain" principle is adopted in their application.

APPLICATION: Despite wide use of the comply or explain principle in many jurisdictions, very little is known about the way in which the mechanism functions in practice. In theory, the principle requires that the listed companies comply with the code of corporate governance most of the time; however, departure from the code may be justified in particular circumstances. Every listed company, therefore, must review each provision of the code carefully and give a considered explanation if it departs from such provisions. Non-compliance, or perhaps better, non-application of the relevant provision can still be said to be consistent with the spirit of the code. Judgments on these matters, such as the extent to which deviations are indeed justified, are to be monitored by shareholders. Originally put forward by the Cadbury Committee, UK in 1992, the comply or explain principle avoids an inflexible "one size fits all" approach and ensures compliance with the code by operation of a threat of the consequential undesirable market reactions. In practice, listed companies are required to disclose in their reports and accounts the extent to which they comply with the code of corporate governance and explain reasons for any non-compliance. The assessment of such disclosure is then monitored and judged by the individual shareholders and at an aggregate level by the capital market. Shareholders take into account the level of compliance when making a decision whether to buy, sell or hold shares in that company. Accordingly, unjustified deviations from the code are expected to be sanctioned through a sharp decline in share price. The capital market has two functions in this regard: evaluation of the possible deviation and enforcement. The comply or explain principle thus does not present companies with a free pass for rule avoidance.

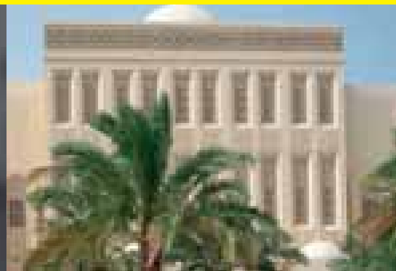
ENFORCEMENT: In Bahrain, only part of the code – the recommendations – relies on the comply or explain approach for its enforcement. Principles and directives, on the other hand, are broad in their application and every company is required to comply with these. The Ministry of Industry and Commerce and the Central Bank of Bahrain are of the view that market monitoring alone cannot guarantee adequate compliance with the code. Therefore, a combined monitoring system is designed to ensure better compliance.

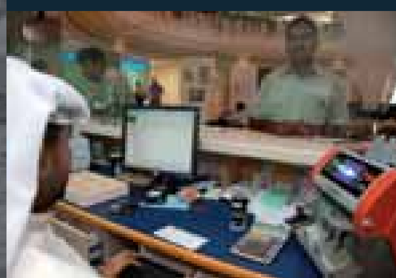
While deviation from the recommendations will only require the board of directors to justify such deviation to the shareholders of the company, non-compliance with the principles and the directives will attract some form of actions that the relevant regulatory authority will be entitled to take against the company and its board of directors. Since the code has just been issued and precedents are unavailable, the extent and severity of the penalties the regulatory authorities would impose for deviation from the code remains to be seen.

Undoubtedly, efficient corporate governance encourages investment and fights back corporate corruption. However, there is also an argument that a controlled and monitored approach towards corporate governance may potentially discourage companies from going public. Nonetheless, it is anticipated that the promulgation of the code, backed by sanctions in particular, will be necessary for a growing market. It will force listed companies to develop corporate governance, which in turn will put in place a support system, enhancing public confidence and capital liquidity in the market. As a result, a sophisticated market will not only attract public investments but will also present an appealing avenue for prospective listing of companies.

The Guide

Centres showcasing handicrafts keep traditions alive
Hotel listings for business and leisure travellers
Telephone numbers for ministries, embassies and more
Useful information for first-time visitors

The goal is to keep traditions alive while providing jobs and revenue

The art of the craft

Dedicated centres encourage locals to make and sell handicrafts

The handicrafts industry in Bahrain is one that reflects both the culture and heritage of the Kingdom. In line with efforts to preserve the country's cultural heritage, Bahrainis are keenly aware of the role that handicrafts play in the local economy today, as well as their centrality in the past. A country's crafts often reflect its natural environment and geography. Bahrain is no exception in this, and its handicrafts industry reflects both in the range of products highlighting its longstanding relationship with the sea and sand, date palms, pearls, gold and wood.

Both the Ministry of Culture and the Ministry of Industry & Commerce (MOIC) have invested in developing centres devoted to preserving and enriching the role of handicrafts, an industry that provides potential employment opportunities for Bahrainis and adds to the country's overall economic output.

PRESERVATION: As an example, the MOIC developed the Craft Industries Development Centre in 1990 to preserve and encourage the development of creativity in traditional skills. The centre houses a number of workshops where different types of local handicrafts are produced. Located in central Manama off of Isa Al Kabeer Road, the centre is open to visitors, allowing them to watch local handicrafts as they are made and speak with artisans about their work. It also displays handicrafts produced in local homes.

The MOIC and the people of Diraz established a workshop in the centre dedicated to handmade wool products, including carpets, wall hangings and cushions. In June 2011 the project was transfered to the Ministry of Social Development and Human Rights.

There is also a workshop for *naqda*, the art of sewing silver thread into linens. Although naqda was traditionally used to ornate Bahraini women's attire, locals can now be observed sewing the silver thread into modern linens, including napkins, curtains, bedspreads and tablecloths, among other items.

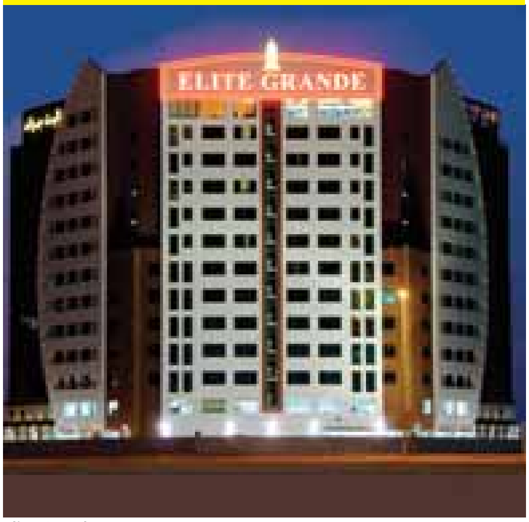
Another handicraft that draws off of Bahrain's natural environment is the art of producing palm leaf paper. The country is well known for its palm trees, whose leaves locals have used to produce paper for years. The paper is then made into greeting cards, business cards and the like. In keeping with this idea, other products produced at the centre incorporate elements that are available locally, like clay, shells, metals and stones, into artwork.

Other specialities found at the centre include the production of *nasaej*, or embroidery; enamel painting; *nuqoosh*, which uses gypsum to produce replicas of ancient doors and windows found in Bahrain; doll making that features traditional Bahraini clothing; and production of replica dhows, which are traditional Arab sailing vessels that demonstrate the Kingdom's history as a shipping and trading centre.

EXTENDING TO ECONOMICS: Another important centre for the craft industry is Al Jassrah Centre for Handicrafts, located in the village of Al Jassrah near the King Fahd Causeway. The centre falls under the purview of the Ministry of Culture and features a number of local talents and crafts, including mat weaving, basket making, silk weaving, tanning and the production of local musical instruments.

The Al Jassrah Centre is regarded as one the most important official agencies dedicated to the continuation and development of local handicraft production. The centre emphasises both training in crafts and marketing the finished products through summer courses, and it also hosts a specialised craft training centre, the first of its kind in the region, aimed at training future generations of Bahrainis in the traditional arts of the Kingdom. Al Jassrah is also open to tourists, conveniently located a short drive from the Saar and Aali burial mounds.

Supporting the local craft industry not only helps to preserve Bahraini national identity but also adds to economic output, providing both income and job opportunities for locals. Training in these crafts affords Bahrainis the opportunity to learn a traditional craft while also supporting their economy.



Elite Grande

Comfort class

AL SEEF

ELITE GRANDE
Al Seef District
T: 17 565 888 / 17 558 200
F: 17 565 858 / 17 558 229
cro@elitegroup4u.com
www.elitegroup4u.com

Rooms: 130 suites comprising of one, two or three bedrooms.
Business & Conference Facilities: Fax, e-mail, internet and photocopying services. Multi-functional hall with all computing and audio-visual facilities. Banquet facilities (90- to 120-person capacity), and two smaller meeting rooms (suitable for 10-12 people each).
Health & Leisure Facilities: Gymnasium, steam room (separate facilities for ladies), swimming pool and Jacuzzi, recreation room and video games arcade.
Guest Services: Airport transfers (charges apply), visa assistance, car hire, ticketing and travel services, laundry, safe deposit lockers, 24-hour room service.
Wining & Dining: Zodiac Lounge (business lounge), Temptation (international).

ELITE SEEF RESIDENCE & HOTEL
Al Seef District
T: 17 583 388 / 17 558 200
F: 17 583 343 / 17 558 229
cro@elitegroup4u.com
www.elitegroup4u.com

Rooms: 152 suites comprising of studios, or one, two or three bedrooms.
Business & Conference Facilities: Business centre, fax, e-mail, internet and photocopying services. Multi-functional halls with state-of-the-art facilities.
Health & Leisure Facilities: Gymnasium, sauna, large swimming pool (temperature controlled), kids pool, Jacuzzi, spa and a large barbecue area.
Guest services: Airport transfers (charges apply), visa assistance, car hire, ticketing and travel services, laundromat, safe deposit boxes, 24-hour room service.
Winning & Dinning: Temptations (24-hour international cuisine) and Sip & Dip (poolside bar and cafe).

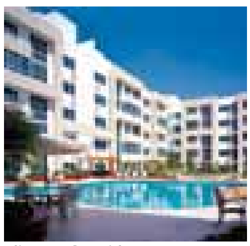

Fraser Suites Seef Bahrain

FRASER SUITES SEEF BAHRAIN
Bldg. 2109 Road 2825 Block 428
T: 17 569 333 / 17 171 626
F: 17 569 338
sales.bahrain@frasershospitality.com
bahrain.frasershospitality.com

Rooms: 91 suites comprising of one, two or three bedrooms.
Business & Conference Facilities: 24-hour business centre with fax, free wireless high-speed internet and photocopying services, two function rooms (8- to 40-person capacity) with conference facilities.
Health & Leisure Facilities: Outdoor pool with jacuzzi, children's pool, gym, indoor spa pools, sauna and steam, Fraser Kids Club (children's playroom), massage chairs, direct access to Seef Mall from the lobby.
Guest Services: 24-hour reception and concierge, mail and message delivery, laundry and dry cleaning, valet parking, airport transfers, newspapers, welcome amenity pack, limousine and taxi reservations, luggage room, baby-sitting service (upon request), barbecue facility, ladies salon, free wireless internet, daily shuttle to Seef Business District.
Wining & Dining: The Gallery Lounge, room service, order-in restaurant facilities.

JUFFAIR

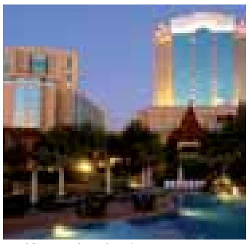
ELITE CRYSTAL HOTEL
T: 17 360 360 Reservations: 17 558 200
F: 17 360 333 Reservations Fax: 17 558 229
cro@elitegroup4u.com
www.elitegroup4u.com


Elite Seef Residence


Al Safir Hotel & Tower

Rooms: 120 suites comprising of 1-bedroom and 2-bedroom suites.
Business & Conference Facilities: Fax, internet and photocopying services, Multi-functional hall with computing and audio-visual facilities, banquet facilities (350-person capacity), 2 boardrooms (for up to 20).
Health & Leisure Facilities: Gym, steam room (separate facilities for ladies), pool, jacuzzi and rec room.
Guest Services: 24-hour reception and concierge, mail & message delivery, laundry & dry cleaning, valet parking, airport transfers, newspapers, limousine and taxi reservations, baby-sitting service (upon request), daily shuttle to malls and central business district, currency exchange, safety deposit box (available in all rooms), luggage storage, shoe-shine.
Wining & Dining: Klub 360 (nightclub), La Cascada (24-hour coffee shop), Bora Bora (poolside bar), The Circuit (boardroom) and Lounge Bar

AL SAFIR HOTEL & TOWER
Building 670, Road 2411
T: 17 827 999
F: 17 827 888
alsafirh@batelco.com.bh
www.alsafirhotel.com


Gulf Hotel Bahrain

Rooms: 112 single/twin deluxe rooms and 71 studio and two-bedroom apartments.
Business & Conference Facilities: Four meeting rooms that can accommodate 10 to 60 persons
Health & Leisure Facilities: Fully equipped gym, indoor and outdoor swimming pool, steam, sauna and Jacuzzi.
Guest Services: 24-hour room service, Wi-Fi internet, same-day laundry service, currency exchange, courtesy shuttle to the shopping malls, car rental, tour desk, on-call doctor.
Wining & Dining: Savoy Coffee shop, The Lounge (Bar), Khan Al Marjan (Iraqi Cuisine Restaurant).

GULF HOTEL BAHRAIN
Bani Otbah Avenue
T: 17 713 000
F: 17 713 040
info@gulfhotelbahrain.com
www.gulfhotelbahrain.com


Elite Resort & SPA

Rooms: 357 rooms and suites and 97 Executive Apartments.
Business & Conference Facilities: All essential services, including secretarial, translation and courier services. 21 meeting rooms, one conference hall (20- to 3000-person capacity for receptions and 1400-person capacity for banquets).
Health & Leisure Facilities: Sauna, steam room, Jacuzzi, gym, aerobics studio, two squash courts (with air conditioning), two outdoor tennis courts, nearby bowling facilities, outdoor swimming pool, kids swimming pool, separate facilities for men and women.
Guest Services: Car hire, airport shuttle, limousine service, shuttle service to city centre, in-room safe, valet service, dry cleaning and laundry, babysitting.
Wining & Dining: Al Waha Restaurant (international), La Pergola (Italian), Margarita Mexicana (Mexican), Takht Jamsheed (Iranian), China Garden (Chinese), Royal Thai (Thai), Zahle (Lebanese), Fusions Restaurant, Sato (Japanese), Typhoon (cocktail bar), Sherlock Holmes (restaurant and pub), Atrium Café, Waterside Café, Al Andalus Lounge, Palace Lounge, Vintage Wine Bar.

THE K HOTEL BAHRAIN
P O Box 1412, Juffair
T: 17 360 000
F: 17 360 049
info@thekhotel.com
www.thekhotel.com

Rooms: 237 rooms and suites.
Business & Conference Facilities: Five meeting rooms
Health & Leisure Facilities: Pools, separate men and women's gyms with jacuzzis, steam rooms and saunas.
Guest Services: Business centre, car hire, gift shop.
Wining & Dining: Klouds, Mo Kan (Asian), The Terraza (Bistro), The K Lounge.

SERENE LANDMARK HOTEL APARTMENT
Juffair
T: 17 364 364
F: 17 364 365
stayin@serenelandmark.com
www.serenelandmark.com

Rooms: 37 suites, seven one-bedroom Deluxe rooms, 14 two-bedroom Deluxe rooms, 10 three-bedroom Deluxe rooms, and six three-bedroom Royal rooms.
Health & Leisure facilities: Swimming pool, gym, sauna and steam room.
Guest Services: 24-hour front desk and security.
Wining & Dining: Serene Lounge and Restaurant.

MUHARRAQ

ELITE RESORT & SPA
Sheikh Hamad Causeway
T: 17 313 333 Reservations: 17 558 200
F: 17 313 344 Reservations Fax: 17 558 229
cro@elitegroup4u.com
www.elitegroup4u.com

Rooms: 149 suites with 1, 2 or 3 bedrooms.
Business & Conference Facilities: 24-hour business centre with fax, high-speed internet and photocopying services. Multi-functional, conference and party rooms with computing and audio-visual facilities. Banqueting facilities (10- to 500-person capacity).
Health & Leisure Facilities: Gym and steam room (separate steam facilities for ladies), 2 pools, jacuzzi.
Guest Services: Airport transfers (charges apply), visa assistance, car hire, travel services, laundromat, safe deposit box, 24-hour room service.
Wining & Dining: La Brasserie (24-hour international dining), Shift 7 (bar & lounge), O-Club (lounge), Waikiki (poolside bar), Al Noor Tent (Arabic).

Major religious holidays include the birthday of the Prophet Muhammad, Eid Al Fitr (celebrated at the end of the month of Ramadan), Eid Al Adha (celebrated after the hajj), Al Hijra, New Year and Ashoora. Other local holidays include Labour Day and National Day.

Travelling by cab is generally quite easy, and taxis can usually be found at most malls, hotels and restaurants. London-style cabs, a premier taxi service that can be hailed or called in advance, are a recent introduction to the Kingdom. Cabs are required to use meters.

MINISTRIES

Bahrain Defence Force
17 653 333
Cabinet Affairs
17 213 800
Civil Aviation Affairs
17 333 000
Culture
17 211 026
Education
17 684 152
Finance
17 575 000
Foreign Affairs
17 227 555
Health
17 288 888
Housing
17 533 000
Industry & Commerce
17 574 777
Information
17 871 111
Interior
17 572 222
Islamic Affairs
17 812 812
Justice
17 513 000
Labour
17 873 777
Municipalities Affairs & Urban Planning
17 501 501
Prime Minister's Court
17 200 000
Social Development
17 873 998
Shura Council
17 748 888
Transportation
17 534 534
Works
17 545 555

GOVERNMENT ORGANISATIONS

Bahrain Bourse
17 261 260
Bahrain Chamber for Dispute Resolution
17 511 311
Bahrain Chamber of Commerce & Industry
17 380 000
Central Bank of Bahrain
17 547 777
Central Informatics Organisation
17 725 725
Civil Services Bureau
17 574 646
Economic Development Board
17 589 999
eGovernment Authority
www.ega.gov.bh
17 388 388
Electricity & Water Authority
17 546 666
General Organisation of Sea Ports
17 359 595
Social Insurance Organisation
17 532 222
General Organisation for Youth and Sports
17 725 500
Tamkeen (Labour Fund)
17 383 333
Labour Market Regulatory Authority
17 388 888
National Oil & Gas Authority
17 312 644
Quality Assurance Authority for Education & Training
17 562 333
Telecommunications Regulatory Authority
17 520 000
Tender Board
17 566 666

EMBASSIES

Algeria
17 740 784
Belgium
17 229 995
Brunei Darussalam
17 720 222
Canada
17 536 270
China
17 723 900
Cyprus
17 598 800
Denmark
17 216 473
Egypt
17 720 005
France
17 298 660
Germany
17 530 210
Greece
17 598 800
India
17 712 785
Indonesia
17 233 875
Iran
17 722 400
Iraq
17 741 472
Ireland
17 728 146
Italy
17 252 424
Japan
17 716 565
Jordan
17 291 109
Kuwait
17 534 040
Lebanon
17 579 001
Libya
17 722 252
Malaysia
17 564 551
Morocco
17 740 566
The Netherlands
17 530 704
Norway
17 813 088
Oman
17 293 663
Pakistan
17 244 113
Palestine
17 276 099
Philippines
17 250 990
Portugal
17 456 688
Qatar
17 722 922
Russia
17 725 222
Saudi Arabia
17 537 722
Senegal
17 821 060
Sudan
17 717 959
Sweden
17 339 799
Switzerland
17 517 780
Syria
17 722 484
Thailand
17 274 142
Tunisia
17 714 149
Turkey
17 533 448
UAE
17 748 333
UK
17 574 100
US
17 242 700
Yemen
17 822 110

UN AGENCIES

UN Environment Programme
17 812 777
UN Development Programme
17 311 600
UNIDO
17 536 881
UN Information Centre
17 311 676

Private and public health care services are available in the Kingdom. A plethora of international private hospitals offer good-quality care. Payment is usually expected at the time of service. Pharmacies are easy to find throughout major cities and are quite affordable.

A large portion of the population speaks English as well as Arabic. Road signs are clearly labelled in both languages, for example, and English is often used in business settings for meetings and documentation. You may also hear Farsi, Urdu or Hindi spoken as well.

ASSOCIATIONS

Bahrain Association of Banks
17 823 000
Bahrain British Business Forum
17 813 488
Bahrain Insurance Association
17 532 555
American Chamber of Commerce in Bahrain
17 522 777

BANKS

Ahli United Bank
17 585 858
Bahrain Islamic Bank
17 546 111
BMI Bank
17 133 555
BBK
17 207 777
BNP Paribas
17 531 152
Citibank Bahrain
17 582 484
HSBC
17 569 999
Ithmaar Bank
17 584 000
National Bank of Bahrain
17 228 800
Standard Chartered
17 223 636

ACCOUNTANCY

BDO
17 530 077
Ernst & Young
17 535 455
KPMG
17 224 907
PricewaterhouseCoopers
17 540 554

LAW FIRMS

Qays H Zu'bi Attorneys & Legal Consultants
17 538 600

HOSPITALS

Al Kindi Specialised Hospital
17 240 444
American Mission Hospital
17 253 447
Awali Hospital
17 753 333
Bahrain Defence Force
17 766 666
Bahrain Specialist Hospital
17 812 000
Ibn Al Nafees Hospital
17 828 282
International Hospital of Bahrain
17 598 222
Salmaniya Hospital
17 288 888

PHARMACIES

Al Bader Pharmacy
17 242 100
Aljishi Pharmacy
17 224 624
Awal Pharmacy
17 772 023
Bahrain Pharmacy
17 264 088
Jaffar Pharmacy
17 291 039
Nasser Pharmacy
17 740 900

EMERGENCY

Directory assistance
181
Fire, ambulance & police
999
Traffic & accidents
17 872 222

AIRLINES

Air Arabia
17 505 111
Air India
17 223 849
Bahrain Air
17 506 060
British Airways
17 587 777
Cathay Pacific
17 226 226
Emirates
17 588 700
Egypt Air
17 243 317
Ethiopian Airlines
17 215 022
Etihad Airways
17 519 999
Flydubai
16 199 187
Gulf Air
17 335 777
Iran Air
17 210 414
Iraqi Airways
17 401 199
Jazeera Airways
17 329 301
Jet Airways
17 227 114
KLM
17 229 747
Kuwait Airways
17 223 300
Lufthansa
17 828 762
Oman Air
17 500 020
Qatar Airways
17 212 202
Royal Jordanian
17 229 294
Saudi Arabian Airlines
17 211 550
Sri Lankan Airlines
17 224 819
Syrian Arab Airlines
17 533 668
Turkish Airlines
17 516 100
United Airlines
17 214 062
Watania Airways
17 220 690

CAR HIRE

Al Kobaisi Car Rental
17 735 991
Avis
17 531 144 / 17 583 887
Bahrain Car Hiring
17 534 343
Budget
17 321 268
Europcar
17 321 249
Hanco
17 310 656
Hertz
17 321 358
Marshall Car Hiring
17 727567
National Car Rental
17 311 169
Oscar Rent a Car
17 211 682
Sixt
17 711 770

TRAVEL AGENCY

Algosaibi Travel
17 212 333
Al Bader Tourism & Travel
17 710 011
Al Jazeera Travel & Tours
17 321 252
Al Kobaisi Travel
17 212 333
Kanoo Travel
17 220 798

PLACES TO VISIT

Al Areen Wildlife Park & Reserve
17 836 116
Bahrain National Museum
17 292 977
Bahrain International Circuit
17 400 000
Oil Museum
17 753 257
Riffa Golf Club
17 750 777
Capital Club Bahrain
17 100 100

Facts for visitors

Helpful hints for newcomers

NATIONAL CHARACTER: Bahrain is widely regarded as being one of the most liberal countries in the Gulf region. Foreigners are often drawn to Bahrain for its tolerance, religious diversity and relaxed atmosphere. With a large percentage of resident expatriates, Bahrainis are very interested in other cultures but hold strong to their values and national identity.

LANGUAGE: The country's official language is Arabic, but a large portion of the population speaks English. Road signs are clearly labelled in both Arabic and English. English is frequently used within the business community and documentation is often provided in both English and Arabic. As there is a large population of expatriates, it is not uncommon to hear Farsi, Urdu, Hindi, Malayalam or Tagalog in the country as well.

ETIQUETTE: Although Bahrain is relatively liberal, one should still be aware of certain taboos that exist within an Islamic society. Accepting or giving anything with the left hand, showing the soles of one's feet and public displays of affection should all be avoided. In addition, during the month of Ramadan both Muslims and non-Muslims in Bahrain are prohibited from eating, drinking and smoking in public from sunrise to sunset.

DRESS: Many Bahrainis opt to wear traditional attire. Bahraini men often wear the *dishdash* and the traditional head scarf, or *keffiyeh*, either in white or a red and white checker pattern. Bahraini women often wear an *abaya* that covers them from neck to toe. Head attire among women varies, with many opting to wear a *hijab* that covers the hair or a *niqab* that covers the face. While Western-style business attire is common, foreigners should remember that wearing revealing clothing that exposes the shoulders, chest or legs is frowned upon and can garner unwanted attention.

TRANSPORT: Car hire facilities can be found at the airport and in the city. Buses come infrequently and are an impractical mode of transportation. Cabs are available at most hotels, shopping malls and restaurant areas. Cabs are required to use meters and one should request they be turned on if the driver does not do so.

CURRENCY: The national currency is the Bahraini dinar, more commonly referred to as the BD. The currency is pegged to the US dollar at the rate of $1:BD0.376. The dinar is subdivided into 100 fils. Bank notes come in denominations of 20, 10, 5, 1 and ½, while coins come in values of 100, 50, 25, 10 and 5 fils. Saudi riyals are also accepted in Bahrain at an exchange rate of BD1:SR10. Credits cards are accepted throughout the country; however, it is best to keep some cash on hand to pay for taxis and local vendors.

VISAS: All nationalities require a visa to enter Bahrain, except for citizens of the GCC. Entry permits can be obtained online or through a Bahraini embassy. Tourist visas on arrival are available for citizens from EU member states, the US, Canada, Australia, New Zealand, Japan and Hong Kong. Tourist visas allow for a stay of up to 14 days in the Kingdom and cost BD5 ($13.33) on arrival. UK and Irish nationals can receive a visa on arrival for a stay of up to 90 days. The General Directorate for Nationality, Passports and Residence can assist with obtaining visas electronically and can be easily accessed at www.evisa.gov.bh.

BUSINESS HOURS: The workweek in Bahrain is Sunday through Thursday. Government offices are open Sunday to Thursday from 7.00am to 2.00pm. The private sector generally operates from 8.00am until 5.00pm, with banks typically open from 7.30am until 2.30pm. Many businesses and shops are closed on Friday.

ELECTRICITY: Bahrain uses the British 230V, 50Hz, three-pin electrical system. Other plugs will need adaptors that can be easily obtained in most hotels.

HEALTH: There are a plethora of private hospitals, in addition to Salmaniya Hospital, the primary public facility. Payment is generally expected at the time of treatment. Pharmacies can be found throughout Manama and are usually quite affordable.

COMMUNICATIONS: The country code for Bahrain is +973, followed by the national area code 17. GSM SIM cards are prevalent and easy to obtain through Batelco, Viva or Zain in outlets throughout the country.