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Gulf Sovereign Wealth Funds

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Gulf Sovereign Wealth Funds

I – Role of sovereign wealth funds in the global economy

I.1 – *Gulf sovereign wealth funds among the most powerful in the world*

Sovereign wealth funds (SWFs) in the Middle East region have proved their influence on the international monetary and financial system. Their role was decisive in rescuing the international financial system, particularly during the 2007 financial crisis, by injecting several tens of billions into the capital of financial institutions. These measures not only helped to support financial institutions by avoiding any systemic crisis, but also helped to support the U.S. dollar.

The primary ambition of a SWF is to accumulate long-term national savings for the benefit of future generations, in particular by diversifying investments on a sectoral and geographical level. Following this logic, Gulf countries have for many years replenished their sovereign wealth funds with huge oil rents, particularly when crude oil prices were at their highest, reaching an all-time high of \$143 per barrel in 2008.

Over the past decade, they have grown in power, gaining considerable weight to the point of becoming major players in the global economy and forming a new class of investors. Of the \$5.5 trillion held by SWFs today, nearly 40% comes from the Gulf countries.

It should be noted that four of the world's top ten funds originate from the Middle East¹. They alone account for 40% of the sector's global assets. Although their notoriety is relatively recent, most of them were founded several decades ago. As it is often the case, Kuwait was a pioneer, with the creation of its fund in 1953.

However, it is still difficult to know precisely the extent of their financial resources, which are generally still largely underestimated. Managing most of the region's capital,

¹ Sovereign Wealth Fund Institute ranking.

their strike force is estimated at more than \$2.5 trillion, three-quarters of which are held by three institutions: ADIA (Abu Dhabi), SAMA (Saudi Arabia) and KIA (Kuwait).

Recently, the number of SWFs has increased to the point where there are now several dozen. Within the same country, several funds may coexist, but with different objectives (local or sectoral development, accumulation of money to build savings for future generations, etc.) and governance methods specific to each fund.

Faced with losses in the wake of the stock market collapse and the subprime crisis, Gulf SWFs have also made a significant shift in their strategies.

Indeed, after investing their reserves in US Treasury bonds, in safe and liquid assets or in the jewels of European and US capitalism, Gulf SWFs have diversified their investments in more profitable assets such as private equity, infrastructure, listed shares, etc. and, for some of them, by actively contributing to local economic and industrial development, thereby accelerating the diversification process of the region's economies. They thus participate in the process of innovation and access to knowledge through strategic investments in research or education.

1.2 – **United Arab Emirates**

In the United Arab Emirates, there are at least three SWFs: Mubadala, Emirates Investment Authority (EIA) and the most powerful of them, the Abu Dhabi Investment Authority (ADIA). Founded in 1976, the latter would have had, shortly before the 2008 crisis, nearly \$1 trillion invested in all asset classes. This amount is now estimated at \$800 billion, which still makes it the largest investment fund in the region. It is funded by payments from financial surpluses from oil exports. Although its interest in emerging countries seems to be growing, Europe and North America represent about three-quarters of the fund's assets invested abroad. The new strategies aim to strengthen Asia's influence.

Mubadala, a fund wholly owned by the Emirate of Abu Dhabi and placed under the authority of Crown Prince Sheikh Mohamed Bin Zayed, would have nearly \$226 billion in assets. Its main mission is to invest its resources in projects that are structuring and strategic for the Abu Dhabi economy, with energy, major infrastructure projects and aeronautics at the forefront, in partnership with the major international companies that contribute their savoir faire, technologies and capital. *Mubadala* holds direct stakes in industrial groups considered important for the Emirate's development: aeronautics (Piaggio Aero), ICT (with operator Du), private equity and venture capital (Carlyle and GE), microelectronics (ATIC and AMD) and tourism (with the American chain Viceroy). To improve efficiency, Mubadala has recently merged with two other SWFs, Abu Dhabi Investment Council and Aabar, which are more focused on industrial assets.

1.3 – Saudi Arabia

In Saudi Arabia, the Public Investment Fund (PIF) manages approximately \$360 billion in assets. It plays an important role in the implementation of the economic diversification plan "Vision 2030". The role of the PIF consists, on the one hand, in financing investments with a secure and sustainable profitability in order to support future Saudi generations who will no longer be able to rely on oil revenues, and on the other hand in quickly financing projects that will structure the Vision 2030.

It acts as a government investment agency and strategic investment fund, holding financial interests in many national and private companies. With local and international expertise, the PIF also finances strategic projects in Saudi Arabia as well as direct investments abroad. The fund's philosophy is above all based on the search for performance. It should obtain part of the funds raised by Aramco's initial public offering or the sale of SABIC (Saudi leader in petrochemicals, in which it holds 70%) to boost its development based on the model of Emirati, Singaporean or Norwegian SWFs. Internally, it is PIF that leads the vision of the three flagship projects of Vision 2030: the futuristic Neom city at 500 billion dollars, the leisure city and the Red Sea tourism project.

The Saudi Arabian Monetary Agency (SAMA), founded in 1952, aims to stabilize the country's monetary system and manage the Kingdom's foreign exchange reserves. It now manages some \$500 billion in assets, a large portion of which are liquid assets.

1.4 – Kuwait

The other Gulf countries are part of this movement. Among them, the Kuwait Investment Authority (KIA), the world's oldest SWF, is estimated to have approximately \$592 billion in assets under its management. Each year, the fund is replenished with an amount equivalent to 10% of Kuwait's income. KIA manages both the general reserve, which itself manages the State's participation in major groups, both public and private, and the fund for future generations, which is fully invested outside the region, particularly in North America, Europe and more recently in Asia (China in particular). Its strategy is to remain a minority shareholder, and thus never to exceed the 5% threshold of the capital of a publicly traded company. KIA's assets in France are estimated at around 6 billion dollars (real estate assets, equities and bonds combined).

1.5 – Qatar

In Qatar, the Qatar Investment Authority (QIA), created in 2005, is estimated to have \$320 billion in assets, thanks to the country's huge natural gas reserves. This influx of funds and the diversity of holdings prompted QIA's management to create different entities within the fund: Qatar Holding (for foreign holdings), Qatari Diar (real estate sector), Qatar mining (mining), Hassad Food (agricultural land) and Katara hospitality (hotels).

Qatar has minority stakes in many large French companies, including Total, LVMH and Vivendi. Abroad, the Emirate holds shares in the British bank, Barclays and the Swiss, Credit Suisse (more than 5%).

Emerging countries now offer the most attractive growth prospects for SWFs. QIA is now largely focused on the MENA/Africa region and devotes 21% of the funds invested to it. Not to mention Asia, which accounts for 14% of its investments. Nevertheless, QIA remains strongly committed to its domestic market. The Qatari sovereign fund is the major shareholder of very large companies such as Qatar Airways, Qatar National Bank or Ooredoo (formerly Q-tel).

1.6 – Bahrain and Oman

Finally, Bahrain created Mumtalakat in 2005, its own SWF which currently holds more than \$30 billion in assets and which today focuses mainly on supporting local economies. The Sultanate of Oman, for its part, created the State General Reserve Fund (SGRF) in 1980, which holds \$30 billion in assets, and participates in the economic development of the Sultanate, particularly in the industrial sector, tourism and renewable energies. It also invests directly or through funds in Asia, the United States and Europe.

2 – Diversification strategies

2.1 – Their evolution

These funds all pursue, without exception, economic and financial objectives. But these can be of a different nature. It may be a question of:

- Stabilization funds: income from financial investments that offsets the increase in raw materials and makes it possible to fill any budget deficits, as SAMA did in Saudi Arabia;

- ➔ Future generation funds: oil resources are more diversified asset income that are hoarded for future use;
- ➔ Development funds: whose mandate is to invest massively in domestic infrastructure in order to increase the potential for economic growth and attractiveness.

Traditionally, the management of these institutions has been very conservative, such as budget regulation funds or central banks, and has focused exclusively on investments in US Treasury bonds, bank deposits and real estate assets (safe and highly liquid assets to deal with possible budget deficits).

Since the 2008 crisis, these SWFs have been betting on more dynamic management, such as future generations funds and investments in much riskier and, above all, more profitable products (private equity, listed shares, real estate, hedge funds or infrastructure), particularly in Europe and the United States. New, longer, and more diversified investment horizons are gradually helping to include other asset classes.

Performance requirements are becoming more and more demanding. To maintain its "IRR" (rate of return on investment) at 8%, ADIA is turning more towards more alternative and more profitable investments (equities, private equity, hedge funds, real estate) and considers co-investments as a priority. KIA adopts the same strategy, in line with the "Yale model" which tends to favour riskier assets.

Funds such as KIA and ADIA are expected to remain long-term players, focusing on foreign investments and partnerships with *Fund Managers*, particularly Anglo-Saxon and European ones. Others such as Mubadala, the Public Investment Fund in Arabia, and QIA, while being present internationally through direct investments or in funds, have mixed mandates to participate in local industrial development while also supporting the emergence of national champions.

2.2 – **Sophistication**

Regarding their investment strategy, financial institutions have long been among the priorities of SWFs. This is evidenced by the investments made since the end of 2007 in banks, asset managers, brokers and stock exchanges. ADIA thus holds 4.9% of Citigroup's share capital and 40% of Apollo Management, while Mubadala holds 7.5% of Carlyle Group. QIA acquired more than 25% of the capital of the London Stock Exchange and 6% of Credit Suisse.

But the other sectors of activity, particularly the industrial one, are also in the sights of SWFs. This "bulimia" is explained by the need to diversify their portfolio (QIA in Porsche and Sainsbury's, the British retail giant).

Moreover, it is important to note that the oldest funds such as ADIA or KIA have reached such a degree of sophistication and performance that they could even do without the oil windfall and earn interest exclusively on the dividends they receive. Some disposals have taken place but mainly motivated by their desire to have a more dynamic approach to their portfolio. This financial autonomy gives them the ability to adapt to complex economic conditions and allows them to find appropriate solutions without having to call on the government's funds.

2.3 – Local development fund and focus on the Middle East

It is also in this logic that local development funds are created. Indeed, the objective is not to invest the profits from commodity rents in assets in Europe or the United States, but to allow the local economy to develop. This requires real ambitions for the capture of savoir faire, the recovery of patents, a desire to influence the strategy of the companies in whose capital they have invested, but also to develop a local industry and to acquire their own research capacity. This refocusing has made it possible to develop major local players that have acquired a regional or even global dimension (in telecoms with Ooredoo, Etisalat, and also with the world leading petrochemical enterprise, the Saudi Arabian SABIC or in airlines with Etihad or Qatar Airways).

2.4 – New technologies, infrastructures and major projects

In recent years, SWFs have diversified from traditional investments and are moving towards new technologies.

Thus, in 2011, SWFs investments in technology were close to \$600 million. By 2014, they had reached \$3 billion in about 20 transactions. They have invested around \$1.5 billion in about ten technology start-ups. In 2014, four SWFs, including Mubadala, accounted for three-quarters of SWFs investments in technology.

Funds invest directly in companies or specialized private equity funds that in turn invest in technology companies. A global quest where they do not hesitate to invest in companies of all sizes and from all over the world, especially emerging countries. Mubadala or PIF are giving increasing attention to artificial intelligence, biotechnologies, *fintech* and in particular blockchain.

For example, the PIF acquired 5% of Uber's shares for \$3.5 billion, the PIF also invested alongside the Japanese SoftBank to launch Vision Fund, the world's largest technology

fund with an expected size of \$100 billion (PIF: \$45 billion, Mubadala: \$15 billion). Internally, it is also the PIF that brings the three flagship projects of Vision 2030: the futuristic Neom city at 500 billion dollars, the leisure city or the Red Sea tourism project.

2.5 – SWFs challenges

The crisis has led SWFs to rethink their investment strategies by diversifying both assets and target regions of the world. Before being saviors of distressed companies or long-term financial support, SWFs are first and foremost wise investors who do not hesitate to give up securities or reduce their share of capital if the prospect of capital appreciation is significant or if the volatility of the securities is such that it requires a rapid sale.

It is important to note that the fall in the price of oil since 2014 has had repercussions on the strategies of some funds, which have been encouraged to actively participate in financing the budget deficit, thereby reducing their room for manoeuvre.

Indeed, profound changes in the organization of Gulf SWFs have been observed in recent years. Two types of funds coexist:

- ➔ Future generation funds, focusing on performance, long-term and foreign investment, particularly in Europe, the US and Asia;
- ➔ Funds whose main purpose is local economic development. Foreign investments are driven by their impact on their economies, particularly in terms of technology transfer or wealth creation, as illustrated by the emergence of sectoral funds such as Hassad Food (in agriculture and food security), QSI (in sport), Qatari Diar (in real estate), Katara hospitality (in luxury hotels) and TAQA (in power plants and upstream oil).
- ➔ Some funds have set up an organization that allows them to pursue both objectives.

SWFs can now count on young managers, aged thirty or forty years old, who demonstrate real professionalism. Before, long entrusted to expatriates, management is increasingly entrusted to a generation of trained and skilled local people with a perfect knowledge of investment techniques. For example, ADIA is the financial institution with the highest number of Chartered Financial Analyst graduates. From now on, funds will set up their own investment teams, focusing on direct investments or co-investments alongside other funds. However, they continue to work very closely with major Anglo-Saxon consulting firms, which can intervene at several levels, develop their investment strategy or mandate for their direct investments.

These skills will also be necessary for a reallocation of government resources derived from oil to the benefit of major companies in the Persian Gulf in order to turn them into

national champions capable of making international acquisitions in a way that is no longer exclusively financial, but more industrial and strategic. It is in this context that powerful companies have developed in the fields of petrochemistry, aeronautics, telecommunications, etc. These were first imposed on a regional scale before going on to conquer the world. The massive investments made in recent years in new technologies and digital technology reflect a real desire to be fully integrated into modernity and to be at the forefront of future transformations of the global economy.

The real challenge for SWFs is to find the right pace. Indeed, in a region that is sometimes unstable, SWFs must be independent of political powers and economic fluctuations in order to sustain investments and maintain their credibility.