THINK ACT

BEYOND MAINSTREAM

November 2015

How to do business in Iran - successfully

An overview of the benefits and challenges of doing business in Iran and how to prepare

THE BIG 3

OPPORTUNITY

As Iran is opening up, it offers an attractive opportunity for multinationals.

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CHALLENGE

Iran's unique economic situation, business context and culture will not be easy for new entrants.

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SUCCESS

Multinationals can be successful in Iran, but need to adhere to some basic rules.

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Iran offers compelling reasons to do business but only solid preparation will lead to success.

The world reacted with relief and excitement to the signature on 14 July 2015 of the Joint Comprehensive Plan of Action (JCPOA) by Iran, China, France, Russia, United Kingdom, United States, Germany and the European Union. Iranians took to the streets of Tehran to celebrate the end to their isolation whilst executives around the globe toasted this game-changing breakthrough. On 13 October the Iranian parliament approved the JCPOA and it was adopted by the UN Security Council on 18 October. Under this historic agreement the UN, US and EU sanctions that have paralyzed Iran for years will begin to be relaxed once there is an International Atomic Energy Agency (IAEA) verified implementation of agreed nuclear-related measures.

Iran is the only sizeable economy to remain closed off from international business in an ever more globalized world – representing an enticing growth opportunity for multinationals. Within a month of the JCPOA's signature, hotel prices soared and the United Kingdom announced it would reopen its embassy in Tehran. This excitement is justified – there are many global examples of countries experiencing stellar growth after liberalization → **A**.

OPPORTUNITY BECKONS

This enthusiasm towards Iran from the global business community is well-founded as the country offers some compelling reasons to do business. Its fundamentals clearly suggest a sleeping giant, but it's not mere basics that make Iran a tantalizing business destination. The country is relatively sophisticated and the government has ambitions to transform Iran into a regional powerhouse. Foreign companies will find Iran a rewarding target for their goods, technology and expertise.

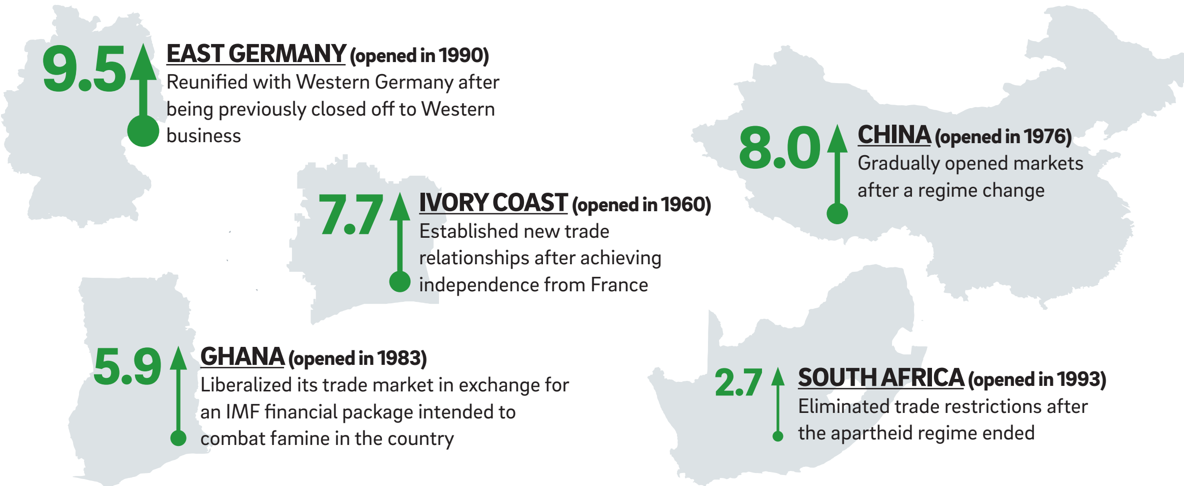
A. STRONG FUNDAMENTALS

At 1.6 million square kilometers, Iran is the 17th largest country in the world and its population of 78 million is similar in size to Germany. Remarkably, 41% of Iranians are below 25 years of age, offering a firm foundation for economic growth. Despite the sanctions and their consequences, Iran's GDP still stands at a sizeable USD 415 billion – almost equal with the United Arab Emirates. Apart from its sheer size, Iran is rich in natural resources: it is the world's largest proven natural gas reserve holder (18.2 % of total) and the third in terms of conventional crude oil

A

OVERVIEW OF HOW OTHER COUNTRIES FARED ECONOMICALLY AFTER OPENING UP

Annual GDP growth in the five years following liberalization [%]



Source: Statistical offices of the German states, Statistical Office of the GDR, World Bank World Development Indicators

reserves. Iran also boasts vast reserves of copper, iron ore, zinc and lead.

Iran is not only rich in natural resources but also in history and culture as one of the world's oldest civilizations dating back over five millennia. This does not constitute a prime economic motivation, but this rich heritage and friendly social environment make working in Iran a pleasant experience.

B. SOPHISTICATION

Although economically classified as a developing or emerging market, Iran can be considered in many ways a developed country. It has strong established industries such as auto manufacturing (capable of producing more than 1 million vehicles per year → B) and pharmaceuticals (mainly generics). Several hundred companies are listed on the Tehran stock exchange and around 8 million Iranians own shares. Its rail infrastructure is internationally respected and the metro system in Tehran can compete with its European counterparts in terms of efficiency and service levels.

Iran has impressive education standards with a youth literacy rate of 98% and a university enrolment rate of 58% (similar to developed countries like France and Germany). Building on the golden era of Persian scientific prowess, Iran is making advances in various areas. Iran ranked 16th on global output of academic articles and is placed 43rd worldwide on availability of scientists and engineers. Bloomberg included Iran in their 2013 overview of the 50 most innovative countries.

Despite its economic isolation, Iranians are generally more internationally oriented than western media would have us believe. Foreign languages are compulsory at school (with a surprisingly high number of people speaking German) and social media are used extensively to stay abreast of the latest fashion, technological and economic developments. Another important link between Iran and global markets is the Iranian diaspora, which is estimated at between four and five million people (although some believe the actual number is much higher), located mostly in Europe, the Middle East and North America. They are often well established in their adopted countries (e.g. many Iranians hold senior positions in Silicon Valley companies) and gain valuable international experiences to bring home – numerous Iranian executives and government officials have studied abroad, including the best universities in the US, UK, France and Germany.

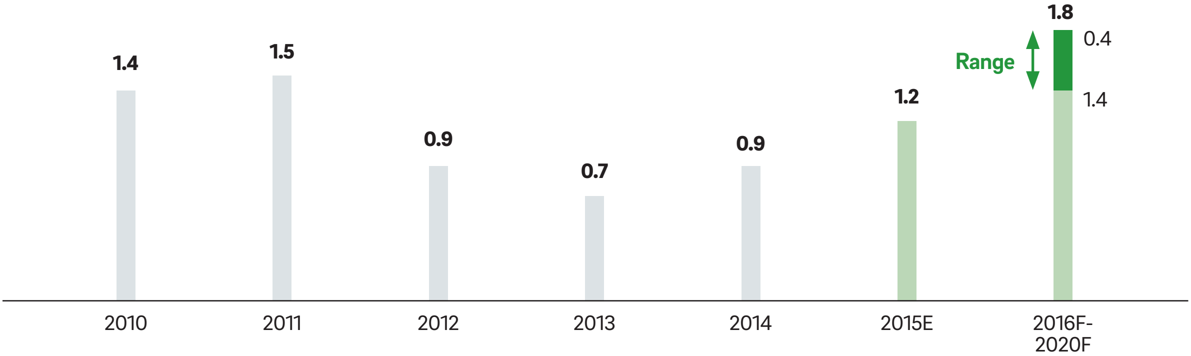
The Iranian population is tech-savvy and rapidly digitizing with 35 million smartphones and an Internet

B

AUTOMOTIVE DEEP-DIVE

Yearly passenger car sales in Iran [millions]

Iran has a large automotive industry with six major car manufacturing groups, and is expected to grow driven by economic reform, scrapage of old cars, and demand for foreign cars



Source: OICA, IHS, Roland Berger

penetration above 50%. Social media usage is widespread and Iran has witnessed a surge in online services in the past few years. A positive side effect of the national censorship is that large international ecommerce players like Amazon and eBay are blocked, providing a unique and protected market for local companies to address. Although the nascent ecommerce industry is hampered by lack of capital, know-how and a limited number of operating licenses, the thirst for digital services will quickly put Iran on par with its regional peers. The country's leading ecommerce player, Digikala, is already estimated to be worth around USD 300 million.

C. AMBITION

The Iranian government has ambitious plans for the country's future with domestic industries being stronger exporters, reduced unemployment and research and development to become even more central to growth (with a target of 4% of GDP spent on R&D by 2030).

Iran is increasingly nurturing SMEs and business creation, clearly acknowledging their importance for growth. To further spur entrepreneurship, awareness campaigns are being launched and policies implemented to create a friendly environment for new business. On the 'Ease of Doing Business' Index for the category 'Starting Your Own Business', Iran is currently ranked 62nd out of 189 countries – a promising score. Numerous Iranian accelerators and incubators are further evidence of a growing base of young entrepreneurs.

These initiatives demonstrate an ambitious drive for Iran to become both a hub in a region with more than 400 million inhabitants and a global business player to be reckoned with.

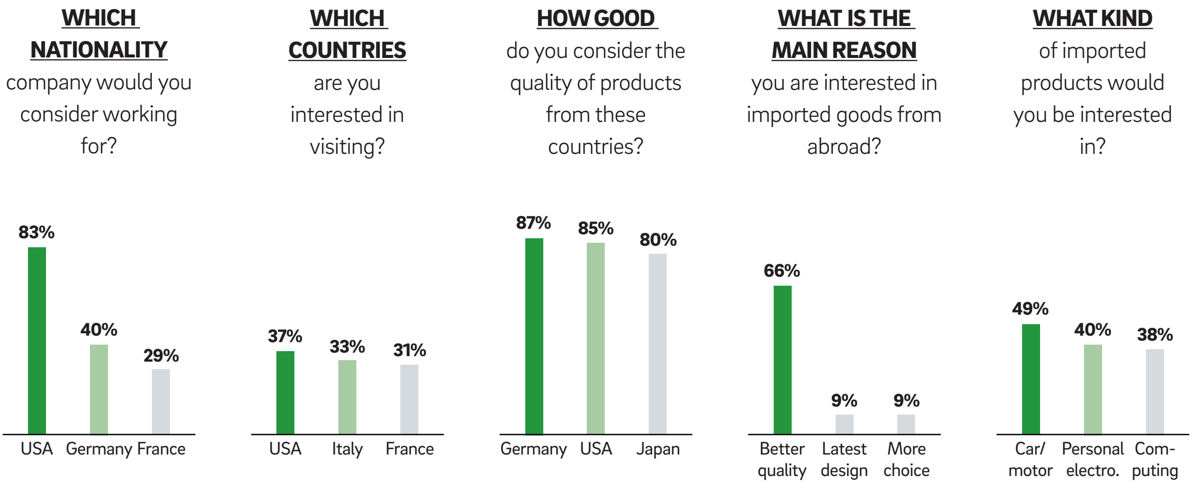
D. HELP NEEDED

Iran's allure is derived from the business opportunities it offers. Iran's natural resources ignite great interest and have a prominent role in the Iranian economy: in 2014, 80% of the USD 64 billion exports were hydrocarbons, of which more than 75% found its way to China, India and Turkey. Once sanctions are eased, other countries should be able to tap into these natural resources. Furthermore, Iran announced plans to increase output significantly, offering opportunities for foreign companies with the right expertise and financial strength to boost extraction and refinery infrastructure.

With a total spend of USD 180 billion, Iranian consumers are an undeniable attraction for foreign companies. The young population has already developed an affinity for foreign brands. One survey by

C

IRANIAN CONSUMER ATTITUDES TOWARD THE OPPORTUNITY FOR FOREIGN COMPANIES TO SELL GOODS AND SERVICES IN IRAN



Note: Survey conducted by On Device Research in August 2015 via mobile internet for a sample of 1,000 Iranians

On Device shows that 66% of respondents prefer imported goods because of their perceived better quality → C. Shops in Tehran are stocked with European apparel, Asian electronics and American beverages. These brands often find their way into Iran through the grey market or are well-executed "knock-offs" such as the 'official' Apple stores in downtown Tehran. Once sanctions are lifted, foreign brands can export directly thereby reducing prices. Foreign companies will then also be able to support the products through marketing and after sales services.

Currently, China is the major source of imports, accounting for 44% of the total, but Western companies are well positioned to challenge them (the aforementioned survey indicates that 87% of Iranians consider German brands to be of high quality, versus only 18% for Chinese).

Foreign companies are not just expected to sell goods – local partners will require foreigners to perform financial investments due to limited financial liquidity, and to bring expertise and know-how to professionalize their business. Practically all industries, ranging from car manufacturers to banking are in need of upgrades. For example, only 6% of the retail industry is organized (similar to Pakistan). Foreign retail players can help professionalize retail operations, such as category management and procurement.

A CHALLENGING PLACE TO DO BUSINESS

With all these positives, Iran is being discussed in the boardrooms of many multinationals, but at the same time it is not an easy place to do business and foreign companies must tread with care.

Despite a promising outlook, Iran is still a fragile economy, plagued with uncertainties. Foreign companies need to establish a strategy for coping with Iran's unique business context and culture. The Iranian government understands that foreigners are nervous about conducting business in Iran and emphasizes privatization and economic reform – some experts believe this is even more important than the lifting of sanctions and eagerly anticipate more economic reform.

A. FRAGILE ECONOMY

Although of considerable size and impressively resilient whilst facing international sanctions (with strong scores on national savings and government debt and serious attempts to boost non-oil exports), the Iranian economy is still fragile – making foreign players wary. Iran's unstable economic context, largely due to sanctions, creates uncertainty around workforce availability, regulatory initiatives that impact business dealings and guarantees of government contracts, and makes the country as a whole more vulnerable to global shocks.

The Iranian government is wrestling with a mounting budget deficit as the fiscal budget for 2015 cannot be balanced with the current low oil price. Some relief is expected from access to over USD 100 billion of oil revenues frozen abroad, but nevertheless government spending will be under pressure. Similarly, Iran is scoring high on the Misery Index, which is calculated by adding the unemployment rate to the inflation rate. The Misery Index assumes that both a higher rate of unemployment and a worsening of inflation create economic and social costs for a country. The indicator surged in the past few years and will take time to return to more normal levels. Combined with the huge currency shocks of the past years and the challenging banking sector, Iran faces a massive task in laying down the foundations for a well-functioning economy.

Given the difficult background, numerous educated Iranians have left the country over the last decade. Each year, around 150,000 talented people emigrate from Iran (which is equivalent to an annual loss of USD 150 billion for the country according to the Iranian Minister of Science, Research and Technology). Such brain-drain undermines economic growth prospects and adds to the fragility of the Iranian economy.

B. BUSINESS CONTEXT

Operating in the Iranian business sector is not necessarily simple either. Iran typically ends up towards the bottom of various indices such as Ease of Doing Business, Global Competitiveness and Network Readiness → D. Although Iran scores well on some dimensions, it cannot be ignored that doing business there has its challenges.

Taxes used to be opaque in the past. This landed the country in 123rd place (out of 189) on Paying Taxes in the Ease of Doing Business index, a score driven particularly by the complex tax structure and the amount of time spent on filing. Foreign companies will face similar issues with the local employment regulation. The rigid labor laws are very employee-friendly and offer limited options to lay off staff.

A further obstacle is the sheer amount of red tape. Iran is a highly centralized country with the government regulating (close to) all activities. Even a basic request requires complex forms, administrative processes and stamps of approval. One can expect serious delays when dealing, for example, with construction permits and property registration.

A final point concerns the lack of transparency with regard to companies' ownership. Private and public companies are often entangled in a web of holdings and cross-participations, making it hard to understand who you are really dealing with, and given the active role of the government in the past, with an influence beyond regulation, large truly private companies are rare (but, where they exist, tend to be well-run).

C. BUSINESS CULTURE

Iran's business culture is characterized by centralization and consensus at senior management level. Delegation of responsibility to lower levels is rare and senior management is involved in most decisions. Once matters have reached the senior level, then various boards, members and committees must be consulted before anything is signed off. Such drawn-out processes have obvious implications for the speed of decision-making.

Borders between personal relationships, community and business tend to be blurred. Family friends are brought into meetings to consult and middlemen can demand decision-process involvement. Such nepotism is probably a side effect of the collectivist consciousness but needs to be acknowledged when operating in Iranian territory – it can become a substantial roadblock if not carefully managed.

FOUR RULES FOR SUCCESSFUL BUSINESS

Clearly, entering Iran is not as attractive as a first look would have us believe. However, most obstacles can be overcome if companies adhere to certain rules and guidelines. Some foreign companies are better positioned than others (e.g., based on perceived product features or loyalty throughout the sanction years), but in principle most foreign companies should be able to be successful in Iran. We have identified four rules to facilitate a smooth entry.

I. GET THE BASICS RIGHT

Before flying off to Iran, it is essential to do one's homework. A good understanding of the country's history, culture and business landscape is a minimum

D

IRAN'S SCORES ON VARIOUS INDICES
Ranking [out of total countries]

2015 **Global Competitiveness** 74/140

2016 **Ease of Doing Business** 118/189

2015 **Networked Readiness** 96/143

2014 **Corruption** 136/174

2016 **Paying Taxes** 123/189

Sources: World Bank Group, World Economic Forum, Transparency International

condition. The same goes for language capabilities: many documents are only available in Persian and some older Iranians do not speak English or German. Having Persian speakers in your team will prove invaluable.

Gaining a good understanding and the build-up of trust will not happen overnight, and certainly not through emails and conference calls. Expect to be present often and ideally establish an anchor on the ground. The country and all its intricacies demand frequent face-to-face interactions.

II. START AT THE TOP – BUT BE AWARE OF MIDDLEMEN

Given the centralized nature of companies and governments bodies, it will take considerable time to get anything off the ground if companies start at the lower end. Aim for an entry point in the highest echelons of an organization. It may not be easy at first, but it will speed up the overall process (and expect to mirror the level of seniority in terms of attendance).

It is always best to go directly to senior management when possible. If this proves difficult, foreign companies may need to leverage middlemen to gain access – a common practice in the Middle East which can be an effective business accelerator. Such locals can possess essential know-how on how to navigate within their culture and have the right contacts, but using these individuals requires careful consideration of compliance regulations and it comes with certain risks.

For example, it can initially seem to work well by opening doors and helping to identify opportunities. Later, it may turn out that the middleman has his own agenda or that he closed other doors for you, or that he promised contacts which turn out to be weak and months are wasted.

Companies should therefore tread carefully, particularly given the vast number of agents and intermediaries that have sprung up in the wake of the positive nuclear deal negotiations. Selecting a reliable middleman could be one of the most strategic moves that a company entering Iran makes.

III. PREPARE YOURSELF LEGALLY

Following the JCPOA, it is expected that most economic sanctions for non US-companies will be lifted or relaxed in the first quarter of 2016. However, regardless of the status of sanctions – whether they are in the process of being relaxed or are already lifted upon entering Iran – companies need to have a good understanding of the Iranian legal context in order to mitigate their investment risk.

One way to mitigate investment risk is to structure the business in a way that it falls under a Bilateral Investment Treaty (BIT) and/or another investment agreement. There are 52 BITs in force between Iran and other countries, such as Germany, France, Italy, Austria and Switzerland. Amongst other things, BITs with Iran provide protection against expropriation without compensation, free transfer of capital, guaranteed equal treatment with nationals and, in principle, the possibility of arbitration proceedings (UNCITRAL), even though the free choice of the governing law is limited.

In addition to the BITs, protection and incentives are also provided under Iranian national law. The Foreign Investment Promotion and Protection Act 2002 (FIPPA) guarantees important privileges to foreign investments such as an equal treatment standard, transfer of funds and dividends, compensation against expropriation and access to foreign courts. However, in order to be privileged, the foreign investor has to obtain a permit from the so called OIETAI Organization. The permit will be issued fairly promptly, if – based on a substantial business plan – the applicant can demonstrate that the business activities are eligible (e.g. not purely commercial). So, as is often the case, the devil is in the detail. Thus, the careful and timely preparation of the business plan is essential.

A positive aspect is that foreign investors are, with few exceptions, allowed to hold up to 100% of the shares when investing in Iranian companies, which is a rare privilege in this region. Foreign investors can also choose freely between the legal forms provided by Iranian Commercial Law, with the Private Joint Stock Company proving to be the most common and suitable corporation form for foreign investors.

There are also various tax and legal provisions privileging the establishment of foreign companies in free trade zones and special economic zones. Iran has concluded numerous double taxation conventions (DTC) essentially based on the OECD Model Tax Convention with Germany, France, Spain, Austria and Switzerland. However, knowledge of the Iranian practice of implementing the relevant dispositions is essential for any tax optimized structuring → E.

Overall, the legal framework in Iran is mature, but it can hold surprises. It is highly advisable to engage a law firm with expertise in international business that has on-the-ground experience in Iran and can demonstrate up-to-date and reliable knowledge.

IV. POSITION FOR THE LONG TERM

Although establishing a company does not legally require an Iranian partner, no matter the type of business, foreign companies are dependent on local Iranian companies and need to establish such partnerships. Looking for a partner may seem easy given the sheer size of the economy, but the packed hotels in Tehran indicate the interest is high and many companies are vying for the same business.

A differentiating and long-term positioning is crucial to spark interest. Providing financial investment is appreciated (and needed) but is more a hygiene factor than a true differentiating factor for a sustainable partnership. Iranian partners expect a long-term commitment from foreign companies and this means collectively building a business, based on mutual respect and transfer of knowledge and expertise. To support such an approach, building local employment through offices and factories is a strong commitment.

A long-term approach will be partly automatic. When doing business in Iran, one key virtue is patience. Decision-making simply takes time due to the culture and administrative roadblocks. When meetings are closed with clear next steps, expect the timelines to be fluid. Pushing the partners in the beginning is a great way to start off on the wrong foot, so prepare for long timelines and unexpected hurdles.

For some foreign companies, conducting business in Iran will become a reality in the short term while others will choose a passive approach as they find this unique country somewhat daunting. We believe that the Iranian opportunity is too big to ignore and companies around the world should start preparing themselves today in order to hit the ground running. We know that it will not be a smooth ride for most, but with a readiness to invest and learn, successful business in Iran is achievable. Or to put it in the words of the famous 13th-century Persian poet and scholar Rumi: "As you start to walk on the way, the way appears".

E

LEGAL FRAMEWORK FOR INVESTMENTS

INVESTMENT
recognized under FIPPA

Foreign Direct Investments (Equity Participation):

- Purchase of Shares of an Iranian Company
- Joint Venture Company
- New Company or Branch Office

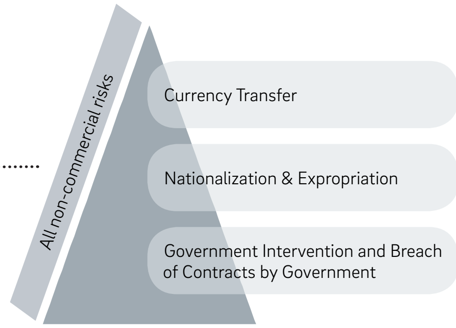
Investment through Contractual Arrangements (Non-Equity Forms):

- Buy Back Arrangements
- Civil Partnerships
- BOT Schemes

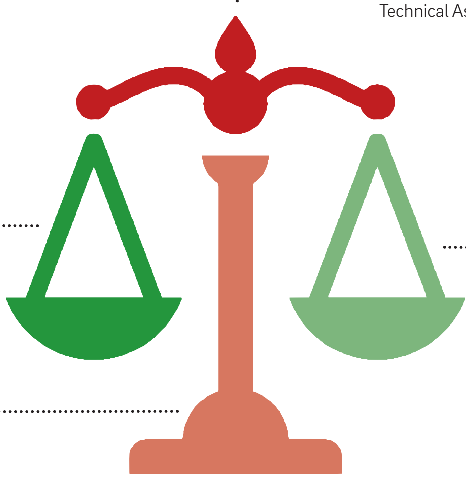
Areas of investment:

- All activities in Industry, Mining, Agriculture, and Services (in greenfield projects, brownfield projects and existing companies); pure commercial/trade activities not eligible under FIPPA

RISKS
covered under FIPPA



Source: Organization for Investment, Economic and Technical Assistance of Iran (OIETAI)



TAX REGIME

- **25%** flat rate as fixed Corporate Income Tax
- **100%** of Exemptions of Income Tax for 20 Years in Less Developed Regions (All Activities)
- **100%** of Exemptions of Income Tax for 20 Years in Free Trade Zones (All Activities)
- **100%** Exemptions of Income Tax Derived from Exportation for Unlimited Time
- **100%** Exemptions of Income Tax for Unlimited Time Derived from Agricultural Activities
- **80%** Exemptions of Income Tax for 4 Years in Production Activities
- **50%** Exemptions of Income Tax for Unlimited Time Derived from Tourism Activities
- Numerous **Double Taxation Conventions** (e.g. Germany and France)

ESTABLISHMENT
of Business in Iran

- Through **Companies and Corporations:** Private Joint Stock Company (Sherkat-e Sahaami-e Khaas), Joint Stock Company (Sherkat-e Sahaami-e Aam) or Limited Liability Company (Sherkat baa Mas'ouliyat-e Mahdood); 100 % Foreign Shareholding possible; in practice, the Joint Stock Company being the most common form used for foreign investments
- Through **Limited Partnerships**
- Through **Branches or Representative Offices**

Article sources: BP, Worldbank, CIA World Factbook, OPEC, ACL, Wikipedia, The Economist, Scimago JR, Bloomberg, GSMA, Internet World Stats, Iran 20-year comprehensive plan for science, ITC, Euromonitor, Central Bank of Iran, The Fiscal Times, Mehr News, Financial Times, Washington Post

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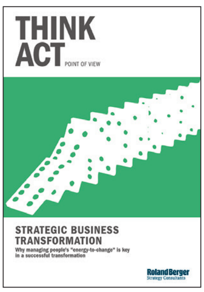

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