PRACTICE NOTE ON
LOCAL PARTICIPATION REQUIREMENTS WHEN INVESTING
IN THE MIDDLE EAST AND SOUTHEAST ASIA

Practice Notes represent the author's view of good practice in a particular area. They are not legal advice and the author will not accept any legal liability in relation to them.

Issue

Many countries limit foreign ownership of businesses through foreign investment laws that include a "negative list" of sectors which are either entirely or partially closed to foreign investment. Apart from the obvious financial consequences, depending on the jurisdiction majority local ownership of a company may also mean that the manager must be a local citizen, limit the number of work permits/visas available for foreigners, and affect the company's ability to bid on government contracts.

Two regions where local participation requirements are common are the Middle East and Southeast Asia.

Middle East

Countries where a foreign investor can hold 100% of capital in most sectors include:

- Bahrain
- Egypt
- Iraq
- Lebanon
- United Arab Emirates (through free zones in Dubai and Abu Dhabi)

Countries where a foreign investor can hold a minority interest in most sectors include:

- Jordan
- Kuwait
- Qatar
- United Arab Emirates

Countries where a foreign investor may not be a shareholder without special auhorization include:

- Saudi Arabia (pursuant to an investment license issued by SAGIA, but subject to higher tax than local companies)

Southeast Asia

Countries where a foreign investor can only hold a minority interest in most sectors include:

- Indonesia
- Malaysia (to be able to contract with government entities)
- Philippines
- Thailand (except for U.S. investors)

Sanctions

Most countries with local participation requirements have also passed laws prohibiting foreign investors and local citizens from entering into arrangements whereby the local partner agrees to hold legal ownership in a local company on behalf of the foreign investor when the foreign investment law prohibits the foreign investor from holding such ownership directly. Sanctions for violations of such so-called "anti cover-up" or "anti-dummy" laws include fines and, in some cases, imprisonment. At the very least, any prohibited arrangement would be unenforceable under local law. In some countries, there are financial incentives for whistle-blowers.

Strategy

Careful planning when setting up operations in these regions can often permit foreign investors to retain effective control over such operations.

For example, it may make commercial sense to base operations in countries where 100% foreign-owned companies are authorized and have those companies enter into contracts with customers in countries in the region with local participation requirements, subcontracting services to affiliates or third parties in the countries with local participation requirements, as necessary.

In other cases, it may be possible for the foreign shareholder to comply with local participation requirements and still retain effective control of the local company through the use of preferred stock and by careful drafting of the governance provisions of the local company's articles of incorporation and by-laws.

In all cases, it will be necessary to review each country's foreign investment law in light of the foreign investor's business and existing operations in the region and globally to determine the optimum legal structure in each country.

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