



Entering the Iranian market

Opportunities and Risks

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The signing of the Joint Comprehensive Plan of Action (JCPOA) in July 2015 and its implementation in January 2016 has fuelled increased interest in Iran from potential Western foreign investors.

This is most apparent in the oil and gas sector; international oil companies (IOCs) have sent several delegations to Tehran this year and held meetings on the side-lines of negotiations in Vienna. Other sectors, too, are keen on Iran; companies in the automobile, banking, and hospitality sectors have accompanied the dozens of trade delegations.

Iran is opening for business

In return, Iran's government, led by President Hassan Rouhani, has shown that it is keen to attract investment once sanctions begin to be lifted. Minister of Oil Bijan Zanganeh has set an ambitious goal of attracting USD 100 billion investment in the oil sector. Improved terms for oil contracts and reforms to improve the country's investment climate are reassuring clients. A conference to unveil new model contracts for IOCs has been organised for February 2016 in London.

Some deals have already been struck. Royal Dutch Shell and Total have recently been granted licenses to operate 100 branded service stations each.

In non-oil and gas sectors, AccorHotels are set to take over two hotels near Tehran's Imam Khomeini Airport. Other companies have announced big plans for investment. Renault and Peugeot are competing to dominate Iran's automobile market by expanding the joint ventures they already operate in the country.

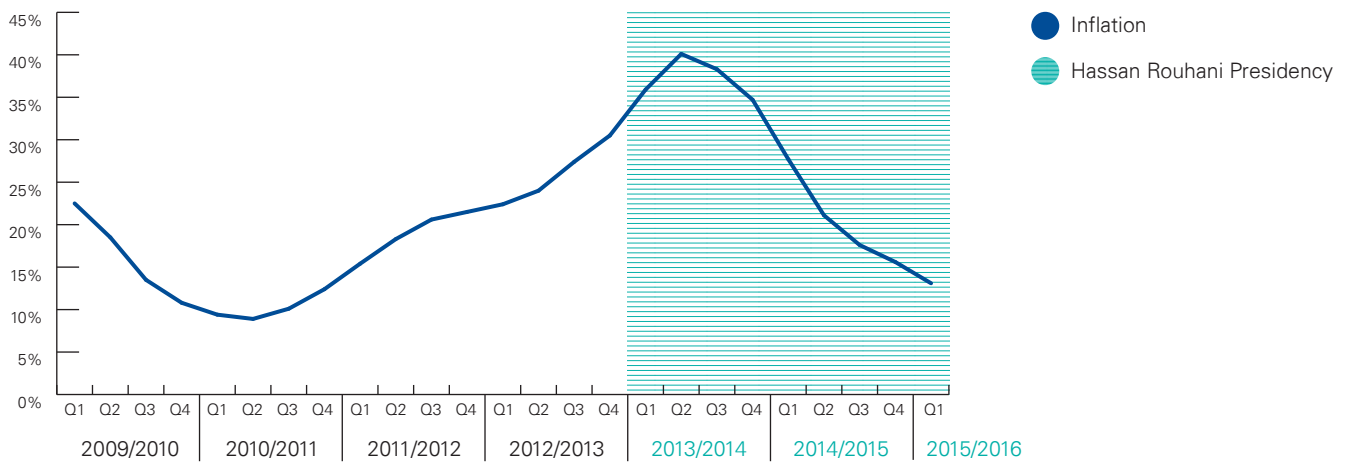
The government is reforming

Interest in the country has been bolstered by a government with a mandate for reform. Inflation has been cut from 40% in 2013 to current levels of around 13.1% and the current budget has raised tax and privatisation revenue by 22.6% and 26.8% year to year, respectively. In July, the president wrote an open letter stating his intention to undertake "structural reform" of the economy.

Low oil prices have meant that growth has remained slow at 3.0%, though long term growth will be driven by a young population (60% under the age of 30) and high rates of education and technological penetration in what is one of the region's most diversified economies.

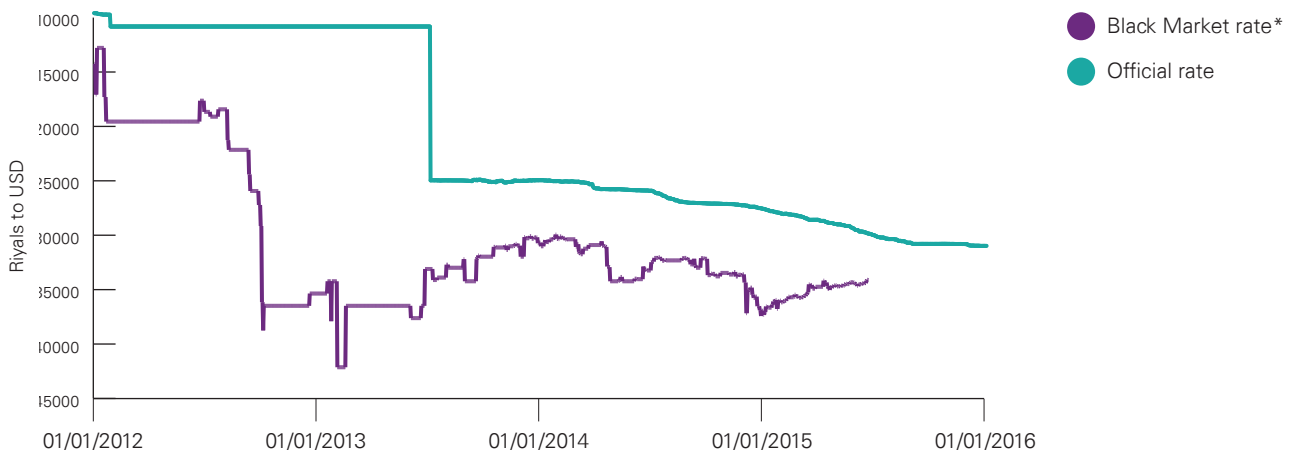
Improved terms for oil contracts and reforms to improve the country's investment climate are reassuring clients

Inflation



Source: Central Bank of Iran

Iranian Riyal: Official vs Black Market Rate



Source: Central Bank of Iran, UANI
 *Figures only available to 16 June 2015

Continued risks

While foreign firms stand to gain from this growth in the long term, we believe that initial investors should consider their next steps carefully as several risks remain:

Sanctions will remain a key consideration for initial investors.

Following the International Atomic Energy Agency's (IAEA) confirmation that Iran has met its commitments under the agreement, the EU has lifted the majority of its restrictions on financial transactions with Iran.

Many sanctions not covered by the JCPOA will remain in place. EU and US sanctions targeting terrorism and human rights violations will continue. U.S primary sanctions will remain in place for the foreseeable future, significantly limiting the ability of American companies to do business in Iran. Those sanctions that are lifted could still "snap-back" into place if Iran fails to uphold its commitments under the agreement.

Oil and gas will receive priority, and investment in other sectors may be slow initially.

The lifting of sanctions will provide an immediate opportunity for the Iranian government to attract foreign investment from major oil and gas companies. A source with contacts in the Iranian government told us that "it is clear the government has been prioritising oil and gas and is expecting significant investment."

Upon implementation of the JCPOA the EU will no longer prohibit most forms of oil and gas trade with Iran and will lift asset freezes it has placed on the key government entities that administer the sector. Foreign companies will immediately be able to enter into joint ventures with Iranian companies. That investment could help Iran position itself as a future exporter of natural gas to Europe. To date, it has produced at levels necessary to meet domestic consumption, despite holding 15.8% of the world's gas reserves.

Other sectors will see a slower pace of investment. Banks, in particular, will be reluctant to enter Iran until they have more clarity on how remaining US sanctions will impact them. More clarity will come when the Office of Foreign Assets Control releases its guidelines on Iran sanctions early next year.

The IRGC has branched out and today wields significant control over Iran's key industries

Third-party and reputational risks will be high.

In particular, companies will need to avoid partnering with entities associated with the Iranian Revolutionary Guards Corps (IRGC), which most non-nuclear sanctions target. Originally an armed force mandated to protect the country's leadership from coup attempts, the IRGC has branched out and today wields significant control over Iran's key industries. Its companies operate in the oil and gas, construction and import.

Some estimates suggest the IRGC controls a third of the country's GDP, using holding companies and 'bonyads', charitable organisations that carry tax-exempt status and are involved in an array of consumer goods production.

The IRGC has benefited from a privatisation drive that has seen 53% of state-owned assets sold-off since 2005. In 2009, Telecoms Company Iran (TCI) was sold for USD 7.8 billion to a consortium of companies associated with the IRGC. Corporate intelligence is essential to avoid the risk of partnering with politically exposed and sanctioned parties.

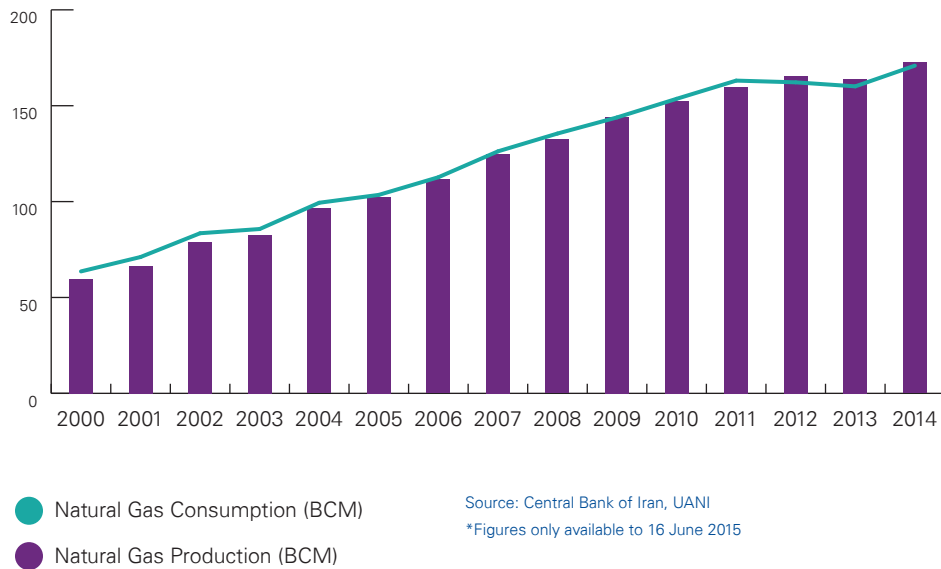
Foreign investment will threaten entrenched interests of the business elite.

Conservative reaction to foreign, particularly Western, investment, provides long-term risk.

Foreign investors will compete with the IRGC's market share of key industries, threatening its commercial and political interests. We anticipate that this will trigger some degree of push-back.

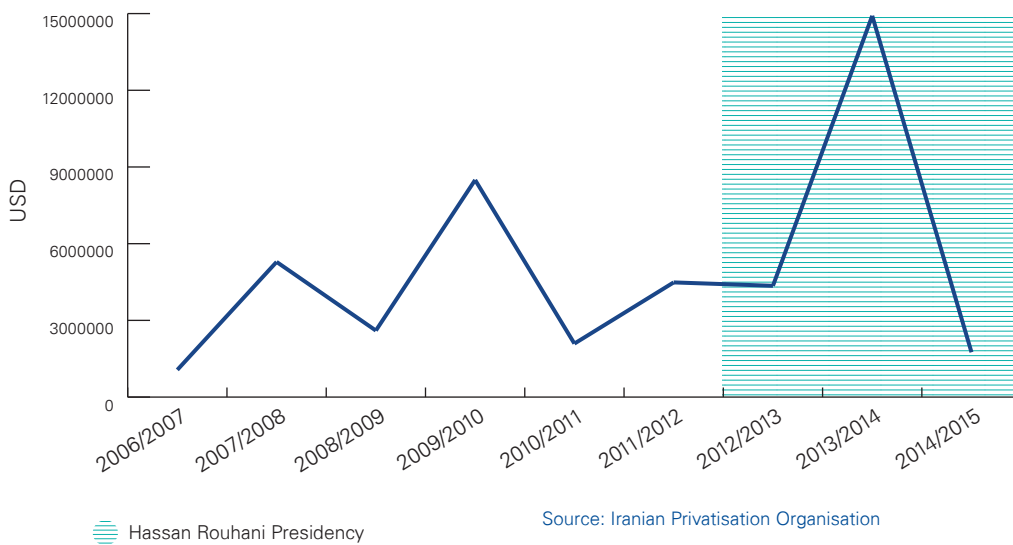
Worryingly, the IRGC could take more aggressive steps that threaten the interests of foreign investors. In 2004, IRGC forces occupied the runway at Imam Khomeini Airport to protest about a deal under which the airport's management would be contracted to a Turkish-Austrian consortium. The deal was cancelled and management of the airport was handed to the IRGC. One of our sources with deep knowledge of the IRGC says that he "wouldn't rule out the possibility of a 2004 scenario happening again, but short term interests mean it is unlikely" in the near future.

Natural gas production vs consumption



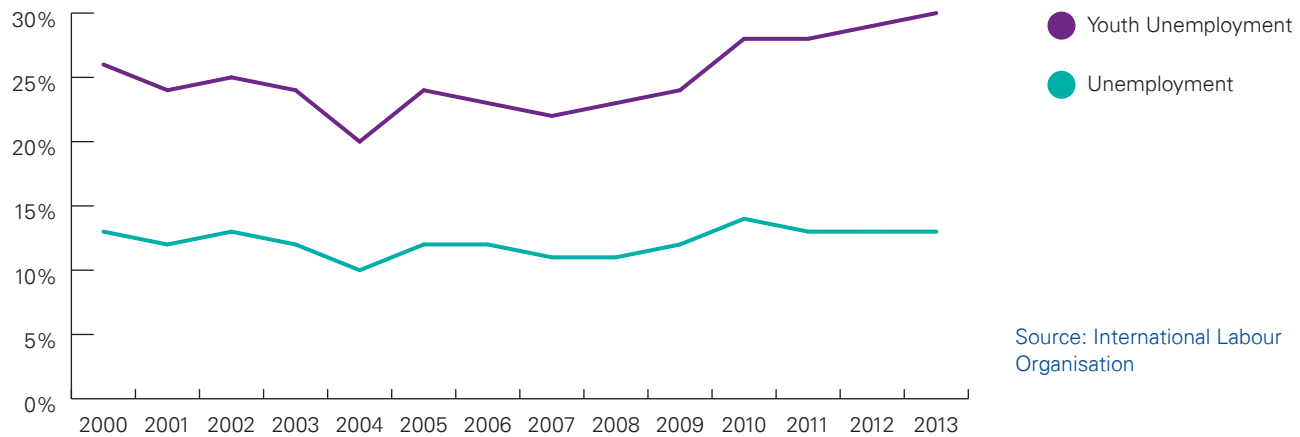
Untapped reserves: Iran has only been producing enough gas to meet domestic demand

Privatisation since 2006



Asset sale: The government's privatisation scheme has seen major state-owned companies sold to investors, often with ties to the IRGC

Youth Unemployment



Much of Iran's policy remains protectionist and its business environment is unclear.

The Iranian economy is in need of significant reform. The Foreign Investment Promotion and Protection Act, adopted in 2002 to regulate foreign investment, contains vaguely worded articles that leave foreign companies vulnerable to nationalisation. Article 53 of Iran's constitution bans foreign ownership of the country's natural resources and has resulted in energy contracts with historically unfavourable conditions to IOCs.

All our sources agree that reform will be slow. Raising steel tariffs last March and imposing import duties on wheat and barley in June raise questions on the government's commitment to open Iran's economy. One of our sources told us that "if there will be reform, it will be in areas needed the most, such as oil and gas."

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Domestic unrest and regional politics are long term risks .

Though the country is unlikely to witness a protest movement of the kind that brought the country to a standstill following the 2009 presidential elections in the near future, high levels of unemployment (10%), inflation (13.1%), and restrictions on political freedoms remain potential catalysts for unrest. Recent protests against educational freedoms and the low quality of domestically manufactured automobiles, though relatively small, show that grievances exist. New grievances will likely emerge should the high expectations of a post-sanction Iran not materialise.

Internationally, Iran's involvement in conflicts in Syria and Yemen and its support for proxy parties across the region will continue to be a source of tension with regional powers, including Israel and Saudi Arabia. Doing business in Iran could pose a potential reputational risk for firms with a presence in the GCC.

How we can help

Our dedicated corporate intelligence team in London has extensive experience of conducting integrity due diligence on companies and their owners and principals in a variety of jurisdictions, with particular expertise in the MENA and Sub-Saharan Africa regions. Our team includes Arabic and Farsi speakers who have lived and worked in the MENA region. We work alongside colleagues in the region, who have first-hand experience of the risks encountered by foreign companies operating in the country.

We offer a range of integrity due diligence services ranging from standardised first-level screening based on research of information in the public domain only, to in-depth, bespoke integrity due diligence services incorporating confidential enquiries with sources familiar with your proposed business partner and its management. Our wide service offering enables our clients to select the appropriate level of due diligence based on their own risk assessment criteria.

Contact us

To discuss these risks further and how KPMG's corporate intelligence team can help, contact:

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