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Asia in the Middle East: The Internationalization of Singapore Private Firms into the GCC

Wilfred How Pow Ngee
Singapore Management University, Singapore

Caroline Yeoh
Singapore Management University, Singapore
Email: carolineyeoh@smu.edu.sg

Sharmaine Neo Si Min
Singapore Management University, Singapore

Abstract

Internationalization efforts into the GCC as a national initiative tend to be spearheaded by a vanguard of government-linked companies (GLCs), usually assisted in their entry through various connections, political or otherwise. As large companies with the presumed reliability of government backing, these GLCs tend to be involved in larger-scale, more critical, and more iconic projects. It is a matter of fact, however, that while internationalization may be led by large-scale and attention-grabbing GLCs, the vast majority of FDI and economic activity is, in the long term, entrenched in the activities of private companies. As such, it must logically follow that the study of these companies and their experiences in the Middle East must be of paramount relevance to assessing the state of internationalization into the region. In this paper, therefore, we focus the ambit of our continuing research into the internationalization efforts of Singapore into the Middle East onto several case studies of Singapore private firms in the GCC, and seek to derive observations pertinent both to the idiosyncrasies of Singapore business in the context of the Middle East, and conclusions pertinent to private firms across the globe with an interest in the region's rich yet cryptic business environments.

Keywords: Asia, Middle East, GCC, Singapore, internationalization, private sector

Introduction

It is a statement of simple fact that the Middle East, in recent years, has been a region at the centre of a constant whirl of economic headlines, both positive and negative. Equally undeniable is the fact that, despite the varying flavours of these economic headlines, the countries of the Middle East region, and of the Gulf Co-operation Council (GCC) in particular, continue to be, and will remain, for the foreseeable future, trading partners and economic destinations of premier importance. Nor does this premier importance rest merely upon the region's critical role in energy provision for the world, but also upon the relatively new and

ravenous appetite of the region for trade and investment, and the continuous (and, in some parts, arguably overboard) pouring of revenue into large-scale infrastructural development and diversification strategies into a variety of industries. And both of these relatively recent directions of development in the GCC have, arguably, further aligned the region's interest with that of their growing number of Asian business partners, equally hungry to feed a fast pace of economic development and ever-growing global economic relevance.

The GCC's development initiatives, in fact, while still relatively recent, are not a new development per se; trade figures from the GCC have been moving away from the long-standing oil-centric economic ties to OECD countries since the late 1990s, towards emerging markets across the world and most particularly in Asia, a function of the growing demand in these markets for not just oil, but also for capital (domestically) and economic space and opportunity (internationally). In recent years, especially, owing heavily to meteoric growth in China, Asia has overtaken most of the GCC's trading partners in volume and prominence; in context, Asia's share of trade with the GCC expanded from just 10% in 1980 to 36% by 2009, with growth in trade with Asia at an effective rate of 12% per year since 1980, double the rate of growth with the OECD. (Economist Intelligence Unit, 2011) Should this pattern continue, Asia is projected to become the GCC's biggest trading partner by 2017, largely accounted for by India, China, and Indonesia, but with significant contributions by other prominent Asian economies – among them Singapore, a country with a history of purposeful and persistent international expansion strategies.

The city-state of Singapore occupies, in many ways, a unique position in Asia; a highly developed nation with a strong economy, despite its infinitesimally small size and dearth of natural resources. It would perhaps not at all be an exaggeration to say that the continued growth of Singapore's economy has largely been due to the city state’s recognition at the onset that it needed to plug itself into the global economy, and to subsequent and continuing efforts to meet this need. Possessing limited economic space and subject to the inevitable rising cost structures of doing business at home, means were sought to encapsulate economic space overseas into which local enterprises could find room to grow their operations. Regionalization, and later, internationalization, became the city-state's key to unlock new and larger markets, and the policy document, Singapore Unlimited (Singapore Development Board, 1995) encapsulated this paradigm shift.

Initial attempts to redistribute resource-dependent operations – particularly those of private local enterprises (PLEs) – to economic spaces orchestrated by the state in other countries reflected the city-state's government’s intent to extend the Singapore state enterprise network, or Singapore Inc., to the region (Yeoh & Wong, 2005; How & Yeoh, 2007); a hallmark of these initiatives laid in the major involvement of the Singapore government itself, from provision of management to negotiation of incentives aimed at, for the most part, enticing the abovementioned PLEs to expand into these economic havens. As regionalization initiatives gave way to the current broader internationalization drives, however, the marked difference in the cultural, legal, and financial profiles of the city-state's new areas of exploration, along with the city-state's own previous experiences with regionalization initiatives, made it clear that a similar

strategy of heavy government intervention would be suboptimal, at best. Going forward, a more firm-oriented approach would have to be taken with regards to internationalization; one relying very much more on the capabilities of Singapore firms themselves.

Nowhere, of course, exemplifies a cornucopia of both the abovementioned critical differences in cultural, legal, and financial profiles conflated with a fertile bed of economic opportunity more than the GCC. Singapore's approach to internationalization into the GCC combines the expected and traditional trailblazing by government-linked companies (GLCs) with various forms of indirect support for private enterprises through governmental organizations and otherwise, and with efforts towards promoting greater awareness and understanding of, and perhaps more importantly, interest in the Middle East domestically – a concerted and intentional effort, it can be inferred, towards creating indirect incentives for PLEs to enter the GCC, to encourage a self-sustaining and critical mass of Singapore private enterprise in this new frontier.

The efficacy of this tactic, however, remains to be seen. That Singapore GLCs have established a strong internationalizing presence in the GCC – most especially the United Arab Emirates (UAE) – is without a doubt; such GLCs have been involved in a good number of flagship infrastructural and property developments, the eventual fate of some of the latter notwithstanding, and arguably have indeed played the role of vanguard and trailblazer in a most exemplary fashion. Indeed, in a ranking of the top 100 Singapore international companies, the top 12 are dominated by GLCs (IE Singapore, 2007), many of which are or have been involved in the GCC. That this is the case is, however, possibly in and of itself a matter of concern; suggesting, as it does, evidence towards a confirmation of the perception of a high degree of risk aversion among Singapore PLEs – an especial concern towards internationalization into the GCC, which, to said Singapore PLEs, represents an unfamiliar region with substantial uncertainties, albeit one with high potential return. (Yeoh & How, 2011) In the context of Singapore's internationalization efforts, then, the performance of PLEs currently with operations in the GCC must be of great relevance, both towards the long-term sustainability of internationalization efforts in the region, and, to the city-state particularly, towards the efficacy of current methods of creating economic space on foreign soil for (ironically, perhaps) Singapore private firms.

This paper, thus, continues our research series on Singapore's gambits in the Gulf region, this time with the spotlight on the state of Singapore PLEs that have extended operations into the GCC countries. In the following section, we examine the performance of these PLEs; first presenting theoretical frameworks relevant to the prevalent entry methods taken by said PLEs. We then present three case studies of PLEs which have ventured into the GCC region using these methods, using information gleaned, as always, primarily from face-to-face interviews with senior management personnel involved in the Middle East from the companies in question. From there, we discuss and evaluate the performance of Singapore PLEs in the GCC; drawing conclusions that, we intend, will be of relevance to private enterprises looking to the GCC, and of particular relevance to Singapore's internationalization stratagem and the city-state's intent to reconfigure the economy for the international marketplace.

Theoretical Considerations

Franchising presents an attractive mode of entry PLEs, as it provides, potentially, a lower-risk mode of entry into new markets that are of greater uncertainty and risk. Most franchise businesses are designed for replication; the franchisor tends to look for suitable franchisees with a similar modus operandi in order to ease adaptation of the value chain to the new market. The main challenge of franchising is balancing the additional flexibility of operations with the consistency of the company's brand. For a franchise to be recognizable, certain aspects of branding and identity have to remain consistent across all franchises. This balancing act of the inevitably necessary adaptation of value chains and operations to suit local conditions with consistent branding so as to prevent the dilution of the company's image and reputation is often the deciding factor in how much control the parent company exerts over franchisees – and one that sometimes, needless to say, results in bad decisions.

Under master franchising, in particular, the franchisee gains expanded methods of generating income over that of a normal franchisee, while the franchisor further defrays direct risk. A master-franchising agreement involves two main parties, the franchisor and the franchisee. In this model, the franchisor will deal with just one franchisee which will be responsible for a pre-specified area (Bashel, 2001). A master franchisee can be responsible for tasks such as support and training to maintenance, and receiving fees to paying out royalties. The master franchise relationship is more easily managed and enforced in environments with less-developed regulatory frameworks. The flexibility of a master franchisee stems from the concept of a global franchisor permitting affiliations with other franchisors (Pizanti & Lerner, 2003).

Management contracts as a method of entry, on the other hand, has gained recognition in recent years for being a strategy that holds little asset risk, yet promises the possibility of high yields from the outset. While there are no standardized management contracts, it typically involves the owner assuming full ownership of the capital intensive assets required for the business, and a company with the in-depth knowledge and experience has to bear the responsibility of managing the daily operations for the business (Guilding, 2003). This situation is particularly common in economies which face managerial scarcity (Brooke, 1985).

Management contracts are attractive because owners stand to benefit from a reasonable amount of cash flow without having to operate the business and invest in the necessary human resources (Horwath and Horwath, 1988). Operators meanwhile, receive monetary incentives from managing the business, and it gains the exposure to market its brand internationally without investing heavily in the capital assets required (Welch and Pacifico, 1990). This strategy theoretically results in both parties being better off but drawbacks manifest itself in the agency problem that management contracts create. A divorce in the goals of the business for the operator and owner can lead to volatile situations that undermine the fundamental assurance and trust required for this strategy to work (Beals and Denton, 2005).

Regarded as a knowledge-intensive business, consultancy adds value to companies because the

consultant effectively brings to the table in-depth knowledge about a particular topic at hand and helps address the issues that the company faces by driving knowledge transfer. This value creation allows consulting companies to charge a premium on their services. Immense expansion into international markets through large office-networks has also been observed in this sector (Jones, 2003). Consulting firms are able to enter emerging markets, especially, with a value proposition that local firms are not able to match up to as the latter falls behind in terms of knowledge and human capital (Svensson, 2007). Local government development agencies in emerging markets have also begun to ride on the value of international consulting firms through a strategy of active engagement and encouraging direct interaction with local firms, which produces opportunities for knowledge transfer (Siggel, 1986).

From the consultancy firm's perspective, of course, cases exist where knowledge transfer becomes too costly; these costs being the cost of securing the license for the project, adapting to the local environment and the training costs for the locals (Teece, 1981). Companies also have a vested interest in limiting knowledge transfer not eroding their proprietary knowledge base in the course of doing business with the client, because recipients of their services may easily replicate the knowledge given to them in future projects (Svensson, 2007); however, it must be noted that, as is the case with many of the GCC countries, this knowledge transfer is arguably of more interest to the host country than the projects themselves.

Case Studies

Company A: Hospitality Developer

A developer and provider of luxury serviced residences, Company A is a well-known large-scale international operator, with operations spanning more than 16,000 serviced residence units in cities in over 20 countries, including key cities of Europe, Asia Pacific, and the Gulf region. Initially entering the GCC, like so many others, through Dubai in 2006, the company wasted no time in attempting to expand to other countries in the region, among them Saudi Arabia and Qatar – an attempt, most likely, to garner early-mover advantages, and one which arguably succeeded in sidestepping a number of issues, such as occupancy inertia, that later entrants experienced.

Instead, as could perhaps be expected, a number of other issues arose. A reasonably frequent user of management contracts as a tool to reduce risk, Company A went one further in the GCC – to date, every single project they have undertaken in the region has been under a management contract, rather than any equity-based interest, perhaps suggesting a highly cautious approach towards internationalization into this region; indeed, interviews suggest that the company feels it is not yet sufficiently familiar with the region to invest in equity stakes. In the course of Company A's relatively aggressive expansion, then, it is perhaps unsurprising that a host of agency problems were encountered – projects in Dubai fell through due to conflicting interests with the initial local partner, whereas expansion plans elsewhere were hobbled by other local partners refusing to expand to countries outside their own tribal or political spheres of influence, or insisting on exclusivity in their contract with Company A within a certain

country or city. Both issues were, arguably, further exacerbated by well-known later local financial and socio-political shocks; although this was partially due, arguably, to the company's own positioning and target clientele in the GCC.

Company A's focus in the GCC was to be on providing premium quality accommodation for international expatriates, as opposed to local consumers – a tactic in line with the fact that, in many of the company's initial target areas, expatriates did indeed form the majority of the viable customer base, outnumbering the local Arabs. As such, Company A saved any need for customization to the local environment, and was able to offer its expatriate consumers an experience that was consistent with the company's well-established international brand name. This did, however, mean that in the aftermath of the debt crisis, as the amount of business expatriates to some parts of the region fell, so too did occupancy rates in Company A's residences in those same regions, albeit not as badly as hotel occupancy rates. Events relating to the Arab Spring, too, had the effect of scuppering this potential customer base, on top of the usual concerns as to political stability – in one case, Company A has effectively retreated entirely from one such region for precisely these reasons.

From another point of view, however, Company A's strategy of a pure management contract-based entry to the GCC then seems almost prescient – in point of fact, even completely defunct projects like those mentioned above each created relatively minimal loss for the company. Certainly the company itself is undeterred; it continues to aggressively secure new management contracts in the GCC, most recently for a property in Oman scheduled to open in 2014, a move further consistent with the company's strategy of, effectively, stealing a march on potential competitors. Even considering this relative lack of monetary risk, however, a rather pertinent question mark yet hovers over the long-term viability of a business strategy which appears, from above anecdotal evidence, to be quite susceptible to disruptions emanating from a local socio-political context – especially in the light of continuing events in the region. It is worth noting, however, that Company A itself may appear to be aware of this same problem – plans are apparently underway to allow some amount of customization among individual properties, most notably in pricing, and the company's choice of Oman, one of the more cosmopolitan areas in the region, as its latest destination may be a conscious choice with which to avoid said socio-political complications. Should this be indeed the case, it is a cautiously positive sign for Company A's growth going forward in the GCC.

Company B: Property Developer (Architectural)

Focusing on urban planning and project management, Company B is one of Singapore's premier architectural and design firms, a well-known name in the typically GLC-saturated Singapore property development market. Internationally, the company has interests focused largely in Asia, specifically in Southeast Asia, China, and India, but also spanning parts of Africa and, of course, the Middle East. Having entered the GCC (specifically, Dubai, like so many others) in 2005, Company B was a reasonably recent player in the GCC market, and faced stiff competition from rather larger international architectural firms already with a presence in Dubai. The company's entry into Dubai with a contract for an immense and iconic commercial development

was, in the first place, only made possible through the cultivation of relations with a major local property developer – breaking into a market with such entrenched competitors would have otherwise been, presumably, quite the Sisyphean task.

As an architectural and design firm, Company B's operations in the GCC are most adequately described as consultancy services specializing in providing design expertise and, in what the company terms a 'value-added' proposition, management proficiencies relating to property developments the company has designed, if required. Worth noting is the apparent alignment of interests with the local context; the management consultancy services provide, arguably, a valuable source of knowledge transfer to local companies and personnel, whereas Company B itself is less than bothered by this knowledge transfer, its main value proposition lying in its designs and architectural expertise. This, theoretically, translates into two consequences, one positive, the other arguably less so; the former, greater opportunity to cultivate the company's reputation in the region, an important element in a design-based industry; and the latter, a somewhat longer-term commitment to individual projects, on average, than most architectural firms. The company was, apparently, aware of these issues; it phases in the availability of these planning and management services only incrementally, so as to ensure lower initial commitment and a lighter investment requirement, showing, perhaps, endemic Singaporean caution, albeit caution not out of place for a relatively smaller company.

In many ways, the initial experiences of the company in the GCC – Dubai in particular – was a study in culture shock. Company B has a highly centralized decision structure, with all architectural design performed in Singapore, reducing the need for local offices, which are generally more responsible for project management. In Dubai, however, like in much of the rest of the GCC, potential clients proved to prefer the ability to visit an office of and communicate regularly in person with the company, requiring a level of physical presence and responsiveness that Company B's structure did not encourage; especially with the high costs of maintaining an office in Dubai at the time, which a relatively smaller company like Company B was ill-prepared to sink into a yet uncertain market. In working with local contractors, too, Company B found itself faced with international standards more onerous than the company's experience with contractors in Singapore and the Southeast Asian region, requiring an exactitude in design drawings and labeling resulting in added expense of time and effort on the part of the company. And finally, the company faced the familiar problem of finding Singaporean staff willing to work in the region, and staff that did make the move experiencing culture shock of their own. In each such case, the company has adapted or made adjustments; the company's continued presence in the GCC attests, at least, to the efficacy of said adjustments.

The debt crisis proved to pose far more of a threat, in fact, to said continued presence. While having begun to undertake projects in other parts of the GCC, a major part of Company B's presence at the time remained in Dubai, and was, obviously, affected quite adversely by the crisis. Consultancy services, after all, require a continuous flow of clients; and in the aftermath of the crisis, property development ground to a halt in Dubai, and slowed in a number of the surrounding regions. Staff in the Dubai office were left idle, and the company had to go to some lengths to retain them, while at the same time experiencing cash flow issues resulting from the

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stalling and/or renegotiation of several projects and extreme delays in payment for others – a heavy enough setback, indeed, that some companies may have begun considering an exit strategy. Perhaps Company B, too, did so – but in any case, the company chose the path of perseverance in the region, albeit with a focus now on other parts of the GCC, most notably Saudi Arabia and Qatar. The company has, in fact, secured several large-scale projects in Doha, the most recent being a prime commercial district slated for completion in 2015 – a new area of focus, perhaps, chosen with the raised profile of the 2022 World Cup in mind. Company B, it seems, has learned from its experiences and moved on; how much exactly it has learned, however, remains to be fully seen. One of its later projects, after all, was in Syria.

Company C: Retail (Footwear and Accessories)

Company C is a company in the business of retailing lines of ladies' footwear, men's footwear and accessories, most of which it owns and produces, and operates, at the current time, well over 160 outlets across more than 14 countries across the world; a rather significant portion of which – some 40-50 – are located in the GCC, underlining the significance of the GCC market to Company C. The term 'operate', in this case, is also used loosely; while the company undertakes direct retailing in its home country of Singapore, its outlets in most other countries are operated by local retailers under franchise agreements. Such is the case with all of Company C's outlets in the GCC, from its initial (and initially largest) foray in Dubai, to Abu Dhabi, Qatar, Bahrain, Oman, and its current largest concentration of outlets in Saudi Arabia. Taking these facts together, then, it becomes apparent that the choice of franchisees in the GCC is, similarly, highly significant to Company C as well.

As it turns out, Company C's franchisees in the GCC are, in general, quite influential factors indeed on the company's fortunes in the GCC. Largely consisting of major local retailers managing multiple brands, including several of Company C's most pertinent competitors, these local franchisees hold a great degree of clout in the local market, capable of operating on a large scale and commanding premium retail space. As such, these local franchisees tend to hold a rather substantial degree of bargaining power, and are highly concerned with garnering profit – to the extent of, in Saudi Arabia, dropping brands judged to be unprofitable for themselves with no hesitation. It appears to have been, at least partially, with this in mind that Company C's ventures into the major markets of the GCC have been through the vehicle of master franchising – and furthermore, with agreements with these master franchisees including no franchising fees or royalties whatsoever (at least for initial periods), with profit coming from sales of the company's product lines to the franchisees; instead holding the condition that in each case, a certain number of outlets be opened within a particular time frame, taking the strategy, apparently, of aggressive and daring expansion into the market with the purpose of establishing the company's brand and physical presence in the GCC – performed in such a way as to feed the profit-aligned interests of the local partners quite well indeed. It is entirely likely that this alignment of interests forms a cornerstone of good relations between Company C and its franchisees, which play their vital role of implementing adjustments and adaptation strategies fairly well indeed, especially in Saudi Arabia, where, owing to local cultural influences, sales of womens' footwear became rather more complicated affairs, with house

International Journal of Academic Research in Business and Social Sciences
October 2012, Vol. 2, No. 10
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visits to close sales being more frequent while more bags, rather than footwear, were being sold in the retail outlets.

Which is not to say, of course, that Company C experienced no issues at all with local franchisees. The company relates an anecdote of haphazard storefronts that the franchisee initially dismissed as being irrelevant to sales, an opinion with the company had to do some convincing to change. Nonetheless, it is perhaps partially due to this good working relationship that Company C was relatively unaffected by the the region's financial and socio-political storms; retail industries already being somewhat naturally more resilient to such shocks, the debt crisis put a temporary halt to expansion of outlets in the UAE, but changed little as far as expansion into other countries, and the company reports that even at the height of the crisis, stores in Dubai consistently generated some of the highest revenues in the region, despite being in the business of, technically, luxury goods. Sometimes, it seems, fortune favours the bold.

Discussion

The need for adaptation and adjustment to new frontiers is a well-tread track of discussion in discourse on internationalization, one that we, too, have touched on to varying degrees in previous papers. That such adaptation and adjustment might be rather more pertinent for a private enterprise than a GLC is also fairly self-evident – lacking political patronage and national credibility to take as shelter from socio-political influences, a private enterprise has to, at least to some degree, forge their own reputation, build their own bridges.

In the context of the above case studies, then, such adaptation and adjustment takes two distinct forms; modification of operational practices and strategies to better suit local markets and conditions, and alignment of interests with local partners. It is certainly possible to avoid both of these to some extent, and thereby incur less adjustment costs and commitment risk; as can be easily observed from the above, this is, in fact, precisely what Company A did to an extent, with its choice of target clientele, product strategy, and contract terms. The side effect of this, however, appears to be a greater vulnerability to market shocks, especially those emanating from the socio-political dimension – a local market is, at the end of it, a more stable and captive market than one dependent highly on international financial and corporate interests in said market.

Such adaptation also becomes markedly more important for smaller private companies, which have neither the advantage of size and capital nor of the political patronage GLCs enjoy. That the specific market strategies employed by both Companies B and C include attempts to align their interests with those of local partners points, arguably, to an implicit understanding of this fact; and both companies have certainly had to make operational adjustments in line with local cultural and business standards. A question, however, arises as to far this process of adaptation actually ameliorates business risk and promotes the performance of a company in the GCC – and it is here that we arrive at decidedly mixed results, which appear to be mostly owing to distinct industry differences. Company B, engaged in a growth-reliant industry, performed quite

well indeed in the GCC, but found itself just as vulnerable to shocks engendered by the debt crisis and subsequent socio-political instabilities in the region, albeit with a better recovery time than some of its peers experienced; whereas the retail industry Company C, with its emphasis more on stable operations, experienced only minor inconveniences, arguably due to the strong correlation of interests between the company and its franchisees. The adaptation process alone, it seems, is no foolproof shield against the vagaries of uncertainty; but can yet be, depending on the fundamentals of one's business, a very valuable tool indeed.

Conclusion

While, in recent years, the subsequent shocks of the debt crisis and of the Arab Spring have cooled international fervour for the Middle East somewhat, it remains a fact that the region in general, and the GCC in particular, yet presents a highly relevant horizon for internationalization and expansion. To many, though, it is now clear that companies seeking new horizons in the Middle East should and must now take into account the further potential of similar shocks in the future, and put into place contingencies for and strategies to ameliorate such eventualities; most especially for private companies, who are most vulnerable to such instabilities, and most definitely for companies in industries heavily reliant on the continued growth of the host market.

So it has been with many of Singapore's private companies, which by and large have realized this after the fact. While many continue to retain an expanding presence in the GCC, a distinct pattern emerges upon a simple study of this continued expansion – one in which the casual observer easily notes a drift away from areas such as Dubai and Bahrain, towards ostensibly more stable growth markets, most notably Oman and Qatar, as well as a continued movement into Saudi Arabia, the largest market in the region. Despite, in many cases, a demonstrated vulnerability to financial and socio-political shocks, this choice of future directions appears to imply, instead, yet another expression of the Singapore tendency towards caution and conservative movement, having, to arguably, more in common with avoidance than adaptation. This may perhaps cast some doubt upon the viability of any internal measures being taken to reduce said vulnerability, which would seem to be a rather paramount concern for real long-term and sustainable internationalization into the region. Such measures being, of course, internal, only time and the test itself will tell – a test which, we likely all hope, will not be administered once more to the region any time soon. The state of Singapore's private enterprises in the GCC appears to be, at least at the current time, a healthy one – albeit one that should, perhaps, append a bracketed question mark to the end of that assessment.

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International Journal of Academic Research in Business and Social Sciences
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