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The Saudi Arabian Economy

Policies, Achievements and Challenges

Second Edition



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CHAPTER 7

THE PRIVATE SECTOR: GLOBALIZATION CHALLENGES

Overview

- A key Saudi economic development objective is for the **private sector to take the lead** in reducing reliance on oil revenues.
- To do this, the **operating framework** has to be reformed, as modern commercially oriented societies operate under certain frameworks that enable the private sector to perform under a degree of certainty.
- The **legal setting** is a crucial element. Progress has been made in this respect to reform certain elements of the Saudi legal system, especially **commercial dispute and arbitration**.

Table 7.1 Saudi Arabia: Legal, commercial and dispute settlement system

<i>Legal System</i>	<i>Observations</i>
• Judicial System	• Supreme Judiciary Council created in 2008. Consists of both general courts and specialized tribunals. Courts may consist of a combination of judges and non-judges. Decisions can be quick or lengthy. Decisions may be appealed.
• Jurisdiction	• <i>Sharia'h</i> courts are courts of general jurisdiction. <i>Sharia'h</i> judges preside over almost any disputes, unless Saudi law provides otherwise. <i>Sharia'h</i> judges apply Islamic law to decide a case. Decisions may be appealed.
• Board of Grievance	• Has exclusive power to decide disputes over Saudi government contracts and may decide some types of commercial disputes. Unlike <i>Sharia'h</i> , the board observes a system of <i>precedent</i> . Decisions may be appealed. System reformed in 2008 to strengthen right of appeal. Specialised commercial courts established to bring Saudi legal system with international practices.
• Civil Rights Directorate	• Responsible for enforcing judgement of Saudi courts or tribunals.
• Negotiable Instruments Committee	• Decides on cases involving bills of exchange, promissory notes and checks.
• The SAMA Committee	• Resolves disputes between banks and clients
• Conciliation Committee	• At the Saudi Chambers of Commerce, assisting in problems between foreign partners and Saudi companies, especially in agency matters.
• Preliminary Committee for Settlement of Labour Disputes	• Hears all matters related to labour and employee relations.
• Human Rights Commission	• Strengthened and reshuffled in 2009 and given wider powers of access to government bodies without official permission to investigate cases.

The Saudi corporate setting

- Saudi law recognizes **nine** different forms of business organization structures.
- As of 2008, there were nearly 22,000 Saudi companies with a capital of SR 640 billion, compared with 11,000 companies and SR 171 billion capitalization in 2002.
- Saudi **Joint Stock Companies**, while representing less than 2% or 400 companies, represented nearly 74% or SR 470 billion of total capitalization in 2008.

Table 7.2 Total outstanding number of companies operating in Saudi Arabia by legal structure (2002, 2008)

<i>Type of companies</i>	<i>2002</i>		<i>2008</i>	
	<i>Number</i>	<i>Capital SR Million</i>	<i>Number</i>	<i>Capital SR Million</i>
1. Joint-stock companies	121	81,305.6	400	470,273
2. Limited liability partnerships	7,816	83,567.3	16,908	155,623
Saudi	6,159	52,238.6	13,123	90,996
Joint venture	1,421	29,896.9	2,974	55,125
Non-Saudi	236	1,431.8	811	9,502
3. Joint-liability partnership	2,630	3,747.6	3,139	4,136
Saudi	2,593	3,714.8	3,103	4,104
Joint venture	19	15.7	35	27.3
Non-Saudi	18	17.1	1	5.0
4. Mixed liability partnerships	1,054	2,747.1	1,241	10,770.1
Saudi	1,043	2,709.7	1,231	10,733
Joint venture	8	21.9	8	21.9
Non-Saudi	3	15.5	2	15.2
5. Mixed liability partnerships by shares	1	0.5	4	209
Total	11, 622	171,368.1	21,692	640,805

Source: SAMA.

Private Sector: key economic indicators

- Despite an increased government emphasis on “**Saudization**” or replacing of foreigners with Saudi labor, the **opposite** has been the case, with the number of foreign workers increasing by 2008 compared with 2001.
- Saudi **female employment** continues to be negligible at around 52,000 in 2008 in the private sector.

(Contd....)

- The **non-oil GDP contribution** has grown in size to reach around SR 440 billion in 2008 compared with SR 275 billion in 2001. In relative terms it was only around 25% of total GDP in 2008.
- The largest non-oil GDP economic sectors are **manufacturing, finance and insurance, wholesale and retail, followed by construction.**

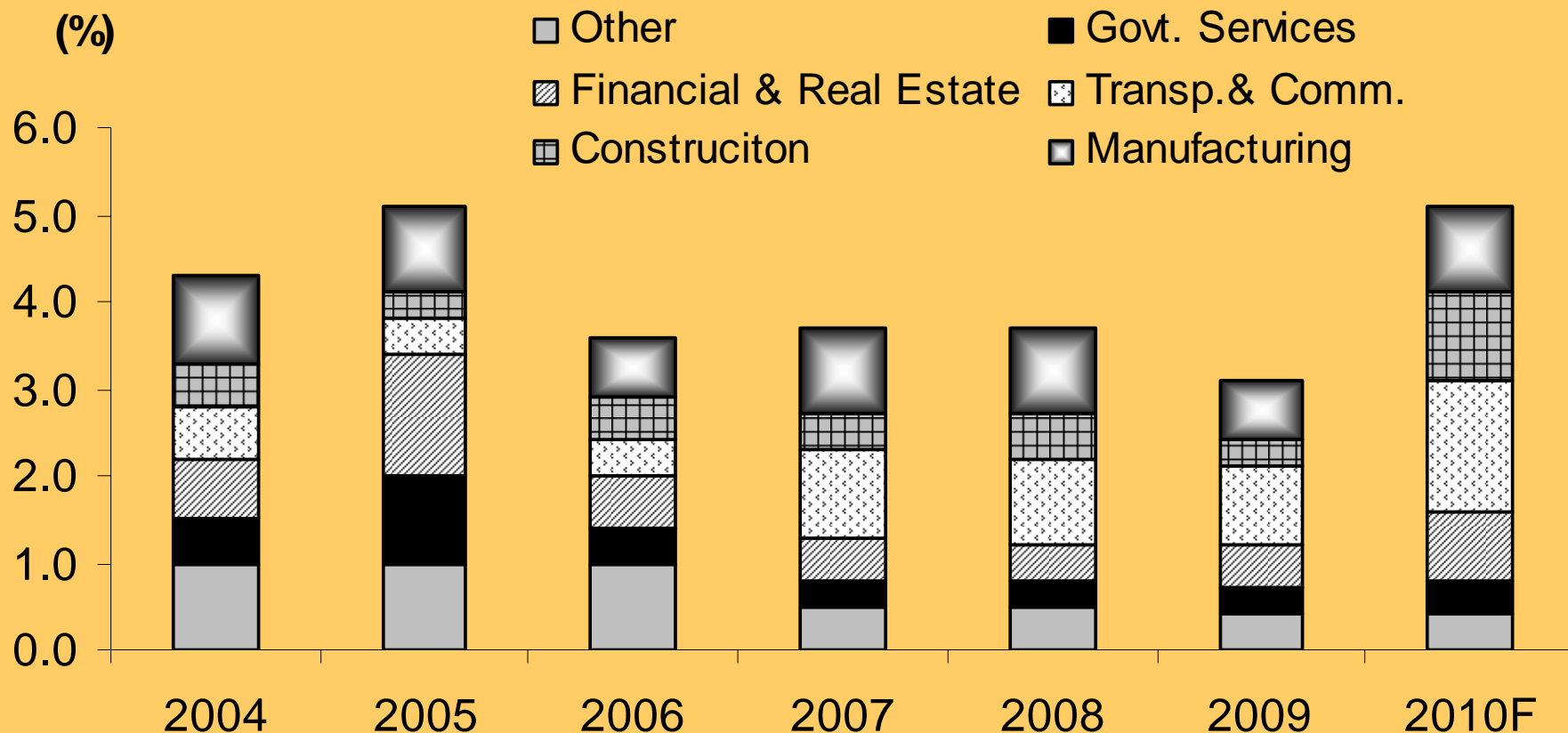
Table 7.3 Private sector economic indicators 2001-2008

Indicator	2001	2008
* Employment Total	2,376,974	6,221,947
- Saudis	540,817	829,057
A) Male	N/A	777,6.6
B) Female	N/A	51,451
- Non-Saudis	1,836.157	5,392,890
* GDP (SR Billion)	686.3	1,746.0
* Non-oil GDP	275.1	440.0
- % Contribution	40.0%	25.2%
* Non-oil GDP by economic sector (SR Billion)		
- Agriculture & Fishing	35.7	39.9
- Manufacturing (Incl. oil refining)	69.2	102.5
- Public utilities	8.9	14.0
- Construction & building	43.2	58.8
- Whole sale & Retail trade	49.8	70.7
- Transport & Communication	30.6	55.6
- Finance & Insurance & Real estate business	78.8	105.9
* Gross final consumption (SR Billion)	448.4	841.4
- Government	188.9	359.8
- Private	259.5	481.5

Source: SAMA,

N/A = Not Available

**Figure 7.1: Drivers of the non-oil Saudi real GDP growth
(2004-2009, 2010 forecast)**



Source: SAMA,

Forecast Estimate 2010

Saudi national strategy for industry

- A **blueprint** has been announced for a national industrial strategy that sets out the following **strategic goals**:
 - Tripling the national industrial base by 2020.
 - Induce significant structural transformation to support value added in the sector.
 - Active role of national industrial sector in international trade.
 - Increase Saudi manpower in sector.

(Contd....)

- To achieve this, the following **actions** are planned:
 - Support industries that rely on comparative advantage.
 - Direct industrial products towards high value added.
 - Promote high tech knowledge based industries.
 - Adopt pattern of industrial clusters.
 - Enhance role of Small and Medium Sized Enterprises (**SME's**).
 - Develop business environment, laws and procedures.

Foreign participation in Saudi economy

- The Kingdom has always welcomed **foreign investor** participation, especially through **technology transfer**.
- Most popular form of Saudi and foreign collaboration has been at the distributorship level through commercial agency or “**wakeels**”. These represent around 90% of all collaboration.
- Majority of foreign agencies are with Western companies.
- Wholly owned foreign ownerships are prevalent in all sectors of the economy, but are **preferred** in manufacturing, construction, and transport and communications. **Joint ownership** predominates.

Table 7.4. Saudi-Foreign trade agencies by categories as of 2008

<i>Category</i>	<i>Number</i>	<i>%</i>
Distribution agencies	9,225	89.4%
Concession agencies	557	5.4%
Commercial agencies	310	3%
Service agencies	226	2.2%
Total	10,318	100%

Source: *SAMA, Ministry of commerce*

Table 7.5 Saudi Arabia foreign establishments by economic activity, 2008.

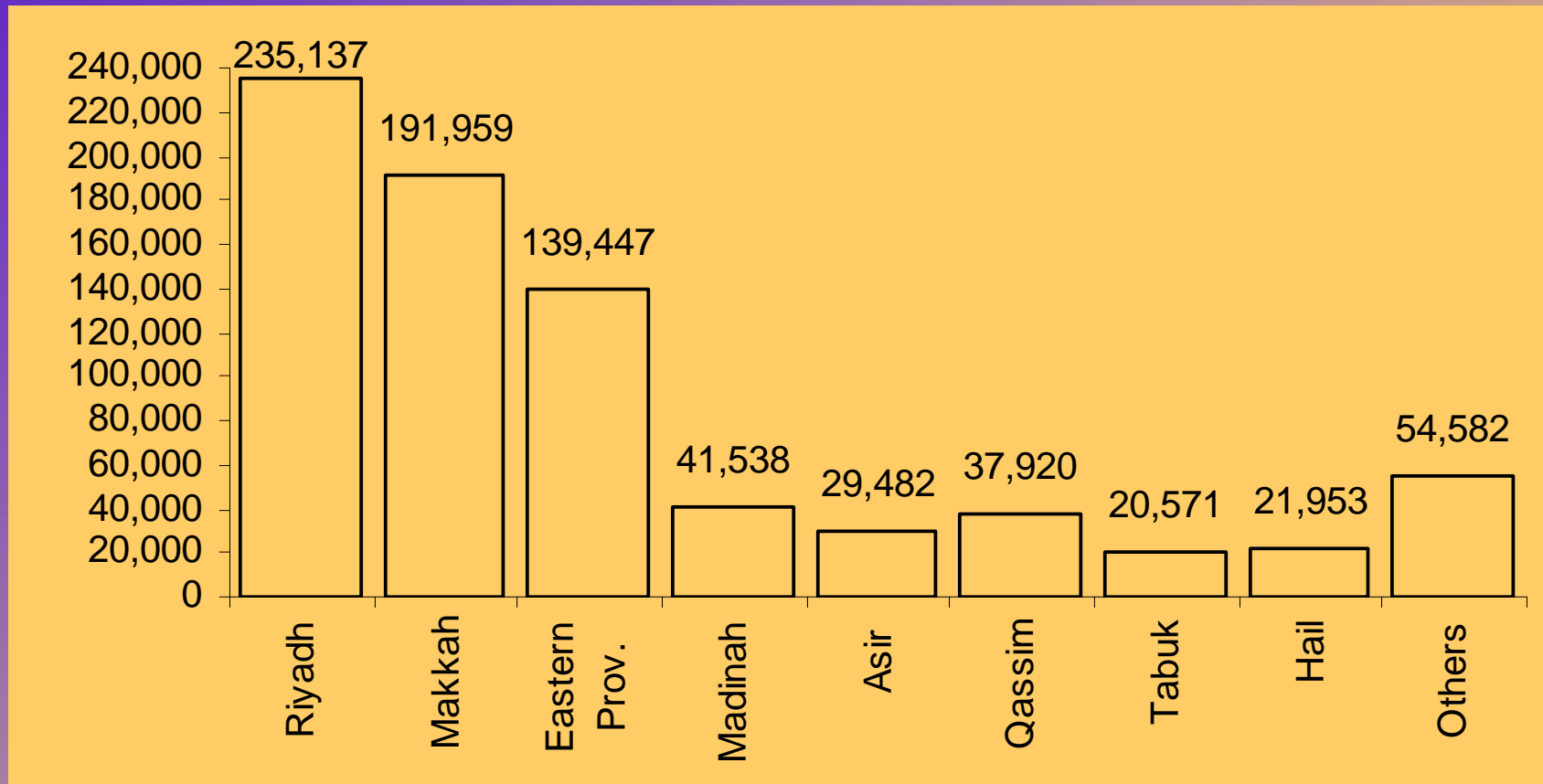
<i>Economic Sector</i>	<i>Joint Ownership</i>	<i>Wholly Foreign Ownership</i>
Agriculture/fishing	3	6
Mining and Petroleum	26	49
Manufacturing	220	275
Electricity	27	42
Construction	650	128
Trade/Hotel	1,240	85
Transport/Communications	370	110
Financing/Real Estate	293	89
Community/Social Services	188	30
Total	3,017	814

Source: *Ministry of commerce, Central Department of Statistics*

Small and Medium Sized Enterprises (SME's)

- Saudi government is increasingly emphasizing the importance of **SME's in economic diversification** and job creation.
- In 2008, there were around 763,000 individual and SME proprietorships in Saudi Arabia, with majority being in Riyadh, **Makkah** and Eastern Province.
- SME's continue to suffer from **institutional and bureaucratic obstacles**, but they are an important employment generating segment.
- The Saudi government has increased the amount of funding to the SME sector through soft loans, but more needs to be done to enhance the SME sector's survival and growth.

Figure 7.2 Individual proprietorships in Saudi Arabia 2008



Source: SAMA

Table 7.6 Economic sectors by employee segmentation (2008)

<i>Sector</i>	<i>Wholesale and Retail</i>	<i>Real Estate</i>	<i>Manufacturing</i>	<i>Construction</i>	<i>Restaurant & Hotels</i>	<i>Electricity, Gas, Water</i>
Employee Segment						
1-9	120,600	19,600	32,750	8,200	75,400	1,200
10-49	75,200	15,850	29,600	58,250	48,600	950
50-99	18,400	2,300	17,400	60,219	1,300	1,900
100+	10,003	3,009	21,312	101,000	247	9,450
Total	224,203	40,759	101,062	227,669	125,547	13,500

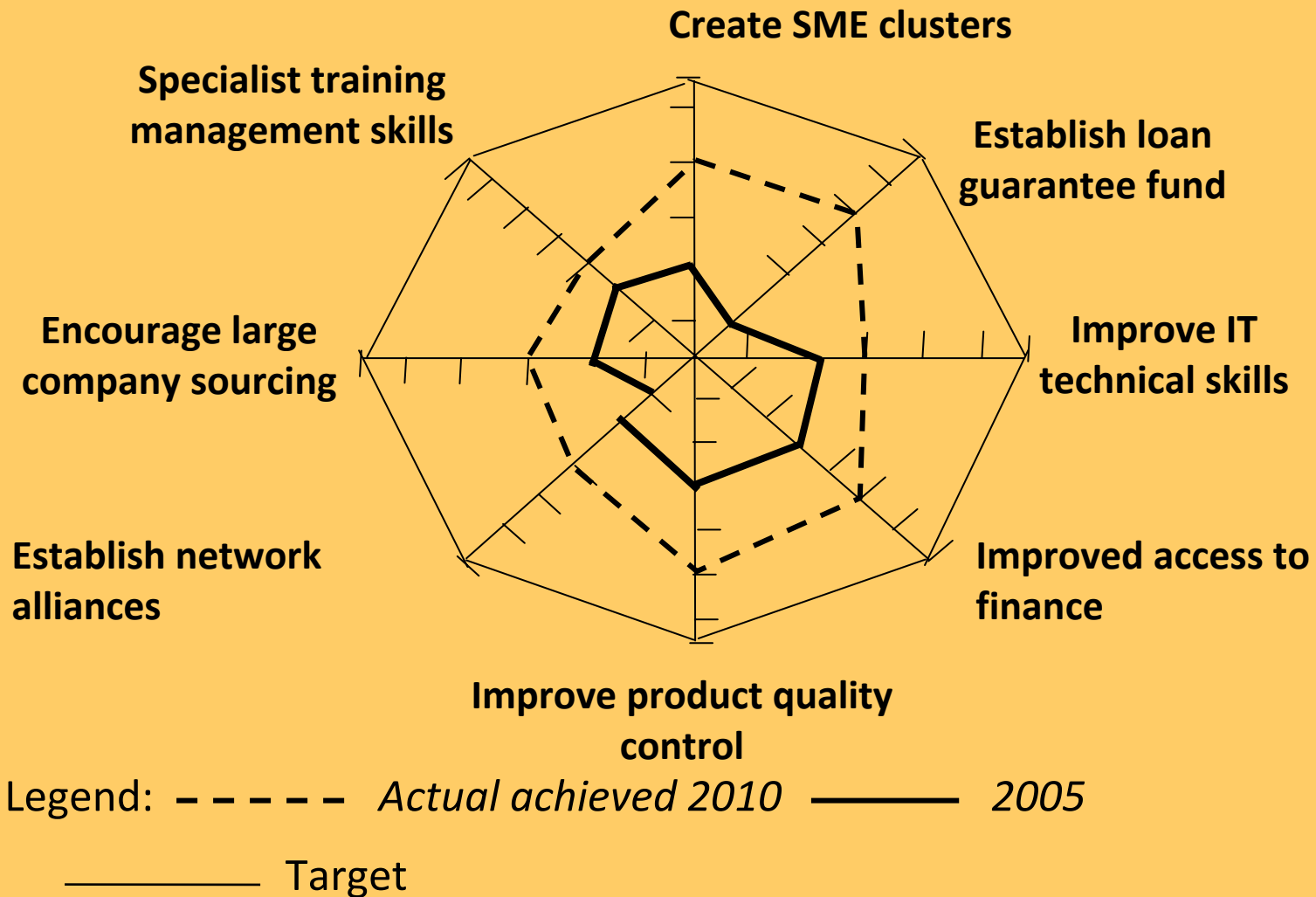
Source: *CDS, SAMA*

Table 7.7 Saudi large SME soft loans programme (2008)

<i>Type of loan</i>	<i>Number granted</i>	<i>Value (SR million)</i>
Hotel and tourism	103	2,358
Health projects	118	2,195
Agricultural projects	19	332
Press and misc. projects	45	197
Bakeries	68	258
Contractor financing	64	167
Cooling warehouses	44	179
Dates factories	6	59
Educational establishments	46	862
TOTAL	513	SR 6,607

Source: SAMA

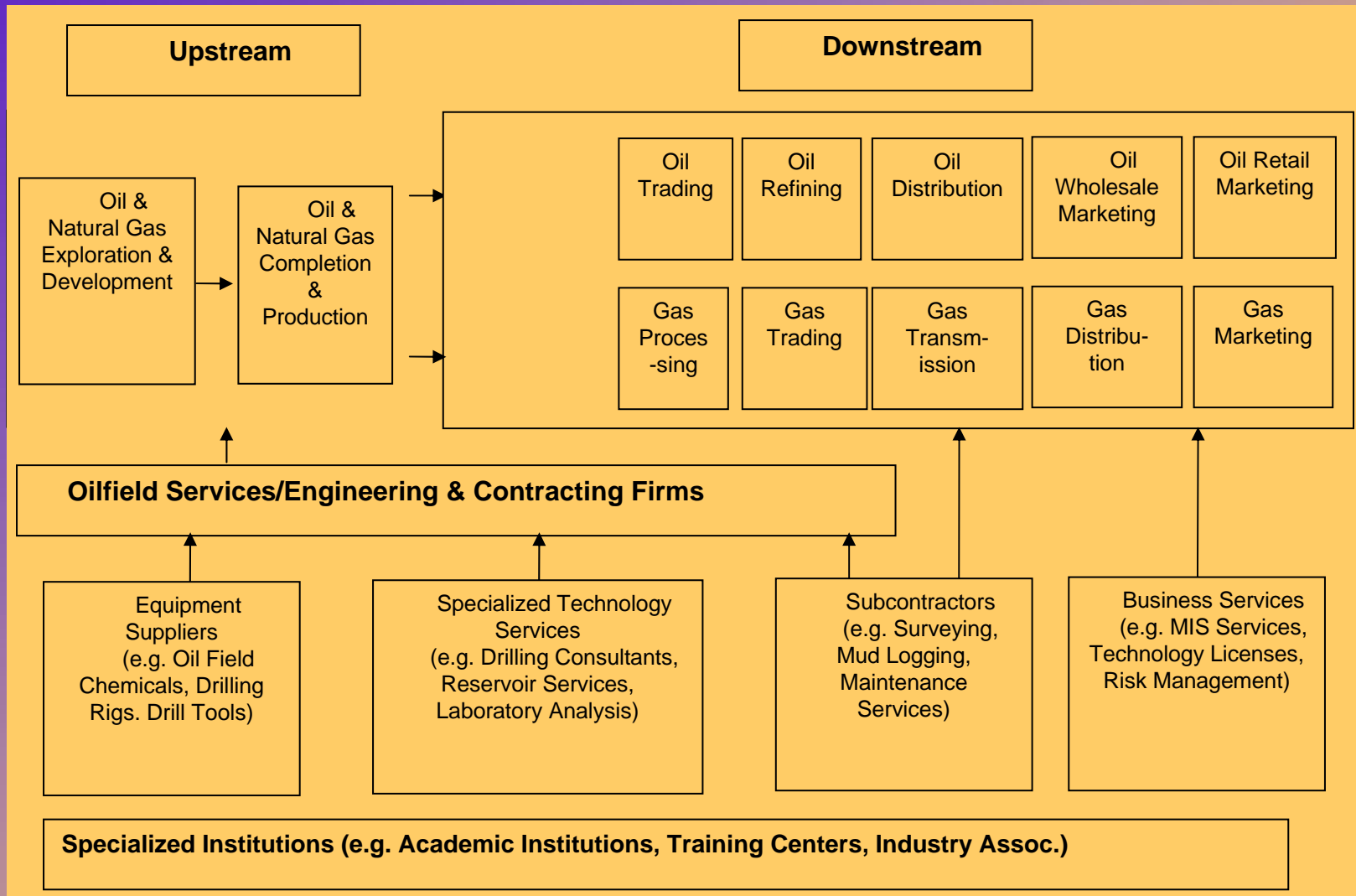
Figure 7.3 Enhancement of SME survival and growth in the Saudi economy (actuals 2005, 2010)



SME's: A new cluster approach

- The Saudi Arabian General Investment Authority (**SAGIA**) and the various Chambers of Commerce have now begun to emphasize the importance of SME “**clusters**” to enhance the role of the SME's in major projects.
- One such model could be in the Saudi **energy and petrochemical sectors** (upstream and downstream) where there are opportunities for SME's to participate in service and equipment supplies based on international standards.

Figure 7.4: Saudi SME energy cluster development



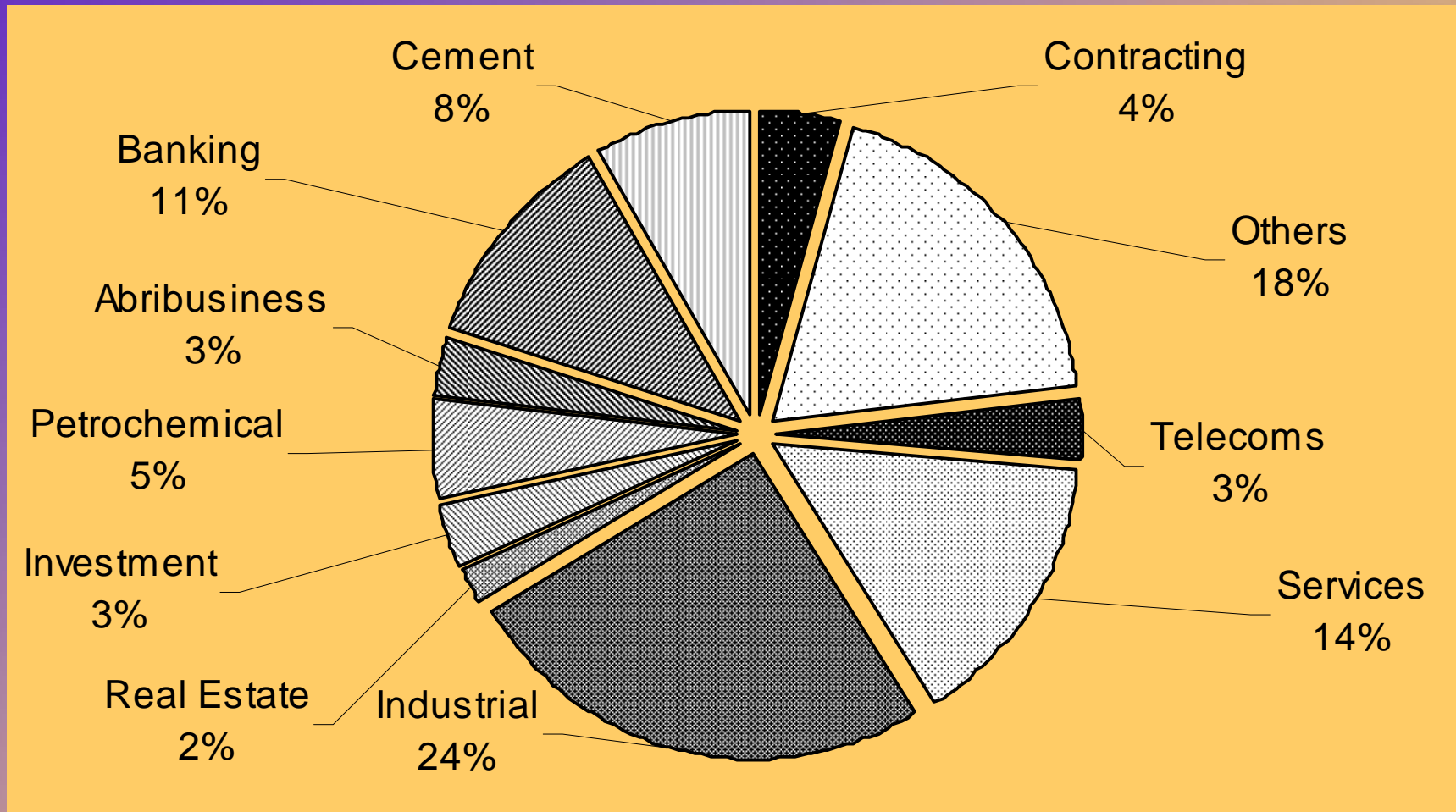
Source: Porter, 2010

Saudi family businesses: a necessary evolution

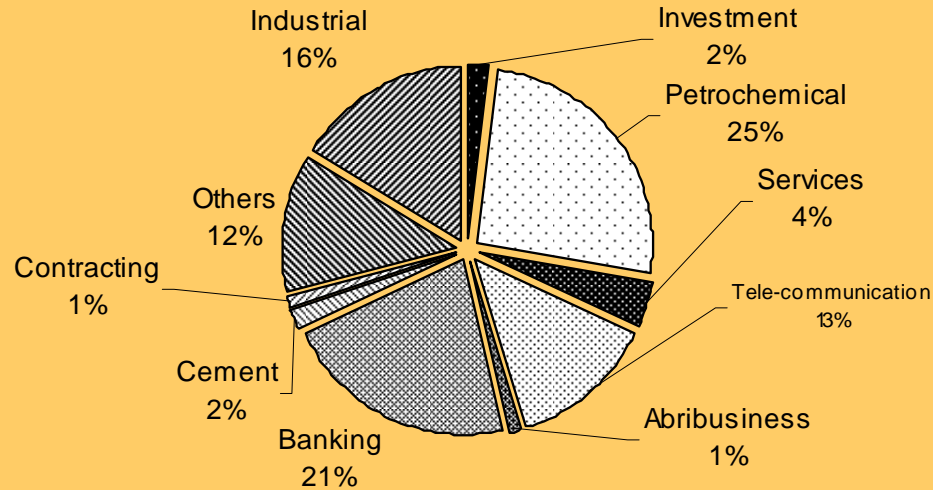
- The role of the **family businesses** in the Arabian Gulf is an important one for the economic fate of these nations.
- They play a significant role in all sectors of the economy, especially in the industrial and services sectors.
- The **“Top 100”** Saudi family companies also play an important role by revenue source, as well as employment.

Figure 7.5 Top 100 Saudi family companies (2008)

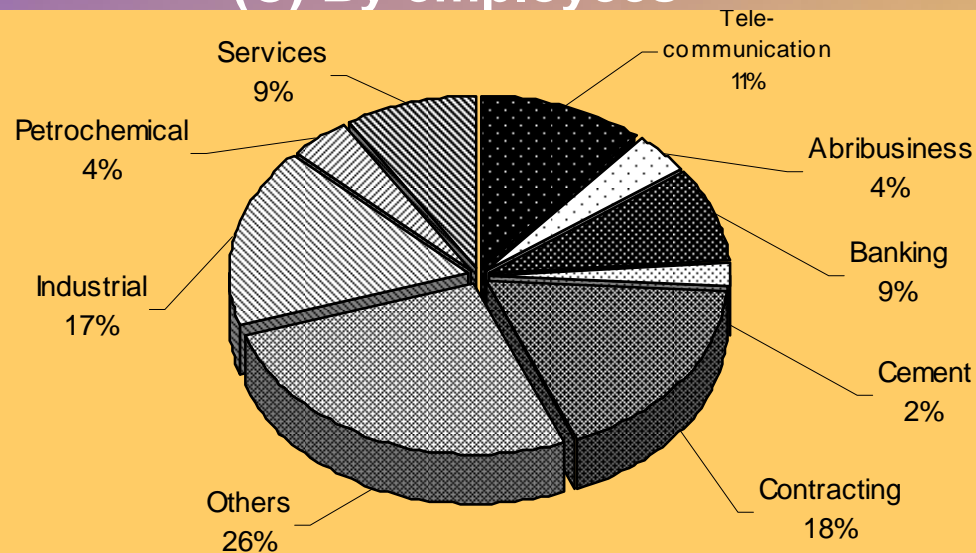
(A) By economic sector



(B) By revenue source



(C) By employees

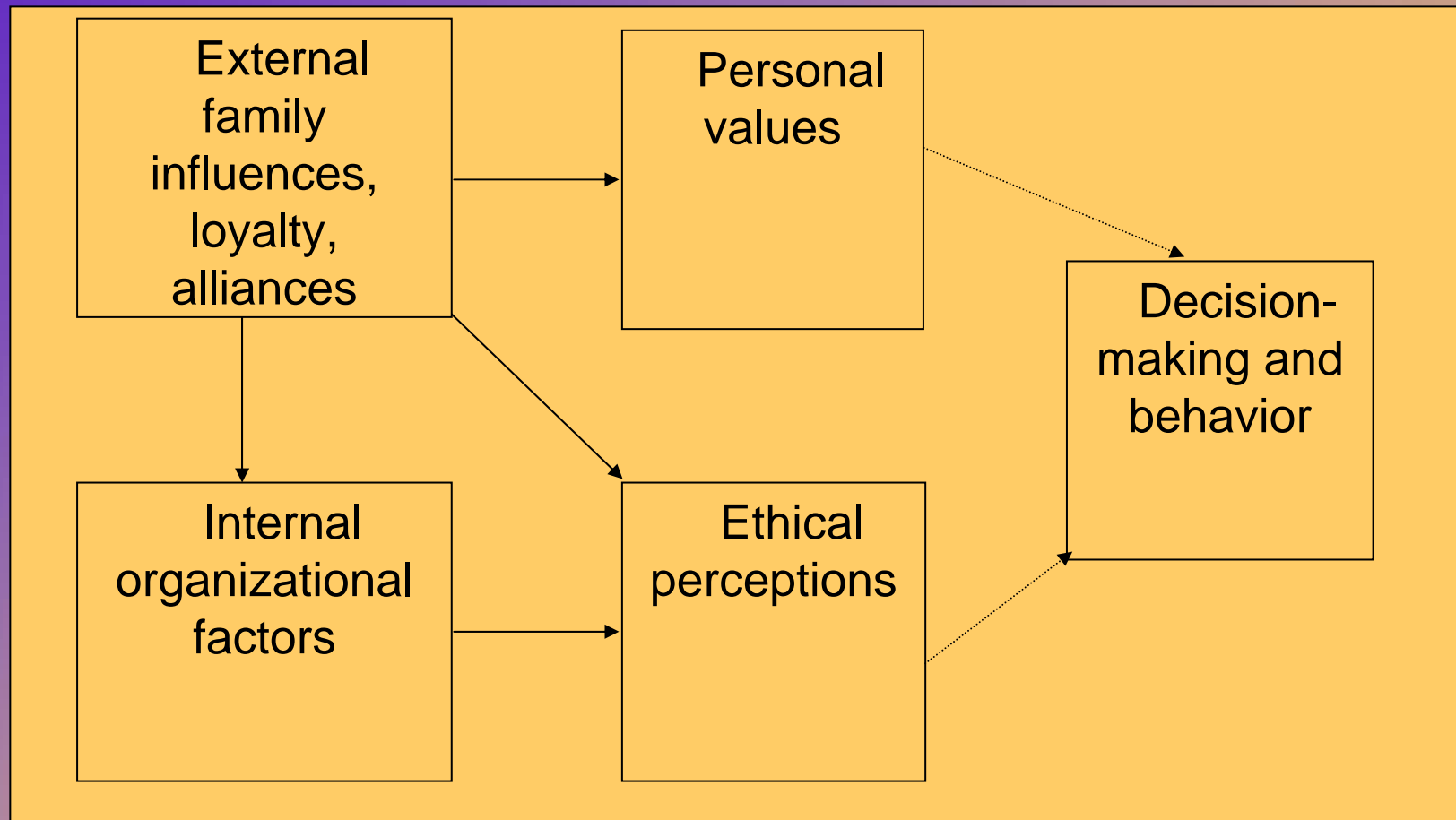


Source: *Top 100 Saudi Company Surveys, Saudi Research and Marketing, 2007.*

Family businesses: decision making and ethical dilemmas

- Family businesses are often run on **blood alliances** and decision making ranges from progressive delegation to professional managers, to autocratic decision making.
- Decision making for family businesses is affected by both **internal and external factors**.
- Recent financial troubles faced by some high profile family groups has prompted a debate on the **need for reform and going public** for some of the more prominent family businesses.

Figure 7.6 Decision-making and ethical dilemmas
in family-run businesses



Adapted from *Morris et. al.*, 1996.

Table 7.8 Family businesses: changing management operating structures

<i>Characteristic</i>	<i>Current Structure</i>	<i>New Structure</i>
<ul style="list-style-type: none"> • Organization • Focus 	<ul style="list-style-type: none"> • Pyramid, strict hierarchy • Balance sheet growth, agencies and franchises 	<ul style="list-style-type: none"> • Horizontal, delegation • Profitability, maximizing shareholder value, production
<ul style="list-style-type: none"> • Ownership • Financial structure 	<ul style="list-style-type: none"> • Family, affiliated groups • Internal raising of capital 	<ul style="list-style-type: none"> • Publicly listed joint stocks • External funding, IPOs
<ul style="list-style-type: none"> • Resources • Competition 	<ul style="list-style-type: none"> • Physical assets • Between family groups 	<ul style="list-style-type: none"> • Human capital • Between brands, services and products
<ul style="list-style-type: none"> • Expansion 	<ul style="list-style-type: none"> • Using influence, family alliances and “<i>Wasta</i>” 	<ul style="list-style-type: none"> • Productivity and achievement
<ul style="list-style-type: none"> • Financials 	<ul style="list-style-type: none"> • Internal, annual, not audited 	<ul style="list-style-type: none"> • Quarterly, audited financials
<ul style="list-style-type: none"> • Leadership style 	<ul style="list-style-type: none"> • Top down, paternalistic, dogmatic 	<ul style="list-style-type: none"> • Bottom up, inspirational
<ul style="list-style-type: none"> • Worker 	<ul style="list-style-type: none"> • Mere employees 	<ul style="list-style-type: none"> • Shareholders, participatory, critical, professional management delegation
<ul style="list-style-type: none"> • Job expectation 	<ul style="list-style-type: none"> • Look for security, obedience 	<ul style="list-style-type: none"> • Personal growth, satisfaction.

Adapted from Azzam, 2002.

Saudi women and the national economy

- **Women-related issues** have now assumed a higher profile in Saudi Arabia with support from Saudi leadership to allow for women's participation in the national economy.
- Saudi **female employment** is a critical issue with over 85% of the estimated female working population employed in the **government sector**, despite some progress in employment in high value private sector jobs such as banking and wholesale/retail.
- **Investment by women** in the Saudi economy is significant in real estate, and nearly 30% of all bank accounts. There are still **barriers** faced by Saudi women, some of which the government is trying to overcome.

Table 7.9 Saudi female employment by economic sectors (2008)

<i>Economic Sector</i>	<i>Number</i>	<i>%</i>
• Government sector/Education	275,128	84.88%
• Agriculture/Fishing	203	0.06%
• Mines, oil	694	0.22%
• Manufacturing	3,254	0.99%
• Electricity, gas, water	74	0.03%
• Construction building	6,243	1.92%
• Wholesale/retail	8,708	2.67%
• Transport/Communication	190	0.06%
• Finance, Insurance, real estate	2,969	0.98%
• Community, social and personal	28,757	8.82%
TOTAL	326,240	100%

Table 7.10 Saudi businesswomen's operating barriers

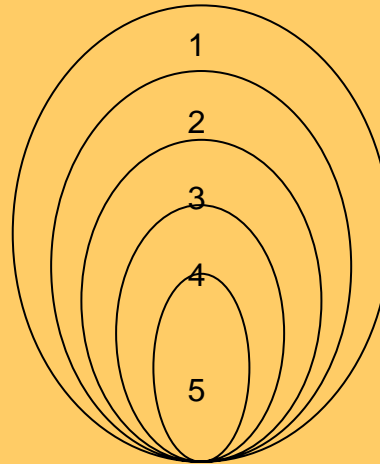
<i>Barriers</i>	<i>Status</i>
<ul style="list-style-type: none"> • Difficulty for businesswomen to accomplish official business in person without using male intermediary • Lack of training organizations and specialist women-related business programmes • Difficulty of obtaining required market information • Difficulty in qualifying for loans • Limited allowable investment sectors • Unavailability of women's sections in major government ministries • Clarification of legal rights of businesswomen with government agencies • Limited networking groups for businesswomen • Travelling in Kingdom unescorted by male relatives or spouses. • Ban on hiring trained female staff form abroad 	<ul style="list-style-type: none"> • Government has now allowed women to submit applications directly without intermediary • Chamber of Commerce establishing training programmes • Special sections of Chamber of Commerce set up to provide data • Government lending institutions instructed to handle female loan applicants on equal basis • Industrial zones planned and special investment advisory service from SAGIA set up • Some progress in this field and some ministries have established women-only sections • Steps are being taken to ensure that women can correspond direct in their own legal capacity without intermediaries • Businesswomen's associations established to facilitate networking • More flexibility and acceptance now to allow mobility in Kingdom based on written approval from next of kin without male chaperones • Case by case submission to ensure that qualified Saudi females can be employed for position but in Kingdom mobility for Saudi females is still an issue.

Evolving government and business relations

- The centrality of government interaction with the private sector in Saudi Arabia has **evolved** over time but with different emphasis.
- In the 1970-1980's period the government's key relationship with the private sector was primarily as a **planner**, followed as financing partner, and as a significant buyer and seller.
- By the 1990's, the role of government had changed to being a **regulator**, followed as a buyer and seller of services, and with planning being indicative, rather than directive to the private sector.
- The Saudi government is still a **significant financier** to the private sector, with nearly SR 30 billion disbursed in 2008.

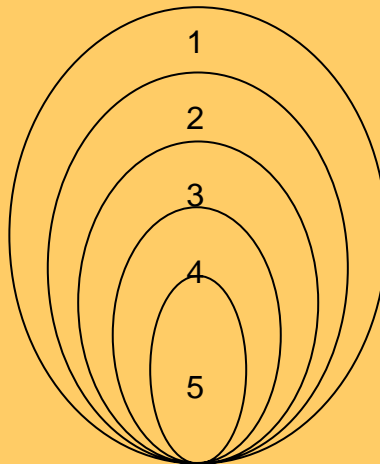
Figure 7.7 Saudi Arabia: Evolving government-private sector relationships - 1970s-1980s

1970s-1980s



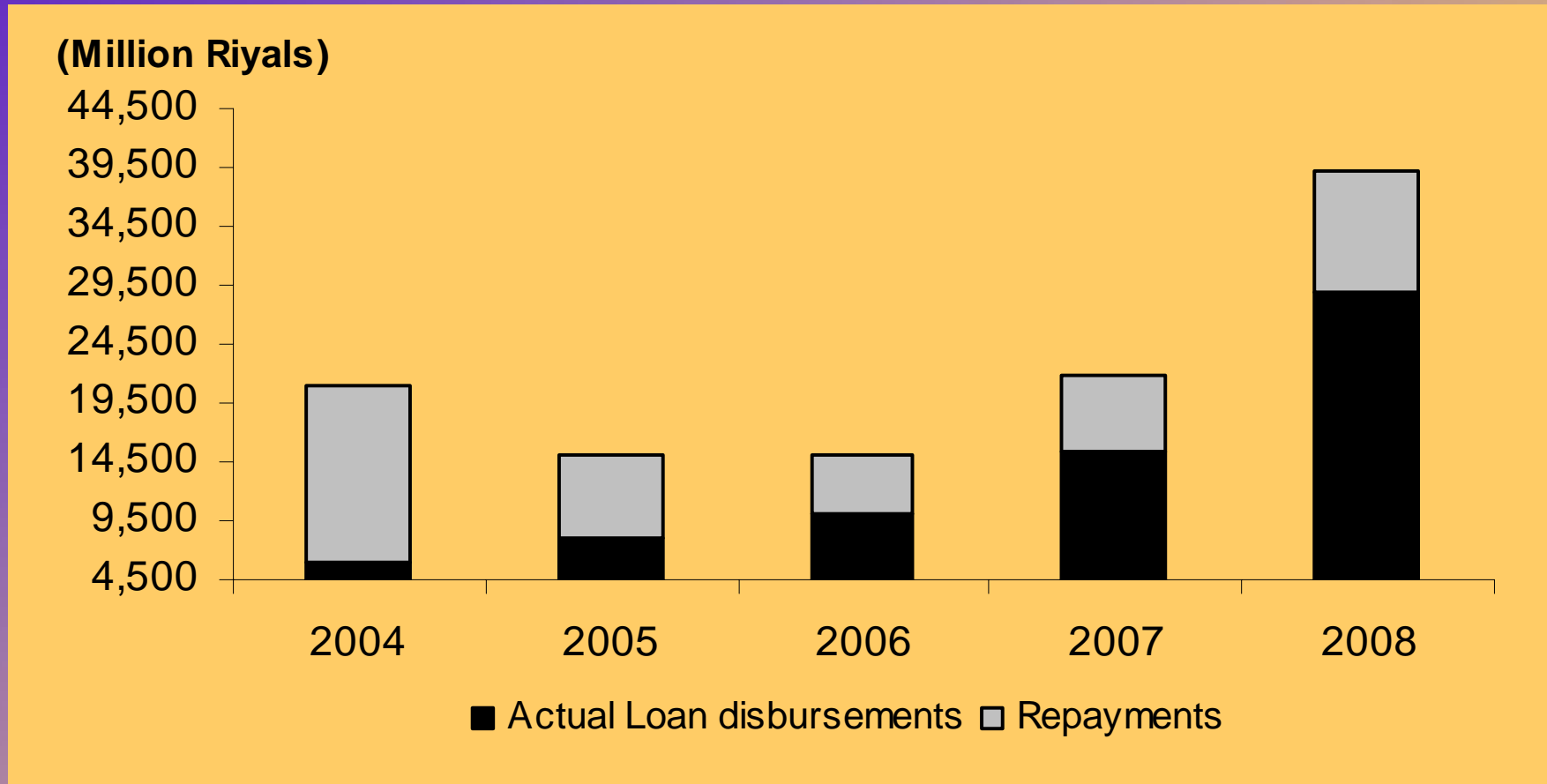
1. *Government as planner*
2. *Government as financing entity*
3. *Government as buyer and seller*
4. *Government as regulator*
5. *Government as revenue collector*

1990s-present



1. *Government as regulator*
2. *Government as seller and buyer*
3. *Government as planner*
4. *Government as financing entity*
5. *Government as revenue collector*

Figure 7.8 Actual disbursements and repayments of loans of specialized credit institutions (2004-2008)



Source: SAMA

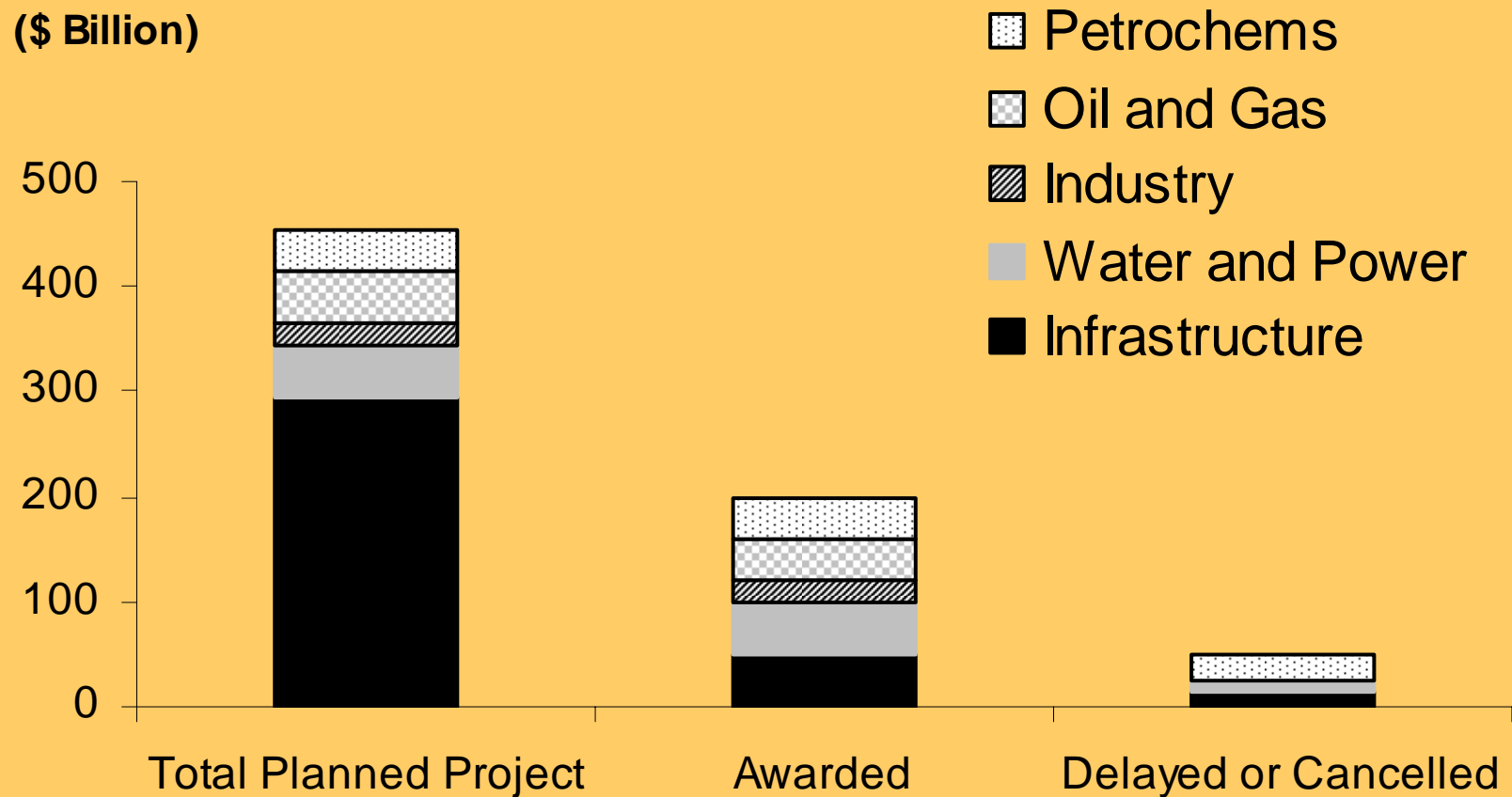
Promoting private sector self-sustained growth

- In the face of **globalization challenges**, the private sector needs to be resilient in many sectors, including investment channels, privatization participation, international competition and internal business environment.
- Despite such challenges, the private sector has **many opportunities** to participate in the ongoing mega and other projects in the Kingdom, totaling nearly **500 billion dollars in 2010** with most awarded during the oil boom period of 2007-2008.

Table 7.11 Private sector challenges and solutions

<i>Challenges</i>	<i>Opportunities and Solutions</i>
<ul style="list-style-type: none"> • Promoting government-business dialogue and collaboration • Internal business environment and international competitive comparisons • Expansion of the privatization policy • Paying attention to scientific research that might serve the production sector • Increasing investment locally • Reduce national unemployment 	<ul style="list-style-type: none"> • The private sector has to engage the government in a dialogue on competitiveness and impediments to improving productivity • Up-to-date information on local and international market opportunities made available as well as comparing relative costs and efficiency with international standards • Private sector must engage in dialogue to ensure that transfer is done on a transparent basis with no “hidden” costs and commitment;; flexibility in hiring and firing • Poor communication between the productive sectors and research centres must be overcome through R + D funding, and developing science park/incubator concepts • Better coordination with SAGIA and Chambers of Commerce to create business and investor friendly environment; update and harmonize business regulations; create a demand driven economy • Short term “fix” through expatriate labour reduction vs. long-term solution of employing productive Saudis; ensure that the market knows of the skill needs of the private sector

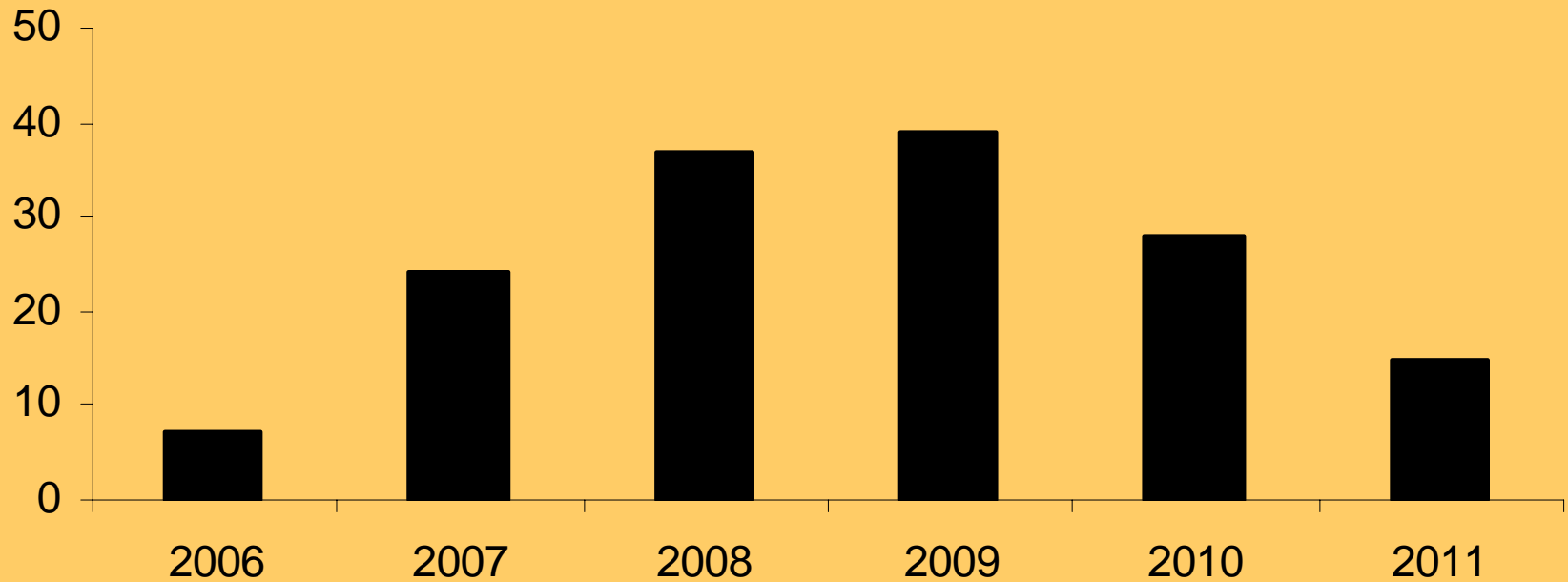
Figure 7.9 Saudi investment program
(A) Investments by project sectors



Source: *MEED Projects*

(B) Awarded project workload 2006-2011

(\$ Billion)

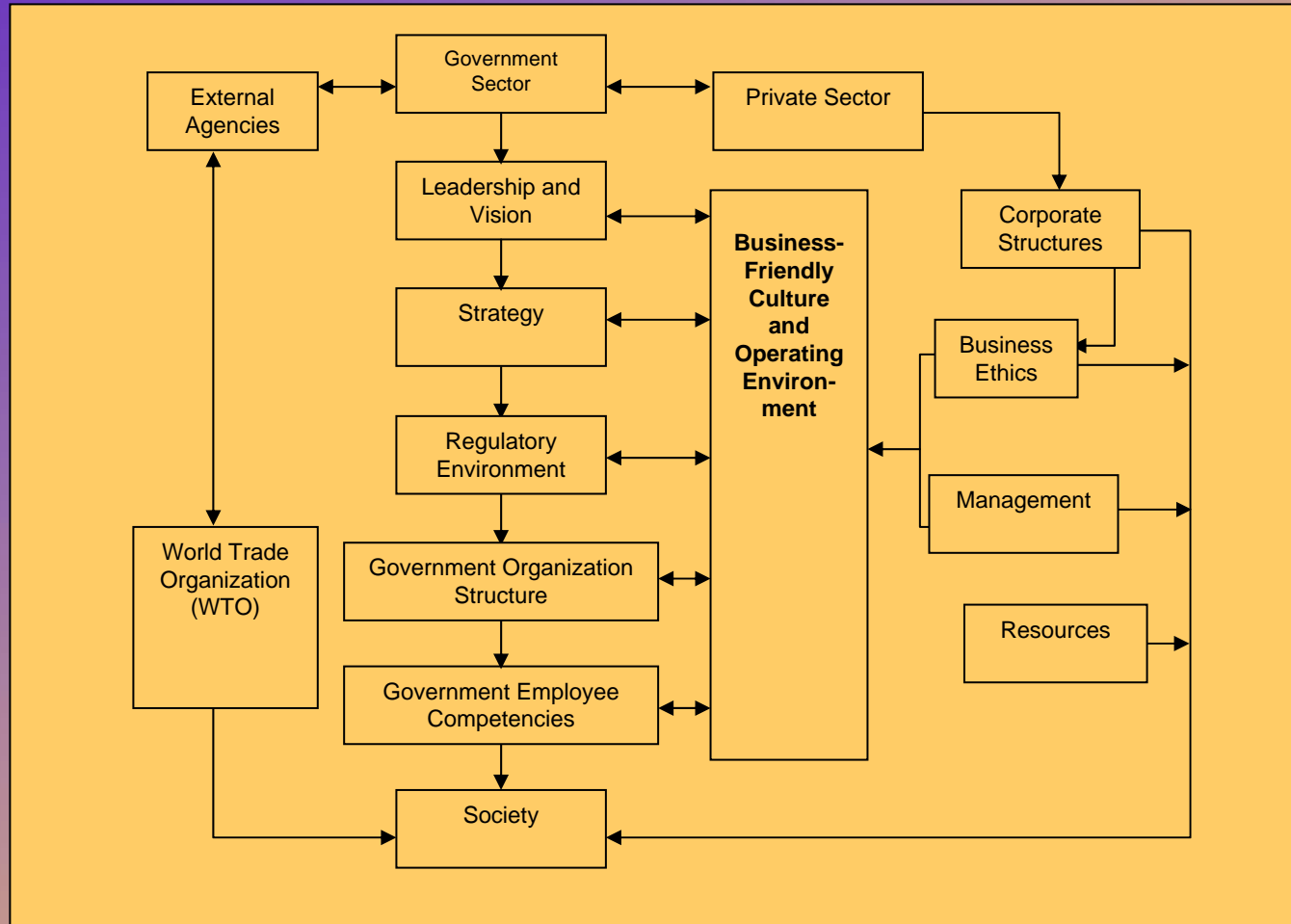


Source: *MEED Projects*

Looking ahead: A model of government and private sector cooperation

- Despite an **element of mistrust**, there is a genuine desire to succeed by both the government and the private sector to establish a **viable model** of cooperation.
- This will require the government to streamline its civil service and bureaucracy and to establish a **business friendly culture and operating environment**.
- This will involve the private sector to learn to take **charge of its own economic life** and speed up corporate governance.

Figure 7.10 Saudi Arabia: A government-private sector business model of cooperation



Conclusion

- The Saudi private sector is now a **significant player** in the national economy and has learned to take more charge of its economic life.
- The **Chambers of Commerce and Industry** are now more effective in having their members voice heard by the government and they have argued for a more viable public-private sector partnership.
- At the same time, they need to adapt to globalization challenges and seek opportunities **internationally**, create efficient economic clusters to survive, as well as carry out internal **corporate governance reforms**.