

CHAPTER 6

THE PRIVATE SECTOR

6. THE PRIVATE SECTOR

This chapter is concerned with the private sector, in particular its role in the development process and its relationship with the government sector. The purpose of the chapter is to:

- examine the private sector in terms of the scope and nature of its activities and its contribution to the development process;
- discuss the main changes that have taken place in the economy over recent years and consider their effect on the future development of the private sector;
- identify the main problems likely to be faced by the private sector during the next five years; outline the Government's main policy proposals and the desired responses from the private sector.

6.1 THE SCOPE AND NATURE OF PRIVATE SECTOR ACTIVITIES

In light of recent history it is easy to overlook the important role of the private sector. Traditionally, private sector activity centered on commerce and the provision of the country's imported requirements. However, it has not been limited to these activities. Some of the first schools were financed by private philanthropists; some of the earliest electricity networks were established and run by private companies; private industries also financed and instituted several major public works, such as roads and drainage schemes.

Today, there are few, if any, social and economic activities in which the private sector is not heavily involved, a feature which reflects the market orientation of the economy and the encouragement given to private enterprise and the profit motive. The main emphasis of private sector involvement is in the productive activities of manufacturing, agriculture, construction, trade and transport, but there is also substantial private sector investment in education, health, social services and municipal developments, such as housing and utilities. In most sectors, but particularly in industry, finance, health, education, transport and mining, private sector activities are complemented by the direct involvement of the Government, which has followed a policy of stimulating private sector investment by undertaking particularly large projects that were considered beyond the scope of the private sector.

The size structure of the private sector comprises a wide range of commercial establishments, from the many one-man businesses to some very powerful and diverse multinational corporations. Although the great majority of commercial entities are not incorporated there is an increasing number of joint-stock companies, particularly among the joint-venture projects. There is also a growing number of companies with publicly quoted share prices. In line with current government policy an in-

creasing number of public corporations are being privatized, and thus a number of mixed public and private companies also operate.

Moreover, private sector activities are no longer limited to supplying the domestic market; significant inroads are being made into export markets, not only by the petroleum and petrochemicals industry but also by private manufacturing, mining and agricultural companies. In consequence, the private sector's growth, its expanding sphere of influence and its diversity of interests has been one of the notable features of Saudi development during the last ten years.

6.1.1 PRIVATE SECTOR GROWTH

Undoubtedly, the rapid growth and increasing influence of the private sector over the past decade was made possible by the very large rise in government oil revenues over the same period. As important, however, have been the development policies pursued by the Government in deploying this revenue, and which placed great reliance on the private sector for the implementation of development projects.

There are three key elements in government policy which have had a major influence on the private sector's pattern of growth. *First*, there has been the commitment, both in principle and in terms of capital resources, to providing the Kingdom with a comprehensive, efficient and modern economic and social infrastructure. The commitment to a high level of capital expenditure resulted in a massive increase in demand to which the domestic private sector, in partnership with foreign companies, responded. It created a sellers' market in almost every sphere of economic activity and enabled the private sector to amass large capital resources and to develop new business skills.

Second, there has been the Government's commitment to a market economy and private enterprise system, but one which was tailored to conditions within the Kingdom, to ensure the widespread distribution of the benefits of development among the people as a whole. A notable feature of Saudi Arabia's private enterprise system is the provision of incentives to encourage enterprise into specific activities.

Third, there is the Government's policy of diversification, to reduce the economy's dependence on the oil sector by developing a strong domestic capability in the producing sectors. Driven by the growing government sector demand, private enterprise has been encouraged to invest in new activities, through the provision of substantial investment incentives, soft loans and the promotion of easy access to foreign technology and expertise.

These policies have combined to create a business environment that is attractive to both Saudi and foreign companies alike. The Kingdom's approach to development hinges successfully on a partnership between the Government and the private sector. As a result, the economy has been transformed in a very short time and a strong, influential and increasingly sophisticated private commercial and industrial sector is now firmly established.

6.1.2 SIZE AND CONTRIBUTION OF THE PRIVATE SECTOR

The progress made by the private sector is demonstrated by almost all measures of performance, but particularly by the growth in number of establishments, the sector's contribution to GDP and its share in national investment.

6.1.2.1 Number of Establishments

During the first four years of the Third Plan the number of private sector establishments, as shown in Table 6-1, more than doubled to nearly 195,000.

Table 6-1

REGISTERED ESTABLISHMENTS AND COMPANIES (number)

	1399	1401	1403
Central Region	34,963	45,239	73,683
Western Region	20,271	40,447	57,507
Eastern Region	10,182	22,448	35,862
Northern Region	9,492	15,016	17,736
Southern Region	3,862	7,220	10,029
Total	78,770	130,370	194,817

Most private businesses are very small-scale: over 80 percent employ less than 5 persons and less than 2 percent employ more than 50 persons. The bias towards small establishments reflects not only the comparatively recent development of the private sector, but also the high degree of entrepreneurial drive within Saudi Arabia.

Only a very small proportion of the total number of private establishments are companies, of which only some 110 are publicly quoted. Table 6-2 summarizes the structure and growth of private sector companies.

Table 6-2
NUMBER OF COMPANIES AND CAPITAL INVESTED

	1395		1400		1403	
	No.	SR(mn)	No.	SR(mn)	No.	SR(mn)
Saudi	958	1,088.9	3,012	21,069.1	4,230	38,981.5
Non-Saudi	38	269.3	39	270.0	15	21.6
Joint Venture	158	851.1	1,038	13,616.4	1,390	19,265.8
Total	1,181	2,209.3	4,089	34,955.5	5,635	58,268.9

One of the most significant features of corporate growth over the last decade has been the increasing number of joint-venture companies. In 1395 joint ventures accounted for nearly 13 percent of all private companies; by 1403 this had increased to 24.6 percent, reflecting the growing trend towards higher technology production and generally larger-scale companies. Average investment size in Saudi companies increased from SR 1.1 million in 1395 to SR 9.2 million in 1403, while the average investment in joint-venture companies increased from SR 5.4 million to SR 13.9 million over the same period. On average, joint-venture companies recorded higher capitalization than the domestic companies, thus demonstrating the importance and success of this type of company.

6.1.2.2 Contribution to GDP

As shown in Table 6-3 the non-oil private sector's contribution to GDP is estimated to have increased from SR 74.6 billion to SR 127.2 billion over the Third Plan period, thus averaging 11.3 percent growth per annum in current price terms. By 1403/04 its share of non-oil GDP had increased to almost 60 percent.

Table 6-3
INSTITUTIONAL ORIGIN OF NON-OIL GDP
(current prices)

	1399/1400		1404/1405		Average Annual Growth
	SR(bn)	%	SR(bn)	%	%
Non-Oil Private	74.6	57.0	127.2	59.8	11.3
Government*	56.3	43.0	85.4	40.2	8.7
Total**	130.9	100.0	212.6	100.0	10.2

* Includes state-owned enterprises

** Totals are marginally different from the activity-based sectoral definition of non-oil GDP

In constant price (1389/90) terms the share of the private sector in 1399/1400 and 1404/1405 was higher: 67.9 and 72.5 percent respectively. In terms of total GDP the private sector's share increased in current prices from 19.4 percent in 1399/1400 to 35.5 percent in 1404/1405. To a large extent this increase resulted from the fall in the value of oil revenues over the period, rather than from the absolute growth of the private sector.

6.1.2.3 Investment

A further measure of the growing importance and strength of the private sector is shown in Table 6-4.

Table 6-4

STRUCTURE OF GROSS FIXED CAPITAL FORMATION
(current prices)

	1399/1400		1404/1405		Average Annual Growth Rate
	SR(bn)	%	SR(bn)	%	%
Non-Oil Private	23.2	23.9	36.5	35.3	9.5
Government	61.6	63.4	52.4	50.7	-3.2
Oil Sector*	12.3	12.7	14.5	14.0	3.3
Total	97.1	100.0	103.4	100.0	1.3

★ Includes private oil

During the Third Plan period the private sector consistently increased its share of gross fixed capital formation to 35.3 percent in 1404/05, having invested SR 173 billion over the five-year period.

6.1.2.4 Manpower

The broad sectoral shares of employment remained relatively stable during the Third Plan period, with the private non-oil sector, as measured in Table 6-5, slightly increasing its share from 85.3 percent in 1399/1400 to 88 percent in 1404/1405. This increase was at the expense of the reduced share for government-sector employment, which is a positive trend reflecting an expansion of the productive base through the private sector.

Table 6-5

PRIVATE SECTOR EMPLOYMENT

	1399/1400		1404/05		Average Annual Growth Rate
	(Thousands)	%	(Thousands)	%	%
Non-oil Private [*]	2,581.9	85.3	3,911.8	88.0	8.7
Government	399.4	13.2	469.1	10.5	3.6
Oil Sector ^{**}	44.7	1.5	65.1	1.5	7.8
Total	3,026.0	100.0	4,446.0	100.0	8.0

^{*} Includes State corporations and quasi-government agencies.

^{**} Includes private oil sector employment.

The dominance of the private sector in employment emphasizes its responsibility for future reductions in manpower by increasing productivity, particularly through the adoption of more labor-saving technology.

6.2 NEW ECONOMIC AND BUSINESS ENVIRONMENT

The striking growth of the private sector over the last decade was spurred on by a dynamic and buoyant business environment. There was a high and increasing level of demand and the structural (as well as institutional) bottlenecks provided local companies with a substantial degree of natural protection against foreign competition, which they were able to exploit. The expansive environment was reflected in the nature of the problems reported by the private sector. At the beginning of the Third Plan, the private sector's principal concern was maintaining sufficient throughput to meet demand in the face of manpower and raw material shortages, bureaucracy in government procedures and inadequate information about government policy generally.

During the last years of the Third Plan conditions began to change. By the end of the period the domestic market had fallen from the high levels of the mid-1970s to one approaching the world norm, where business success depended on tight financial control, high standards of service and product quality, and efficient and well planned sales strategies.

Moreover, as consumers became more sophisticated, markets became more discerning and quality-conscious. New investment projects had become less transparent; the era of easy trading had ended. Finally, the downturn in construction put many building and construction companies and their suppliers under extreme pressure, while some foreign companies had to leave the Kingdom.

At the end of the Third Plan a new set of problems faced the private sector which reflected the tighter business environment:

- falling demand increased competition on domestic markets and emphasized the need for and value of effective selling and marketing strategies, and generally increased business risks;
- profit margins narrowed and the need for sound financial discipline increased;
- high expertise in management became a precondition for corporate survival; poor decision-making could no longer be cushioned by high margins;
- substantial excess capacity now existed throughout the private sector, which had been installed in anticipation of continued high levels of economic activity.

The Government was quick to take action in support of the private sector, and by the beginning of the Fourth Plan several initiatives were operational. Open tendering on all government contracts had been introduced to provide an equal opportunity for all Saudi companies. Greater attention was given to the 30 percent regulation, which required at least 30 percent of the value of government contracts awarded to foreign companies to be provided by Saudi companies. New procedures were introduced by the Government to speed payments to the private sector, and the offset program was initiated to facilitate the transfer of technology to the Kingdom. Against this there was also the need to ensure stability in the Government's own financial position; as a consequence of falling revenues it was necessary to reduce advance payments on government contracts from 20 percent to 10 percent.

Nevertheless, the implications for future private-sector development are clear:-

- the previously experienced high rates of growth cannot be expected to continue throughout the Fourth Plan;
- even if oil revenues picked up substantially, with most of the infrastructure in place there will be no return to the high rates of activity in the construction sector, as government expenditures will be channelled to new sectors;
- there is likely to be a further continuation in this adjustment, as firms ill-equipped for the tougher trading environment fail to keep pace;
- there will be an increasing demand for outside finance which will place growing demands on the Kingdom's financial structure.

6.3 FOURTH PLAN PERSPECTIVES

In response to the new economic conditions in Saudi Arabia the Fourth Development Plan Strategy has introduced a major change in the respective roles of the Government and the private sector. In particular, it places greater emphasis than previous plans on the role of the private sector.

Previously the Government took the leading executive role, especially in developing the country's infrastructure and in the large industrial developments at Jubail and Yanbu. With these programs nearing completion, and with the growing strength of the private sector, the Government will in future concentrate more on regulatory and promotional functions and allow the private sector, through the market system, to meet the Kingdom's demand for goods, services and facilities.

Thus, during the Fourth Plan period and beyond, many of the key development goals and objectives will be achieved through the activities of the private sector, in particular the continued diversification of the economy through further development of the producing sectors of industry, agriculture and mining, and improvements in the efficiency and productivity of existing economic units.

However, the changing emphasis in the roles of the public and private sectors will result in substantial adjustment problems. To overcome them concerted action will be required on the part of both the Government and private enterprise.

6.3.1 GOVERNMENT OBJECTIVES AND POLICIES

The second basic strategic principle of the Fourth Plan states the Government's adoption of a policy giving the private sector the opportunity to undertake many of the economic tasks of the Government.

The policies to be adopted by the Government in respect of the private sector over the next five years reflect directly the new economic conditions and the ensuing problems posed for the private sector. They are elucidated clearly and in detail in the Fourth Development Plan Strategy and focus on five broad areas, in particular to:

- increase opportunities for the private sector to acquire, manage, and operate projects currently operated by the Government, providing that this will result in lower costs;
- encourage greater participation of the private sector in the financing of development;
- ensure that government policy concerning the private sector is appropriate to present conditions;
- encourage and facilitate private sector investment in new areas, and encourage banks to give more facilities for productive projects, instead of concentrating on the import trade;
- encourage the establishment of more joint-stock companies so that the largest number of citizens can benefit from investment.

Considerable attention has been given to the issues of private sector development and a great many programs have been identified for implementation by the government executive agencies. These are detailed in the operational plans of the sectors. In addition, a range of initiatives is planned for implementation during the next five years which is intended to facilitate the changing emphasis of the private sector's role in development. These programs reflect clearly the changing nature of government assistance to the private sector, with greater attention being given to non-financial support to supplement and reinforce the management skills needed by the private sector.

6.3.2 FOURTH PLAN INITIATIVES

Essentially, there are seven key areas for combined action by the Government and the private sector, as described below.

6.3.2.1 Privatization

During the Fourth Plan the Government will continue with its program of transferring ownership of government corporations to the private sector. A further issue of SABIC shares has already been announced and the Government is giving careful consideration to the timing and proportion of shares that could be offered in other government corporations and institutions.

6.3.2.2 Development Finance

One of the most fundamental issues facing the private sector in the Fourth Plan is the requirement by government that a greater proportion of development should be financed directly by private capital. This will require private individuals, households and commercial entities to reappraise their holdings of wealth and consider ways in which their capital reserves can be made available and channelled to productive projects. To facilitate this the financial system needs greater flexibility and adaptability at all levels to provide appropriate finance in sufficient amounts as required by the growing economy, and to accommodate the risk-sharing preferences of investors and financial intermediaries.

To promote the development of a more appropriate financial system the Government is considering a number of initiatives:

- a review of regulations concerning the establishment of public joint-stock companies to ensure they are in line with current development needs; and of methods to stimulate the incorporation of public companies;
- encouraging the formation of venture-capital and public-subscription investment companies;
- promoting the formation of appropriate financial intermediaries and financial instruments to help attract private capital and channel it to productive uses;

- examining methods of equalizing the benefits and risks of investing within the domestic economy with those available to private investors abroad, to encourage greater investment of local capital within the Kingdom;
- through the regulatory powers of SAMA, encouraging the commercial banks to participate to a greater extent in longer-term finance, particularly in project finance;
- improving the access of small- and medium-scale companies to sources of finance to facilitate their participation in the new activities proposed for the private sector.

For its part the private sector will be expected to make a positive commitment to increase its role in development finance in four respects:

- greater use of its own capital resources to finance new projects;
- increasing the opportunities for private individuals to invest in commercially viable development projects by making a larger proportion of company shares available for public subscription;
- adopting a more positive approach to long-term finance by commercial banks, particularly for projects of national strategic significance;
- evaluating the establishment of new financial institutions in line with development needs.

6.3.2.3 Private Sector Restructuring

To meet the challenges of a more competitive business environment the private sector will need to undertake substantial changes and rationalization, both in terms of company structure and operations, and in terms of their focus of activities. Positive action will be required in three key areas if companies are to survive the harsher but more realistic trading conditions that are developing:

- more appropriate organizational and management structures will be required to accommodate rational growth and facilitate effective decision making;
- greater attention to developing and improving marketing and sales capabilities will be necessary to ensure that Saudi companies' shares of the domestic market are maintained or increased, and that Saudi companies can effectively penetrate and compete on export markets;
- better financial and management control will be required in the future, as profit margins narrow and recourse is sought in outside sources of finance; a prerequisite of modern corporate growth is good financial and management accounting, combined with comprehensive and audited records of current and past performance.

While principal responsibility for implementing these changes must lie with private businesses, the Government has identified a series of action programs to facilitate this restructuring. These include:

- providing consultation and non-financial assistance to companies considering entering export markets;
- establishing national and regional trade exhibitions;
- organizing conferences on management and marketing subjects in association with the Chambers of Commerce and Industry, entrepreneurs and Saudi universities;
- increasing the focus on commercial and management subjects in the training curricula;
- encouraging the establishment of marketing and promotional support companies;
- intensifying the utilization of media sources available for advertising by national companies;
- ensuring economic feasibility and greater financial discipline from companies requiring loans from specialist lending institutions.

6.3.2.4 Diversification

In the recent past it has not been necessary for Saudi Arabian entrepreneurs to have highly developed skills in project identification; they have largely been guided by their experience in trade, the pattern of government expenditure and the high growth of the economy. Together these offered high levels of security in almost all investment projects.

During the coming decades there will be limited opportunities for the more obvious types of investment in retailing, import trade, conventional agriculture, servicing or manufacturing of products which involve simple technology and small economies of scale. Future opportunities are likely to be significantly more complicated, more expensive and requiring advanced technology. This means that projects will become increasingly more difficult to identify and more time-consuming and complex to develop into viable investments. The private sector will need to develop efficient combinations of finance, management skills, technology and entrepreneurial talent in order to prosper and expand in future markets.

To help minimize the increased risks of investment the Government proposes to:

- carry out studies to consider the Kingdom's comparative advantages and to identify investment opportunities which can be evaluated in detail by the private sector;
- make specific provision for continued assistance to the private sector in project identification within existing institutions including:
 - ★ Ministry of Planning
 - ★ Executive Ministries;
 - ★ Specialist Lending Institutions;
 - ★ Chambers of Commerce and Industry;
- establish specialist committees to monitor opportunities on a sectoral basis.

6.3.2.5 Employment and Technology

A particularly important aspect of private sector activity concerns the demand for labor, especially expatriate labor. The Fourth Plan states the Government's intention to reduce the non-Saudi labor force, while improving its skill composition. This calls for corresponding attitudes on the part of the private sector as the sponsor of many expatriates.

Ultimately, the private sector will need to adopt a more positive approach to investment in labor-saving technology and a deeper commitment to upgrading the skills of Saudis, through on-the-job training and through greater participation in government training schemes for Saudis.

6.3.2.6 Private Sector Policy

With the new emphasis on private sector development it is important that the Government's policies towards the private sector, particularly that concerning investment, are both appropriate to current business and economic conditions and consistent with the Fourth Plan Strategy. The Government therefore proposes to:

- hold detailed discussions with the Chambers of Commerce and Industry to identify shortcomings and areas of conflict between the Plan's objectives for the private sector and existing policy;
- undertake a comprehensive evaluation of the impact of policy on the pattern of investment and private sector development;
- identify specific policy areas for revision as necessary.

6.3.2.7 Private Sector Liaison

A particular feature of the Fourth Development Plan will be a more pressing need to facilitate a flow of accurate and detailed information between the private sector and the Government. To this end the Government proposes to:

- expand the activities of the Chambers of Commerce and Industry to assist in the development of the private sector, and to act as a forum for private sector opinion and an interface between the Government and the private sector in planning issues, and to provide advice to the private sector on government policy;
- undertake a mass media program to maintain a high level of awareness of government policy, action and procedures among private sector firms.

To obtain maximum benefits from these initiatives the private sector will need to adopt a more positive, cooperative and responsible approach to liaison with the government agencies.

The foregoing summarizes some of the more important initiatives to be taken by the Government in assisting the private sector to adapt to the new business environment and its new role in development. Throughout the Fourth Plan period the Government will continually monitor business conditions, the effectiveness of its policies and the performance of the private sector, and will take further action as appropriate. Indeed, one of the key features envisaged for the Fourth Plan will be the establishment and maintenance of closer cooperation with the private sector.

6.3.3 IMPLICATIONS FOR THE PRIVATE SECTOR

It is expected that the private sector will play an increasingly important role in achieving the objectives of the Fourth Plan, particularly in relation to diversification. The sectoral growth rates targeted for the Fourth Plan, as outlined in the previous chapter, have clear implications for the private sector.

New investment will need to be focused on the leading growth sectors of agriculture, minerals, industry and financial services. Indeed, as shown in Table 6-6, private sector investment is expected to grow in real terms at an average annual rate of 10 percent during the Fourth Plan period.

Table 6-6

GROSS FIXED CAPITAL FORMATION IN THE FOURTH PLAN (1399/1400 Prices)

	1404/1405		1409/1410		Average
	SR(bn)	%	SR (bn)	%	Annual Growth
Non-oil Private	35.2	35.4	56.7	47.8	10.0
Government	50.4	50.6	44.6	37.7	(-2.4)
Oil Sector	13.9	14.0	17.2	14.5	4.4
Total	99.5	100.0	118.5	100.0	3.6

By the end of the Fourth Plan it is estimated that the private sector's share of gross fixed capital formation will need to increase to almost 48 percent if sectoral growth rates are to be achieved. The magnitude of the task facing the private sector in the coming five years is underlined by the planned reduction in foreign employment, and consequently in total employment from 4.4 million in 1404/1405 to 4.2 million in 1409/1410.

It is clear that the successful achievement of the Fourth Plan targets require a dedicated commitment by all sectors of the economy; no commitment, however, is more important than that of the private sector.

