

Investment Series 2008

# Saudi Arabia

## The Rise of a Giant



High oil prices and a rolling program of regulatory and economic reforms have triggered a surge of investment into Saudi Arabia, and its economy is booming. With one of the world's youngest populations, its government is using this wealth to lay sustainable foundations for a 21st-century, knowledge-based society.



INTERNATIONAL INVESTMENT GUIDE

# Making the Top Ten

On the coast of the Red Sea, about 120 kilometers north of Jeddah, the world's first "Smart City" is beginning to take shape. On completion, information workers based in the \$26 billion King Abdullah Economic City (KAEC) will enjoy broadband speeds ten times faster than any other available. Due for completion in 2016, the city will support over 2,000 factories and house two million people.



The city's resorts will be able to accommodate up to 100,000 tourists at any one time, while its port will have the capacity to handle the equivalent of 20 million 20-foot containers a year and 300,000 pilgrims bound for Mecca.

The sheer scale may have guaranteed KAEC more than its fair share of publicity, but it is, in fact, only one of six Economic Cities either planned or under construction in the kingdom. And these cities themselves are only single elements of the 10x10 initiative, Saudi Arabia's mission to turn itself, in the space of a few years, into one of the world's most competitive economies.

With oil prices climbing relentlessly and Saudi reserves still the largest in the world, this drive to develop a diversified economy might seem on the face of it counter-intuitive; the kingdom is, after all, currently enjoying its highest fiscal surpluses since the oil boom of the 1970s. Domestically generated investment is also flooding back in, along with increasingly large chunks of Western money, both of which now regard Saudi Arabia as an increasingly attractive haven in today's uncertain global economic climate, rather than the emerging market desperate for inward investment that it used to be.

It is therefore to the credit of King Abdullah and his government that they have elected not to rest on the laurels of their good economic fortune, but to confront the challenges of the future head on.

This has meant facing up to a couple of home truths: Firstly that dependence upon oil revenues is neither sustainable nor viable in the long run; and secondly, that with more than ten million Saudi citizens (or over 50% of the population) under the age of 18, the kingdom is not just sitting on a large potential pool of talent but will shortly be faced with a pressing social requirement to find an outlet for it. And Saudi Arabia is not alone in grappling with these issues; crucially, it recognizes that many of its neighbors in the Gulf have the same problem to a greater or lesser degree.

The implications for Saudi Arabia are both structural and long term, as the kingdom needs to develop a diversified economy not just to decrease its reliance on oil but also to provide sufficient career and development opportunities for one of the proportionately youngest populations in the world. To achieve this will require attracting both expertise and investment from overseas, frequently in the face of stiff competition from other Middle Eastern states—not least Dubai and Abu Dhabi.

The answer that has emerged is simple but highly ambitious: Turn Saudi Arabia into one of the ten most competitive economies in the world by 2010. So the 10x10 initiative was born.

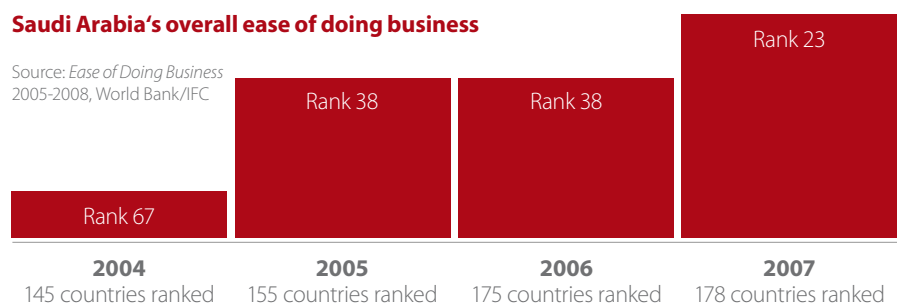
One of the principal architects of this vision has also taken on the responsibility for turning it into a reality. He is His Excellency Amr Al-Dabbagh, governor of the Saudi Arabian General Investment Authority (SAGIA), the organization spearheading the kingdom's drive to attract inward investment and also the prime facilitator behind the KAEC project.

Al-Dabbagh is in no doubt about the significance of SAGIA's role: "Investment is the oxygen of economy," he says. "Without investment there is no growth and there is no job creation. We need to inject a sufficient amount of investments into the economy to increase economic growth, and only then can we create jobs."

Although the 10x10 "brand" was only adopted in 2005, Al-Dabbagh has been working on the vision behind the slogan since he took up his post at SAGIA

## Saudi Arabia's overall ease of doing business

Source: *Ease of Doing Business* 2005-2008, World Bank/IFC



in 2004. His efforts have now come into focus around three main initiatives: the Economic Cities that are being designed to develop pockets of competitiveness where industries other than oil can flourish; the National Competitiveness Center (NCC), established in 2006 to assess, benchmark, and support that competitiveness; and a concerted drive to build up a specialization in three major sectors that build on Saudi Arabia's core competencies, but also represent a diversification away from oil, namely energy, transportation, and knowledge-based industries.

The NCC provides data-driven objective advice based on the systematic benchmarking of the kingdom's performance against international standard reports. It is probably an enjoyable place to work right now as much of the news it has to convey is of the positive variety. Saudi Arabia has jumped from 38th to 23rd in the IFC/World Bank's *Ease of Doing Business* ranking in the space of two years, an improvement that the NCC attributes partly to the removal of the minimum capital requirement and partly to the streamlined registration process for new business startups. It also appeared for the first time in the World Economic Forum's *Global Competitiveness Index* (at 35th, the highest new entrant). This time the NCC pinpointed the importance of Saudi Arabia's exceptional macroeconomic stability as the major lesson to be learned.

But the NCC is definitely not just about pumping out good news. It has read between the lines of both reports and concluded that there is still a long way to go, particularly in the elimination of red

tape, obtaining of credit, protection of investors enforcing contracts, and both starting and closing businesses as key areas for improvement in 2008.

Al-Dabbagh and his colleagues are not trying to reinvent the wheel. The common themes behind all three initiatives are firstly a willingness to draw from the experience of others, and secondly a commitment to long-term and sustainable growth. The development of the Economic Cities concept, for example, included a survey of over 3,000 of the world's free zones, after which 60 of the most successful were selected and analyzed to determine their key success factors. Only then did Al-Dabbagh's team settle on the blueprint of the Economic City as a comprehensive, fully integrated development featuring a "live, work, and play" design—genuine, organic conurbations rather than soulless industrial zones.

Sustainability has also dictated the choice of private-sector partners for the cities, which have been described as the ultimate innovation in public-private partnerships. "The biggest challenge is to create the first 30-40,000 direct jobs in each Economic City," Al-Dabbagh explains, "because each direct job will create five to seven indirect jobs. Human capital is our biggest challenge and everything else is a piece of cake compared to that. The moment we sign up an anchor industry or anchor tenant, we ask them about their human resources requirements."

In the three to four years it takes new investors on average to build a new factory or plant, SAGIA will be looking at their staffing requirements and will design a human resources program to ensure that those



Saudi Arabia's young population enjoys a bright outlook with an ever-increasing number of career opportunities.

requirements can be met by the time the investor is ready to open for business. This does not involve imposing unrealistic quotas on overseas companies; organizations in the operation and maintenance sectors are only required to ensure that 10% of their workforces are Saudi nationals, with that figure rising to 30% in the industrial sector. SAGIA estimates that by 2020, the six cities will accommodate a total of 4.8 million people and will have helped to almost double the kingdom's GDP per capita over the same period.

"We're definitely going to raise the bar further," Al-Dabbagh promises. "The progress never stops." ■

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# Brain Gain

Saudi Arabia's appearance in the World Economic Forum's *Global Competitiveness Index* for the first time this year will have been the source of considerable satisfaction to the kingdom's rulers, for it is not an accolade bestowed lightly.



SAGIA is attempting to establish Saudi Arabia as a destination for knowledge-based industries. In particular, it is developing science and information communication technology.

The World Economic Forum (WEF) is not an organization to pull its punches. "Ensuring that highly qualified Saudi workers with relevant skill sets are available in an innovative economy is crucial to the country in reducing the national unemployment and the current reliance on foreign labor," the report remarks. This assessment will have come as no surprise to the government, which has already pushed education and the development of the human capital required to drive a knowledge-based economy to the top of the kingdom's political agenda.

The possibility of a skills deficit identified by the WEF is, ironically, a side effect of Saudi Arabia's concerted drive toward the creation of a diversified

and deregulated economy. The government has traditionally been the major provider of jobs within the kingdom's oil-based economy, but the number of state jobs has begun to dwindle as the

**"Saudi Arabia's National Science Plan has secured \$400 million in funding for research this year alone."**

bureaucratic structure is systematically overhauled. Although the private sector is gradually replacing the state as the main driver of economic activity, its human resource requirements are different and altogether more aligned to those of a 21st-century Western economy. More

often than not, businesses are being forced to import foreign nationals to fill their skills gaps, particularly in areas such as science and technology.

And the very 10x10 initiative that everyone is convinced points the way to Saudi Arabia's long-term prosperity is likely to make the situation all the more acute. When the kingdom's new Economic Cities are completed, it is estimated that 80% of the employees are likely to be foreign nationals, although the long-term plan is to reduce that number to just 30%. Given that there are over five million expatriates in the workforce (albeit many employed in an unskilled, blue-collar capacity), the scale of the task is immense.

It is for this reason that the Saudi government has made the renationalization of its workforce, and the development of tertiary and specialist education, two of its main goals in an attempt to fill existing key skills shortages and curb dependency on foreign labor. It is a work in progress and has been underway for some time. In 2004, annual overall expenditure on education increased by 24%; the following year, three new universities were approved by royal decree. Another three universities were created via a process of mergers, and then tentative plans were unveiled to transform 102 women's colleges into universities.

But the current jewel in Saudi Arabia's educational crown has to be the \$5 billion, 9,000-acre King Abdullah University of Science and Technology (KAUST) that is now under construction at Thuwal, 80 kilometers up the coast from Jeddah. A project close to King Abdullah's heart, the concept behind KAUST has been compared by one excited commentator to the *madrasas* of Central Asia, intellectual birthplace of both Mohammed al-Khorezmi, father of algebra, and the medical pioneer Ibn Sina—better known in the West as Avicenna.

One of the principal institutions entrusted with the task of transforming Saudi Arabia into a knowledge-based economy—and indeed society—is the King Abdulaziz City for Science and Technology (KACST). Established in 1977, KACST's remit is threefold. Firstly, it has the responsibilities of a Ministry of Science



As Saudi Arabia leaps into the 21st century, it still pays attention to its traditional past.

and Technology, and as such it governs the overall national science and technology planning for the kingdom. The second function of KACST is that it is accountable for funding research nationwide at universities and institutions; and lastly, the

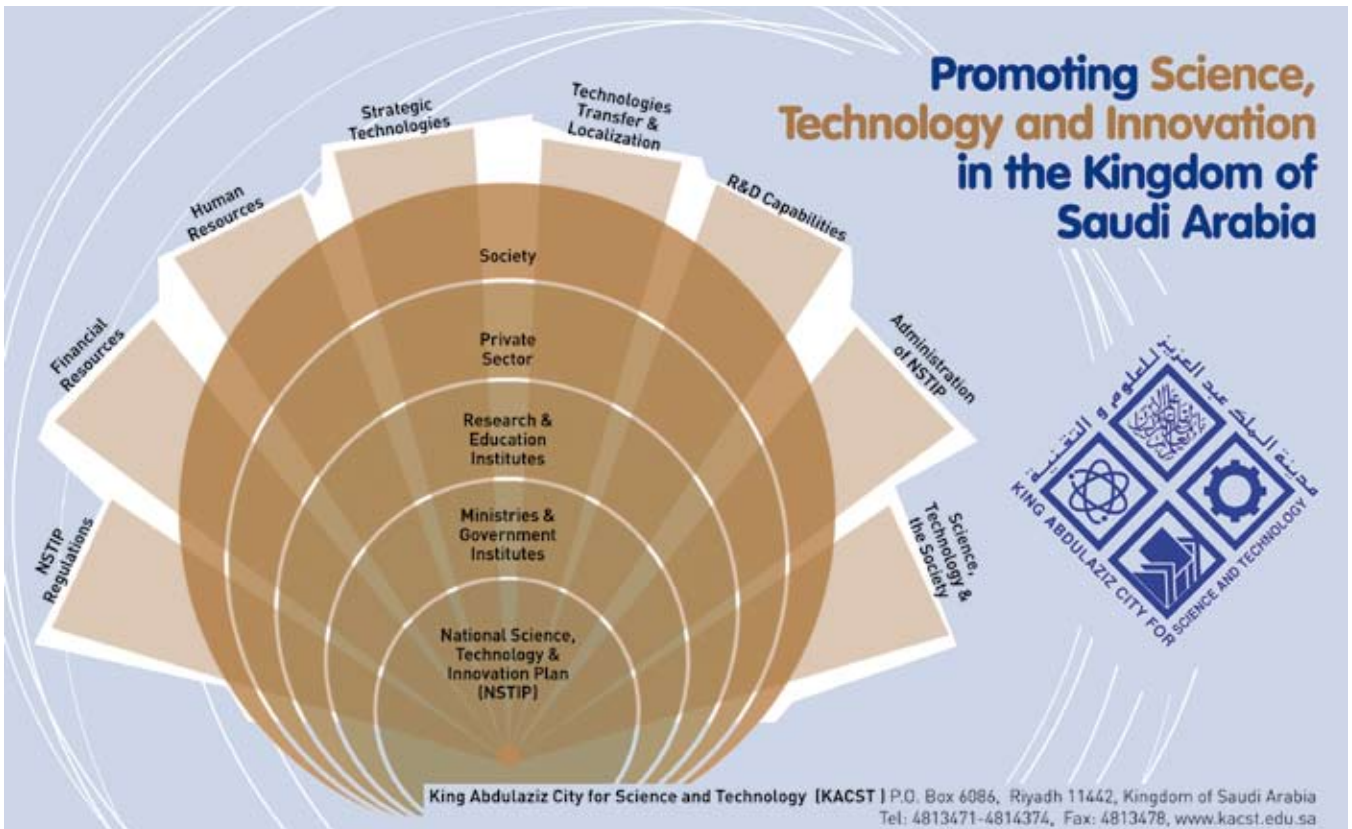
organization conducts national research through its National Research Institutes and Centers, which are located within the KACST facilities.

The move toward a knowledge-based economy has been welcomed by KACST's VP of Research Institutes, HRH Prince Turki bin Saud bin Mohammad Al-Saud, the man with hands-on responsibility and one of the architects of Saudi Arabia's new 20-year National Science Plan, which has just secured \$400 million worth of funding for research in this year alone. "We have defined 11 strategic technologies," he explains. "Water, oil and gas, petrochemicals, biotechnology, nano-technology, IT, electronics, energy, telecommunications, and advance materials; and we have written a road map with specific research priorities for each of them." An important element of the strategy will be the establishment of TICs (Technical Innovation Centers) at ten universities throughout the kingdom, which aim to secure real-world results by partnering with local industry.

He believes that private-sector participation will be critical to the plan's

success and, to that end, KACST is in the process of establishing a network of "incubators", whose role will be to assist startup companies with funding, technical support, and ancillary services such as marketing. "Incubators are a very good mechanism as they can increase the success rate of startup companies from 40% to 80%," Al-Saud points out. An ICT incubator is already in operation and another specializing in biotechnology will be open soon.

Although KACST's contribution to the development of a knowledge-based economy is going to be pivotal, Al-Saud is aware that the overall vision will only succeed if it is built on solid and long-lasting foundations. "We have to put the right infrastructure in place," he says, "and we have to build an innovation system that includes education, R&D, the regulatory framework, funding, and ways of thinking. We need to work hard to establish a sustainable system, and the step after that will be to change the local culture." If he manages that, it will surely rank alongside King Abdullah's finest achievements. ■



# Changing Times

Whichever yardstick you choose to measure it by, Saudi Arabia's economy is in exceptionally good health. In 2007, GDP grew to just under 5% and foreign direct investment into the kingdom topped \$18 billion, making it the main recipient of inward investment in the region. The National Bank of Kuwait forecasts this as the tip of a \$300 billion iceberg that is expected to roll into Saudi Arabia by 2012.

The recent surge in oil prices is one very significant reason for Saudi Arabia's good fortune, but it is only part of the story. The government's rolling program of economic and regulatory reform is also attracting not just Western cash, but an increasingly large proportion of locally generated petrodollars that has in the past found its way abroad.

Mindful of the inflationary pressures that have built up after previous oil booms, the authorities are managing their newfound wealth carefully, using it both to develop an infrastructure suitable for the 21st century and to encourage diversification away from the very source of those petrodollars—the oil and gas industries.

The authorities are not, however, afraid to play to the kingdom's core strengths, and some of the largest projects currently under construction are based around the petrochemical industry. In the next 18 months alone, a number of massive projects are due to come onstream, including several at the twin Industrial Cities of Yanbu and Jubail, recently voted the Middle East cities with the best economic potential.

The government's commitment to controlled diversification is a vision shared by many of the kingdom's

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leading industrialists such as Osman Ibrahim, Executive VP of Rawabi Holding. Once a traditional oil company, Rawabi has transformed itself into a conglomerate whose subsidiaries already operate in a wide range of other sectors. "Our core business is oil and gas, and we believe that this sector will remain the biggest attraction for investment for the next few decades for the simple reason that this is the oil hub of the world," says Ibrahim. "But we can capitalize on that. We have also diversified into other sectors such as telecommunications, electricity, construction, food distribution, and logistics services. We are trying to build integrated services companies that can provide turnkey solutions in most sectors." Like other established Saudi-based organizations such as Cristal Global, Rawabi is balancing its ambition with a total commitment to international principles of corporate social responsibility, particularly around environmental issues.

King Abdullah's drive to build a knowledge-based economy is inevitably having a beneficial knock-on effect on a wide range of supply-side industries, most obviously construction but also IT and telecommunications. The need to provide Saudi Arabia's young population with adequate accommodation when they reach adulthood has meant that the focus of the kingdom's real estate market is moving away from

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villas and luxurious palaces to apartments more suitable and affordable for tomorrow's office workers. According to Samba Financial Group, the value of construction operations will reach \$192 billion by 2010, and to meet the demand for housing between now and 2020, the authorities will have to find a way of building 2.6 million residential units—the equivalent of 163,750 units each year.



Saudi Arabia's new generation is now asking for a high quality of life, with new international restaurants and luxury shops being opened almost every day.

With mobile penetration nearing 100% by the end of 2007, telecommunications is an industry that is also flourishing. Long gone are the days when the incumbent operator Saudi Telecommunications Company (STC) held the monopoly. It now has to compete with Mobily for a share of the mobile market in what will soon become a three-way contest when Zain launches its commercial service later this year. And STC is now only one of four operators in Saudi Arabia's fixed-line market.

The Saudi IT services market is also changing fast. There are currently more than 50 IT services providers with no one vendor dominating the market, and that figure is likely to grow as analysts expect expenditure to increase at an annual rate of 13% over the next five years.

But it is at grass-roots level that the most intriguing change is taking place as a new "can do" mentality gradually takes hold. Encouraged by the elimination of the minimum capital requirement for the registration of a limited liability company, decreased registration costs, and a war on red tape, a record 1,438 joint ventures were authorized in 2007.

As a result, new businesses are springing up everywhere. One that offers a glimpse of how Saudi Arabia could change in years to come is Yibreen Spa, a ladies-only health resort in Riyadh. It is co-owned by HRH Princess Reema Bandar Al-Saud—President of Alpha/Harvey Nichols Riyadh and founder of the Bara Boux brand—who

epitomizes the new determination at large across the kingdom. "The spirit of the Saudi woman is that of pride in their business accomplishments and confidence that their steps today are going to open the doors for the women after them," she says. "As for our limitations, with time, nothing is insurmountable." ■

# An Industrial Success Story

In May 2007, Cristal Arabia and Millennium Inorganic Chemicals of the United States combined their diverse manufacturing platforms to become one unified global producer of titanium dioxide products. By strategically diversifying, Cristal Global propelled itself to be the world's second largest producer of titanium. Cristal Global has also become the market leader in both merchant and specialty titanium products. Today, other Saudi companies are following Cristal's lead in pursuing smart growth.

At the core of Cristal Global's success is a family of more than 3,500 employees located on five continents—employees who are passionate about pursuing perfection in their work. By increasing market share, staying in the forefront of new titanium technologies, protecting the environment, and giving back to the communities where its facilities are located, Cristal Global has become a model corporate citizen and a name synonymous with the benefits of titanium dioxide.

## A quickly emerging leader in titanium dioxide solutions

The joining of Cristal and Millennium Inorganic Chemicals has broadened the company's product line, resources, and service capabilities. Cristal Global covers the wide range of titanium dioxide products for use in coatings, plastics, paper, and photo-catalytic surfaces. It is also a leading producer of titanium chemicals. Cristal Global now directs the operation of eight manufacturing plants on five continents, with locations in Ashtabula, Ohio; Baltimore, Maryland; Salvador, Bahia; Stallingborough, UK;

Thann, France; Yanbu, Saudi Arabia; Bunbury, Australia; and a mine site in Paraiba, Brazil. With a strong focus on customer and technical service and research and development, Cristal Global is constantly developing innovative new products to meet the needs of customers in every industry it serves.

## A friend of the environment

Both in products and practices, Cristal Global values its role in protecting and improving our environment. Cristal is creating titanium dioxide products that actually de-pollute surfaces and the surrounding atmosphere. These specialty products drive a chemical reaction that oxidizes surface dirt and pollutants.

Cristal Global's sustainability initiatives begin at the very top and reach to every plant, office, and facility around the world. Chairman and CEO Dr. Talal Al Shair has made proactive environmental efforts a priority; "We will do everything in our power to reverse dangerous environmental trends and enrich the lives of those in every community we represent," he says. ■



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