

Saudi Arabia: Investment Guide

The Leadership & Democracy Lab



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Introduction:

The purpose of this report is to provide businesses and organisations with a detailed and accessible overview of the investment environment of Saudi Arabia. This will include a theoretical as well as practical understanding of the “Guidelines to Investment” that businesses can use as a starting point when considering growth.

The report will therefore be organised as follows: 1) an overview of key concepts and relevant contextual information; 2) an analysis of the current investment environment; and finally culminating with 3) guidelines to be followed by businesses when entering the Saudi market. This report is mainly concerned with the domestic hurdles a company would have to go through if they were to invest today. A separate report will outline a scenario analysis in order to justify a prediction for the future of the country. Both reports together will provide a very clear picture of current, near, and medium-term Saudi Arabia for businesses.

Leadership & Democracy Lab (<http://www.democracylab.uwo.ca/>)

A student-run research organisation, begun in 2012 by Faculty Directors Dr. Peter Ferguson and Dr. Cristine de Clercy, as well as Chief Research Officer Bruce Fyfe, and a small group of graduate, and undergraduate students. Based out of the University of Western Ontario in London, Ontario, Canada, the Leadership & Democracy Lab (The Lab) has grown to involve a large group of researchers, looking into the investment environment, political and security risks of various countries and regions each year.

Research Team for Saudi Arabia Project

The research for this report has been led, and primarily written by Project Leader Louis-Claude Perrault-Carré. Having 4 years of experience with The Lab, Louis-Claude has led groups researching Tunisia, Libya, and most recently completed a political risk report for a company expanding into the Chinese market. Louis-Claude is currently an MSc Candidate in Security Risk Management at the University of Copenhagen.

Special advisors to this project include Professor Peter Ferguson and Patrick Sackville, as well as Eric De Roos, and Kevin McPhillips.

Primary researchers in this team, contributing to this report specifically include: Moustafa Ezz, Adheeb Rifdi, and Laura Asta.

Key Terms & Background Information:

Ibn Saud and the Unification of the Arabian Peninsula

The modern Kingdom of Saudi Arabia, also known as the ‘Third Saudi State’ was founded in 1932 through the consolidation of power by Abd-al-Aziz. The many tribes, sheikhdoms, emirates, and kingdoms of the Arabian Peninsula were unified under the rule of the self-proclaimed King Abd-al-Aziz.

King Abd-al-Aziz remained in power of Saudi Arabia until his death in 1953. His sons have since ruled the country as head of state and absolute monarch, maintaining the widespread rule of the House of Saud. Current King Salman bin Abdulaziz Al Saud took the throne in January 2015, becoming the sixth direct offspring of Abd-al-Aziz to command the kingdom. The position of Crown Prince of Saudi Arabia, is appointed by the King as selected successor, and is currently being held by King Salman's nephew Muhammad bin Nayef.

The House of Saud and the Role of Islam

The origins of the Saudi royal family dates back to the early 1700's, based on Shaikh Saud ibn Muhammad ibn Muqrin of Ad-Diriyah, close to modern-day Riyadh. His son, Emir Muhammad ibn Saud of Ad-Diriyah, is known as the founder of the "First Saudi State", through an alliance with Muhammad ibn Abd al-Wahhab, a Sunni Muslim scholar. Power was consolidated using ibn al-Wahhab's religious movement known as "Wahhabism", an ultra-conservative movement within Sunni Islam that has grown to become the state-sponsored form of Sunni Islam by the Saudi government.

The Wahhabi school of thought is often made to be synonymous with the fundamentalist Salafi school of Sunni Islam, but it can be thought of as the particularly 'Saudi' interpretation of the Salafi literalist school.

Dating back to the 1700's this relationship between the House of Saud and the Wahhabi school of thought was maintained through the "Second Saudi State", and to the current "Third Saudi State" founded by King Abd-al-Aziz in 1932.

The Role of Petroleum

Until the discovery of petroleum, the central tenets of Wahhabism were followed in Saudi Arabia, keeping the country isolated from the world in terms of travel, communication, and technological advances. Standard Oil of California (Socal) bought a concession in 1933, allowing them access to the entire country, which resulted in the discovery of oil in Dammam of the Al Hasa region in 1938. After the Second World War, development of the expectedly fruitful Saudi petroleum industry continued, through the Arabian American Oil Company (ARAMCO). Daily oil production increased from 0.5 million barrels in 1949 to 3.5 million barrels in 1960.

Petroleum currently constitutes approximately 80% of budget revenues, 45% of GDP, 90% of export earnings, and Saudi Arabia holds about 16% of the world's proven reserves.

The Organisation of Petroleum Exporting Countries (OPEC)

Although petroleum quickly became the most significant source of income for the Saudi government, the international oil markets were controlled by the "Seven Sisters", a group of multinational corporations. The OPEC was formed in 1960 by the governments of Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela in order to "...co-ordinate and unify petroleum policies among Member Countries, in order to secure fair and stable prices for petroleum producers; an

efficient, economic and regular supply of petroleum to consuming nations; and a fair return on capital to those investing in the industry.”

OPEC came to international prominence in the embargoes of 1973 and 1979, where the organisation used their significant petroleum production as a tool to increase the commodity price internationally. With the price of oil having dropped significantly since late-2014 due to global oversupply, OPEC in general, and Saudi Arabia in particular has refused to adjust production levels accordingly.

The 168th OPEC Meeting concluded on December 4, 2015, with no change to official policy, the conference determining that “...Member Countries should continue to closely monitor developments in the coming months.”

This section can be used as a point of reference for all future projects of this research group, including this report, and the following scenario analysis.

Saudi Arabia – Investment Environment:

There are two major economic trends that will be analysed in this section, the first being a general pattern of decreasing foreign direct investment (FDI), which is exacerbated by very low oil prices, making it impossible for the government to maintain spending without running significant deficits and cutting spending. The second trend involves a maintenance of problems of accountability, transparency, and corruption in the country, which only makes the above cash flow issue even worse.

Low FDI, Low Petroleum Prices, High Deficits

The 2014 United Nations Conference on Trade and Development (UNCTAD) reported that FDI flows had decreased for the fifth successive year, dropping to \$9.3 billion, a 24% decrease. The 2015 update by UNCTAD reported a further decrease, down to \$8 billion. This can be explained in various ways, including the implementation of a policy of “Saudization”, which is a policy adopted forcing employers to hire a certain percentage from the Saudi pool of eligible workers, which acts as a disincentive for foreign businesses.

In contrast, the very low oil prices are forcing the Saudi government to diversify its economy. The International Monetary Fund (IMF) has reported that with current spending, Saudi Arabia will survive approximately five years at \$50/barrel, which is even more worrisome with prices dropping more recently. The 2015 budget deficit has been estimated at around \$38.6 billion.

The approximate \$229.3 billion in expenses has been allotted most significantly to education and training (\$57.9 billion), health and social affairs (\$42.7 billion), infrastructure (\$32.8 billion), municipality services (\$10.7 billion), and government financing programs (\$19.7 billion). It can be seen that expenditures are not only focused on maintaining an extensive welfare state, but also in an attempt to boost economic growth in the form of infrastructure and financing programs.

Accountability, Transparency, Corruption

Saudi Arabia has improved its ranking on Transparency International's Corruption Perceptions Index, from a score of 44 in 2012, to 46 in 2013, and 49 in 2014 (100 being the best score). The Saudi government has also created the National Anti-Corruption Commission (Nazaha), in order to improve the integrity, transparency, honesty, justice, and equality of governmental bodies, all in an attempt to provide investors with a more favourable investment environment.

Favouritism and the use of "wasta", or middlemen, are very common when doing business in Saudi Arabia. Bribery is also commonly seen, and the court system is thought of as very slow and inefficient. Corruption is seen in the public services, as well as land administration bureaucracies. It seems like progress has been made when private businesses are dealing with government officials, but less so in private-private affairs. With a lack of free speech and free press, it becomes difficult to portray an accurate picture of Saudi corruption.

The aforementioned Saudization policies have been an attempt by the government to address the high unemployment in the country, which has averaged at approximately 10.5% over the past decade. The main root causes of this issue remain problems with education, as well as barriers to investment, which in turn hinders diversification of the economy.

The most significant negative changes since 2015, as per the World Bank Group *Doing Business 2016*, is that Saudi Arabia has dropped its ranking in terms of starting a business and acquiring credit, but on a more positive note, it has become much easier to register property.

Guidelines to Enter the Market:

This section aims to provide a company with the necessary knowledge if they were to enter the Saudi market today, outlining the most significant institutions and organisations a business would have to deal with.

Overview

In 2000, Saudi Arabia implemented the Foreign Investment Act (the "Act"), which liberalises the foreign investment laws in the Kingdom. The Saudi Arabian General Investment Authority (SAGIA) was created under the Act, which has responsibility for licensing all new foreign investment in Saudi Arabia. Under the new Act, foreign persons and entities are permitted to invest in all industries and services except for those which are specifically excluded from foreign investment. FDI is generally routed through SAGIA, set up as the one-stop shop for foreign investors.

Foreign investors may wholly own approved foreign investments, or a foreign investor and a Saudi national may jointly own them. Licensed businesses are now permitted to own the real estate necessary for the project and to house necessary staff (with the exception of Makkah and Medinah). Foreign investors may also obtain more than one license so as to enable them to participate in more than one business venture.

The minimum capital requirements for projects licensed under the Act are SR 25 million (US\$6.7 million) for agricultural projects, SR 5 million (US\$1.3 million) for industrial projects and SR 2 million (US\$ 533,000) for all other categories of projects. A project licensed under the Act enjoys the same privileges, incentives and guarantees as a national project, with the exception of taxation. Subsidized loans from the Saudi Industrial Development Fund (SIDF) are available to both foreign and Saudi owned enterprises. Additionally, sponsorship of the foreign investor and its non-Saudi employees is undertaken by the licensed entity and not a local person/entity.

Companies are required to register their employee's contracts with the Ministry of Interior before a residency permit can be issued. Each company is permitted a certain quota of residency visas. Employees with residency visas who earn above a certain threshold salary may sponsor family members for residency visas. Residency visas are valid for up to two years. Employees cannot work for anyone other than their sponsor and sponsorship cannot be transferred until the employee has worked for their original sponsor for at least two years.

The Investment Law requires any company in the Kingdom of Saudi Arabia with foreign shareholders to obtain a foreign capital investment license. Foreign capital investment licenses are issued by the (SAGIA). It should be noted that for the purpose of the Investment Law, corporate entities that are nationals of a Gulf Cooperation Council (GCC) member states are only considered GCC nationals if they are wholly owned by citizens or governments of GCC member states and enjoy the nationality of a member state of the GCC.

Except where stated otherwise in the Investment Law, there is no limit on the amount of foreign investment that can be invested in a company incorporated in the Kingdom of Saudi Arabia. The establishment of one hundred percent (100 percent) foreign owned companies is permitted in most cases. The Supreme Economic Council is responsible for issuing and periodically updating a list of activities, which list is generally referred to as the "Negative List", that are prohibited from being carried out by foreign investors in the Kingdom of Saudi Arabia. For the latest Negative List and minimum capital requirements please go to: <http://www.sagia.gov.sa>

When licensed under the Investment Law, a company enjoys all privileges and incentives offered to wholly Saudi owned companies, such as ownership of freehold property that is necessary to carry out the licensed activity, privileges granted by the anti-double taxation treaties to which the Kingdom of Saudi Arabia is a party, law prohibiting against expropriation or confiscation of investments, rights to repatriate profits, etc.

Visas and Entry into Saudi Arabia

Advance visas are required for all foreigners wishing to enter Saudi Arabia. The only significant exception is citizens of the Gulf Cooperation Council nations. Saudis prefer not to grant visas to unaccompanied women, but work permits are common in some fields — especially nurses, teachers, maids — and possible for anyone if your sponsor has enough connections. As a female traveller to Saudi Arabia however, you are more likely to obtain a visa if you are older and you are married.

All business travellers require a business visa for entry into Saudi Arabia. Business visas are issued to the following individuals: business people, investors, representatives of companies, managers, sales managers, sales representatives, accountants, production managers, administrative managers, and consultants.

Visitors to Saudi Arabia who arrive on business visas also require an invitation from a local sponsor that has been approved by the Saudi Chamber of Commerce.

You then need to take the letter along with your passport to the Saudi embassy or consulate in your country. Once this invitation is secured and certified, the actual process of issuing the visa is relatively fast and painless, taking anything from one day to two weeks.

Principal Types of Market Entry

Entering the Saudi market can occur in many ways, the most common are classified as: sales from abroad, sale of goods, and sale of services. The main distinctions can be seen in more detail here: <http://saudi-sia.com/wp-content/uploads/2014/10/KSA-Market-Entry-Presentation.pdf>

Foreign Direct Investment (FDI)

Foreigners wishing to conduct business in Saudi Arabia may do so by establishing a permanent presence in Saudi Arabia or by entering into an agency relationship for the distribution and sale of their products. Below is a summary of the business forms available under Saudi law:

A. Limited Liability Company (LLC)

This is the most common form for entering into joint ventures with Saudi partners; however, a Saudi partner is not required since there are no legal limitations on the percentage of foreign ownership.

The minimum capital investment required to establish an LLC is SR 500,000. An LLC must have between 2 and 50 shareholders and is managed and represented by one or more managers. There is no Board of Directors, although shareholders often provide for a Board and other management arrangements in the Memorandum of Association. The LLC must also have an auditor and, where it has more than twenty (20) partners, it must establish a Board of Controllers.

B. Partnerships

Foreign companies seeking to do business in the Kingdom may enter into a limited partnership. The limited partnership, or “sharikat tawsiya baseetah”, is a separate business entity comprised of several individuals or companies, including general (at least one) and limited partners. The general partners are liable for partnership debts to the full extent of their personal assets while the limited partners are liable only to the extent of their capital contributions.

C. Joint Stock Corporation

A Joint Stock Corporation (“JSC”) is an entity with at least five shareholders holding transferable shares. The minimum capital requirements are SR 2 million for a private JSC and SR 10 million for a public JSC. Liability of shareholders is limited to the par value of each shareholder’s share

capital. The JSC must be approved by license or Royal Decree published in the Saudi Official Gazette. Additionally, it must be registered with the MOC (Ministry of Commerce) Companies Department and the MOC Commercial Registry.

D. Branch Offices

Foreign companies may register a wholly foreign-owned Saudi branch office, provided that they obtain the requisite license. The branch office may engage in any government contract or private sector work within the scope of its license. Branch offices are subject to the requirements of the Government Tenders Regulations, where applicable. Branch office registration follows the same general procedure as for the registration of an LLC.

E. Sponsorship and Temporary Commercial Registration

As an alternative to forming one of the above entities, foreign contractors have in the past performed isolated private sector projects under the sponsorship of their Saudi customer and, in contracts with the Saudi government; the foreign contractor may perform its obligation under a temporary commercial registration (TCR).

With respect to sponsorships, they can be in two forms. The first is where the foreign contractor obtains a business visa, sponsored by the Saudi customer. The second form of sponsorship is where the foreign contractor ‘seconds’ its employees to the employment and sponsorship of the Saudi customer. If a foreign contractor is awarded a project with the Saudi government and it does not have a registered presence in Saudi in one of the above-discussed forms, it must obtain a TCR (Commerce Ministry Resolution No. 680 dated 10 October 1978). TCRs are limited in scope and duration to the substance and term of the government contract for which they are issued.

F. Commercial Agencies

Agencies and distributorships are governed by the Commercial Agencies Regulations and the related Implementing Rules (Royal Decree No. M/11, as amended by Royal decree no. M/32; Ministry of Commerce Decision No. 1897). The rules and regulations reserve a monopoly for Saudi nationals and wholly owned Saudi entities on ‘trading’ activities. Trading activities include the import and local purchase of goods for resale. Therefore, foreign companies engaging in such activities must use Saudi commercial agents and distributors, who must register their Agency Agreements with the MOC Agency Register. The agent must hold a valid Saudi commercial registration permitting him to act as an agent or distributor and the directors and authorized representatives of the agent must be Saudi nationals. The Commercial Agency Regulations bar appointment of shell agents indirectly owned or controlled by the foreign principal, therefore, the Saudi agent must be independent from the foreign principal.

The full SAIGA services manual and detailed sector-specific licensing and investment protocols is available at:

http://www.sagia.gov.sa/Documents/Wizard/SAGIA_Manual_Licenses_Investors_Guide.pdf

Industrial Projects

All industrial projects, whether Saudi or foreign, and joint ventures whose fixed capital exceeds SR 1 million (US \$267,000), excluding the value of land and buildings, must be licensed. Licenses are granted pursuant to either the National Industries Protection and Encouragement Act, which applies to projects by Saudi citizens with full Saudi capital, or the New Foreign Investment Law, which applies to projects with full foreign capital or mixed Saudi/foreign capital. Industrial establishments are entitled to various tariff exemptions, subsidies, export assistance, among other incentives.

Import and Sale of Goods in Saudi Arabia

This area is regulated by Royal Decree M/11 of 1962, which reserves the import of goods for resale in Saudi-to-Saudi individuals, wholly owned Saudi entities and Saudi-foreign partnerships where the foreign partner holds 25% equity.

Therefore, a foreign entity wishing to import into Saudi must use the services of a Saudi agent or distributor. However, Saudi companies with foreign participation with a license from the GIA may import products and materials necessary to perform the activities authorized by their license.

Under its WTO obligations, Saudi Arabia has committed to implement a transparent and predictable import licensing system. The specific documentation and process that must be followed can be accessed here: <http://www.al-norwige.org.sa/global/sitefolders/webriy/dbisa.pdf>

There are many goods that you are not allowed to bring into the country. These include weapons, alcohol, pork, pornographic materials and many others. There are also some products that require approval and/or registration, for example; pharmaceuticals, wireless equipment, veterinary medicines, pesticides, and military uniforms.

Taxation

In general the principal taxes in Saudi-Arabia are corporate tax, Islamic tax on wealth known as Zakat (applicable only to Saudi and GCC citizens), and withholding tax. A comprehensive tax law was enacted in 2004. It states that there is no personal taxation in Saudi Arabia. Neither Saudi nationals nor foreign employees are taxed on their salaries. Generally companies pay a 20% corporate tax. But non-Saudis who derive net income from investment in Saudi businesses; and self-employed individuals who engage in professional activities, are subject to corporate tax on a sliding scale according to their income levels. Tax rules and regulations in Saudi-Arabia are quite simple compared to many other countries. Those subject to tax are:

- A resident capital company with non-Saudi shares
- A resident non-Saudi person who carries out activities in the Kingdom
- A non-resident person who carries out activities in the Kingdom through a permanent establishment
- A non-resident person who has other income subject to tax from sources within the Kingdom
- A person engaged in natural gas investment fields

- A person engaged in oil and other hydrocarbon production

Moving Forward:

This report has provided businesses and interested actors, with the necessary information for investing in Saudi Arabia. First, and foremost, discussing the significant economic trends that will determine the country's ability to maintain competitiveness on an international scale, including the state of foreign direct investment, and the effect of oil prices on the domestic balance sheet. This was followed by the presentation of steps businesses need to take, and institutions it needs to cooperate with in order to successfully enter the Saudi market.

A further prediction of Saudi Arabia's future, using the tool of scenario analysis, will be provided by this research group in a separate report. An amalgamation of intelligence and analysis will provide the reader with an in-depth understanding of all major actors, and how they could potentially balance against each other in the near-to-medium future. This will include consideration of the royal family, global petroleum prices, ISIS, Iran, Russia, the United States, and more.

The scenario analysis will work together with these Guidelines, in order to provide organisations with a clear picture of the current and future position of Saudi Arabia in the region and the world in general.