

## The transformation of Saudi Arabia 2016-30

What are the opportunities for financial companies?



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## Foreword

### What will be the really big wildcards of 2017?

For corporate planners and decision-makers, there are always wildcards to take into account. These are events that are virtually impossible to predict, but which have a fundamental impact on the operating environment. At the time of writing, in late 2016, conventional wisdom is that the wildcards emanate mainly from politics in several of the largest OECD countries.

For example, it is not clear what will be the final outcomes from the unexpected victory for the Brexit camp in the referendum that took place in the UK in June. This report is about a positive wildcard - and one that has not been widely discussed in the mainstream, financial, trade or social media.

As the title of this report suggests, that wildcard is the economic and social transformation of the Kingdom of Saudi Arabia. In April 2016, the government published its Vision 2030 strategy, which is a general 'roadmap' for the country's development and the diversification of the economy away from hydrocarbons.

Two months later, the National Transformation Program (NTP) identified specific targets that are to be achieved by 2020. The International Monetary Fund (IMF) has indicated its strong support for the reforms that are envisaged in Vision 2030 and the NTP.

Among much else, the government is looking to sell a 5% stake in Saudi Aramco, the giant state-owned energy company, by way of an Initial Public Offering (IPO) to raise US\$100 billion. Assuming that this deal goes ahead, it will be by a wide margin the largest IPO ever, and about four-to-five times the size of the biggest IPOs that have taken place to date.

It also appears that the Saudi government is looking for the King Abdullah Financial District (KAFC) in Riyadh to develop in a similar way to the Dubai International Financial Centre (DIFC). To make it easier for expatriates to do business in the KAFC, the government is considering a major relaxation of the rules for issuance of working visas.

The sharp fall in energy prices over the last three years mean that reform has become essential in Saudi Arabia. The massive foreign currency reserves that have been accumulated over the years, and the proceeds that can be raised from sales of the government's interest in Saudi Aramco mean that the transition can be orderly.

The proposed changes make it clear that there will be considerable engagement with foreign companies and investors. That includes engagement with financial companies and with the world class technology companies that provide solutions to the global financial services industry.

The reforms on which the Saudi government are embarking represent one of the most important, and positive, wildcards, globally. There is a potential bonanza for financial companies. This report describes that opportunity.

**Kaushiq Kodithodika**  
**Regional Director, MENA**  
**SS&C Advent**

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## What are the opportunities for financial companies?

Imagine that you are running an economy whose exports have basically halved over the last three years – and largely due to factors over which you have no control.

This has a direct impact on public finances, because export revenues largely fund your government. In 2015, your government ran a fiscal deficit of nearly 16% of GDP, while the overall current account deficit was just over 8% of GDP.

This is essentially the situation that the Kingdom of Saudi Arabia has found itself in given that oil prices have roughly halved since the beginning of 2014.<sup>1</sup>

Fortunately, the government had accumulated enormous reserves while oil and gas prices were high. According to the International Monetary Fund (IMF), the net foreign assets of the Saudi Arabian Monetary Agency (SAMA – the central bank) should amount to around US\$543 billion at the end of 2016, down from US\$724 billion at the end of 2014.

### Saudi Arabia: Selected economic indicators

	2013	2014	2015	2016
<b>US\$bn</b>				
Nominal GDP	744	754	646	646
Total exports	376	343	202	184
Of which: oil and refined products	322	284	151	133
Total imports	153	159	155	150
Net foreign assets of SAMA	717	724	609	543
% Real GDP growth	2.7	3.6	3.5	1.2
Real Oil GDP growth	-1.6	2.1	4.0	0.6
Real non-Oil GDP growth	6.4	4.8	3.1	1.6
<b>% of GDP</b>				
Overall fiscal balance	5.8	-3.4	-15.9	-13.0
Current account balance	18.2	9.8	-8.3	-6.4

Source: IMF

IMF Country Report No 16/326, October 21016, Saudi Arabia Article IV Consultation Staff Report, p4



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Sources:

Vision 2030 and National Transformation Program, cited by IMF  
IMF Country Report No 16/326, October 2016, Saudi Arabia Article IV Consultation Staff Report, p15

## Key targets announced in Vision 2030 and the National Transformation Program (NTP)

<b>Labour markets</b>	<ul style="list-style-type: none"> <li>● Unemployment to be cut from 11.6% now to 9% by 2020 and 7% by 2030</li> <li>● Women's participation rate to be lifted from 22% now to 28% by 2020 and 30% by 2030</li> <li>● Creation of 450,000 new jobs in non-government sector by 2020</li> <li>● Reduction in civil service workforce by 20% by 2020</li> </ul>
<b>Trade</b>	<ul style="list-style-type: none"> <li>● Share of non-oil exports to rise from 16% now to 50% by 2030</li> </ul>
<b>Fiscal</b>	<ul style="list-style-type: none"> <li>● Non-oil revenue to be increased from SR163bn in 2015 to SR530bn in 2020 and SR1tn in 2030</li> <li>● Reduce wages and salaries as percentage of budget spending</li> <li>● Balanced budget</li> </ul>
<b>Subsidy reform</b>	<ul style="list-style-type: none"> <li>● Subsidies to be removed. Direct cash payments will be made to low and middle- income households who rely on subsidies.</li> </ul>
<b>Private and SME sectors</b>	<ul style="list-style-type: none"> <li>● Share of private sector in economy to be increased from 40% of GDP now to 65% of GDP by 2030. SME sector contribution to be raised from 20% of GDP to 35%</li> </ul>
<b>Foreign Direct Investment (FDI)</b>	<ul style="list-style-type: none"> <li>● Increase of FDI from 3.8% of GDP now to 5.7% in 2030</li> </ul>
<b>Tourism</b>	<ul style="list-style-type: none"> <li>● Liberalisation of tourist visa regime</li> <li>● Plans to build world's largest Islamic museum alongside other heritage sites</li> <li>● Increase in number of Umrah pilgrims from abroad from 6mn per year to 15mn in 2020 and 30mn in 2030.</li> </ul>
<b>Healthcare</b>	<ul style="list-style-type: none"> <li>● Plans to increase private sector role in healthcare and to boost life expectancy from 74 to 80 years</li> </ul>
<b>Oil and gas</b>	<ul style="list-style-type: none"> <li>● Increase share of domestically owned oil and gas sector output from 40% now to 75% in 2030</li> </ul>
<b>Housing</b>	<ul style="list-style-type: none"> <li>● Focus on affordable housing. Home ownership to be boosted from 47% now to 52% in 2020.</li> </ul>
<b>Military</b>	<ul style="list-style-type: none"> <li>● Military industry holding company to be created. Local participation in defence production to be boosted.</li> </ul>
<b>Education</b>	<ul style="list-style-type: none"> <li>● Modernisation of curriculum. Greater focus on training teachers and measuring performance</li> </ul>
<b>Immigration</b>	<ul style="list-style-type: none"> <li>● Green card-like program for foreign workers by 2021</li> <li>● Visa exemption for expatriates working in King Abdullah Financial District (KAFFD)</li> </ul>
<b>Aramco</b>	<ul style="list-style-type: none"> <li>● Initial Public Offering (IPO) of up to 5% stake in equity. Dual listing likely.</li> <li>● Government estimates value of Aramco at over US\$2tn.</li> </ul>
<b>Public Investment Fund (PIF)</b>	<ul style="list-style-type: none"> <li>● SWF to be created to boost diversification away from oil. Assets to be increased from SR600bn now to SR7tn by 2030.</li> </ul>

## A middling business environment...up to now

Together, these figures are also reflected in the September 2016 assessment of Saudi Arabia by the World Economic Forum (WEF). The WEF considers that the Kingdom is, overall, the 29th most competitive economy of the 138 evaluated. That Saudi Arabia has slipped in the rankings is due to the deterioration of its macro-economic environment, for which the Kingdom is assessed at 68th out of 138.

All this is in the context of Saudi Arabia being a middle-ranking country in terms of the overall ease of doing business. Thanks mainly to improvements in the procedures to registering property, the Kingdom has improved from being 84th out of 189 countries assessed by the World Bank in 2015 to 82nd in 2016.<sup>3</sup>

Although there are aspects of the business environment that clearly have room for improvement, the positive reforms over the last five years or so, which make it easier to conduct business in the Kingdom, considerably outnumber negative changes.<sup>4</sup>

### Saudi Arabia in a global context - 1

Population: 31.4mn. Per Capita GDP: US\$20,813

Global Competitiveness Index (GCI) rankings out of 138

Overall GCI	29
A. Basic Requirements	32
1. Institutions	24
2. Infrastructure	31
3. Macroeconomic environment	68
4. Health and primary education	51
B. Efficiency Enhancers	33
5. Higher education and training	46
6. Goods market efficiency	41
7. Labour market efficiency	65
8. Financial market development	47
9. Technological readiness	41
10. Market size	14
C. Innovation and Sophistication Factors	36
11. Business sophistication	31
12. Innovation	42

**Source:** World Economic Forum

World Economic Forum - Global Competitiveness Report 2016-2017, profile of Saudi Arabia

### Saudi Arabia in a global context - 2

Ease of Doing Business rankings out of 189

	2015	2016
Overall	84	82
Starting a business	124	130
Dealing with construction permits	17	17
Getting electricity	25	24
Registering property	49	31
Getting credit	71	79
Protecting minority investors	98	99
Paying taxes	3	3
Trading across borders	151	150
Enforcing contracts	86	86
Resolving insolvency	189	189

**Source:** World Bank

<http://www.doingbusiness.org/data/exploreeconomies/saudi-arabia>

## Business reforms in Saudi Arabia

### Positive\*

#### 2016

- Property transfers made faster thanks to new computerised system

#### 2013

- Paying of tax made easier through introduction of online systems for social security contributions
- Computerisation of court system makes enforcement of contracts easier.

#### 2012

- Administrative changes make it easier to register businesses.
- New, streamlined process makes it easier to deal with construction permits.

#### 2011

- An amendment to the commercial lien law makes secured lending more flexible.
- A new container terminal at the Jeddah Islamic Port reduces import times.
- Administrative changes accelerate the insolvency process

#### 2010

- Administrative changes make it easier to start a business
- Administrative changes speed up the process for dealing with construction permits.

### Negative\*

#### 2014

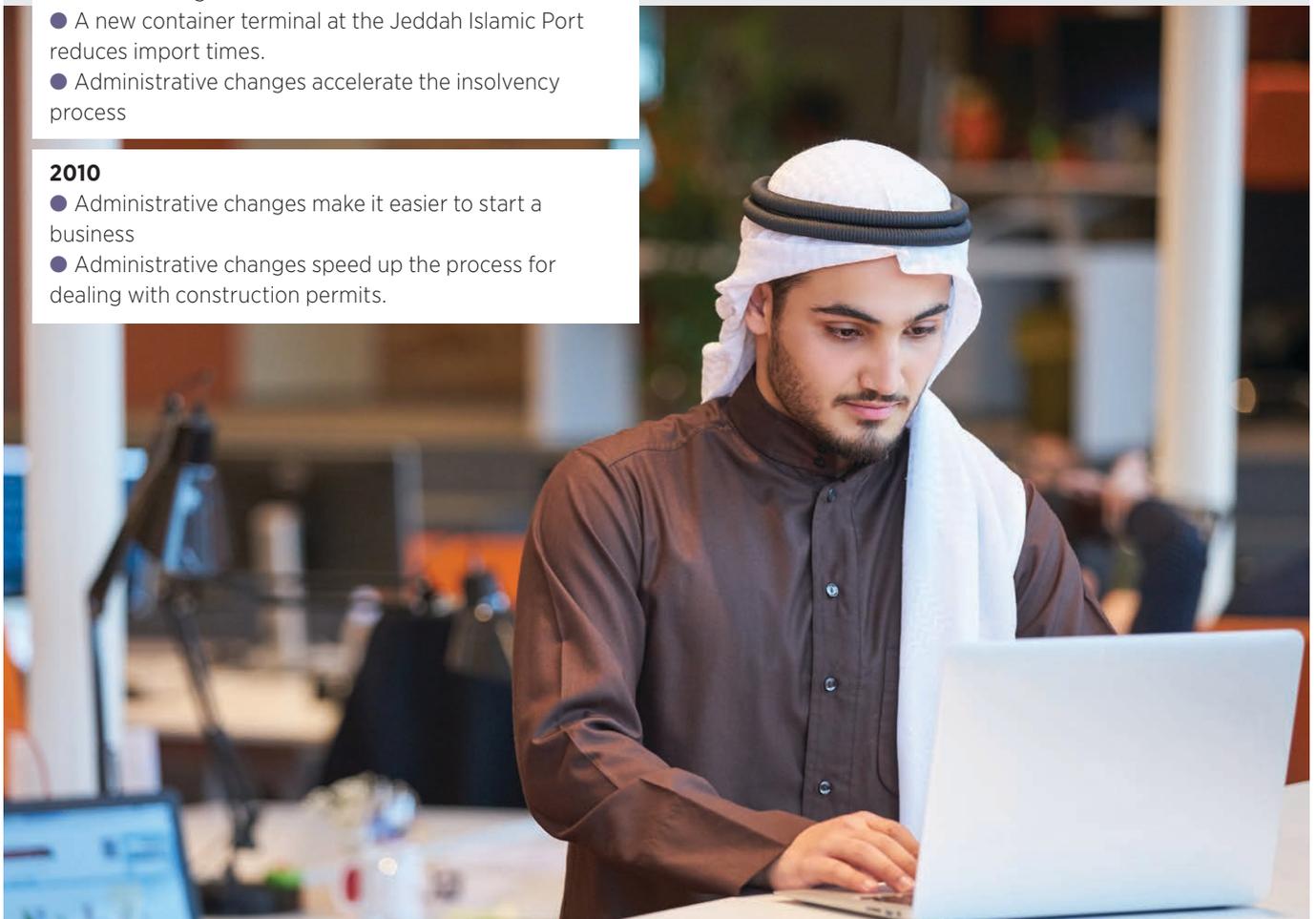
- Increased number of documents needed to export and import

#### 2013

- Higher connection fees make it more expensive to get electricity.

\*Positive changes make it easier to do business, while negative changes make it harder to do business.

**Source:** World Bank  
<http://www.doingbusiness.org/data/exploreeconomies/saudi-arabia>



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## Truly radical changes

The scale of SAMA's reserves mean that time is on the government's side. In fact, the past changes to the business environment pale into insignificance in relation to what is envisaged for the next 15 years. The Vision 2030 strategy, which was approved by the Kingdom's Cabinet in late April 2016, provides general 'roadmap' for the development of Saudi economy and society over the next 15 years.

Specific details, including targets to be achieved four years hence in 2020, were set out in the National Transformation Program (NTP), which was published in June 2016. The Executive Board of the IMF have welcomed the massive reforms that are envisaged in Vision 2030 and the NTP.<sup>5</sup>

In short, the Saudi government is responding to the difficult macro-economic environment by making truly radical changes. The role of the private sector is to be substantially increased.

The economy's reliance on hydrocarbons is to be reduced. Integration of financial markets with those of the rest of the world is to be accelerated. There will be huge changes to the labour market.<sup>6</sup>

### Greater engagement with foreign investors

Through late 2016, headlines in the mainstream and financial media have highlighted the government's plans to raise US\$100 billion through the initial public offering (IPO) of Aramco, the state owned energy company. The IPO could take place as early as 2017.

Assuming that this deal goes ahead, it will be by far the largest IPO ever. To date, the largest IPO was that of Chinese online retailer Alibaba, which raised US\$25 billion in 2014. Other landmark deals that have raised US\$15-21 billion include the IPOs of AIA Group (2010), Visa (2008), General Motors (2010), Enel SpA (1999), ICBC (2006), NTT Docomo (1998) and Facebook (2012).

The success of a transaction of this scale will require the large-scale involvement of foreign investors. A major landmark was the introduction by the Capital Markets Authority (CMA – the financial regulator) in early 2015 of rules that opened Saudi capital markets to Qualified Foreign Financial Institutions (QFIs). These rules were liberalised further in August 2016.<sup>7</sup>

The efficiency and liquidity of Tadawul, the local stock market, should be improved by other changes – such as the introduction of proper delivery versus payment.<sup>8</sup> If these changes are implemented, as planned, by mid-2017, Saudi Arabia will be closer to the point where it can be included in the widely followed Emerging Markets Indices of MSCI.

### Tadawul's inclusion in the MSCI Emerging Markets Indices

'MSCI said that it welcomes the recent market accessibility enhancements announced by the Saudi Arabian Capital Market Authority and the Saudi Stock Exchange (Tadawul) and will continue to monitor the positive evolution in the opening of the Saudi Arabian equity market for international institutional investors. The announced changes, including changes to the settlement cycle of listed securities, elimination of the cash prefunding requirement and the introduction of proper delivery versus payment – as well as changes to the rules for Qualified Foreign Investors – are planned to be implemented by mid-2017. Once in effect, these enhancements will bring the Saudi equity market closer to Emerging Market accessibility standards.'

**Source:** MSCI

Results of MSCI 2016 Market Classification Review', Press Release 14 June 2016

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## Changes to the rules affecting Qualified Foreign Financial Institutions (QFIs), August 2016

- Minimum assets under management (AUM) of QFIs lowered from US\$5bn to US\$1bn
- Types of eligible QFIs broadened to include governments and government-related entities
- Removal/ relaxation of ownership thresholds/limits for QFIs
- QFIs may engage with Saudi or non-Saudi asset manager to manage investments in Saudi capital markets.

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### Aims of QFI rules:

- Addition of expertise of international investors to the Saudi capital markets
- Enhancement of market efficiency
- Encourage local listed companies to boost transparency and governance
- Increase level of research and evaluation
- More accurate information and better valuations of companies.

**Source:** Capital Market Authority (CMA)

CMA Amends the Rules for Qualified Foreign Financial Institutions in Listed Securities after consulting the specialists, interested and related parties', Press Release of 10 August 2016

## Build it, and they will come

Aside from the Aramco IPO, the easing of the QFI rules and the positive changes at Tadawul, there are other opportunities from Vision 2030 and the NTP for foreign financial firms. The government has indicated that it is looking to eventually transfer its shares in Aramco to the Public Investment Fund (PIF), the Kingdom's Sovereign Wealth Fund (SWF).

If this happens, then the government will no longer rely for much of its income on direct revenues from the energy sector. Instead, the government's exposure will be indirect, as an investor in PIF. If the government is able to raise US\$100 billion from the IPO of a 5% stake in Aramco, then the notional value of the PIF could soar to over US\$2 trillion: this would mean that it becomes nearly three times the size of the Government Pension Fund of Norway, which is currently the world's largest SWF in terms of total assets .

Another opportunity, as envisaged by the IMF, is the potential for foreign institutional investors to help fund the massive infrastructure projects that are envisaged for the Kingdom through Private Public Partnerships (PPPs). The PPPs will give rise to new debt and equity securities. There will be far greater transparency in the funding of infrastructure projects than there has been in the past.

### **The assessment of the IMF's Executive Board**

'Directors welcomed the ambitious reform goals announced by the authorities in Vision 2030 and the National Transformation Program, and underscored the importance of clear prioritization and sequencing of the planned reforms to reduce implementation risks and give the economy time to adjust. They supported the authorities' plan to increase the role of the private sector in the economy by focusing on privatization and public-private partnerships, improve the business environment, develop local capital markets, encourage FDI, and support small and medium enterprises. Directors noted that continued labor market and education reforms are needed to encourage private sector employment of Saudi nationals and increase labor force participation of women.'

### **Source:** IMF

'IMF Executive Board Concludes 2016 Article IV Consultation with Saudi Arabia', Press Release 16/368 of 28 July 2016

One of the most prominent infrastructure projects is King Abdullah Financial District (KAFD), which is being built on the north side of Riyadh. Occupying a total area of 1.6 million square metres, KAFD is broadly comparable to London's Canary Wharf. It is managed by Al-Raidah Investment Company, the investment arm of Saudi Arabia's Public Pension Agency (PPA).

At this stage, it appears that the Saudi government envisages that KAFD will develop in a similar way to the Dubai International Financial Centre (DIFC). Reforms to the Kingdom's immigration rules that are outlined in the NTP include an exemption from visas for expatriates who work in the KAFD. In addition to 1.66 million square metres of office space, the KAFD will include residential apartments, hotels, retail shops, government and community service buildings, and exhibition/ conference halls .



## The bonanza for financial companies

Taken together, these changes mean that, over the next 14 years, Saudi Arabia should represent a bonanza for companies that develop technology to provide cutting edge solutions to asset owners and other stakeholders.

Financial liberalisation is occurring a lot later in Saudi Arabia than in other countries. That means that both local and foreign institutions who are looking to invest can take advantage of solutions that were simply not available five or ten years ago.

At a time that yields on bonds in developed markets are very low (or negative), and developed equity markets are frequently volatile, foreign institutions should be attracted to PPP projects and IPOs in Saudi Arabia. And those institutions will need the assistance of fund administrators and technology providers that are established in the region and that truly understand the markets.

Vision 2030 and the NTP are consistent with the transfer of global best practice to the Saudi markets, as well as a general movement towards greater transparency. These are trends that the world's leading fund administrators and providers of financial technology and outsourced solutions are well placed to support.

Vision 2030 and the NTP also promote education and training within the Saudi labour force. Until sufficient numbers of Saudi nationals have received the technical training that they need, the gap will have to be filled by qualified staff who are based outside the Kingdom.

World class technology has long been a game changer for investment managers, and other asset owners, who are looking to achieve better outcomes for their clients. It is also essential for asset owners that are seeking to boost efficiency and to lower costs.

In a similar fashion, world class technology will play a key role in the transformation of Saudi Arabia.



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## About SS&C Advent



SS&C Advent is the leading global provider of technology solutions and services for the investment management industry. We have been operating in the Middle East since 2006, and have more than 30 clients based in the region. The key to SS&C Advent's success has been a strong local presence and deep understanding of regional investment management practices, combined with world-class technology within our integrated middle- and front-office solutions.

As the Saudi market opens and develops, we will see more investors enter, new securities instruments evolve and competition increase. Global best practices around trading and risk management, asset protection, investor protection, fund governance and regulatory compliance will come to the fore.

Our flexible, fully-integrated, front-to-back technology infrastructure spans the entire investment value chain: from multicurrency and multi-asset class research and trading, to portfolio management and accounting, performance measurement, compliance and reporting – helping investment firms make better-informed decisions, manage their risks, enhance operating efficiencies and serve clients better. Whether you prefer to implement systems on-premise, use hosted software or outsource business processes, we can provide the solutions you want. And because all our platforms are highly scalable by design, no matter how much you grow, you'll never outgrow SS&C Advent.

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## About us



Insight Discovery is a consultancy that specialises in market intelligence and strategic communications. Many of our clients seek solutions that involve both. Our clientele includes major conglomerates and industrial groups, government agencies, and many of the world's largest and best known financial institutions. Much of our work focuses on the Middle East, Africa and the Asia-Pacific.

Over the years Insight Discovery has won many awards for its work, including being voted 'Best Consultancy firm' in 2016, 2015 and 2014 by Global Investor, part of Euromoney.

## Insight Discovery

T +9714 4273157

 [info@insight-discovery.com](mailto:info@insight-discovery.com)

 [@Insight\\_Discovery](https://twitter.com/Insight_Discovery)

 [www.insight-discovery.com](http://www.insight-discovery.com)

**Design and production:** [www.pascaldon.com](http://www.pascaldon.com) | **email:** [pascal.don@mac.com](mailto:pascal.don@mac.com)

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