THE INFLOW OF FOREIGEN DIRECT INVESTMENTS INTO THE KINGDOM OF SAUDI ARABIA

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ABSTRACT

This study generally concentrates on the foreign direct investment by the multinational companies in Saudi Arabia. Also, this study contributes to understand more about the foreign direct investment in the developing countries particularly in Saudi Arabia and the role of the government to attract the foreign direct investment to the country. It also analyze motives and drivers of the FDI inflow into Saudi Arabia.

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CHAPTER ONE

Introduction

Saudi Arabia is very special country of what it has. Saudi Arabia is the largest market in the Arabian Gulf region and, despite current political and economic uncertainties, offers investors and exporters many opportunities in a wide variety of business sectors. Key factors driving economic policy include the desire to reduce the dependence on oil, and the need to provide jobs, housing and services to citizens in a time of rapid population growth. The foreign investment law of 2000 significantly changed the rules for foreign investors, permitting 100% ownership of projects. There is a streamlined foreign investment application process with various investment incentives(Sagia, 2006).

The cost of entering the Saudi market is high because of the large cultural distance between most Westernized foreign investors and the Saudis. The market presents many opportunities and is extremely competitive. Saudi Arabia's attractiveness is related to its position at the heart of a regional market that includes the GCC, the Arab world in general. Many Indians and Pakistanis work in Saudi Arabia and they are important in the business sector as middle-level managers, both in the manufacturing sector and in the service sector especially retailing. In the kingdom, there are three major marketing regions with distinct cultures and business communities. These are the Western Region, which contains the commercial capital of Jeddah; the Central Region, with the capital, Riyadh; and the Eastern Province, where the oil and gas industries are concentrated around Aramco's activities in the Dammam/Dhahran/Al Khobar area.

In Saudi Arabia setting , the role of multinational companies is very clear. Many developments in the country are introduced by the multinational companies in different sectors. Starting for the oil and gas sector until the services sectors like communication and transpirations. They are the main concentration of this research because they are the ones who involve in the FDI in Saudi Arabia. Their contribution in the market is quite obvious. They participate in many activities like marketing ,trading, international production, joint venture , consulting, contracting, project management.

In discussion FDI and the flow of FDI to Saudi Arabia this relates to the FDI flow in to the developing countries in general. Some scholars mentioned that FDI has a positive relationship with the country economic growth or the opposite is true.

1.1 Background information

Foreign direct investment (FDI) in its classic form is defined as a company from one country making a physical investment into building a factory in another country. It is the establishment of an enterprise by a foreigner. Its definition can be extended to include investments made to acquire lasting interest in enterprises operating outside of the economy of the investor. The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a multinational corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. The IMF defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investments.

Developing countries are attracting more foreign investment than ever before, according to the latest report from the United Nations Conference on Trade and Development's (UNCTAD, 2006).

UNCTAD's World Investment Report claims that global flows of foreign direct investment (FDI) rose 29% in 2005 from a year earlier to US$ 916 billion, with FDI in some developing regions at record highs. There is a shift in the world economy, with some developing countries gaining economic and political weight. (UNCTAD, 2006). The boom is being fed by rapid economic growth, especially in China and India, high prices for raw materials, and the increasing liberalization of the economy in many developing countries, which has made investment easier. According to the report, many of Africa's poorest nations failed to benefit from FDI last year despite a record US$ 31 billion going into the region, a rise of 78% from the year before. The rise was attributed to sharp increases in commodity prices. However, the benefits of the increased investment were spread unevenly across countries and industries, with South Africa receiving 21% of the region's total FDI. While countries such as Egypt, Nigeria and Tunisia received close to 86% of the African FDI total, levels of investment remained below US$ 100 million for many of the least developed countries. A growing problem in many of these countries, UNCTAD said, was the nationalization of resources. For developing economies, direct investment has long been seen as the most reliable source of foreign capital, and likely to stay in the country even during times of financial crisis(UNCTAD, 2006).

As the trend towards increasingly global markets continues, foreign direct investment (FDI) is regarded as an important way for firms to obtain the benefits of globalization. Policy makers recognize the benefits that inward investment can generate for the destination economy in terms not only of job creation, but also capital, technology, production and management techniques (Clegg, J,1998). In fact within the past decade FDI has grown four times faster than world gross domestic product (Merriden, 1998).

It is thought that managerial assessment of satisfactions with foreign direct investment are conditioned not only the performance, but also extended expectations and intentions, and it is useful to clarify how before and after factors interact to shape judgments and decisions.

1.2 Research Objectives

This study generally concentrates on the foreign direct investment by the multinational companies in Saudi Arabia. Starting with the review of the multinational companies and study available by previous data and reports from the ministry of information in Saudi Arabia and the ministry of trade, it assesses whether they are meaningful enough to explain the nature and the role of these multinational companies in Saudi Arabia. Also, another important issue is whether the Islamic culture of Saudi Arabia has an effect to the multinational companies they do business in Saudi or they plan to do business in the future.

Objective of my research :

- To analyze motives and drivers of the FDI inflow in to Saudi Arabia.
- To examine the locational advantage that Saudi Arabia can offer the FDI
- To analyze the trends and patterns of inflow of the FDI in the Saudi Arabia.
- To assess challenges for the inflow of FDI in to Saudi Arabia.

1.3 Significant and contribution of the study

This study is contribute to understand more about FDI in the developing countries particularly among that is the economic factors and the MNC's in Saudi Arabia. This study will show how the foreign direct investment have been to the country and affected the different factors like economic growth, social, cultural and political issues in the country. Also, this study is going to assess how the Saudi governments is trying to move from the high bureaucratic country to a less bureaucratic country in the flow of the FDI going to the country. Also, the study will cover both the manufacturing and service sectors of the international business in Saudi Arabia and see how the multinational companies play a big role in the Saudi Arabia.

1.4 Scope and limitation of the study

This study only looks at the Saudi Arabia as a developing country. The scope of this study will not be confined to a particular industry or multinational firm or product group in Saudi Arabia. There is no restriction on the type of the foreign direct investment or the multinational companies covered in this study. Also the inflow of direct investment is very broad in its context, it refers to the business scope, nature , activity or function of the multinational companies doing their business in Saudi Arabia.

The data for this study is a secondary data which is collected from different sources such as statistical information, newspapers and T.V economic, social and political reports.

CHAPTER TWO

LITERATURE REVIEW

2.1 Motives and Modes of FDI

2.1.1 Motives for FDI

The reasons prompting firms to undertake FDI have inspired and absorbed international business scholars for four decades now. These reasons have been part and parcel of various theories and paradigms of international production. According to Dunning (1993/1998), four groups of motives for FDI can be distinguished:

* Resource seeking,

* Market seeking,

* Efficiency seeking and

* Strategic asset seeking.

The resource-seeking firms are motivated to invest abroad to acquire specific resources at a lower cost than could be obtained in their home country, if these resources were obtainable at all. Dunning distinguishes three types of resource seekers: (a) those seeking physical resources (such as raw materials and agricultural products); (b) those seeking cheap and well motivated unskilled or semi-skilled labour: and (c) those seeking technological capacity, management or marketing expertise and organisational skills (Dunning, 1993).

resources (such as raw materials and agricultural products); (b) those seeking cheap and well motivated unskilled or semi-skilled labour: and (c) those seeking technological capacity, management or marketing expertise and organisational skills (Dunning, 1993).

Market seekers are firms that invest in a particular country or region in order to serve markets in this country or region. Apart from market size and expected market growth, there are four main reasons for which market-seeking firms may undertake foreign investment, namely: (a) a firm's main suppliers or customers may have expanded overseas and in order to retain its business, the firm needs to follow them; (b) a firm may need to adapt its product to local tastes and specific market requirements, which can only be achieved through market presence in the form of FDI; (c) production and transaction costs of serving a local market from an adjacent facility may be lower than when supplying that market from a distance and (d) a firm may consider it necessary, as part of its global strategy, to have a physical presence in the leading markets served by its competitors. Unlike other types of foreign direct investors, market-seeking firms tend to treat their foreign affiliates as self-contained business units rather than as part of an integrated chain of value adding activities (Dunning 1993).

The motivation of efficiency seeking foreign direct investors is to rationalise their production, distribution and marketing activities through common governance of and synergy-building among geographically dispersed operations. Such rationalisation essentially stems from two sources: the advantages of differences in the cost of factor endowments between countries and the economies of scale and scope (Dunning 1993).

The strategic asset seekers are those firms which engage in FDI to promote their strategic objectives - usually that of sustaining or enhancing their international competitiveness.

Similarly to the efficiency seeking firms, the strategic asset seekers aim to capitalize on the advantages of the common ownership of a network of activities and capabilities in diverse environments (Dunning 1993).

Dunning argues that the former two motives (resource and market seeking) typically characterize initial FDI, while the latter (efficiency and strategic asset seeking) characterise sequential FDI. He also argues that "as strategic asset acquiring investment has become more important, the locational needs of corporations have shifted from those to do with access to markets, or to natural resources, to those to do with access to knowledge-intensive assets and learning experiences, which augment their existing "O" specific advantages" (Dunning, 1998).

2.2 Location Advantages

Location advantages are due to economic differences among countries and may take many forms. The host country may offer such features as low-cost labor, labor with unique skills, better access to vital raw materials or a large relatively untapped market. In addition, it may simply offer the opportunity for a firm to make a defensive investment to prevent its competitors from gaining a foothold. In the absence of L advantages such as these, there would be no incentive for the firm to engage in FDI, and foreign markets would best be served entirely by exports.

There are essentially four principal means of foreign market entry but the most important for the FDI is only tow; Joint-venture partnering; and wholly-owned foreign investment for the foreign direct investment(Buckley and Casson, 1998).

The term "foreign direct investment" incorporates wholly-owned foreign investment, which is the creation of a wholly-owned subsidiary through either acquisition or setting up a new operation on a "greenfield" site. FDI can also be taken to include wholly-owned concerns plus joint ventures, where a joint venture involves two or more separate bodies forming a jointly-owned entity in which they invest and engage in various decision-making activities

Traditionally FDI is regarded as a means of exploiting firm-specific assets in a foreign market (Hymer, 1960; Caves, 1971). Through FDI, the investing firm can not only penetrate the domestic market, but also gain access to raw materials, diversify its business activities and rationalize production processes. Furthermore, investment overcomes some of the drawbacks associated with exporting, such as trade barriers and transport costs. It is thought that a large proportion of overseas investment is motivated by defensive tactics (Dunning, 1971), specifically, as a reaction to problems in the home country (Watters, 1995) and markets reaching saturation. Reduction in transport costs is a further motivation for locating in a foreign market (Davidson and McFetridge, 1985). Increasing technological intensity within the firm's industry is also thought to encourage FDI (Clegg, 1998).

There has been relatively little investigation into differences between firms which engage in joint ventures and those which invest independently in a region through acquisition or setting up in a Greenfield site. One factor that has been found to influence the level of ownership is access to technology . It has also been argued that engaging in a joint venture with a local firm is the only way to invest in markets that are already very competitive and crowded.

Furthermore, in some countries equity ownership laws prohibit wholly owned foreign investment and so joint ventures are the only way that companies can invest in the region.

Huge construction is under way across the country, providing jobs, homes and lucrative work for project financiers and engineering, procurement and construction (EPC) companies. Thousands of kilometres of new roads and railway lines; water, sewerage and electricity plants; 4m new housing units; industrial expansion such as the $22bn-plus Ras Tanura refinery upgrade and petrochemicals complex, steel and aluminium; and the ambitious $40bn tourism master plan for the Red Sea coastline, among other schemes, will (once fully completed) help meet socio-economic challenges and greatly improve the productive capacity of the national economy. According to the Saudi Arabian General Investment Authority (SAGIA), housing investment requirements [alone] through to 2020 could total $320bn. McKinsey consultancy estimates that infrastructural investment has increased from 17% of GDP to 30-35%. This, in turn, indicates the sheer amount of projects under construction following a period of sluggish growth during the late 1980s and 1990s.

Keys to alleviating regional disparities and developing alternative industries are building seven new 'economic cities' - each focusing on different sectors. Five of the cities have been officially launched - King Abdullah City, Medina Knowledge City, Jizan City, Prince Abdulaziz Bin Mosaed City and Sudair Industrial City (the largest). They will be funded by the private sector, with SAGIA acting as the regulator/promoter of these flagship projects. The stateowned Saudi Industrial Development Fund would provide soft loans for up to 50% of the project costs, while SAGIA has introduced fiscal incentives and 100% ownership rights for foreign companies investing in various projects.

The new cities, with a projected total population of 4.5m, will require $500bn in funding according to Saudi British Bank and they are expected to contribute about $150bn to national

"With oil reserves that will last for the next 89 years or so, Saudi Arabia could easily sit back and ride the waves of the oil price," says Mary Nicola, economist at UK-based Standard Chartered Bank.

"But it is not doing that, and slowly they will start to see some fruition from making the country more friendly to foreign investment."

In addition to uncovering the motivations for engaging in FDI, researchers have also sought to investigate the factors that influence the choice of host market. Which are :

1-Knowledge and Experience of the Foreign Market

It is generally agreed that increased knowledge of a foreign country reduces both the cost and uncertainty of operating in a foreign market (Buckley and Casson, 1985). Related to knowledge is experience which is thought to provide important tangible and intangible advantages (Gresser and Gaskell, 1993). Again it is generally believed that a firm with greater experience of a particular location is more likely to invest there than a firm with less experience.

2- Size and Growth of the Foreign Market

The size of the foreign market and its potential growth are regarded as key factors influencing choice of location. (Billington, 1999). Furthermore, proximity and access to a free trade area are also key factors .(Billington, 1999), and as such, the size and growth of the larger, free trade area may be more important than the size and growth of the particular country in which the firm has chosen to invest.

3- Government Emphasis on FDI and Financial Incentives

Economic factors, such as inflation, and particularly tax rates and the tax structure of the host economy, are key investment considerations. Several studies have found that the rate of corporate taxation has a negative effect on investment decisions (Friedman et al., 1992; Billington, 1999).

4- Cultural Closeness

There is disagreement among researchers about the extent to which firms prefer to invest in markets exhibiting near and similar cultures. While some studies conclude that firms will successively enter markets at an increasingly cultural distance from the home country (Johnson and Vahlne, 1977.)other studies do not agree with this theory and ignore it. Which means firms can enter any market whatever cultural difference between the two counties is.

5- Costs of Transport, Materials and Labor

A transaction cost approach has been frequently employed to explain why firms own and control operations in foreign markets. Stemming from this is the cost minimisation school of thought, which implies that a company will choose the lowest cost location for its production activities abroad (Buckley, 1988).

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6- Availability of Resources

The availability of resources, in particular labor and raw materials, are widely acknowledged as influencing a firm's FDI decisions (Moxon, 1975; Dunning, 1988). In terms of labor, population density (Billington, 1999) and unemployment rates (Friedman et al., 1992; Billington,
1999) have been found to influence inward investment. With regard to raw materials, many overseas subsidiaries rely on local suppliers for some standard inputs. However, it is thought that, more recently, availability of raw materials has had relatively less impact since raw materials are already often sourced on a global basis (Batchler and Clement, 1990).

7- Technology

Access to technology has been regarded as an influencing factor in investment location and specifically the ownership level of the investing firm, as mentioned previously (Erramilli et al., 1997). Clegg (1998) warns that even if a country has a high level of research and development expenditure, this may not be due to a high level of technological dynamism

8- Political Stability

In the context of FDI, political stability or risk pertains to the risk that a host government will unexpectedly change the "rules of the game" within which businesses operate (Butler and Joaquin, 1998). It also incorporates the risk of adverse consequences arising from political events.

9-Infrastructure

Infrastructure in the context of FDI also incorporates such factors as expenditure on roads, transport and hospitals. It is related to the factor of "quality of life" which is regarded as an increasingly important incentive in attracting foreign investors, by encouraging senior to locate to a region(Christodoulou,1996).

2.3 Modes of FDI

The literature on foreign market entry mode is vast. Typically, the modes distinguished and analyzed include: joint venture and wholly-owned subsidiary or sole venture (Buckley/Casson 1998).

However, fewer studies address specifically the choice between various forms of FDI. In this category some studies identify and analyse three choices that firms undertaking FDI have: green-field investment, acquisition, and joint venture (Bruning et al. 1997).

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Green-field investment is typically defined as an investment of a firm that uses its funds to set up an entirely new economic entity by constructing a new facility. Instead, acquisition consists of using the firm's funds to purchase an already existing operation. This is done by acquiring the controlling equity share in a company which previously owned the operation. A joint venture consists of combining assets in a common and separate organisation by two or more firms which share ownership and control over the use and fruits of these assets (Kogut et. al. 1998).

Meyer and Estrin (2001) distinguish a special case of acquisition which they call brown-field investment. Under brown-field investment, the foreign investor initially acquires an existing firm but then almost completely replaces plant, equipment, technology, labour and product assortment of that firm.

The authors who have studied the choice between green-field investment and acquisition or between green-field, acquisition and joint venture, point to such determinants of the choice decision as: the entrant's corporate organization and the structural features of its product market , host country's market size, market growth and level of development;firm strategies and target market considerations, firm's multinational diversity (the diversity of the national markets in which the firm operates) and its product diversity (Vermeulen 1998), entry costs and post-entry competition,investment,industry, and target country-specific variables ,cultural distance between home and host countries and attitudes towards uncertainty avoidance (Kogut 1988); and firm's concern for power, required resource commitment, potential for dissemination risk, and financial concerns related to liquidity and leverage .

Although the identified determinants of FDI mode choice encompass a broad spectrum of possibilities, one cannot help noticing the lack of host-government influences on the mode decision. And yet, governments can either provide incentives or disincentives with respect to the choice of individual modes of FDI, depending on these governments' strategic objectives and policies. For example, host governments typically strive to expand the country's industrial capacity and to stimulate local competition, in which case they try to encourage green-field investment and discourage acquisitions(Mababaya, 2002).

2.4 The Eclectic Paradigm

During the past couple of decades the nature of the global economy has changed dramatically Beginning with the reforms of the 1980s, many nations throughout the world leave been engaged to a greater or lesser degree, in a process of structural reform. Enterprises and even entire industries that had been owned and operated by governments have been privatized. Government finances and those of individual firms are becoming more and more transparent. Governments have also been eliminating or reducing regulatory constraints, establishing more meaningful and enforceable property rights, moving toward more flexible exchange rate systems, relaxing restrictions on foreign investment and generally embracing more free-market-based economic systems(Eric,2006).

These reforms have resulted in growing levels of cross-border investment as capital is dramas to new areas of perceived opportunity in both industrialized and non-industrialized countries. The heightened mobility of capital that has accompanied these changes has created renewed interest in the theory of foreign investment.

The world trade organization stated in 1996 stated that Foreign direct investment occurs when an investor based in one country – the home country- acquires and assets in another country that is the host country. Furthermore, FDI involves the transfer of much more than a capital alone. Technological expertise marketing managers skills and other firm specific resources are transferred to the host country as well. Each country has its own way of defining whether a giver investment should be classified as FDI or foreign portfolio investments(Mababaya, 2002).

The basis for the analysis that follows lies in the eclectic paradigm , which was introduced by John Dunning in 1977. Over the past three decades the Eclectic Paradigm has provided a valuable analytic framework for evaluating economic FDI. The primary focus of the paradigm is to explain why firms choose to engage in the FDI to participate in foreign markets rather than employing others, seemingly more convenient ,means of market peroration such as joint venture , strategic alliances or management contracts(Eric, 2006).

According to Dunning , in order to undertake FDI successfully, the firm must first have some competitive advantages in its home market that are specific to that firm. These ownership or"

O" advantages must also be transferable to foreign markets. Then given that "O" advantages exist, there must also be certain features or characteristics of full advantage of its "O" advantages in the host country. This second set of advantages is referred to as location or "L" advantages. Internalization or "I" advantages compromise the third necessary piece of the problem. The "I" advantages are those that allow the firm to maintain its competitive positions by reducing transactions costs. These OLI advantages describe more detail down.

2.4.1Ownership advantage:

A firm's "O" advantages must be unique to the firm and it must be possible for those advantages to be transferred aboard. These "O" advantages of common governance or the possession of intangible assets such as specific know-how, particularly technology patents or brand loyalty which are exclusive or specific to the firm possessing them.

A firm may have substantial financial strength or huge economies of scale, for example, but these would not necessarily be unique to the individual firm, since many firms can develop such advantages, and so competitive advantages such as these may not be "O" advantages. The greater the "O" advantages of enterprises (net of any disadvantages of operating in a foreign environment), the more incentive firms have to exploit those advantages in foreign markets.

2.4.2 Internalization

When "O" and "L" advantages exist, to warrant the risks of ownership, the firm must also possess I advantages. Internalization advantages allow the firm to minimize transactions costs and other agency costs that would likely occur if the firm engaged in some other form of market penetration like a joint venture, for example. This would mean that the cost of having the firm manage and control all of its activities in the foreign country directly would be less than the cost of operating in any other fashion. For example, the costs of monitoring foreign partners, having information filtered through third parties, dealing with foreign financial institutions, etc., would be mitigated. If the firm has the ability to thus effectively exert control over its value chain, it would be more beneficial to the firm to utilize its "I" advantages than to enter into leasing, franchising or other types of agreements with foreign firms in advantageous locations(Mababaya, 2002).

Dunning (1988) utilized the Eclectic Paradigm framework to analyze advantages in the international hotel industry. He found that traditional foreign hotel operators (such as Hilton, Sheraton, etc.) possessed firm-specific advantages that motivated their international investments, as predicted by the Eclectic Paradigm. However, other investors purchased hotels in foreign countries simply for the purpose of diversifying their investment portfolios. These investors did not possess the OLI advantages. As Dunning pointed out:

Ownership of a hotel can be generally viewed as more in the nature of portfolio investment where the objective is to maximize the capitalized value of a future stream from the asset acquired. This might be done by reading the market correctly and taking advantage of differences in capitalization ratios and exchange rate expectations; this is Aliber's explanation (Aliber, 1970) for movements in direct investment between different currency areas, and would seem borne out by the marked rise in net inward investment into the U.S. hotel industry in the last decade, particularly by the Japanese (Dunning, 1988).

Even though many of the hotel investors studied appeared to be motivated by portfolio considerations, the ownership of the hotels was clearly classified as a FDI in that substantial active involvement in the management of the property was required. Investments that are motivated by portfolio considerations, but end up having many characteristics of direct investment, must inevitably cause problems for the investor. To mitigate this problem, and in light of the unique features of many real estate investments, a hybrid of direct and portfolio investment theories is needed in order for investors to make a proper evaluation.

Real estate is often a hybrid of direct and portfolio investment. In evaluating the active nature of Japanese investments in U.S. real estate during the 1980s, Holsapple, Ozawa, and Olienyk (2002) found the distinction between FPI and FDI to be quite complicated in practice. They concluded that internalization and control were often a prerequisite to successful investment in real estate for the Japanese investors. Internalization and control were required to capture the portfolio benefits associated with real estate investment at that time, since the option to invest in real estate investment trusts (REITs) or a minority ownership interest in a real estate limited partnership was limited(Mababaya, 2002).

The activity level required of owners was found to be quite important in distinguishing between (passive) portfolio investment and (active) FDI. Factors such as ownership structure, investment type and phase of the business cycle were all posited to impact the activity level required of owners of real estate. For instance, a general partner is more active than a limited partner regardless of the percentage of ownership. Ownership of a 50-year-old multi-tenanted building is more active than ownership of a new single-tenant building with a triple net lease to a credit tenant, and ownership during times of recession (when tenants are downsizing) tends to be more active than during times of prosperity (when tenants are stable or expanding). The study concluded that many Japanese direct investors in U.S. real estate were motivated primarily by passive portfolio considerations, and therefore capital arbitrage and portfolio diversification theories offered the best theoretical explanation of much of the Japanese investment. However, due to the active nature of real estate in the dynamic U.S. market, the analysis of most large-scale real estate assets during that time warranted active FDI methodology, even if the primary motivating factor for the investment was passive portfolio diversification.

2.5 Saudi Arabia Environment for Multinational Investment

2.5.1 Saudi Arabia General Information

In 1902, at the age of only 22, Abdul Aziz Ibn Saud re-captured Riyadh, the Al-Saud dynasty's ancestral capital, from the rival Al Rashid family. Continuing his conquests, Abdul Aziz subdued Al-Hasa, Al-Qatif, the rest of Nejd, and Hejaz between 1913 and 1926. On January 8, 1926, Abdul Aziz bin Saud became the King of Hejaz. On January 29, 1927, he took the title King of Nejd (his previous Nejdi title was Sultan). By the Treaty of Jeddah, signed on May 20, 1927, the United Kingdom recognized the independence of Abdul Aziz's realm, then known as the Kingdom of Hejaz and Nejd. In 1932, the principal regions of Al-Hasa, Qatif, Nejd and Hejaz were unified to form the Kingdom of Saudi Arabia.

2.5.2 Population

The total Saudi population as of September 2004 increased to 22.7 million, compared with 13 million in 1985 and 21 million in 1999. The population growth rate in the KSA stands at 3.24%, which ranks somewhere between the lowest growth in Kuwait (2%), and the highest growth rate in the UAE (5.84%). However, growth rates in the KSA figure rank above the general average of 2.37%, registered across the Arab world. The high birth rate and the low mortality rate are the result of dedicated and intensive efforts towards health care issues(Mababaya, 2002).

Inhabitants from Saudi origins form 72.9% of the population, which comprises 50.1% males and 49.9% females. Foreigners are 27.1% of the population (6 million people), of whom 69.5% are males, and the remaining are females(Mababaya, 2002).

This rising number of foreign inhabitants is an outcome of the growing interest of foreigners in the Saudi investment sectors. Furthermore, this came as a result of Saudi government policy of using its oil revenues to expand general services and build a solid infrastructure. Egyptian workforce make up the largest number of expatriates, reaching 16% of foreign workers, followed by India, Pakistan, Yemen and the Philippines. But now the total Saudi population as of(July 2007 est.) to 27.6 million. Muslim 100%.

2.5.3 Culture

As is commonly known, Arabia's culture derives from the Holy Qura'an. The richness of its language is without comparison and it is the fountainhead of Arabia's culture and faith. One direct manifestation of this heritage is the art of calligraphy of all Arabic art forms of this artistic expression. Craftsmanship of a high order is evident in the beautiful workmanship in precious metals. The ancient Arab tradition of hospitality continues unchanged to the present day.

The interlinking spheres of mathematics and astronomy are equally important aspects of the Arabian culture heritage. The word "algebra" is derived from Arabic word "Algebra". Navigation and cartography were direct developments of these numerate skills. Similar attributes of outstanding craftsmanship are shown in the development of intricate workmanship in precious metals and even in household goods. It was in the settled communities such as Jeddah, Makkah that these skills flourished. Both town dwellers and bedouins, however, shared one ancient Arab tradition. The method of preparation is traditional, each step is an almost ritually observed process. The poetic tradition of the bedouin is a further example of complex and beautiful art form. Poetry promulgated the virtues and merits of their tribes such as the obligation to respect social values. Generosity, hospitality and courage were, to them, a matter of honor and failure to adhere to this unwritten code was regarded as a great insult. Despite the great pace of growth the Kingdom has witnessed over the last two decades, traditional culture and social values have been maintained steadfastly and the rich heritage of the Kingdom protected and enhanced. The strict observance of religious and moral values adopted by all Saudis will ensure that the continuity of their cultural heritage will not be diminished in the future.

2.5.4 Language and Religion

Saudi Arabia is an Islamic state that all the natives are Moslems religion and speaking Arabic. Arabic is the official language of Saudi Arabia. It is the language of the Qur'an (the holy book of Islam). Through its eloquence and the spread of Islam, Arabic has become one of the most widely used languages of the world. English is also used in the Kingdom, most

2.6 The Saudi Economy

Despite efforts to make the kingdom more attractive to overseas investors, it has a long way to go to achieve its ambition of becoming one of the top 10 countries for foreign investment by 2010. As planned by the Saudi Arabia investment Authority(Sagia 2006).

It was only six years ago that falling oil revenues left a $6bn hole in Saudi Arabia's budget and forced the country to seek outside donors to prop up its economic growth.

At the time, Prince Abdullah bin Faisal bin Turki, head of the country's investment authority, said that plunging oil prices "made us think seriously about plugging our economy into what is happening in the world".

Some years later, the kingdom is in a very different position. Oil prices are hovering around $90 a barrel, and are predicted to stay high throughout 2008. By the end of the year, the local Jadwa Investments predicts Saudi Arabia will have a surplus of nearly $50bn.

Yet despite the surge in public sector liquidity, the drive to encourage greater private sector investment in the Saudi economy continues. The Saudi Arabian General Investment Authority (Sagia) is seeking to make the country one of the top 10 foreign investment locations by 2010.

A report by the UN Conference on Trade & Development (UNCTAD) in 2007 found the kingdom was already the top recipient of foreign investment in the Arab world. Between 2000 and 2006, foreign investment in the kingdom increased by 99 per cent to $143bn.

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2.6.1 Economic Conditions

Current expansion in the kingdom are much stronger reflecting buoyant private sector activity, prudent macro-policies, liberalisation of the financial sector and foreign direct investment (FDI) regime thanks to World Trade Organisation (WTO) accession in December 2005, as well as a spending spree on infrastructural and industrial projects (including building new economic cities) across the country. Thousands of kilometres of new roads and railway lines; water, sewerage and electricity plants; 4m new housing units; industrial expansion such as the $22bn-plus Ras Tanura refinery upgrade and petrochemicals complex, steel and aluminum; and the ambitious $40bn tourism master plan for the Red Sea coastline, among other schemes, will (once fully completed) help meet socio-economic challenges and greatly improve the productive capacity of the national economy. An estimated 4m people could join the labor market over the next decade since three-fifths of the indigenous population are aged under 25 years(Moin 2008).

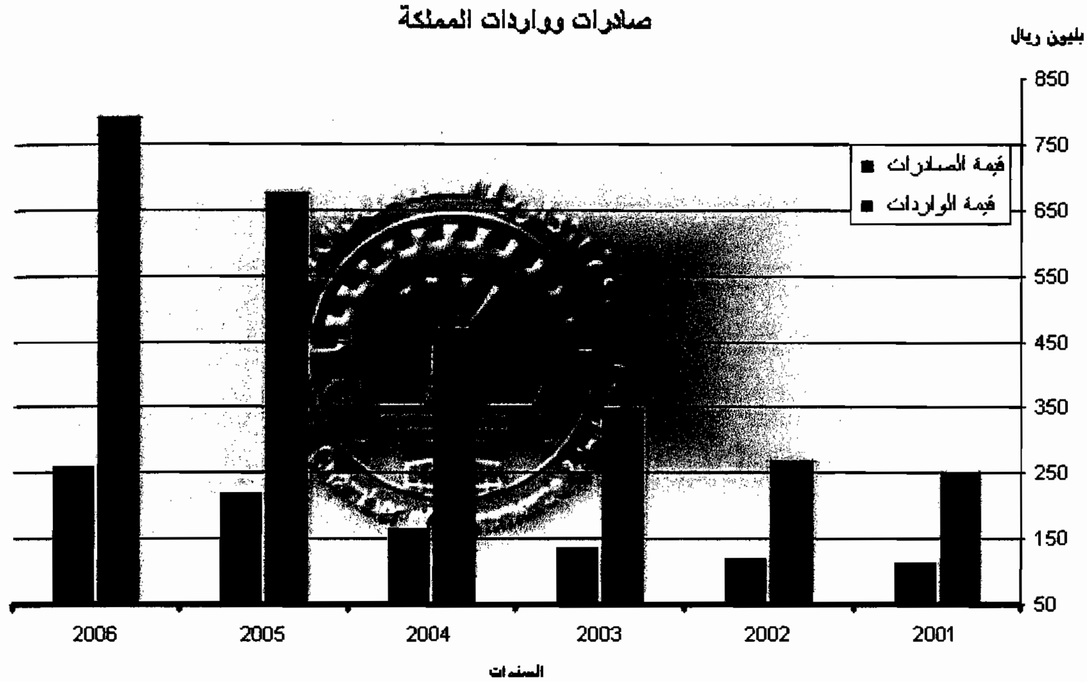


Figure 2.1 Exports and Imports in billions. Source: Riyadh chamber commerce

How flexible is growth in Saudi Arabia to a global downturn? The energy rich kingdom, endowed with one-fifth of the world's proven oil reserves, is in the midst of an investment-led boom that shows little evidence of being derailed by the credit crunch and ensuing slowdown in western (OECD) economies, though a faltering US dollar is adding to inflationary pressures.

A spokesperson for Saudi-based Jadwa Investments noted: "We now perceive the growth driver shifting to the private sector, marking a new phase in a period of sustained high growth in the Saudi economy."

An oil-fuelled 'hyperactivity' is having larger multiplier effects on the broader economy, with its nominal GDP [gross domestic product] swelling by three-quarters to $377bn since 2003,

CHAPTER THREE

THE METHODOLOGY

3.0 Introduction

According to Yin (2003), there are five major research strategies: experiments, surveys, archival analysis, history and case studies. Each of the five strategies has advantages, disadvantages and different ways of collecting and analyzing data on the basis of the following three conditions (Yin, 2003).

Since the main aim of my research is to gain an in depth knowledge about the Inflow of the foreign direct investment and to analyze the role of the multinational companies doing business in Saudi Arabia. ; the secondary data will be appropriate for this research because of the limited time and limited resources if the study were to be conducted in Saudi Arabia. Also, to get some information from multinational companies working in Saudi Arabia would be a difficult task for many reasons.

3.2 Research Design

A research design is the blueprint for the study that guides the collect and analysis data. According to Yin (1994), this blueprint of research deals with at least four problems; what question to study, what are relevant, what data to collect, and how to analysis the results.

Deciding which design will be applied to the research determines what kind of research method and results will be carried out and presented. According to Christensen & Engdahl, 2001,The major parts of all studies are divided in two dimensions: abroad-external and a narrow-deep research. A The abroad-external is based on a broad and external approach is focus on a few variables at many research units. The narrow .deep is focus on deeper study on a few number of research units. The narrow do not need show a statistically generalized picture of a population

In my study, only studying one firm. internationalization process, so this research is Abroad-external.

3.3 Data Analysis

According to Yin 1994 , there is distinction between an inductive, deductive and adductive approach. The inductive approach is characterized by empirical data collected and subsequent theory formulation, based on the findings. The researcher is generating new theories aiming to explain the phenomena, due to a lack of existing theories. In a study with a deductive approach, the point of departure is to test an existing theory using a particular hypothesis. By conducting a logical deduction of the findings, the theory is either confirmed or modified in line with the new conclusion (Yin 1994). The deductive approach is a combination of the inductive and deductive approaches. The starting point is the empirical findings, which together with existing theories form the basis for discovering certain hypothetical patterns. The adductive approach is suitable when the researcher is adductive approach represents the most suitable approach for this study. This is decided by the fact that empirical data is combined with the existing theories in order to discover possible hypothetical patterns regarding the internationalization and entry strategy of enterprise multinationals. Moreover, this study does not seek to elaborate on a theory or to testing one. The main focus is to explore and explain foreign direct investment and multinational companies entries. In this study, using existing theories and modes to explain phenomenon, which is testing an existing theory.

CHAPTER FOUR

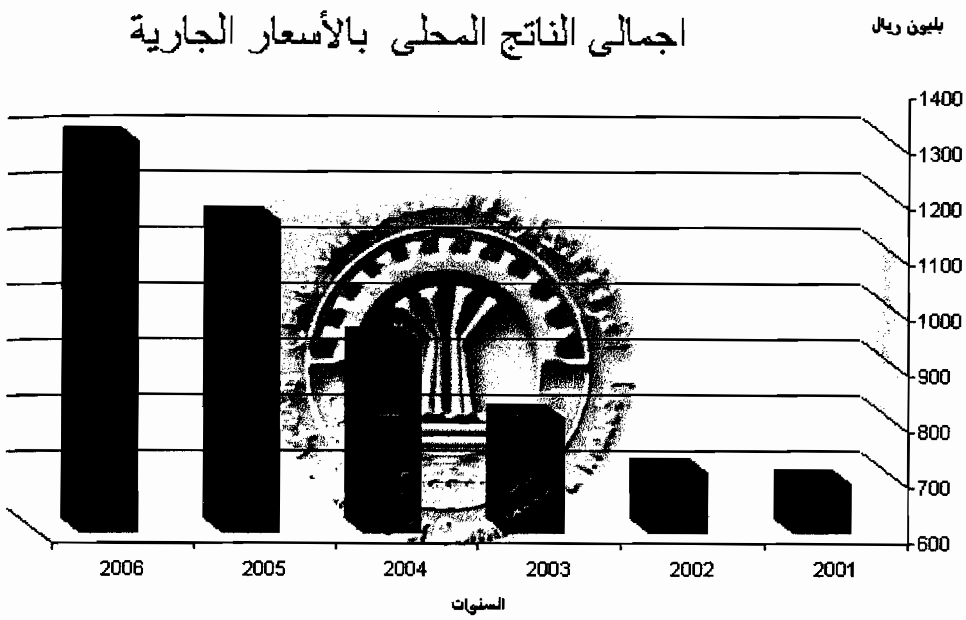
FINDINGS

4.0 About the FDI in Saudi Arabia

This chapter covers the GDP of Saudi Arabia and how is this GDP could be affected by the multiannual corporations that are doing business in Saudi. I also, covers the most important and biggest FDI invaded in the Saudi market. Many of the famous multinational companies are discussed and a explained about their business in Saudi Arabia.

4.1 The GDP of Saudi Arabia

The GDP at constant prices increased more than fourfold during the period 1969-2002 from SR. 156.7 billion to SR. 647.8 billion. At current prices GDP increased 35 times during the same period form 20.18 billion to S.R 705.85 billion in 2002. Figure 1 shows this dramatic growth in the oil and non-oil sectors. (Riyadh chamber Commerce, 2007).



2007	2006	2005	2004	2003	2002	2001	Year
1430	1335	1182	939	805	707	686	GDP in billions)

Figure 4.1 : Gross Domestic Product (at constant 1999 prices)

Source: Riyadh Chamber Commerce.

4.2 The FDI in to Saudi Arabia

The story of growth is equally dramatic in the key sectors of the economy. In the health sector, for example, during the period 1970-2002, the number of hospitals increased from 74 hospitals with 9039 beds to 331 hospitals with 47,242 beds (Figure 2). In the same period the hospitals with 9039 beds to 331 hospitals with 47,242 beds (Figure 2). In the same period the number of physicians increased from 1,172 to 32,683 and the number of nurses from 3261 to 68,097 and allied medical staff from 1,741 to 40,475.

Similarly, the growth in education sector is equally impressive in terms of increase in teachers and students. The number of teachers increased more than 16-folds from 23.1 thousand in 1969 to around 384 thousand in 2002. The total number of students in general, higher and technical education increased from 547,000 in 1969 to 5.1 million in 2002. To support this growth in the education sector, the number of educational institutions increased from 3,283 in 1969 to 24,766 in 2002. The educational institutions for boys went from 2,772 to 12,303 and for girls from 511 to 12,463. These achievements are matched by impressive growth in coverage of social welfare schemes and social insurance.

Table 4.1 : FDI BY SECTOR , 2006

The Field	*Millions $*
Agriculture and fishing	*0*
Mining, extraction of oil and gas services	*4,400*
Industry	*4,613*
Electricity , gas and water supply	*1695*
Trade	*501*

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Hotels and restaurants	*0*
Transport , storage and communication	*0*
Finance services and insurance	*2278*
Real estate and other activities	*805*

FDI=foreign direct investment. Source: Sama

4.3 Joint Venture in Saudi Arabia

Joint venture : the dominant Form of international business in Saudi Arabia

The minister of industry and electricity; Dr.Hashim Yamani, recently underscored the importance of joint venture as a form of business in Saudi Arabia. According to him, joint venture has been a key factor in Saudi Arabia's industrialization process because "it gives us access to stat of the art technology and offered a wider scope for development of our human resources" he further asserts: Saudi Arabia offers the ideal opportunity for foreign investors in a world fraught with political and economic uncertainties. I am certain that those who have participated in Saudi industrial ventures can couch for our track record, our respect for history, tradition, and international law(Middle East Insight 1995).

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4.4 The Foreign MNC's Investing in Saudi Arabia

ROYAL DUTCH/SHELL GROUP OF COMPANIES

Shell is one of the world's largest and oldest multinational groups of companies with investment interests in Europe, Asia, Middle East, Africa, North America and South America. The group has grown out of merger in 1907 of Royal Dutch Petroleum Company ST &T, a Dutch company founded in 1890, and The "Shell" Transport and Trading Company, plc, a British company founded in 1833. The merger gave 60 percent of the new group to the Royal Dutch, and 40 percent to the "Shell" Transport and Trading. The two parent companies agreed at the same time to keep their separate corporate identities.

SHELL ranks among the world's top corporations as listed yearly in the Fortune magazine. With total sales revenue of over $128 billion it ranked Number Six, in terms of revenue, on the list of the world's 500 largest corporations in 1996. SHELL'S staggering profit of $8,9 billion in 1996 showed its ability to maintain for the third year in a row its position as the Number One most profitable company in the world . In 1997 and 1998, however, the SHELL group did not succeed to sustain its top position, in terms of profit.

SHELL's Business Operations in Saudi Arabia

In Saudi Arabia, Shell through its affiliate Pecten Arabian Company is SABIC'S partner in Saudi Petrochemical Company (SADAF). The partners signed the joint venture

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SADAF produces a total of 4.5 million metric tonnes of various/chemicals in 1997 when expansions were completed. These products are ethylene, crude/Industrial ethanol, ethylene dichloride, styrene, MTBE/ETBE and caustic soda. SADAF and other SABIC joint ventures, along with SABIC wholly owned companies, have over the years proved that they are among the most efficient and profitable companies in the world. SADAF has gained many distinctions in recent years, including an international award for safety, ISO9002 registration and the like.

In the future, SADAF may pursue a number of projects like p-xylene, o-xylene, m-xylene, benzene and styrene. The rationale for pursuing these projects is centred on future marketing and investment opportunities that are geared to meeting customer requirements in the global marketplace.

Aside from its joint venture with SABIC, SHELL through SHELL Overseas Investments formed in 1982 the Jeddah-based SHELL Lubricants Company Ltd, in joint partnership with Saudi Arabian Markets Company Ltd. (Bricault 1995).

SHELL Lubricants manufactures in Jeddah SHELL-branded lubricants and distributes them all over the Kingdom. PECTEN Middle East Services Company is SHELL'S representative office in Dhahran to oversee and coordinate business activities in Saudi Arabia and the Middle East (American Businesses Resident in Saudi Arabia. Directory 1998).

MITSUBISHI CORPORTION

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MITSUBISHI CORPORTION

Mitsubishi Corporation is one of the world's largest and most diverse multinational enterprises. The group was incorporated in 1950, with headquarters in Tokyo, Japan. Its origins go back to Tsukumu Shokai, a Japanese shipping company founded in 1870 by Yataro Iwasakh In 1873 this shipping company was renamed Mitsubishi Shokai . This is now known as Mitsubishi Heavy Industries (MHI), which is the forerunner of all Mitsubishi companies. MHI is Japan's largest manufacturer of heavy industrial equipment and machinery, including automobiles, ships, aircraft, power generators, chemical plant and equipment, as well as a wide range of machinery.

Mitsubishi ranks among the world's top corporations as listed yearly in the Fortune magazine. In fact, it was the world's largest company in terms of sales turnover in 1995. Its group sales for the fiscal year that ended 31 March 1996 reached $166.3 billion (Mitsubishi Corporation website). Although it was Number One on the Fortune list in 1995, Mitsubishi's sales in 1996 Were surpassed by General Motors (Number One), Ford Motor (Number Two) and Mitsui (Number Three), With total sales revenue of $140.2 billion Mitsubishi was only Number Four, in terms of revenue, on the list of the world's 500 largest corporations in 1996 . In terms of profit, Mitsubishi's profit c $394.1 million was only No. 271 on the Fortune's list of Global 500 in 1996.

Mitsubishi's Business Operations in Saudi Arabia

In Saudi Arabia, Mitsubishi is SABIC'S partner in Eastern Petrochemical Company (SHARQ), a 50/50 joint venture which is located in Al-Jubail Industrial City. In the SHARQ venture with SABIC, Mitsubishi Corporation led a consortium of Japanese companies. SHARQ was established in 1981 to produce linear low-density polyethylene

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The original Mitsui group, traditionally known as the House of Mitsui, was founded about three centuries ago, as a family business — comprising a senior main family plus ten more family branches, which were guided by a formal constitution. The company's constitution of 1722 prescribed explicit responsibilities, duties, policies and behaviour expected of each individual. It also prescribes the unalterable hierarchy of the families, their shares in the business proceeds, as well as the nature of official and personal relationships to be maintained among them.

Today Mitsui & Co. is Japan's largest sogo shosha, or general trading company (Mitsui Annual Reports 1999). Based on Fortune's listing of the 500 world's largest corporations (under the trading industry category), Mitsui remained consistently in 1996, 1997 and 1998 as the world's largest international trading company (Fortune 1999). Based on 1996 ranking, Mitsui was followed by six more Japanese trading companies .These were Mitsubishi, Itochu, Marubeni, Sumitomo, Nissho Iwai and Tomen (annual reports of these companies are available in their own web sites). In 1997 and 1998, VEBA group of Germany improved its ranking as the 7th largest trading company in the world, overtaking Tomen of Japan.

Mitsui is, in fact, a huge conglomerate of numerous enterprises that encompass all sorts of industries. These include cement, chemicals, commerce, construction, electronics, energy, engineering, finance and insurance, food, glass, machinery, mining, non-ferrous metals, optics, real estate, retail merchandising, paper, steel, transportation, warehousing and other businesses (services) . The company hasjoffices in more than 200 cities in almost 90 countries across the globe (Mitsui & Co. Brochure).

Mitsui owns major subsidiaries in Japan, Australia, Belgium, Brazil, Chile, Canada, Germany, Indonesia, Malaysia, Taiwan, United Arab Emirates, United Kingdom and the United States. It has also affiliates/joint ventures in Japan, Malaysia, Singapore, South Korea, Thailand, and elsewhere.

Included in the Directory of Multinational Enterprises is Mitsui Toatsu Chemicals Incorporated, the Mitsui group's chemical arm. This is an integrated chemical company, which resulted from the 1968 merger of Toyo Koatsu Industries and Mitsui Chemical Industry. Mitsui Toatsu produces and markets urea fertilizer, industrial chemicals, synthetic resins and specialty chemicals. The company entered into a joint venture with the U.S.-based Continental Oil, among other partners, in 1968 for the manufacture of aluminum alkyls. Mitsui Toatsu had also set up in the 1960s other joint ventures in Southeast Asia .

Mitsui's Business Operations in Saudi Arabia

Mitsui is present in Saudi Arabia through Mitsui Engineering & Shipbuilding Arabia Ltd, which is based in Al Khobar. The company was established in 1983 as a joint venture between Mitsui Engineering & Shipbuilding Company Ltd and Abdul Mohsen Al Mousega. It has a branch office in Al-Jubail.

The principal activities of Mitsui Engineering & Shipbuilding Arabia Ltd include construction, installation, start-up and maintenance of offshore/onshore oil production equipment and facilities. They also include designing, construction, installation, start-up and maintenance of chemical and petrochemical equipment/machinery, as well as handling equipment.

EXXON CORPORTION

EXXON Corporation is one of the largest and oldest multinational enterprises in the world. Its origins began in 1863 with the acquisition of Cleveland Refinery by Rockefeller who later founded the Standard Oil Trust. In 1892 the Trust was dissolved to give way to the creation at the same time of Standard Oil Company of New Jersey, which was later known as EXXON.

EXXON controls and manages principal (virtually all wholly-owned) subsidiaries in the United States, Bahamas Islands, Belgium, Brazil, Denmark, Finland, Germany, Japan, Liberia, Netherlands, Norway, Panama, Sweden, Switzerland, Thailand and the United Kingdom. It has joint ventures in Australia, Canada, Chile, France, Hong Kong, Indonesia, Italy, Japan, Malaysia, Pakistan, the Netherlands and Saudi Arabia. EXXON's investment interests in the Philippines were sold to the Philippine government in 1973, while interests in Venezuela were nationalised in 1975, In 1979 the company acquired 93 percent of the U.S.-based Reliance Electric Company for $1,087 billion. Sometime in 1980s EXXON's interests in Arabian American Oil Company (ARAMCO) was sold to the Saudi government.

EXXON's Business Operations in Saudi Arabia

In Saudi Arabia, Exxon is SABIC'S partner in Al-Jubail Petrochemical Company (KEMYA). The partners signed the joint venture agreement in 1981, and KEMYA came on-stream in 1985. It produces polyethylene, using ethylene as the feedstock, which is supplied from Saudi Petrochemical Company (SADAF) (SABIC Annual Report 1996).

EXXON Chemicals Company, one of EXXON's subsidiaries has an affiliate in Al-Khobar, called Oilfield Chemicals Company (American Businesses Resident in Saudi Arabia).

MOBIL CORPORATION

MOBIL Corporation is one of the world's pre-eminent multinational companies, whose energy and chemical operations reach into some 140 countries. (MOBIL Annual Reports 2000). It has also substantial investment interests in retail merchandising and paperboard packaging. The company was incorporated in 1882 as the Standard Oil Company of New York; and it became part of the Standard Oil Trust from 1889 to 1911 .

Mobil companies employ approximately 62,000 people world-wide in operations covering oil and gas exploration and production, manufacturing and marketing, chemicals, and research and development. It has wholly owned subsidiaries and joint ventures across the globe, including those in the United States, Canada, Latin America, Europe, Australia, Middle East, Africa and Asia.

In 1996 MOBIL entered into alliances with British Petroleum to strengthen refining and marketing in Europe, and with Pan Energy Corporation to enhance energy marketing in North America, In its joint partnership with BP, MOBIL has 30 percent interest in the fuels venture and 51 percent share in the lubricants venture . Mobil's U.S. retail marketing network now offers one-stop shopping for convenience items, takeout foods, gasoline, a car wash and banking services In 1998 MOBIL agreed to a merger transaction with EXXON, services (MOBIL Annual Report 2002).

MOBIL Business Operations in Saudi Arabia

MOBIL's extensive involvement in Saudi Arabia began in 1927 with the marketing of Mobilgas j and Mobiloil in the Kingdom. The company acquired a 10 percent shareholding in the Arabian American Oil Company (Aramco) in 1948. In 1961 MOBIL became a joint-venture partner of Haji Abdullah Alireza & Co in the Arabian Petroleum Supply Company (APSCO) — marketing lubricants and other MOBIL products in the Kingdom (Saudi Gazette Supplement on Saudi American Trade Relations, 31 October 1998; 35). Today, MOBIL is the largest foreign investor in the Kingdom,

Mobil's investment" interests in Saudi Arabia include the Saudi Aramco Mobil Refinery (SAMREF), 50-50 partnership with Saudi Aramco (Ministry of Planning. Achievements of the Development Plans 1970-1997: 36). MOBIL also jointly owned with Saudi Aramco the Petromin Lubricating Oil Company (LUBEREF) and the Petromin Lubricating Oil Company (PETROLUBE). Moreover, MOBIL jointly owns with SABIC the Saudi Yanbu Petrochemical Company (YANPET), on a 50-50 partnership basis (SABIC Annual Report 1998).

MOBIL has a Jeddah-based affiliate known as Mobil Saudi Arabia, Inc. This company has branch offices in Riyadh and Dammam (American Businesses Resident in Saudi Arabia Directory 1995-1996; 66). MOBIL Saudi Arabia offers oil and gas services through participation in APSCO and other joint venture projects in the Kingdom .

In Qatar, Mobil is a 10 percent partner in Qatar gas and a 30 percent partner in the Ras Laffan Liquified Natural Gas Company Ltd, In the UAE, Mobil is a partner in the Abu Dhabi Company for onshore Oil Operations (ADCO) and participates in a joint venture refuelling facility at the Dubai Airport with Emirates General Petroleum Corporation. Mobil markets lubricants in the UAE through a marketing joint venture, and through distributors in Bahrain, Kuwait, Oman, Qatar, Yemen and Jordan.

CHEVRON

CHEVRON Corporation is one of the world's largest international energy and chemical companies. Its origins began in 1879 when a group of oil merchants and investors contributed $1 million to establish the Pacific Coast Oil Company in San Francisco, California. In 1900 the west coast operations of John D. Rocker feller's original Standard Oil Company, a part of the Standard Oil conglomerate, bought the company and named it Standard Oil Company of California (SOCAL). The company became autonomous in 1911 when the U.S. Supreme Court decided to divide Standard Oil into 34 independent companies . In order to be more closely identified with its "Chevron" branded products, Socal officially changed its name to Chevron Corporation in 1984. (Saudi Gazette).

CHEVRON'S international operations cover all phases of the petroleum and chemical industries spread in nearly 100 countries through its association with approximately 450 subsidiaries, joint ventures and affiliate companies. It also has substantial investment interests in fertilisers, fibres and real estate.

CHEVRON employs 43,000 people across the globe. Founded in 1879 as Pacific Coast Oil Company, the CHEVRON of today is an amalgamation of people, experience, technology and expertise that has come to be known as "The Partner of Choice" by its host governments and partners.

CHEVRON'S Business Operations in Saudi Arabia

On May 29,1933, Lloyd Hamilton, a lawyer working on behalf of the Standard Oil Company of California, met in Jeddah with Saudi Arabia's minister of finance, Abdallah As-Sulayman. The meeting was a milestone as it resulted in the signing of the basic Concession Agreement granting Socal exclusive rights to explore 320,000 square miles in the most promising areas of the Kingdom.

On September 23, 1933, Chevron geologists set foot in the Kingdom of Saudi Arabia at Jubail. Five days and 25 miles later, the team arrived at a hilly area they had earmarked for the centre of exploration activity. Their decision was based on the area's geologic features, similar to those found in Bahrain where Chevron had made the first crude oil discovery the previous year,

CHEVRON began its drilling activity in the Dammam on April 30, 1935. For nearly three years, the activity had remained fruitless. However, Dammam No. 7 well found large quantities of oil at a depth of 4,727 feel (1,441 metres) in a geological formation called the "Arab Zone" on March 3,1938. In its first 50 days, Dammam No. 7 had produced more than 100,000 barrels of oil. This was, indeed, a milestone as it marked Saudi Arabia's future as a world leader in crude oil production.

Over the years since mid 1930s, Chevron allowed other American oil majors: CALTEX, MOBIL and EXXON to have equity interests in its Saudi operations, which became known as the Arabian-American Oil Company (ARAMCO). In the mid-1970s the Saudi government began to acquire the assets of ARAMCO. By 1980, it became a wholly owned Saudi company.

CHEVRON does not have any more equity interest in petroleum operations in the Kingdom. However, its presence in the Kingdom remains strong partly through a partnership with Saudi International Services Company (SISCO), which provides technical services to Saudi ARAMCO. Chevron also maintains long-term supply agreements with Saudi ARAMCO to I purchase Saudi crude at market prices, and is one of the largest lifters of Saudi crude for its US-based refining system, and for its Caltex affiliate in the Far East.

In a first-of-its-kind arrangement with the Saudi private sector announced in September 1996, Arabian Chevron Petrochemical, a wholly owned subsidiary of the Corporation, and Saudi Industrial Venture Capital Group (SIVCG) formed a 50/50 joint-venture to build and operate a $650-million petrochemical complex at Al-JubaiL Saudi Chevron Petrochemical is a limited liability partnership registered under the laws of the Kingdom of Saudi Arabia.

Construction of a brand-new, 480,000-tonne-per-year benzene plant and a 220,000-tonne-per' a year cydohexane unit is scheduled for completion in mid-1999. Chevron's proprietary AROMAX processing technology, developed and patented by Chevron and designed to produce higher yields of benzene than conventional reforming methods, will be used to manufacture benzene from a natural gasoline feedstock supplied by Saudi Arabia. Today, Chevron manages and co-ordinates its business interests in the Kingdom through Arabian Chevron Inc, its wholly owned subsidiary, headquartered in Riyadh (Saudi Gazette Supplement, October 1998).

GENERAL ELECTRIC COMPANY

General Electric (GE) Company is also one of the largest multinational companies in the world. It has business interests ranging from power generation to sophisticated diagnostic medical equipment to information services. It is the world's largest electrical equipment producer, and has diversified investments in electronics, gas turbines, nuclear power and natural resources. GE was incorporated in 1892 to assume ownership of Edison General Electric and the Stanley Electric Works. It has wholly-owned subsidiaries in the United States, Argentina, Denmark, France, Germany, Hong Kong, India, Indonesia and Ireland, Japan, Liberia, Mexico, Philippines, Portugal, Turkey, United Kingdom and Uruguay. It has also joint ventures (either majority-owned or minority-owned) in Australia, Brazil, Canada, Colombia, Italy, Mexico, Netherlands, Spain, Taiwan and Venezuela .

General Electric's Business Operations in Saudi Arabia

General Electric has eight joint venture projects in the Kingdom of Saudi Arabia, namely:

- General Electric Middle East Engineering Ltd. Saudi Arabia (GE MEELSA), engaged in power generation and electrical equipment service and repair;
- Jeddah Electrical Distribution Assemblies Company (JEDAC), which manufactures electrical distribution equipment;
- Saudi American General Electric Company (SAMGE), which carries out contracting and information services.
- Saudi Electric Supply Company (SESCO), which is a full line eleciric product distributor;

• Saudi Conduit Coating Company (S3C), which engages in specialist coating application and manufacture;

• Middle East Diagnostic Imaging Company (Medico), whose business is medical equipment service and installation;

• Middle East Propulsion Company (MEPC), which performs aircraft engine overhaul and repair; and

• The Middle East Power Company (MEPCO), engaged in power, gas, and steam turbines manufacturing.

GE has been an active participant in the Saudi Arabian market for over 60 years, with a trading relationship that dates back to 1933. In 1976 the company established in the Kingdom a Hill-time office which now operates as the regional headquarters, supporting more than 20 GE | offices throughout the Middle East, Africa, and Central and Eastern Europe (Stewart. Middle East Insight 1995: 102).

Recently GE successfully completed a number of strategic projects, including the radar systems on the Peace Shield Project and a state-of-the-art ground Satellite Tracking Station for King Abdulaziz City for Science and Technology. On June 7, 1995, through its local affiliate, Saudi American General Electric (SAMGE), GE Power Systems signed a $1.3 billion contract with Saudi Consolidated Electricity Company for the Central Region (SCECO-C), to build a 1,285-megawatt combined cycle plant in Riyadh. This plant, Riyadh Power Plant 9, will be the largest crude oil-fired power plant of its kind in the world. It will be constructed 20 miles from Riyadh. and will be executed in a phased construction program over the next six years. Power projects totalling $4 billion over the next five years are currently being tendered and GE is also in active negotiation with Saudi partners for the local manufacture of turbines. A substantial local ^ presence has been a key point in the company's market strategy. The company has gone to great lengths to create this through joint ventures and strategic alliances, believing this combination or its technology, coupled with local content and local experience gives it a strong competitive advantage.

Today GE, and GE affiliates, account for more than 50 percent of the gas turbine market in Saudi Arabia, having installed 283 units for utility and industrial use in the Kingdom. In addition, GE has installed a base of 26 mechanical drive steam turbines and 9 large steam turbines.

In the future, Saudi Arabia is expected to remain an attractive market for power generation equipment sales. Frosty Berg, Director for GE Power Systems Middle East Region, remarks:

"Demand for power is currently greater than supply, Saudi Arabia is undergoing rapid industrialisation and is forecast to need an additional 10 to 12 gigawatts over the next 10 years. This is a potentially huge market and we are very keen to be a major player in it." (Middle East Insight 1995: 103)

In June 1995, as part of a partnership with Saudi companies, GE won the $1.3 billion order to supply and install equipment lor SCECO-C's Riyadh Power Plant 9, and to add additional gasl turbines to Riyadh Power Plant 8. Subsequently, contracts were awarded to GE to extend the Rabigh and Medina power plants. The Riyadh Power Plant 9 will offer the highest ever local content for a Saudi power plant, demonstrating local support for the spare parts and services industry. GE is also a 75 percent owner of GE MEELSA, which provides the Kingdom with turbine apparatus overhaul capabilities and is a focused, dedicated customer support centre and a major powe» generation service centre.

Based in Dammam, MEPCO, a joint venture between GE Power Systems and Ali Abdullah Al-Tamimi & Co., is building a new plant for the manufacture of gas and steam turbine-generator sets, and high value spare parts for gas and steam turbines. This capability to manufacture turbines and associated spare parts in Saudi Arabia will enable MEPCO to expand its business into the other GCC markets. By procuring its products locally, the company keeps its costs down, and will be able to respond quickly when required to provide turnkey power plants to other parts of the region(Middle East Insight, 104-105).

The GE joint ventures are consistent with Saudi Arabia's industrialization policy, as they establish indigenous suppliers, create increased market for local industries, reduce outflow of foreign capital and create export potential for hi-tech products. GE benefits through an increased market share and an increased commitment to the Kingdom. GE partner Ali Abdallah Al-Tamimi & Company, a leading Saudi enterprise, gets access to a new market and a broader range of GE technology. This is a win-win-win situation,"

GE's Aircraft Engine business is a well-established supplier in Saudi Arabia. Active since 1970, it currently supplies engines to meet Saudi Arabia's defense needs and is competing on the Saudi fleet renewal program. It is also the supplier of choice for the AWACS (Airborne Warning and Control Systems) and tanker fleets and is well positioned to respond to all the Kingdom's future requirements. GE has established MEPC as a dedicated aircraft engine overhaul facility, developed to fulfil its offset obligations. When operational, the overhaul facility will provide a unique capability in the Arab Gulf region (Middle East Insight 1995: 105).

Through its local distributor the El-Seif group, GE Medical Systems has been a supplier of medical diagnostic equipment to the Kingdom since 1978 and currently accounts for 57 percent of the installed base. GE's equipment is present in all major central and government hospitals in the Region and in most private hospitals. In January 1995, GE Medical Systems signed a $26 million order to provide MRI (Magnetic Resonance Imaging), CT Scanners, and other medical equipment to the Ministry of Health.

Other GE businesses such as home appliances, lighting, plastics, motors, electrical distribution, and control and information services divisions are also well represented in the Kingdom. GE Appliances sells its Hotpoint-branded products through its local distributor Abdullah Al-Gaith, and its GE-branded appliances through its other distributor, Saad Al-Swailem. Al-Swailem is the largest GE distributor in the world, selling over $20 million worth of domestic appliances a year.

The very diversity of GE's businesses makes it an ideal partner in the Saudi growing market, GE is able to match its products to the Saudi Arabian business, economic, and social priorities, in the light of the increasing local demand for electrical power, employment in high technology areas, such as health care, infrastructure development, export-geared and energy-savings projects.

INTERNATIONAL BUSINESS MACHINES (IBM) CORPORATION

IBM is the world leader in information technology, with substantial activities in office products. It was incorporated in 1911 in Armonk, NY as the Computing-Tabulating Recording Company by the merger of Tabulating Machine Company, Computing Scale Company of America, and International Time Recoding Company (IBM website www.ibm.com).

IBM's Business Operations in Saudi Arabia

The presence of IBM in Saudi Arabia started in 1947 when the first 1UM system was installed in the Kingdom. In 1981, IBM World Trade Corporation appointed as its General Marketing and Services Representative Saudi Business Machines Ltd. (SBM), a subsidiary of Juffali Group of Companies. From then on, SBM has been active marketing and implementing IBM's latest IT technologies in Saudi Arabia. With five decades of active participation and contribution to the development of Saudi computer technology know-how, SBM is looking forward to maintaining and strengthening this market presence in the future.

SBM is collaborating closely with IBM in implementing the strategy of providing Total Solution in Information Technology across a number of industries both in Government and in the private sector. The customers targeted by SBM are those engaged in petroleum, banking, utilities, retail, distribution, manufacturing, airlines, health, education and public transport. SBM's strategy is to provide a complete solution that includes the necessary products and services to meet customer requirements. The solutions include transfer of technology to customers through structured classroom training, practical hands-on experience and on-the-job assistance and support, In addition to the wide spectrum of IBM hardware and software products, SBM keeps abreast with the latest products and developments in the IT industry is order to use such development in designing, tailoring and implementing solutions that meet customer needs.

To increase effectiveness and to meet customer demands, SBM utilizes several marketing and support channels. These include in-house professional and experienced teams of system engineers, customer maintenance engineers, software engineers and service and consulting engineers. These also include business ventures and strategic alliances, which add value to customers' requirements by providing specialized products or complementary support services. In addition, IBM's global network links SBM directly to specialized support centers, product development centers, and manufacturing plants.

SBM and IBM strive to meet customer require merits in the Kingdom through running an application system based on his specific needs. These needs vary over time, hence the solution provided should be dynamically responsive to cope with the changes without adversely affecting the customer's business operation. It should also be able to cope with growing business requirements in the future. Thus, SBM structured its in-Kingdom businesses into diverse industries. Each industry group has the resources, support and management structure to ensure quality service to its customer. SBM'S success is based on a dear understanding of customer requirements and the willingness and commitment to meet such requirements in a prompt and equitable manner. SBM considers satisfying customers as the key to future growth.

CHAPTER FIVE

DISCUSSION

5.0 Introduction

Kingdom of Saudi Arabia Industrial Sector has been growing in order to provide an in depth overview of the industrial sector in Saudi Arabia with specific focus on major industries such as Petrochemicals and Fertilizers and the oil products. This chapter explains what is major happening in the Saudi Arabia's economic factors and what are the government's procedures and law regulations in attracting the FDI in to the kingdom. It also, covers the patterns where the FDI take place and the challenges to the FDI in Saudi Arabia.

5.1 Motives For the Foreign Companies to Go to Saudi Arabia

According to information previously in chapter four we can see that the Kingdom today is an ideal base for Foreign direct investment between Saudis and foreign investors for many reasons, aside from the availability of abundant oil and hydrocarbon resources. These include:

- The presence of free market conditions.
- The increasing role of the private sector in the Saudi economy
- The government's promotional role in supporting new joint ventures for the foreign direct investment.
- The prospective entry of Saudi Arabia into the World Trade Organization (WTO).
- The quality and cost advantages of land and infrastructure facilities in the modern industrial cities of the Kingdom.

5.1.1 Economic motives

In harmony with the objectives of diversifying the economic base and utilizing the comparative advantage of the national economy in acquiring new competitive advantages, the industrial sector is expected to play a vital role in achieving an average annual growth rate of 7.8 percent during the strategy period for next decade. Its share in GDP is expected to increase from 19.6 percent to 24.9 percent between 2004 and 2024, which will contribute to diversifying the economic base.

The services sector, is expected to be the leading sector in the process of economic diversification during the strategy period due to international advancements in communications and information technology which will be applied in the service sector in the Kingdom of Saudi Arabia. This role will be of more importance with the increasing attention to upgrading the innovative skills of scientific cadres in the Kingdom as well as enhancing the tourist sector and utilizing the geographic position of the Kingdom in providing services that enhance international trade and capital flows through international markets.

The oil sector, is expected to grow at an average annual growth rate of 4.3 percent during the period of the strategy- 10 years strategy- , while its share in the GDP is expected to decrease from 27.5 percent to 17.9 percent. The non-oil sector will represent 82.1 percent of the GDP by the end of the strategy, i.e. growing from about 72.5 percent at the beginning of the strategy. This reflects the increasing role of the private sector in GDP which will grow from 52.3 percent in 2004 to about 69.3 percent in 2024. This represents an average annual growth rate of 8.1 percent at constant prices of (1999) compared with the targeted annual growth rate of 4.1 percent for the public sector.

In addition to the inherent strengths of the Saudi economy, some opportunities have also presented themselves. Success happens when opportunities meet awareness. That is, for these opportunities to translate into results, Kingdom has to be prepared and do its part. Otherwise, The Kingdom may not be able to make full use of the potential benefits offered by these opportunities.

5.1.2 The Government Participation

The Saudi Arabian's business have become more attractive for foreigners and local companies as well, for many reasons, these are including:

1- Encourage and expand manufacturing industries.

2. Consider competition among commercial, industrial and other enterprises as the structural basis of the Saudi economy.

3. Adopt competition as the best means of influencing industry towards beneficial manufacturing and market-oriented projects.

4. Ensure that businessmen have access to the right information they need to identify, implement and operate feasible projects such as Aramco and Sabic projects.

5. . Make available attractive financial incentives to encourage businessmen to invest in projects of prospective benefit to the national economy.

6. Ensure the granting of license to operate bigger industrial projects that exceed a specified size of invested capital, employment or production capacity, except in cases where the projects are in conflict with supreme national interests.

7. Encourage as much participation as possible from the private sector in large and important industrial projects initiated by the Government.

8. Avoid the imposition of quantitative restrictions or price control on projects that are in line with the Government's industrial policy.

9. Uphold the right of the business community in the industrial field to select, utilize and manage the economic resources.

10.Encourage the entry of foreign capital and foreign expertise and encourage foreign joint ventures with Saudi businessmen.

11.Promote the growth of all economic sectors to make local resources sufficiently available to the producers and to increase consumer purchasing power within an ever-growing national economy(Saudi Consulting House ,1994)

The Government of Saudi Arabia offers ample investment opportunities to the international business community, in line with its determination to improve the socio-economic welfare of the people, without sacrificing their religious and moral values. This is consistent with its role as the largest market in the Middle East and being strategically located mid-way between the East and the West. The country also qualifies to be a gateway to other Middle Eastern and Islamic markets. The country's vast oil reserves and plentiful hydrocarbon resources clearly make it a promising investment opportunity for international business and, the Director General of the Saudi Consulting House, has said to the investment opportunities in Saudi Arabia:

Saudi Arabia is a politically stable country with an open economy, where investors are free to select opportunities of their choice. The Saudi economy is diversified and offers investment opportunities in each of its-sectors, ranging from agriculture, industry, construction, mining, transportation, finance and business services. (Saudi Consulting House. *Investing in Saudi Arabian Industry,* 1995).

Since early 1970s the Government realised the need for attracting foreign investment that involves transfer of technology, modern management techniques and the development of the private sector capabilities. In order to fulfil this need, the Government has continued to offer more foreign investment protection guarantees to the industrial countries and to facilitate the institutional and administrative procedures for licensing projects in the Kingdom (Ministry of Planning 1996). The policy of attracting foreign investment into the Kingdom has also been implemented through the Saudi Economic Offset Programme.

Development projects shall be determined by a resolution from the Ministry of Industry and Electricity following the recommendations of the Foreign Capital Investment Committee within the guidelines of the National Development Plan." The Foreign Capital Investment Committee, as stated in Article 5, of the law for encouraging the foreign investment, is mandated to propose projects that will be classified as development projects. It is also tasked to consider foreign investment applications, and examine any complaints or claims submitted by foreign investors or other parties. It has the power to recommend penalties, which in the opinion of the Committee should be imposed on any project

violating the provisions of this Law, as well as to consider matters referred to it by the Ministry of Industry and Electricity, concerning the provisions of the Law.

The Government encourages multinational firms to invest in Saudi Arabia, assuring them of no restriction on the entry or repatriation of capital, profits or salaries. Foreign investors are entitled to the following privileges embodied under Article 7 of the Foreign Capital Investment Law:

- Tax holiday. Any local-foreign industrial or agricultural project with at least 25 percent Saudi capital shall enjoy an exemption from corporate tax for a period of 10 years. Other projects shall enjoy a tax holiday for a period of five years only.
- Financing assistance. Low-cost financing through the Saudi Industrial Development Fund (SIDF).
- Industrial facilities. Nominal rent on building sites and low fees for water and electricity.
- Duty exemption. Exemption from customs duties on imported equipment and raw materials.
- Protective tariffs. Tariff protection once the local product achieves a good standard.

• Ownership of any real estate required by foreign investment projects in accordance with the Law of Non-Saudi Ownership of Real Estate.

Joint ventures between local and foreign partners registered under the Foreign Capital Investment Law are allowed to own land for their own use and for staff accommodations.

5.1.3 Legal Factors for the FDI

Multinationals need to recognize that the legal basis of doing business in the Saudi market is the *Shari'ah* — the basic body of Islamic law set forth in the Qur'an, the *Sunnah,* as well as the legislation taken from these two. When it comes to disputes and legal action, the Arabic translations of documents concerning the case must be the basis of court decision. The *Shari 'ah* is a very dynamic and adaptable system of law, which has covered transactions from ancient times through the present. However, that flexibility often makes it rather difficult to apply clearly established rules to a particular situation, or to predict an outcome with the degree of certainty many foreign firms would expect (but not always appropriately) under their own legal system.

Among the most important factors that will contribute to the success of multinational companies in the Saudi market include having the right people, familiarity with the Saudi business and legal environment, knowledge of local culture, as well as sensitivity to cultural differences. Another important factor in doing a profitable business in Saudi Arabia is the company's ability to understand the local legal and commerce regulations, including the inherent uncertainties from the legal perspective. The company also needs to analyze the risks in a proper commercial and political context, and then to rely on good common business sense in deciding whether, and in which manner, to proceed.

In Saudi Arabia joint ventures have historically been, and continue to be, the most common route through which multinational companies do business as we have seen in previous chapter. Joint ventures with foreign firms commonly take the form of locally incorporated limited liability companies. The exceptions to this include the joint venture banks (like Saudi British Bank) and petrochemical projects (like those of Saudi Basic Industries Corporation), which take the form of joint stock companies. Professional partnerships also fall outside the region of locally incorporated limited liability companies.

The formation of a limited liability company falls under the jurisdiction of the Foreign Capital Investment Committee (FCIC) at the Ministry of Industry and Electricity, which has the authority to grant a license authorizing the foreign party's equity in the business. In evaluating the application, the FCIC and all concerned Saudi ministries will determine whether the products to be produced support the import-substituting policy of the Government. They will also evaluate whether the business has good export potential; whether it will make good utilization of natural resources; whether it will involve transfer of desirable foreign technology; and whether it will contribute to the development of the nation's economy and human resources.

A key prerequisite to securing a license authorising the formation of the company is that it must have at least 25-pcrcent Saudi participation. For industrial projects, the approval of the Industrial Licensing Department (ILD) is also required. After securing the FCIC license (and the ILD's if needed), the articles of association must be submitted to the Ministry of Commerce for approval.

A Saudi limited liability company requires a minimum capital of SR 500,000 and a minimum of two and a maximum of 50 shareholders. For industrial projects, the FCIC may require substantially greater capital as a precondition to granting an investment license. All capital must be paid in full. Ten percent of the net profits of the company must be set aside as a statutory reserve until such reserve equals 50 percent of the original capital of the company.

An industrial limited liability company with at least 25 percent Saudi participation is eligible for a 10-year tax holiday, and for secure financing from the Saudi Industrial Development Fund at favorable rates. A contracting limited liability company is eligible for a five-year tax holiday. Products manufactured by a limited liability company could have up to 20 percent duty protection. Land for the development of commercial establishments is often made available in industrial estates for nominal amounts.

In practice, multinational companies enter into joint ventures with Saudis who commit capital, personnel and needed support services. These include knowledge of the local industry, government liaison and distribution channels .

In this regard, two basic documents are involved — a joint venture agreement, and the articles of association. These may be supplemented by a number of other documents such as technical assistance agreements, trademark license agreements or know-how agreements, and technology transfer license agreements.

While the content of joint venture agreements varies considerably from one transaction to another, most will contain provisions, which are required for all projects. These include a clear acknowledgement by both parties that the company will be treated as a separate and important profit centre, a mechanism for funding capital expenditures and working capital requirements, and the obligations of the parties to provide advances, or guarantees in connection with commercial or other debt. The basic management structure and the mechanism for protecting minority interests arc likewise needed to be included in the agreements. They also need to make clear the terms governing transactions between the company and the shareholders or related parties, and in which conditions the shareholders might be allowed to compete with the company. They also need to spell out the relationship between the shareholders, the allocation of expenses up until the time the company is formed, and the bases upon which the company may be dissolved.

For a joint-venture company to be registered it must have its own articles of association. For convenience of the applicants, the Ministry of Commerce has issued standard articles of association, but their use is not mandatory. They may serve a useful guide for judging the completeness and correctness of the articles. The joint venture agreement and the articles of association are an integral package and should therefore be consistent with each other. The articles of association of a joint venture, limited-liability company must be governed by the Saudi Law. More importantly, the Arabic version of the articles would be given precedence in the event of any inconsistency or dispute. In practice, Saudi government agencies especially when they arc parties to a joint-venture agreement, will not allow the agreement to be governed by foreign law or that disputes be settled by foreign arbitration .

To put together a viable management structure, the foreign company may have the right or upper hand to appoint key management and technical staff. However, the Saudi partner retains the right (after consultation) to require the foreign partner to remove someone who may fail to tune into the unique aspects of doing business in the Kingdom.

As regards taxation, a tax holiday applies only to the foreign partner's share of the net profit, which is proportional to its share of the joint-venture company's equity. If the foreign partner in a joint venture company is paid an additional percentage of profit, or

receives income under ancillary agreements (such as a technical assistance agreement), the related income will not be covered by the tax holiday, and therefore be subject to income tax. In this regard, the basic rule regarding taxation is that Saudi individuals and entities wholly owned by Saudi individuals pay *Zakah* (religious tax), and foreigners pay income tax.

Foreign companies often insist on majority ownership, even though it may result in the loss of various benefits and the imposition of other obligations. Frequently, the foreign company assumes that it must have majority ownership in order to have control of the joint venture project.

5.2 Patterns of FDI in Saudi Arabia

As seen previously , joint venture is almost 90% of the dominant form of multinational business in Saudi Arabia, and also the one most preferred by Saudi industrial investors seeking foreign partners. Joint venture commonly exists in the developing counties , including Saudi Arabia, as a business arrangement between a company that has stronger technical and commercial capabilities and a company that has better local knowledge and general commercial strengths . One of the strongest appeals of joint ventures is that they substantially reduce, by the amount of the partner's contributions to the venture, the political and economic risks that are the principal obstacles to direct foreign investment. Many feel that the presence of a local partner in a business venture abroad guards against outright expropriation in the more unstable countries of the world. Likewise, some other developing countries do not permit a subsidiary controlled by a foreign licensor to remit royalties or deduct them from taxable income. Another advantage of a joint venture is that it facilitates ready access to a new market and to market information.

In general, joint venture arrangement or the broader concept of alliance capitalism is consistent with the notion that co-ordination is done on an arm's length basis or within the open market system. Joint venturing conforms to free private enterprise economy, where co-ordination of economic activities occurs through non-coercive voluntary cooperation, in order for the parties involved to take advantage of modem science and technology. This conforms to the proposition advanced by Friedman that "both parties to an economic transaction benefit from it, provided the transaction is bilaterally voluntary and informed." In order to conclude a market transaction, both parties involved need to know and meet the underlying information requirements.

In Saudi Arabia, the joint venture is registered as a separate joint-stock company, which is treated like any domestic joint-stock enterprise, with both partnering companies fairly represented in the board of directors. In terms of ownership, control and decision-making, the ability of the foreign partner to influence the joint venture is directly proportional to its capital shares in the business. Likewise, the prices of goods and services supplied from the joint venture to the co-operating companies and vice versa arc determined freely according to the market interaction of demand and supply. As per agreement between the joint venture partners, probationary prices may be applied to facilitate smooth flow of goods and services between the joint venture and the cooperating companies. By the same token, probationary prices may be fixed for the supply of output from the joint venture to some agreed cross-border market outlets, including affiliates of cither of the two partners. In practice, the probationary prices will later be superseded by final prices determined according to some pricing formula that is based ultimately on the arm's length (open market) price mechanism. In this sense, the existence of joint ventures cannot be explained through the internalization theory of multinational enterprises or the theory of international production. This is so because the internalization theory, considers the tendency of multinational firms to internalize a market, say via "vertical" integration, as a means of superseding the free market system or price mechanism A joint venture may also be favored in Saudi Arabia as an offshoot of the Saudi economic offset programme (The Economic Bureau. Saudi Economic Survey ,May 1998). Offset projects arc forms of counter-trade measures used by developing and emerging economics typically in an effort to reduce the heavy burden of contract-based imports. The offset scheme between contracting parties may involve joint ventures, technology transfer, product buy-back, and so on. It may include, among others, arms purchases, food imports, construction projects, as well as provision of management services.

In just 10 years from 1984 through 1994, various offset programs emerged with a total value of about $20 billion. These were the Al Yamamah (with British Aerospace as the prime contractor), Peace Shield I (with Boeing), Peace Shield II (with Hughes Aircraft), General Dynamics Economic Balance Programs (with General Dynamics Corp), McDonncl Douglas Peace Sun IX (with McDonncl Douglas Corp), Al Sawari (with Thompson-CSF) and AT&T Offset (with AT&T International).

The Saudi government has over the years enhanced its offset programs to help develop and diversify the national economy. For instance, the Al Yamamah Economic Offset Program aims at encouraging and assisting the creation of profitable joint ventures and other commercial deals between Saudi and British companies. The program is expected to provide a substantial and long-term incentive to UK.

companies seeking or planning to do business in Saudi Arabia. The success of the Al Yamamah Offset Program, as well as other economic offset projects, has attracted a number of foreign companies to invest locally. Aside from joint ventures and offset projects, many foreign companies in Saudi Arabia have been engaged in broad value chain and diverse business activities beyond the frontier of international production. These include licensing, exporting and retailing, as expounded in the earlier chapters of this study. So, while various ideas have been given to explain the nature, existence and growth of multinational enterprises, the multinationals themselves arc never weary of generating and implementing ideas and strategic options that may help them enhance their competitive position and profitability, locally and internationally.

The decision by any multinational company doing or planning to do business in Saudi Arabia depends on numerous factors. In general, these include the need to improve market shares, the attractiveness of the host country's location-specific advantages, and the need to earn more profits. The firm's tendency towards protecting and exploiting its own company-specific advantages (like the possession of a comparatively superior technology) also influences its plans and decisions to invest abroad. Likewise, the strategic thrusts and core values of a firm, notably the one that deserved the title of a visionary company, influence the success of its plans, strategies and actions locally or internationally .

In Saudi Arabia, multinational business operations cover all kinds of profitable, value-adding activities outside the bounds of international production. These include setting up international marketing offices, trading agents, project management, joint ventures, consulting services or international production prove that cross-border activities of multinational companies actually embrace the whole range of global business.

In the petrochemical industry, well-known MNCs like Mitsubishi, Mobil, Exxon and Shell have opted for joint ventures with SABIC, as a means of getting shares in the Saudi market and nearby regional markets. These multinational companies do not have their own production subsidiaries in the Kingdom, despite their own ownership-specific advantages like technology, management expertise and abundant capital.

Some multinational companies have various types of businesses in Saudi Arabia . One Japanese manager, for instance, revealed that his company is engaged in consulting, professional services and technology/product franchising. At the same time, he indicated that the multinational company he is managing is a contractor for government projects. Another manager indicated that the American multinational company he is working for does not have wholly owned subsidiaries in Saudi Arabia. The company's liaison offices in Riyadh and Al-Khobar only serve as the parent company's channels for participating in local tenders for government or private projects. In effect, the company serves as a contractor for the installation of heavy-duty machinery, plants and related requirements in government or private projects. One country manager of an American multinational firm indicates that his company serves as a contractor for technical services.

Major multinational companies have virtually no wholly owned manufacturing subsidiaries in Saudi Arabia, as national policy does not really encourage it. What the government encourages is for foreign companies to have joint ventures with Saudi companies or Saudi nationals. As such, multinational companies opt for other business routes other than international production. This does not mean, however, that foreign companies are prohibited from having wholly owned subsidiaries in the Kingdom. As mentioned earlier, the Saudi Arabian government adopted in 2000 the new Foreign

Investment Act which allows foreign investors full ownership of projects and gives them freedom to repatriate capital and profits.

It is worth noting that foreign companies, having no foreign direct investment in Saudi Arabia, can usually export their products to the Kingdom without significant barriers. In the Kingdom, therefore, it is quite common to sec major brands of well-known American companies (like Compaq, IBM and Hewlett Packard) whose products areneither produced in Saudi Arabia nor in the United States, but in China, Malaysia, South Korea or elsewhere. These companies prefer to export their products to Saudi Arabia from their branches elsewhere in the world, instead of internalizing the Saudi market.

International firms can be affected to invest in a foreign country, if the country enjoys competitive advantages relative to other countries. In the case of Saudi Arabia, these

competitive advantages include the favorable factors of better communication services, presence of modern seaports and airports, presence of excellent highways and inter-city roads network and the like. All of these are quite impressive and among the best anywhere in the world.

5.3 Locational Advantages

Saudi Arabia, in fact, possesses most of the determinants of national advantage, advanced by Porter (1990). As to the factor conditions, for instance, modern basic industries in Saudi Arabia, under the realm of SABIC, have in recent years attracted major multinational companies to invest into the Kingdom. Big multinational companies like Shell, Mobil, Exxon and Mitsubishi entered into joint ventures with SABIC. The investment returns from these joint ventures have been very attractive. Abundant low-cost raw materials are coupled with modern infrastructure and cheap skilled labor supply from Asia – India and Pakistan- and elsewhere. As regards demand conditions, the Saudi market for consumer and industrial goods is the largest in the Middle East, and keeps on growing over time. There is also the presence of related and supporting industries in Saudi Arabia, which arc internationally competitive. Likewise, the state of rivalry in many consumer products sold kingdom-wide is sufficient to cause international firms to react rationally and competitively.

In short, the way multinational companies operate in Saudi Arabia or elsewhere in the world is part of an intemationalization process that takes the form of international trade in FDI , joint ventures and wholly owned operations and so on . It is a process where the players involved have to deal with a dynamic environment where the business of change is the norm, rather than exception. It also involves, among others, global co-ordination and integration of activities, if the situation dictates; and responsiveness to market-specific requirements and conditions. International business players need strategic thinking, strategic positioning and all sorts of appropriate management techniques to cope with globalization trends and changes. They can no longer stick to only one cross-border business option, like that of wholly owned international production. At times, they have to take very tough decisions, including mergers, acquisitions, joint ventures and the like, for them to survive and grow in today's and tomorrow's dynamic business world.

Major business players sometimes compete on the international front by selling the same product; and they sometimes work as partners via a joint venture that produces and markets the same or some other products. In today's business world, therefore, it is hard to find a multinational company that does not have a joint business partner locally or internationally. Joint ventures, strategic alliances, as well as mergers and acquisitions always feature in the business news quite regularly. In the foreseeable future, the same trend may continue, for as long as the players find mutual satisfaction and benefits in their strategic actions and decisions. However, as more and more nations adhere to the globalization of world economics, barriers to foreign investment may eventually disappear once and for all. If multinationals do not have to worry about foreign government intervention, host-country's nationalization thrust and policy constraints in the future, they may be tempted to get away from joint ventures and may resort to wholly owned business operations. This scenario may be tempting, knowing that joint venture is normally not the best option for multinationals as it involves tough decisions with respect to ownership structure, management composition and profit sharing. In Saudi Arabia, the joint venture route is still dominant, and is expected to remain so in the foreseeable future by virtue of national investment policy and priorities.

Saudi Arabia has a bright business outlook for the long term on the following grounds:

- The country's dependence on oil has been declining over time, due to the rapid expansion of the agricultural, industrial, manufacturing and service sectors.
- The non-oil industries in the Kingdom, particularly those under SABIC, are

expanding tremendously. Some of the new expansion projects are being planned and implemented in partnership with major multinational companies.

• The basic prerequisites of developments (ports, airports, roads, logistics, communication and other facilities) are all readily available in the Kingdom.

• The Government is doing everything possible to support the business community.

• Highly qualified technocrats and officials are manning the ministries and government institutions.

The government of the Kingdom of Saudi Arabia is now instituting all appropriate measures to further attract foreign investment *(Riyadh Daily,* 26 November 1999).

In this regard, the Saudi government approved in April 2000 the new Foreign Investment Law, allowing foreign investors full ownership of projects and giving them freedom to repatriate capital and profits *(Arab News,* 19 August 2001).

Based on the new law, the Saudi Arabian General Investment Authority (SAGIA) has come into being with the authority to issue a license for a foreign capital investment in the Kingdom (Saudi Arabian Monetary Agency (SAMA) Annual Report 2001). As of August 2001 the SAGIA had already issued 91 licenses worth around SR. 30.5 billion, of which 93.6 percent is foreign capital belonging to foreign companies *(Arab News,* 7 August 2001).

Concerning the national economy, the Kingdom's real GDP was previously expected to hold at 1.5-2% in 1998 and 2-3% for the period covering year 2000 through 2003 (The Economist Intelligence Unit (EIU) Country Report on Saudi Arabia, 4th Quarter 1996: 7; 3rd Quarter 1998: 8; 2nd Quarter 1999: 8; and Bank of America March 1998: 164; Bank of America July

1998: 6). Real GDP (at constant 1970 prices) reached 1.5% in 1998, but declined to 0.8% in 1999. SAM A estimated a 4.5% real GDP growth for 2000; and projected an average 3.2% annual growth through the year 2004 (Saudi Arabian Monetary Agency (SAMA) Annual Report 2001: 31 -42, 187).

In the years to come, opportunities for foreign investors are expected to remain attractive in the oil refineries, gas and other sectors. Also the so-called new gas initiative, which gives major oil companies the opportunity to have foreign direct investment in the gas sector, is foreseen to drive Saudi Arabia's industrial expansion over the next five to ten years. Attractive and innovative financing packages from the Saudi commercial banks and potential privatization of a number of state-owned enterprises further encourage foreign investment in the Kingdom. The privatization policy and strategy, which arc in line with the process of 'conversion into market mechanisms', have recently gained substantial significance especially with the establishment of the Supreme Economic Council in August 1999 (Saudi Arabian Monetary Agency 2000). Transferring state-owned enterprises and corporations into the private sector certainly offer further opportunities to both Saudi and foreign investors.

5.4 Challenges for the Saudi Arabia Attracting the FDI

In designing a strategy, it is also important to be aware of potential developments that may distract from the central path to the Vision. Fortunately, most of these trends and developments can be mitigated if anticipated and internalized in the design of the strategy. Saudi Arabia needs to keep a close watch on the following factors:

5.4.1 Rapid Change in the Neighboring Countries

While changes in the distant part of the world can make interesting case studies, changes in the neighborhood have a profound effect on both the psychic and material welfare of a country. Investors looking for opportunities are more likely to compare neighbors before making their location decision. Similarly, Saudi businesses are likely to make their decision to migrate or stay based on the relative investment climate in neighboring countries.

It is a fact Kingdom's neighbors in the GCC are changing at a tremendous pace and the success of their reforms cannot be attributed to their small size alone. A deeper analysis of the decision making and implementation record will reveal that the lessons of their experience are very relevant and pertinent for the Kingdom.

5.4.2 Increasing Global Competition

Increased global competition is a major factor to consider in any strategic analysis of a nation. With the Kingdom joining the GCC customs union and the impending WTO accession, the challenge posed by global competition is likely to increase at an accelerating pace. The pace of this trend cannot be controlled by any one individual country. Thus, the strategy has to take the existence of global competition as given and devise ways to thrive in a competitive environment.

Once Kingdom joins WTO, its trade regime will have to become more transparent and trade barriers will need to be dismantled gradually. The stability of rules and regulations coupled with the ongoing investment law reform process will greatly enhance the environment for attracting domestic and foreign investments and expanding joint ventures. However, the private sector in general and SMEs in particular will face a number of challenges through increased openness and competition.

In general the previous restrictions on international investment and trade e.g. restrictive business visa sponsorship, inability of foreigners to own land, mandatory joint ventures and restrictive import licensing will need to be reviewed. This will imply increased competition from overseas products but also increased interest in investing in the local market.

5.4.3Political Risk

Saudi Arabia's unique role in the Arab and Islamic worlds, its possession of the world's largest reserves of oil and on the other side it has the most attractive place for all Muslims which is the two holy mosques in Makkah and Madinah. The continued availability of reliable sources of oil, particularly from Saudi Arabia remains critical to the prosperity of the United States as well as Europe and the Far East.

Saudi Arabia yearly spends an estimated one third of its budget on defense/national security and has the ninth largest defense budget in the world. While the Saudi military purchased large numbers of many weapons systems throughout the 1990s, budgetary constraints have in recent years resulted in far fewer purchases of new weapons systems. The Saudi Government is interested in finding inexpensive solutions to upgrade existing systems. After the May 12 attacks in Riyadh, Saudi cooperation with the U.S. on counter-terrorism has become the most important issue in bilateral relations especially there was a threaten to the oil reserves and some biochemical cites. Cooperation and information sharing on investigations and other counter-terrorist operations, including efforts against the financing for terrorism, has reached a high level.

Saudi Arabia relay on the US to share many common concerns about regional security and stable development. Military cooperation during the 1991 Gulf War and from that date it started to strengthen the relationship with US.

5.4.4 Human Resource Challenges

The labor force volume has been identified through the rate of national labor participation and the estimated volume of population at working age. The participation rate is anticipated to increase from 36.9 percent in 2004 to 56.3 percent in 2024. In line with the policy of reducing the volume of foreign labor, reducing unemployment, it is expected that steps aimed at increasing the supply of national labor will go on. The increase of the total labor supply requires raising the contribution of women in the labor force by providing more job opportunities for the Saudis to participate in the economic growth. The contribution of women to the national labor force is expected to grow from 10.3 percent to 30.0 percent for the long strategies. Saudi Arabia's lack the skilled, cheap labors and this is a big challenges for attracting FDI.

Table 5.1 Indicators of Manpower and Employment

Indicators	(000s)					Average Annual Growth Rate - (2004-2024)
	2004	2009	2014	2019	2024	
Total manpower*	**8549.74**	**9360.21**	**11128.66**	**12813.54**	**15004.94**	**2.8**
Total Saudi Manpower *	3804.19	4885.96	6757.04	8984.45	11850.18	5.9
Total Labor*	**8281.84**	**9221.30**	**11028.6**	**12763.54**	**15004.94**	**3.0**
Foreign labor*	4745.55	4474.25	4371.62	3829.09	3154.76	-2.0
National labor*	3536.29	4747.05	6657.04	8934.45	11850.18	6.2
Saudi unemployment*	**267.90**	**138.91**	**100**	**50**	**0**	--
Total participation rate of Saudi labor (%)	36.9	39.2	45.3	50.4	56.3	--
Manpower Participation rate of Saudi males (%)	63.8	64.5	70.0	75.0	80.0	--
Manpower participation rate of Saudi females (%)	10.27	14.16	19.52	26.90	30.0	--
Ratio of Saudi unemployment (%)	**7.04**	**2.84**	**1.48**	**0.56**	**0.0**	--
Indicator of Saudization (%) **	**42.7**	**51.5**	**60.4**	**70.00**	**79.0**	--

* Thousand workers.

** **Overall labor force = Total labor force – Volume of unemployment.**

Source: Riyadh chamber commerce

CHAPTER SIX

CONCLUSION AND FUTURE RESEARCH

CONCLUSION

This thesis provides an extremely detailed overview of factors driving latent demand and accessibility in Saudi Arabia. Latent demand is largely driven by economic fundamentals. But, latent demand only represents half of the picture. A country may at first sight appear to be attractive due to a high latent demand, but it is often less attractive when one considers at the macro level how easy it might be to serve that entire potential and/or general business risks. Saudi Arabia, the largest economy in the GCC has undergone significant transformations in a relatively short period of time. It has evolved from a basic agricultural society into a regional and global economic power with a modern infrastructure. Kingdom of Saudi Arabia Industrial Sector has been growing in order to provide an in depth overview of the industrial sector in Saudi Arabia with specific focus on major industries such as Petrochemicals and Fertilizers and the oil products.

Given that the Saudi economy is still oil-driven, the price of oil is an important consideration in the timing for any development strategy. The long run is always harder to predict, particularly in the volatile oil sector. So, the government of Saudi Arabia has to play an important role in trying to adapt many of the foreigen direct investments to the country to diversify the economic incomes.

As discussed in chapter two, firms resort to international production by virtue of their ownership-specific advantages, location-specific advantages, as well as internalization incentives, and in response to imperfections or externalities in the goods or factor markets. There is common view among international business scholars that market imperfections (such as tariff and other import barriers) prevent the efficient operation of international trade, hence the emergence of multinational companies. More specifically, the internalization theory supposes that multinational firms emerge because market failures or imperfections prevent the efficient operation of international trade. However, when a firm goes multinational by, say, having two or more stages of production processes located in two or more countries, it will not mean the disappearance of international trade and other business modalities. Also, when a firm internalizes a market by creating, for example, a wholly owned subsidiary outside its national boundary, transactional imperfections remain albeit to a lower degree than before internalization. No doubt, external transactional imperfections particularly due to opportunism, information asymmetry and uncertainty remain as long as the internal market has to deal with the external open market system, considering the bounds of its supply chain to the customer ends. Thus, as long as the multinational enterprise has to deal with the external markets, by virtue of the need to market its finished products or services, international trade will continue to exist and grow.

A multinational firm may not be in a position to establish a wholly owned manufacturing subsidiary in a foreign country, not necessarily because it is prohibited to do so. The foreign government may allow it, but the underlying investment terms, conditions and regulations may be discouraging to multinationals. In the case of Saudi Arabia, the presence of very low import tariff makes it difficult for any firm to contemplate on putting up a wholly owned manufacturing branch locally. So, many multinational companies have settled for joint ventures with Saudi partners. Like a wholly owned subsidiary, a joint venture is subject to transactional imperfections internally and externally. In fact, all supposed alternatives to multinational enterprise are likewise subject to imperfect or conflicting conditions. Joint venturing, international trading, licensing, consulting and other modalities are, in real business life, alternatives to international production not alternatives to multinational enterprise. This is why multinational companies account for most international forms of business operations.

By the will of Allah, the Saudi economy in the future will be a more diversified, prosperous, private-sector driven economy, providing rewarding job opportunities, quality education, excellent health care and necessary skills to ensure the well-being of all citizens while safeguarding Islamic values and the Kingdom's cultural heritage by putting the efforts from the government as well the people.

Areas of Future Research

A number of areas of concern relating to research and sampling methods need to be properly addressed in future work. These include the problem of obtaining the required data or information. this issue is not new and not confined to multinationals operating in Saudi Arabia. There is, however, a growing keenness by the Saudi Arabian government to create an attractive environment for foreign investment. This is evident in the recent creation of the Supreme Economic Council (SEC), the new Foreign Investment Act and the Saudi Arabian General Investment Authority (SAGIA). One important function of SAGIA is to provide to all would-be investors, and to interested researchers, available information and statistics. The possibility of obtaining a supporting cover letter (an integral part of the mail survey) from SAGIA or any other appropriate Saudi government institution will be an added advantage to encourage would-be respondents to cooperate.

Another area of concern is the possibility of bias due to the fact that some required data or information might not be obtained for some units of a sample, totally or partially. Any future work to replicate the study, therefore, needs to be well funded — if possible, with financial grant, research fellowship or some other support from prominent institutions like the United Nations Centre on Transnational Corporations.

One area of future research is to replicate the cultural aspect of similar study, on a comparative basis, using other Middle East countries (like Oman, Kuwait, Libya) or other Muslim developing countries elsewhere (like Indonesia). These countries have both oil resource and Islamic culture — the two common factors that make them similar to the case of Saudi Arabia.

Another interesting research area is to conduct an in-depth empirical work on the success indicators of multinational enterprises operating in the Middle East or elsewhere. One relevant objective in this regard is to investigate deeply the correlation between the various positive aspects of cultural responsiveness and the indices of multinational business success.

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