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SAUDI ARABIA'S
CHICKEN OR EGG QUESTION

"Riyadh to invest in Giga Projects or SMEs?"
Job creation first starts by thinking SMALL!

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Saudi Arabia's Chicken or Egg Question: "Riyadh to invest in Giga Projects or SMEs?"
Job creation first starts by thinking small!

The future of Saudi Arabia is currently in the making. Saudi Crown Prince Mohammed bin Salman's Saudi Vision 2030, presented in 2016, is set to be changing the oil-rentier state economy of the Kingdom into a diversified economic giant able to address the challenges of the future. The first three years of the Vision 2030 approach, which is based on a McKinsey strategy report, however has shown that some re-assessments need to be made to reach the targeted future economic progress. The success formula currently followed by Saudi sovereign wealth fund Public Investment Fund (PIF), the main recipient of the in-kingdom privatization efforts ongoing, such as the IPOs planned for Saudi Aramco, multitude of ports and airports and other government owned entities, is however under pressure. By setting up a strategy, which should not only diversify the economy into a 21st Century power-house, but also engage around 5 million new job-entrants the coming years, is not in place. Investments are currently largely made into the so-called Giga Projects (Qiddya, Red Sea Islands and NEOM), or into high profile international targets (Uber, Tesla, Lucid Motors) and real estate.

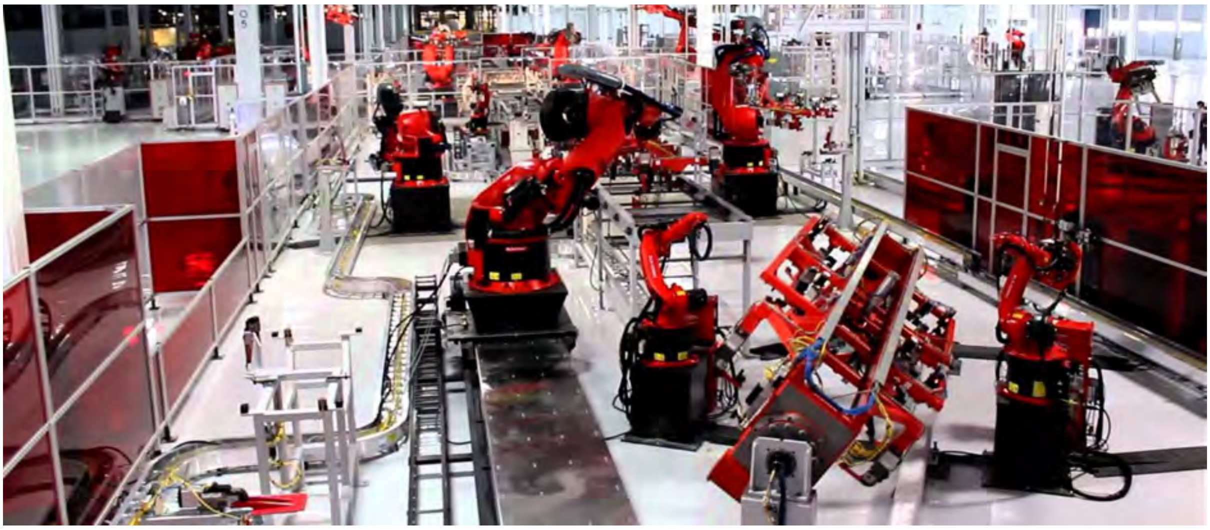
At the same time, in-Kingdom main focus is also put on the set up and development of high-tech related and data driven sectors. The latter relevance is clear, but while looking at the current state of the Saudi economy and its social fabric, more is needed to remove the high youth unemployment levels and still heavy dependency on expatriate workers and experts. The role of Small and Medium Size Enterprises (SMEs) is still undervalued but could become a critical factor for the possible success of Saudi Vision 2030, and indirectly the position of the current Young Eagles of the Saudi Kingdom, aka the supporters and backers of MBS' endeavors.

The Kingdom is currently facing the eternal "Chicken or the Egg Question". High profile projects are needed to garner the hard-needed international attention of investors, governments and companies, to receive an influx of investment and technology to reshape its economy. The backbone however of every sustainable economy is SMEs, even within the Silicon Valley or other regions, small companies are the instruments in innovation or production. Small in the end is beautiful, especially within new technology and innovation. A refocus should however be put in place in Kingdom to increase the impact and output of SMEs the coming years.

Saudi Arabia, since decades leading global oil and gas sectors, supported by its OPEC leadership and immense oil reserves, needs to have a look outside of its comfort zone. At present, advisors in Riyadh, Khobar and Jeddah, are still having a single-minded view on the world. The experiences of the USA, China and Russia, are not compatible with the situation on the ground. At the same time, the role of large-scale enterprises (private or government owned) in these three focus countries is almost 180 degrees the opposite of the situation in the Kingdom. American companies or global conglomerates are not going to be the savior or pivotal factor in diversifying the Kingdom. The capitalism of the US, as represented in Silicon Valley, Chicago or Boston, or the communist-capitalistic state governed approach of Russia and China, are not 100% feasible for the diversification needed in the Kingdom the coming years. Saudi Arabia is coming from a situation which can be seen as a rentier-state, suddenly realizing that it has been suffering from a Dutch Disease 2.0 situation for the last decades. By only distributing wealth, which was not being received via manufacturing or old-school economics, but due to resources available below the surface, a social fabric was created currently assessed as not anymore feasible.

Changes to a whole set of economic and social contracts are needed, with as the most pressing point the high levels of unemployment of young Saudi men and women. The former wealth distribution, used to support the social contract between the Saudi ruling elite (and royalty) and the population, is under pressure due to increased needs and higher volatility of oil prices, the main revenue base at present. Crown Prince Mohammed bin Salman's Vision 2030 has recognized this but seems to be having difficulties to get appropriate plans in place.

The main message to be taken in from global experiences and practices is NOT to head for high profile projects or step into high-tech or IT related sectors through investments and acquisitions, but target a real diversification will be sustainable and create the millions of jobs needed the coming decade. Without the



latter in place, all other media-genic profiling and flashy projects will not be the cornerstone on which a Young Saudi Eagle will be able to build his own power base.

For Saudi advisors and investors the main message is to change flight patterns literally. Without blocking US, Russian or China – bound flights totally, attention needs to be given to experiences and capabilities available in other regions or countries. European countries, such as the Netherlands, Germany or even Sweden, can give the right input for a real sustainable economic diversification the coming years, build upon the development and expansion of the SME sectors, currently in the whole Arab world (according to IMF/WEF/WorldBank) a still fledgling and struggling part of the economy.

As stated in several IMF reports, SMEs account for 60 to 70 per cent of jobs in most OECD Countries. In the whole OECD SMEs also account for a disproportionately large share of new jobs, especially in those countries which have displayed a strong employment record, including the United States and the Netherlands. The same reports reiterate that young SMEs generate more than their share of employment. SMEs are however not a Heaven Sent opportunity, they also have their own struggles or particular hick-ups to counter. Main hurdle that most (young) SMEs have to take are related to financing. SMEs generally tend to be confronted with higher interest rates, as well as credit rationing due to shortage of collateral. As the IMF, WB and even the European Union in its reports, states, financing differs between existing and new firms. Within the OECD markets, some relief is currently coming from private equity or other informal markets. At the same time, regulatory hurdles are another main obstacle, while transparency is seen as another one.

These hurdles are being removed in countries, such as Germany, Iceland, Japan and others, by government programs supporting SMEs. These programs are currently targeting to help start-ups, the acquisition of equipment, R&D, training and consultancy services. The IMF reports that OECD governments are still asked to intensify their efforts to disseminate information, eliminate unnecessary red tape, and make programs more responsive to the changing needs of SMEs. Within the OECD the main barriers to the development of high-growth SMEs are market failures in capital markets, government regulations, indirect labor costs, access to foreign markets, and difficulties in recruiting qualified staff and skilled workers. Remarkably however, which could be a very important asset for Saudi Arabia, while looking at its enormous women-based capabilities available, it has been shown that women-owned

SMEs are growing at a faster rate than the economy as a whole in several OECD countries. As research has shown, not only does female-ownership remove issues such as ‘glass-ceiling’ but also the balancing work and family responsibilities. The latter is in the Saudi context an important one looking at the current social fabric.

Saudi Arabia should draw its own lessons out of the experience that countries such as the Netherlands, as one of the former global gas exporters and culprit for the Dutch Disease theory, have gone through. As the OECD and others reiterate in all of their reports, employment is the most widely used criterion for determining firm size. SMEs are usually defined as firms with fewer than 500 employees, although a number of countries -- including those in the European Union -- use a lower cut-off point of 250. Even that most of these companies are small, especially when looking at the super giants of the US, China or India, or even in comparison to Saudi Aramco and SABIC, SMEs play an important role in all OECD economies. At present, SMEs make up over 95 per cent of enterprises and account for 60 to 70 per cent of jobs in most OECD countries. In OECD manufacturing sectors this share is somewhat lower. Within the OECD, wholesale and retail trade and hotels and restaurants are dominated by SMEs. In construction SMEs account for 80 to 90 per cent of all employment.

Other OECD and IMF data states that SMEs account for between 30 and 70 per cent of value added with variations between countries and industries. When looking at export potential, SME output is less likely to be exported. On average SMEs contribute between 15 and 50 per cent of exports, while between 20 and 80 per cent of SMEs are active exporters. The latter situation however is partly caused by lower financial and human capacity to act internationally, as larger companies have much larger footprint and access.

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Class size	Number of enterprises			Number of persons employed			Value added		
	Netherlands		*EU-28*	Netherlands		*EU-28*	Netherlands		*EU-28*
	Number	Share	*Share*	Number	Share	*Share*	Billion €	Share	*Share*
Micro	1 039 763	95.2 %	*93.0 %*	1 565 210	28.2 %	*29.8 %*	66.6	19.7 %	*20.9 %*
Small	41 827	3.8 %	*5.8 %*	1 021 455	18.4 %	*20.0 %*	64.7	19.2 %	*17.8 %*
Medium-sized	8 674	0.8 %	*0.9 %*	987 619	17.8 %	*16.7 %*	81.0	24.0 %	*18.2 %*
SMEs	**1 090 264**	**99.8 %**	***99.8 %***	**3 574 284**	**64.4 %**	***66.6 %***	**212.4**	**62.9 %**	***56.8 %***
Large	1 690	0.2 %	*0.2 %*	1 973 073	35.6 %	*33.4 %*	125.0	37.1 %	*43.2 %*
Total	**1 091 954**	**100.0 %**	***100.0 %***	**5 547 357**	**100.0 %**	***100.0 %***	**337.4**	**100.0 %**	***100.0 %***

These are estimates for 2016 produced by DIW Econ, based on 2008-2014 figures from the Structural Business Statistics Database (Eurostat). The data cover the ‘non-financial business economy’, which includes industry, construction, trade, and services (NACE Rev. 2 sections B to J, L, M and N), but not enterprises in agriculture, forestry and fisheries and the largely non-market service sectors such as education and health. The following size-class definitions are applied: micro firms (0-9 persons employed), small firms (10-49 persons employed), medium-sized firms (50-249 persons employed), and large firms (250+ persons employed). The advantage of using Eurostat data is that the statistics are harmonised and comparable across countries. The disadvantage is that for some countries the data may be different from those published by national authorities.

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The position of SMEs in Saudi Arabia is already important some say. Based on statistics by the Saudi agency General Authority for Statistics (GASTAT), the number of small- and medium-sized enterprises (SMEs) in Saudi Arabia reached 949,900 with 4.7 million employees during 2017. The latter figures are impressive, but some caution needs to be taken. The total number of Saudi employees hit 1.01 million, representing 21% of all employees, while Non-Saudi workers stood at 3.7 million, making up 78.6%, GASTAT revealed too. The largest workforce is still in wholesale and retail trade with 452,900 companies, while manufacturing represents around 103,700 companies.

There is much room for improvement, as the total workforce will need to increase and numbers of expats to decrease at the same time. For SMEs to become the backbone of Saudi Vision 2030, providing necessary work opportunities to decrease current unemployment levels from 11.6% to 7% the next couple of years, a lot needs to be done. Saudi Vision 2030 also envisages that total female workforce will increase from 22% to 30% of total.

الهيئة العامة للإحصاء
General Authority for Statistics

Vision 2030 envisages also that SMEs will be the key driver in the diversification of the economy. The Kingdom has reiterated that to increase SME revenues from 20 to 35% of GDP, new funding facilities will be provided, while financial institutions will be urged to allocate up to 20% of total loans to SMEs. At present SME loans are only at 5%. In a separate move, the establishment of the General Authority for SMEs (Monshaat) is to support innovation, funding and job creation. The PIF also has been tasked to support the sector, which already resulted in the creation of a SR4 billion ($1billion) fund to provide capital to SMEs.

To need to increase financing is clear. Even that Saudi SMEs constitute 90% of registered companies, and provide 60% of employment, funding is also still a major hurdle. Sufficient financing, while removing legal and other hurdles, will support the development. Already in 2011, a report “Flagship Report 2011”of the Union of Arab Banks and the WB stated that in 2011 just 2% of Saudi Arabia’s total lending was directed to SMEs.

While this low percentage might be expected in small, corporate-dominated economies such as Qatar (where SMEs account for only 0.5% of the aggregate loan book), the result is a surprising one for a nation such as Saudi Arabia, which has travelled further down the road of economic diversification than some of its hydrocarbons-rich neighbors. In countries such as Morocco (24%), Lebanon (16%) and Tunisia (15%), SME lending is much higher. In theory, these challenges however can be dealt with between the Saudi government (setting rules and regulation while

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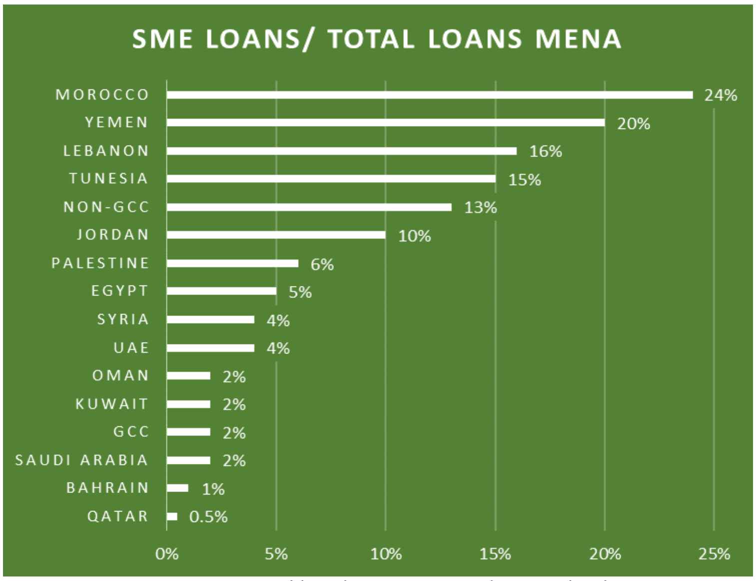
monsha'at

putting in place incentives), the Saudi banking sector (removing their reluctance to finance SMEs) and the respective companies.

Within even a very conservative Saudi finance sector, still largely focused on big ticket clients, changes are made, such as the SME Loan Guarantee Program, which is managed by the Saudi Industrial Development Fund. The so-called Kafalah program, established already in 2006 by Ministry of Finance in cooperation with banks, is meant to support SMEs. Part of the Kafalah goals was to access the liquidity of the banking sector and channel it towards the SME sector. Since short, banks have gone beyond the Kafalah program. Specific SME program and financing schemes are now being supported, but results are still not high enough.



Source: World Bank MENA Financial Sector Flagship Report 2011

Looking at the overall fabric of Saudi society, money will NOT be the only success factor. Creating jobs is one side of the coin, that financing is playing its role. However, even by setting up companies, opening new finance schemes and introducing new regulation, several other major factors have not been addressed yet. One is the availability of the right skill sets for young Saudi men and women to be able not only to take part in the job market but also be productive and relevant. At present, the right pool of talents and skills does not yet exist to stimulate SMEs to reap the fruits of innovation, manufacturing technology, IOT and AI.

Without the right schooling and training, new jobs will not be able to be filled by Saudis as their qualifications don't match. At the same time, without the right education and skills, new opportunities or technologies will not making an impact in Saudi society. A sustainable and productive SME sector is needed, based on Saudi skills and knowledge. The latter will not only be jobs in IT, IOT, AI, Augmented Reality, Fintech or High Tech, but mainly in high-tech manufacturing, agriculture and aquaculture, financial services, engineering and possibly defense and security development. The impact on a country's workforce is much larger from a more productive, hardware producing sector, than the white collar IT and consultancy services SMEs. To set up a sustainable economic future for Saudi Arabia, focus areas, as partly being proposed and discussed within the NEOM approach, will need to be on food, agriculture, construction and manufacturing. High-tech is involved in all, not only producing products to be exported, but also decreasing overall import volumes, which are still a major burden on Saudi's government budget and trade balance sheets.

The overall main message to be discussed within the Saudi government and the economic-social advisory groups surrounding Crown Prince Mohammed bin Salman, Khalid Al Falih (Ministry Energy), and others, should be to continue the drive to propone the Kingdom as a potential high-tech non-oil dependent power of the future, but at the same time increased efforts should be put on the development and support of a sustainable SME sectors. The latter will take longer than to build Qiddya or Red Sea Island resorts, but is the only way to back up economic change for the future of Saudis. Education, innovation and new management skills are needed to push young Saudi men and women to be able to counter future challenges but also grab the opportunities presented to them. Without a functional, based on global experiences such as in Europe's leading economies (Germany, Netherlands), government supported strategy for the development of sustainable future proof SME sectors, Hollywood and Silicon Valley will enter the Kingdom in full, but young Saudis will not be able to live only on pleasure and high-tech gaming, food and jobs are needed for stability too.

ABOUT VEROCY

VEROCY IS THE STRATEGIC FORESIGHT AND DEVELOPMENT GATEWAY FOR INTERNATIONAL INVESTMENTS, (NEW) BUSINESS AND VALUE MANAGEMENT OF ASSETS AND RESOURCES IN DYNAMIC, COMPLEX, POLITICALLY CHALLENGING COUNTRIES AND REGIONS IN THE MIDDLE EAST AND NORTH AFRICA.

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We bring unique solutions for Econometric Portfolio and Scenario Analysis, Critical Incidents Analysis and Reporting, Mobile Incident Alerting & Notification and Critical Asset Monitoring.

Main services provided are advisory and representation, investment and technology assessments, and geopolitical and security related services for energy (oil, gas, renewable), infrastructure, financial and security sectors in Europe, Middle East, North Africa and Sub-Saharan Africa. Based on over 50 years of combined experience in the MENA, European and African regions, partners hold a vast network of governmental and business contacts, providing the necessary network to open up doors and bring clients and providers together to acquire new business and secure contracts.

ABOUT THE FOUNDERS

Cyril Widdershoven is a veteran global energy market expert and co-founder of Verocy. He holds several advisory positions at various international think tanks and Western energy firms. Dr. Widdershoven, with his regional expertise in Africa and the Middle East, oversees the Mediterranean Energy Political Risk Consultancy. Across the MENA region, he has been heavily involved in the oil and gas sectors throughout his career, holding positions at Capgemini Consulting (Principal Consultant Centre of Excellence Oil and Gas International), Deloitte Financial Advisory Services (Sr. Manager, Oil & Gas), and as Sr Financial Analyst Oil & Gas Sector FDA, where he managed and advised the oil and gas department on equity and bond markets.

Experienced Business Management and Growth Strategy professional with an extensive background in Strategic Business Development and Investment Due Diligence in innovation and technology driven organizations. He applies scenario-based thinking and methodologies to master complexity, reduce uncertainty and develop new opportunities to support the creation and diversification of organizations that support the transition of traditional energy reliant countries and regions in the MENA region. He has 20+ years of professional experience in business management and marketing of complex technical product portfolio's. Rob van der Stel worked for a research and technology development organization TNO as the Sr. Manager New Business & Ventures of TNO Energy. He was Commercial Director at the Insulcon Group, and Business Manager/Producer of Medialab at ATG.

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