

## Introduction

Kingdom of Saudi Arabia is one of the most devoted and interesting in economic, political and cultural terms country. There is, perhaps, no other country that may be proud of its fast development from completely underdeveloped kingdom into one of the wealthiest states in the world with the richest oil reserves and extremely strong primary sector of economy (BBC, 2010).

Saudi Arabia economic and financial centres are located in three major cities, AlKhobar, Dammam and Dhahran. Major distinguishing characteristic of this famous triangle in the Eastern Saudi Arabia is its unprecedented growth and dramatic transformation into one of the strongest economic hubs in the world. Convenient location of the city on the Arabian Gulf allowed it to develop into a medium size trading port but no one at that point of time could expect that the discovery of oil in Saudi Arabia would turn the city into the golden industrial hub (SAE, 2010). Commercial trade of oil transformed the city into the industrial port in a pace faster than the government and international society could ever expect; in less than fifty years the city grown not only in primary goods, but also in secondary sector trade.

Taking into account the overall objective to transform Saudi Arabia from the primary sector based economy into the one, based on the export of valuable finished goods and services; it was decided to look at the current situation and the transformation process and milestones for one selected area. Our preliminary research showed that the example of AlKhobar will provide the writer with essential and reliable statistical and qualitative data and help to derive the arguments to support findings and recommendations. Another reason for the selected scale of the analysis is the historical background of the city and its social and infrastructural environment that allow for in-depth analysis of the situation that could be further conceptualized for the entire country.

It was also identified, however, that the development of AlKhobar is a joint effort of the economy and major share of development comes from the growing international trade with the city as well as with the other regions in the country. AlKhobar, being a port and the main gateway to the Eastern part of the country benefited from the overall growth and it would be wrong to assume that future growth of export in secondary sector would come solely from the city growth. In order to provide sufficient information and background for the opportunities of AlKhobar city, it is crucial to look at the economic picture on the wider scale that will include all three cities in the famous Saudi Arabia triangle.

The objective of this document is to provide recommendations and findings for the Dammam Metropolitan Area and specifically AlKhobar city in regards to the anticipated transformation of economic focus from primary to the secondary sector. In order to achieve the objective it was decided to structure the report in the following sections approach the research through four major areas of influence: a) available resources and services b) infrastructure c) labour situation d) historical statistical data. The report will provide in-depth examination of the current situation in all the mentioned areas and provide a link and analysis for the interdependence of the factors and opportunities that derive from them. Additionally the writer will be in the possession to provide the outline of the major risks and possible concerns that should be taken into consideration during the implementation phase or avoided through proactive approach.

The structure of the report will support the research objectives by maintaining simple and logical analysis structure, first providing the outlook in current processes, resource and infrastructure base.

In the following chapter we will look at the required transition from the primary to the secondary sector based economy and existing barriers for its smooth and fast achievement. The report will equally focus on the economic benefits as well as operational requirements and will look at the external factors that may have significant influence on the success of the governmental endeavours. Finally, the writer will focus on the analysis of the findings and recommendations that would be relevant for the analysed situation and could benefit the implementation of the strategy with the set objectives in mind.

To prepare the research the writer had to perform significant qualitative and quantitative data analysis that was based on several reliable data sources. The nature of the research allowed us to find statistical data on the online resources, mainly official governmental web sites and country analysis report available from the reliable analytical web sites, such as Global Insight and Data Monitor International. Qualitative analysis will be based on the observations of the current situation and economic outlook of the country, provided by the same sources. Based on this data, the writer believes, the report will achieve its objective and introduce the reader to the coherent and valuable examination of the topic.

## **Current Situation**

### Country Level Snapshot

The border of Arabian Persian Gulf with the Red Sea is one of the largest trading channels in the world that makes ports in this region grow due to the internalization of the trade. AlKhubar's development is majorly determined by the accelerating Oil & Gas trade and its function as the main Eastern gateway for the industrial products and LNG port. In order to analyse the situation and understand the business and economic drivers that determine the opportunity for the export expansion in secondary and tertiary sector of economy.

Unlike many countries global economic crisis did not hit Saudi Arabia and resulted in marginal decline in the country's GDP of only 1% (EI, 2010). The remarkable fact that the major impact was caused in the Oil & Gas sector and no significant decline was evidenced in the retail and tertiary sectors. Even though the forecast for the fast recovery of the Saudi Arabia economy mainly rely on the healing of oil profits, we believe that essential benefits in Saudi Arabia immune against the global economic downturn come from the sustainability of its export trade and scarcity of the export product that the country is offering to global consumers. It is worth mentioning that construction industry was the only sector that was hit by the crisis, following the energy industry (A-1).

There are several major challenges that the country is going through and that are seen on the surface. First of all, Saudi Arabia is experiencing the fastest population growth, where 60% of the indigenous population are less than 20 years old. Secondly, due to economic and demographic issues, unemployment rate in the country reached the highest historical level of 25% and is the highest among Arabic countries.

On the industry side, Saudi Arabia is exceptionally dependent on the development of its petrochemical production and oil trade. This prevents the economy from risk diversification and significantly undermines the opportunities that could be expanded through other sectors of economy. The development of the businesses in other sectors will, consequently, create opportunities for leveraging unfavourable situation on labour market and reduce unemployment rate. Additional

complications could also be seen in the structure of the oil and primary sector market as a whole, as major share of foreign trade and primary activities are held by the state owned company. Limitations set on the development of private companies in this sector of economy could potentially hold the country back from enhancing unemployment prevention and reduction policies. Further in the document we will analyse in details all the mentioned risks and challenges in closer relation to the specific area of AlKhobar city.

## **Exportable Goods Composition**

Booming oil sector played a significant role in the development of AlKhobar region and created a number of working places that was always a major issue for Saudi Arabia economy. With the growth of the city population and industry development, governmental authorities started to develop infrastructure, including transportation, health system, industrial sectors as well as bring in a lot various businesses that were attracted by the export opportunities in the region. Significant interest of local and foreign corporations to the AlKhobar region determined its success by diversifying the portfolio of both, primary and secondary sector. Today AlKhobar is a leading exporting port in the Eastern region of the country that is handling containerized, break bulk and LNG volumes and accounts for more than 23% of total country export volumes (EI, 2010).

Looking at the regional split of the commodity export, going through the port of AlKhobar, we can build the picture of the major trading partners, based on the outlook for 2009. While the below graph represents the country level export split, we believe that AlKhobar as one of the major export hubs follows the same trend.

### **Major export destinations 2009 Share (%) Major import sources 2009 Share (%)**

Asia-Pacific	43.9	Europe	35.4
North America	17.8	Asia Pacific	29.5
Other countries	14.7	North America	12.9

Africa and the Middle East	11.3	Africa and the Middle East	9.3
Europe	10.8	Other countries	7.0
Latin America	1.1	Latin America	3.3

Source: Euromonitor International. Saudi Arabia Country Profile

According to the Economist, major export is comprised of mineral products (85%), chemicals (4.1%) and plastics (3.3), with the main trading partners being the US, Japan, South Korea and China. This list, however is not limited to these commodities and countries. Significant revenue comes from the export of finished textile commodities and print and photo chemicals, electric machines and base metals.

In an effort to diversify economic portfolio, the government has initiated one of the biggest industrialisation programme ever attempted globally. The programme is looking at the range of industrial city developments, and the development of investment zones with strong focus on the AlKhobar region. It is important to admit, however, that despite all this government spending and attracted foreign direct investments, some of the industries did not experience expected growth. According to Euromonitor, in contrary, construction industry is experiencing a dramatic contraction due to the cut back of the private investors during the recession year and number regional projects are deferred. The manufacturing sector represents 7.8% of GDP. It is largely concerned with the production of petrochemicals and fertilisers that comprise a significant part of the AlKhobar economic picture. The state-owned Saudi Arabian Basic Industries

Situation in the agricultural sector is also controversial. The attempt of the government to facilitate the development of the export agricultural commodities by purchasing a large amount of fertile land overseas to supply the home market was unsuccessful due to political objections that the country faced with. Statistics of the AlKhobar port shows that in spite of the efforts to re-focus export from primary to secondary sector commodities, the outcome of the strategy is not meeting expectations. Saudi Arabia strategy is also generating more and more opposition from its neighbouring countries.

In view of several significant obstacles on the way to achieving the objectives of the export diversification strategy, there are still a lot of opportunities that are recognized by the country authorities and attract a lot of attention from the government. One of the opportunities lies in Saudi

Arabia's banking industry. It accounts for US\$290 billion in assets and benefits from tax exemption. This makes Saudi Arabia banking sector the most profitable in Middle East region (EI, 2010).

Another cash cow of the Saudi Arabia in non-primary activities is the retail sector. In spite of the economic crisis a lot of Saudi Arabia retail companies continued to expand their business and contribute to the export of finished goods, balancing foreign trade situation. First of all, grocery and clothing come to the leading position in regards of their contribution to the development of the AlKhobar region. Companies like Al-Azizia Panda, Meed Trading and Al Othaim Commercial Group create healthy competitive environment not only in the retail sector, but also among their suppliers that start growing outside of the country limits. It is especially noticeable through the growth of medium size manufacturers of aluminium products, cement, printing and furniture production.

Rising production and foreign investments made tremendous contribution to the development of mall culture within AlKhobar region and turned the city and the region as a whole into the retail and exporting hub. According to Euromonitor analysis, penetration of both multinational brands, such as Carrefour, Géant, Mothercare, Next, Benetton, Debenhams, LuLu Hypermarkets and The Body Shop, as well as local brands such as Arabian Oud, Nayomi, and Maghrabi, has also become a strong characteristic of these shopping malls. Some experts see opportunities in companies like Jaris Marketing Company that offers retailer and wholesaler services for office products, school supplies and books. With the headquarters in Riyadh, company has stores in all the major locations in the Middle East and main export hub is AlKhobar commercial port. Jaris is one of the examples of the growing amount of local producers that expand their activities on international business arena and therefore significantly contribute towards governmental objective to diversify its GDP portfolio.

In spite of the fact that the economy of the region is already growing in a fast pace, the government recently decided to strengthen focus on the AlKhobar area and identified the city as a part of the next development wave. Looking specifically at the export statistics of AlKhobar port, shown in Appendix 2, we can evidence significant growth of 32% in grain exports, in spite of the volatile economic situation. Looking back in the historical exports of other products, such as cement and building materials, both experience growth of 35% and 17% respectively (AlKhobar Port, 2007-2009, p.25).

With the opportunities that opened for local brand on domestic market, companies started to expand their activities overseas. A lot of international companies set up their Middle East region distribution hubs and reverse logistics centres in AlKhobar city. The impact on the development of the local infrastructure by these factors will be further discussed in this document.

Based on the above overview, we can draw the following picture of the opportunities within AlKhobar region, determined by the growth of non-oil exporting services. First of all, retail sector is booming, facilitated by the growth of both, international players and local companies that start to develop "mall mindset". Secondly, loosened legislation for the inflow of foreign direct investments in the region significantly contributed to the growth of education and market competition that resulted in the growth of production, distribution and sales efficiency of local companies. And finally, port statistics of the export commodities tells us that efforts of the government brought their fruits and it can be seen from substantial growth of containerized exports of grain, cement and building materials.

Overall, the government is planning to spend over US\$400 billion from 2009 to 2013 for infrastructure development. An estimated one-third of these investments is still planned for expansion of the petrochemical and natural gas sectors. Construction projects, including the building of “economic cities” and other megaprojects represent another major expenditure component. The education and financial sectors as well as tourism, water, roads and railways are also expected to receive a boost during the next few years (G20, 2010, p.2).

## **Labour situation**

Labour situation and average skills level in the country call for immediate attention. With the growth of economy and development of the area, Alkhobar and Dammam Metropolitan areas as a whole start experience significant shortage of expertise and skills in new economic spheres, such as IT, product development and specific technical disciplines, such as civil engineering, telecom engineering and the others. The education system in general fails to equip students with the technical and scientific knowledge required for today's job market. The gap between economic growth and education is becoming bigger with the years and today it starts influencing job market. In the situation, where unemployment is a significant problem, ability to create job places and facilitate development of industries and service is the key. It is, however, undermined by the necessity to attract foreign workforce in order to leverage the risks of inefficient operations. Looking at the majority of international corporations, operating on the territory of the AlKhobar area, statistics shows that 75% of the middle and senior management positions are occupied by expats and 50% of the overall workforce comes from other countries (A-3).

Interesting fact is that female population accounts for more than half of all college graduates but make up just 16.2% of the work force. Production of the finished goods in the scale it is performed now is a new occurrence in the country and development of the required expertise will take another decade. The government realized the issue quite some time ago and revised legislation for foreign direct investments in the secondary sector created more favourable conditions. The idea behind this step was not only to increase the efficiency and output, followed by general growth of secondary sector exportable goods, but also to attract capital and knowledge from outside to raise education level and on field expertise of local workforce.

The situation on the market remains very controversial creating at the same time a number of opportunities to leverage the economy, but at the same time proved to be not fully efficient in regards to the solving of unemployment issues. Foreign organizations and fast pace of economic growth created controversial situation on the labour market that cannot supply required skills and expertise from local workforce and driving increase in expat management and even production workforce.

## **Infrastructure and Activity locations**

It is not a secret that the government invests tremendous amount of money in the development of infrastructure in AlKhobar to facilitate and ease the process of industrialization and growth in exporting goods and services from Saudi Arabia. As we discussed before, the policy and efforts that the government put in the development of the region resulted in the expansion of retail sector and increase in number wholesale producers on the market. Current policy also changes the geography of the logistics operations and production facilities within the country.

The change in economic geography can be summarized in the following way:

- Re-location of foreign warehouses and distribution centres, done by the international corporations in response to the trade growth and domestic demand. This economies of scales for the company along with favourable FDI policy allows for significant savings in their production cost and at the same time increases Saudi Arabia export (AlKhobar port specifically) of finished goods mainly into Middle East Region.

- Growth of local production is determined by the growing demand and, consequently, reduced market entrance costs and higher returns on investments. With the development of infrastructure, such as road and rail connection and favourable local business tax legislation smaller producers of plastics, cement and finished goods, started to be more competitive not only on local, but also on regional market.

- Investments in the development of local education facilities, health system and, what is of most importance, transportation system brought new logistics players on the market, starting from the largest container companies, such as Maerk Line and CMA-CGM to the small local players that provide trucking and other 3rd party logistics service a lower cost.

AlKhobar is the major industrial centre of the country and development of local infrastructure from the government side as well as natural growth coming from the increase in business operations are obvious. According to the government announcement, it will continue to invest in the area to improve transport and health system further. Business environment, from my point of view, captured the majority of opportunities offered by this unprecedented growth, but it is now dragged back to some extent by functional and strategic barriers that open market and competition created for them and, as a result limited the pace of growth in finished goods and services in overall trade balance of the country and GDP. In the next chapter I will talk in more details about the barriers that should be addressed in order to achieve the same pace of exporting goods production growth as Saudi Arabia experienced several years ago.

## **Functional and Strategic Barriers**

Taking into account a number of positive changes in the country's secondary and tertiary sector and the results of the export and production growth, there are still a lot of concerns and issues that needs to be addressed by the government. Socio-demographic factors always played important role in the development of local retail industry and determined the direction and speed with which local secondary sector producers will change the export portfolio of the country. One of the major natural advantages of the country that helps to support governmental initiative is the growth of domestic income and, as a result, overall demands for finished goods and services. For the infrastructure of AlKhobar it resulted in significant growth of production facilities and deposed consequent development of opportunities for the newcomers. These factors, however, may in the near future create opposite effect, by increasing monopolistic competition and preventing diversification of exportable goods portfolio. International players will range of experiences across cultures and industries flood the market and if on the initial level it creates "educational and competitive" environment, already now we can see the power that grounds the opportunities for the local businesses growth.

Several major retailers, discussed before, create the situation, where smaller businesses are not in the possession to compete with the increasing entry costs, facilitated as a measure of protection by their larger competitors. Local producers that entered the market on the earlier stage developed strong and sustainable relations and reputation on international arena and especially on Middle East market. If the government and economy is satisfied with the achieved growth this situation would be ideal. The objective is, however. To continue leveraging the risk of high dependence on oil revenues and trade and therefore, much stronger growth and development of secondary and tertiary sector is required.

Another element of concern is the development of the tourism industry and services. While import of these services has grown substantially with the inflow of foreign capital, exportable services are still on a very low level. It is obvious that the development of this sector is very dependent on the social factors, such as educational level, culture and traditions and the shift to more service oriented mentality will take more time than the growth of the physical goods production and trade. In order to achieve equal growth in the service sector it should be considered as one of the focus areas of the governmental strategic program.

Another observation is high dependence of the ALKhubar region on the governmental investments. In spite of the overall growing investments in the country, most of this capital is concentrated in the retail business and services. With that in mind, development of physical infrastructure and social services is fully reliant on the government and this does not facilitate the situation when secondary sector develops self-sustainable mechanism, able to support itself.

Saudi Arabia's strategy and strong support of the economic shift through extensive financing makes the government the most important investor in the economy. However, the employment impact on Saudi nationals of the planned investments is likely to be low, either because the investments are in capital-intensive sectors, such as oil and gas, or in sectors that typically do not attract Saudi nationals, such as construction (G20, 2010, p.2).

Growing secondary sector of economy creates turbulent situation on the labour market also through significant shift that the labour force should go through in order to remain competitive on the local market.

## **Findings and Recommendations**

Based on the analysis of the primary data we have built the picture of current social, economic and political environment, in which the strategic initiative of the Saudi Arabia government is being developed and implemented. In order to be able to provide our recommendations and possible creative ways in which government can further improve existing trends in exporting goods and services as well as generate new opportunities, we decided to first analyse the risks, associated with each individual attribute of the current situation and look at other goods and services that have significant potential that, however, was not yet explored on the market.

### *Exportable Goods and Services*

As it was identified, there are three major commodities, experiencing significant growth in production sectors:

- Cement

- Grains

- Building materials

The above commodities are growing at a rate significantly higher than it was expected by the government, mainly due to increased demand in the neighbouring Middle East countries. The demand is to a great extent determined by lower transportation costs and good port infrastructure for containerized and break bulk cargo in the port of AlKhubar. Our observations show that the growth of export in these commodities had increased together with introduction of new rail connection to the city (EI, 2010). The statistics show, however, that none of the above commodities is currently exported in significant quantities to other major trading partners, such as the US, Japan and European countries. With that in mind there is a potential opportunity to introduce this product on the mentioned market and increase export of these commodities by widening the geographic scale.

Apart from the above mentioned commodities, we believe that there are specific opportunities for initiation of the textile and plastic exports on a large scale. According to the government statistics, the country is continuously growing its production of plastics and textile, which is, however, sold primarily on the local market. Taken into account that the majority of plastics and textile producers are now located in the industrial AlKhubar city, it would be reasonable to seek for the opportunities to expand this business outside the country through already existing infrastructure of the port. By facilitating expansion of these businesses to the external partners, Saudi Arabia will significantly contribute towards the achievement of its strategic objectives.

The opportunities, lying in further development of the cement and grain exports are essential and the government realizes the potential of agricultural sector in particular. By providing small and medium size businesses with subsidies, the authorities were relatively successful in raising production and export numbers for grains.

We have already mentioned before, that banking sector is one of the most developed in the country and there is a potential in bringing banking system closer to the governmental objective and creating self-sustainable mechanism. That said, we believe that the best way to further influence and guide the development and improvement of current exporting goods. Through banking financing, companies can invest in their R&D activities as well as apply more developed production technologies. Additional benefits from external financing could be achieved through training of the personnel and local management.

#### *Infrastructure Support and Activity Location*

Existing technologies and infrastructure along with opportunities to receive short or long-term loans from the banks can help the companies to develop new goods and services. With strong transport and production infrastructure in place, costs associated with the development of greater variety of products can be reduced significantly. This is especially relevant for the plastic and textile producers that will, most probably, require adjusting their product for better sales on the external market.

Saudi Arabia's secondary sector is currently in the process of creative probation of new products. This domestic demand sensing brings more and more businesses from Western part of the country to AlKhubar region and, consequently, diversifies the product portfolio. The trends in overall development of logistics and manufacturing operations for local as well as foreign producers, shows that the majority of the medium and large companies, such as clothes shops and supermarket brands

like Carrefour, Géant, Mothercare and others already moved their facilities to the city in the attempt to reduce their upstream costs in the supply chain. The number of service providers and logistics operators created competitive environment that will further drive the costs of operations down. The opportunity for new and developing businesses under these circumstances are growing, allowing for cheaper export opportunities of new types of building materials, plastic goods and clothes.

Saudi Arabia is a country with the great history and AlKhobar region is definitely a place to visit. While there are some regions in the country that are quite popular destinations for the tourists, AlKhobar is considered and perceived outside the country limits as purely industrial area. Development of tourism represents additional opportunities in regards to the new exporting services. In order to facilitate cultural exchange and develop cultural image of the Dammam Metropolitan area, it would be beneficial to establish Cultural Development Centre that would be responsible for tourism development.

### *Manpower and Skills Development*

Looking back at the split of the workforce, we can see the biggest constraints for the optimization and interrelation of the unemployment initiatives and export diversification are represented by the following attributes:

- Half of the population, receiving college (and above) education are female, while workforce on all levels is only represented by around 16%.
- Lack of skills and expertise in the secondary and tertiary sector production makes producers seek for qualified manpower outside the country, resulting in 50% of foreign workforce.
- Educational level of employees and language knowledge create obstacles for the development of cross country trade.

In order to address the above issues, one of the major and immediate actions that should be taken by the government is education facilitation. As it was mentioned before, bank loans and investments could be partially used by the companies to increase skills and educational level of the personnel. In order to motivate employers to invest in education of local workforce, government could potentially look at the reduction of corporate taxes for the employers that actively promote training and personal development in the companies.

We realize that the situation with the female employment is more complex and involves ethical, cultural social factors. In order to achieve improvement in average level of female employment, the government should undertake a number of parallel measures that will a) Change the mindset about female employment b) bring in corrections to the legislation, eliminating gender discrimination c) promote specific specialities among women. It is important that all the above measures are involving both, employees and employers and benefits for both sides should be clearly communicated.

Foreign employment is not purely a problem and should not be considered as a risk, but rather taken as an opportunity. There are several reasons for that. First of all, foreign employees bring in new knowledge and experience to the business and facilitate learning. And secondly, expat communities promote exportable goods and services on the external market and represent free advertisement opportunities.

## **Conclusion**

We have looked at the current situation in the Saudi Arabia market and narrowed down our analysis to the region of AlKhobar city and its surroundings. Based on the primary statistical and qualitative data, obtained from various internet sources, we have determined that there are a number of ways in which AlKhobar could improve current exporting goods and services level and introduce new products and, consequently, contribute towards achievement of the overall objective to diversify export portfolio and lower risk and dependency on oil sector. Among other conclusions the major recommendations are based around focus on the following:

1. Increase export share of cement, grain and building materials, look for the way to export plastics and textiles as well as clothing.
2. Use existing infrastructure to diversify the products and improve production and logistics operations. AlKhobar is one of the biggest ports in the country and taken that 95% of export goes through water gateways, it is a perfect location for growing export opportunities.
3. Link personal interests of bankers with governmental objectives through facilitating financing of small and medium businesses in secondary sector.
4. Address labour issues, by promoting special jobs among women and motivate employers through tax regime to investment in personnel training.

We strongly believe that above recommendations will improve current exportable goods and services and will help the government to achieve further growth of their strategic objectives in diversification of exports.