Exporting to Saudi Arabia: Opportunities and Challenges

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Abstract

Over the past decade, world trade has almost doubled from $7 trillion to more than $13 trillion, and Saudi Arabia is by far the largest trading country in the Middle Eastern region, with total trade volume in excess of $102 billion. Saudi Arabia's lucrative market presents both challenges and opportunities for exporting companies. Many companies have been disappointed with the nature of the market and competition that has turned to be far fiercer than initially anticipated. However, decades of experience has shown that by adopting well focussed strategies it is possible for global exporters to penetrate the Saudi market. This paper reviews economic and market perspectives of the Saudi marketplace. It discusses important considerations for formulating guidelines for exports of goods and services to Saudi Arabia. Finally, this paper proposes a set of key strategies to enable exporting companies to enter and sustain business in Saudi Arabia.

Keywords

International trade; export; guidelines; strategies; Saudi Arabia.

INTRODUCTION

International trade plays a major role in the world economy. Over the past decade, world trade has almost doubled from $7 trillion to more than $13 trillion (IMF, 2004). As a consequence of this nations are impacted to a greater extent by international business activities than at any time in the past. Global linkages have made possible investment strategies and marketing alternatives that offer tremendous opportunities for international business.

The main aim of this paper is to synthesize guidelines for exports to Saudi Arabia. The paper also discusses on key strategies for the exporters to enter Saudi market and sustain business. The paper concludes by highlighting important considerations in exporting goods and services to Saudi Arabia.

EXPORTING

Companies consider entering international markets when their domestic market is saturated, irrelevant, or less profitable, or more opportunities are found in the overseas markets. Exporting is the simplest mode of internationalization, especially for entrepreneurial and small businesses. In an evolutionary model of the internationalization process, as proposed by Czinkota and Ronkainen (2000), the focus is on exporting a as a first step in internationalization. From there it grows gradually growing to become a full participant in the global arena, at a later stage. With the help of this model an exporter's stage in the export development process and the changes needed to attain continued progress can be determined.

However, sometimes company either lacks sufficient capital or human resources for direct exporting or alternatively, may consider this strategy as inappropriate. In such cases, there are alternative methods of entering the global marketplace. The main options include use of licensing, franchising (Robinson, 1984), and utilization of the services of global market intermediaries (Harrell and Kiefer, 1993). These alternatives are open to and used by all types of companies, large and small. They offer flexibility in the foreign market approach, depending on the needs of the company and the circumstances in the market. While a large multinational corporation may use the same strategy to rapidly enter foreign markets in order to take advantage of new conditions and foreclose some opportunities to its competition, a small exporting company, for example, may choose to use licensing to benefit from a foreign business concept or to expand without much capital investment. Similarly, a new-to-export company may use intermediaries because of a lack of in-house expertise with exporting (Harrell and Kiefer, 1993).

Economic integration of regions is another factor that plays a decisive role in a company's decision to enter the global arena. Economic blocs, like European Union creates its own power and procedures (Rajan, 1997) presenting both opportunities and potential problems for exporters. This may have an impact on a company's entry mode by favoring direct investment because one of the basic tenets of integration is to generate favorable conditions for local production and intra-regional trade. By design, larger markets are created with potentially more opportunities. Because of harmonization efforts, regulations may be standardized, thus positively affecting exporters.

An exporter needs to consider yet another important factor in making assessments and decisions about entering into an export market (Harrell and Kiefer, 1993; Rajan, 1997). The first task is to envision the outcomes of its entry into new horizons. Dynamics of the target markets and changes in the competitive landscape can be dramatic if opportunities can be exploited in relatively homogenous demand conditions. This could be the case, for example, for industrial goods, consumer durables, such as cameras and watches, as well as professional services. Secondly, the exporter will have to take into consideration varying degrees of readiness within the markets themselves; that is, governments and other stakeholders, such as labor unions and other pressure groups, who may oppose liberalization of competition in all market segments.

An understanding of the internationalization stages together with the behavior of risk and profitability helps a company to overcome the seemingly prohibitive cost of going global. Companies must be aware that any negative developments are only short term and realize that in general, export success requires a company to be risk taker, and that having a satisfactory export performance takes time (Miller et al, 1993).

ECONOMIC STRUCTURE OF SAUDI ARABIA

In general, Saudi Arabia has set a framework of free market economy. Government policies tend to encourage commercial enterprises, but a strict interpretation of Islamic mores limits the range of policy options as well as that of commercial endeavors. Saudi Arabia's economy has been largely dependent on oil and its derivatives, which account for 85-95% of its export earnings, 75% of budget revenues and about 35-40% of GDP. Saudi Arabia's high population growth (3.3-3.5%) continues to outpace GDP growth. Nearly 70% of the population is under age

30. In 2003, GDP per capita rose to over $9,000 for the first time since 2000. Having peaked in 1981 at $28,600 per capita, GDP had been steadily decreasing. It is forecasted that per capita GDP will continue to stagnate unless economic growth increases significantly and/or the birthrate declines (SAMA, 2004; EIU, 2004).

The year 2003 saw significant strides with the adoption of capital market and cooperative insurance laws, a new corporate tax law, the passage of an anti-money laundering and terrorist financing law, and an updated copyright protection law. In spite of the war in Iraq, a vulnerable security situation, and a volatile oil market, the Saudi economy turned in its best performance in twenty years in 2003, with a record oil profits that fueled a 6.4% real increase in GDP and also bringing along with a second budget surplus in two decades.

The exchange rate for the Saudi Arabian riyal (SR) of 3.75 = U.S. $1.00 has been set since 1986 with no taxes on the purchase or sale of foreign exchange. Generally speaking, there are few foreign exchange controls for either residents or nonresidents, in keeping with the government policy to encourage an open economy. A few restrictions applies, the most noteworthy among them being prohibition of commercial transactions with Israel and Israeli-registered corporations and restrictions on local banks inviting foreign banks to participate in riyal-dominated transactions without prior central bank's approval. While gold may be freely traded, held, and shipped, there are prohibition son the same for gold that is of 14 karats or less is prohibited (EIU, 2004; Park, 2000).

Price Controls

The government maintains price controls for basic utilities, energy, and many agricultural products. The effect of these subsidized prices is that petroleum products, including many petrochemicals, are sold in Saudi Arabia at prices that effectively eliminate competing imports. However, agricultural subsidies were dramatically curtailed in the early 1990's and have been reduced in the two most recent budgets. This is in line with the government's deficit reduction plans (Azzam, 2004; Saudi Arabian Monetary Agency, 2003).

Tax System

While there is no taxes on personal income, tax on business incomes ranges from 25% on profits of less than $26,667 to a maximum rate of 45% for profits of more than $266,667. Some foreign investors avoid taxation, either in part or totally, by taking advantage of various investment incentives, such as 10-year tax holidays for investments in approved projects meeting specified requirements.

THE MARKET STRUCTURE

Saudi Arabia is at the heart of the second fastest growing market (at an average 17-25% pa). Saudi Arabia is a key member of the Gulf Cooperation Council (GCC), the most powerful of any trade groups in the Middle East. In the trade arena, GCC's objective is to achieve free trade arrangements with the European and Asian nations besides unification of trade policies and importation systems. Member countries have not finalized some of the practical details, such as the mechanism for revenue distribution after tariffs are collected at the first GCC point of entry. Nonetheless, the GCC is moving forward with its plan for greater economic integration and with ambitious plans that include establishing of a monetary union in 2005; a common market in 2007; and a unified currency based on the dollar by 2010.

The per-capita income of its six member states in 2002 (that is, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) was $10,183 with Saudi Arabia's per capita income being about $8,027 (Central Department of Statistics, 2003).

Saudi Arabia's population is growing between 3.3-3.5%, poised to reach 25.3 million in 2005, and further up to 29.2 million by the year 2010. The average annual real GDP growth is projected at 3.5-4.0% by 2006; and, the purchasing power at $11,700 (EIU, 2004). About 70% of the population is under the age of 30. Modern technological influences such as computers, mobiles, digital products, video games and the Internet are all contributing to broadening the buying habits of these young people.

Table 1 presents the market size and growth patterns in Saudi Arabia. The size of the Saudi market is US$ 189 billion constituting 0.58 of the world GDP. The market is very open with an openness factor of -100 largely due to the dependence on imported goods and services. With sound market infrastructure and economic freedom, the market opportunities rating has been rising reaching 6.21 on 10-point scale.

Table 1 Market size and Growth

Market	1992	1997	2002
EIU market opportunities rating (10=high)	…	5.15	6.21
Nominal GDP (US$)	136.30	164.99	188.80
GDP per head (US$)	7,753	8,192	8,027
Real GDP (US$ bn, 1999 prices)	…	157.8	172.7
Real GDP (% change pa)	2.87	2.61	0.13
Growth of real GDP per head (% pa)	0.12	-0.50	-2.81
Exports (US$ bn)	50.2	60.7	72.6
Share of world GDP, at market exchange rates (%)	0.57	0.56	0.58
Openness (Exports – Real GDP)	…	-97.1	-100.1

Sources: EIU forecast data 2003; Various reports, IMF.

As Saudi Arabia's industrial base is insufficient to meet most of its market needs and demand, it relies heavily on imports. The main export opportunities to Saudi Arabia include electrical equipment and machinery, building materials, food products, oil, gas, petrochemical equipment and supplies, and desalination equipment and supplies, consumer goods, computer hardware and software, education (the large youth population generates a large demand for education services and products), healthcare products, and communications equipment. Emerging sectors include leisure, home entertainment, education, training, and electronic publishing (Azzam, 2002; Branch, 2000).

While Saudi Arabia is a very attractive market with actual returns exceeding projected returns, it has not been an easy market to penetrate. Branch (2000) observes that the Saudi consumer market is developed one, with a generally sophisticated and well-off consumer base, good quality and well-designed products. It is a market that is steady within the local cultural bounds, and increasingly becoming modernized. Due to the sheer size of the market and the wealth of urban middle class, foreign companies have found an attraction to the Saudi market and have been pouring goods and services worth billions into Saudi Arabia over the last few decades. Yet, many exporting companies have been disappointed because of the narrow nature of their offerings and a far fiercer competition than initially anticipated. Exporters are advised to broaden the range of products offerings.

WTO Accession

Accession to the World Trade Organization (WTO) has been a fundamental component of long-term Saudi economic reform program. In compliance with WTO regulations Saudi Arabia has been working towards removing protectionist barriers; place ceilings on tariffs; further open key services sectors to foreign participation and improves intellectual property rights protection. These changes provide immense opportunities even to exporters as such measure will result in an open, transparent and rules based trade regime.

Saudi Arabia made substantial progress towards accession to the WTO and the outlook for membership in 2005 is promising. WTO membership will bolster reform by increasing competition, transparency and diversification. Foreign oil companies have been permitted to explore in Saudi Arabia since the nationalization of the oil giant, Aramco. Bilateral market access agreements have been signed with virtually all interested trading partners except the United States.

Foreign Trade

According to International Monetary Fund statistics, Saudi Arabia is the only Middle Eastern trading country among the top 30 leading trading countries of the world. It ranks eighteenth in the world with $93 billion exports in merchandise trade, and thirty-second with $37 billion in import of goods and services.

Exports

Crude oil, refined products and natural gas liquids account for the bulk of Saudi exports (accounting for 88% of the total exports). Nevertheless, the percentage of crude oil and petroleum product exports fell slightly during the 1980s as a result of the growth in petrochemical and other chemical exports. These products have come mainly from Sabic's companies. After declining to their lowest levels in the 1970s and 1980s, following the oil price crash of 1986, exports had steadily recovered by 1992, both as a result of improved oil prices and Saudi Arabia's global market share of world oil supplies. Moreover, as Sabic created a new petrochemical capacity, non-oil exports rose as well. The direction of exports has been influenced by Saudi Arabia's oil customers (Al-Qahtany, 2001).

Imports

Saudi import levels have closely followed overseas oil earnings and government expenditures. Machinery, appliances, and electrical equipment constituted the largest import category, although in line with lower domestic investment these items fell in terms of total share. In 1990 this category accounted for 16 percent of imports but by 2002 it had risen to 55.3 percent. Foodstuffs have been the second largest category: in 1990 these items made up 14 percent and rose only slightly to 16 percent in 2002. During the 1980s, chemical products, jewelry and metals, and other transport items exhibited the largest growth in imports. Chemical products, the third largest import category since 1990, constituted around 13 percent of imports. Table 2 presents Saudi Arabia’s top commodity imports over the five-year period between 1998 and 2002.

Table 2 Saudi Arabian Top Commodity Imports (US $ Billions)

Commodity	1998	1999	2000	2001	2002
Foodstuffs	4.70	4.81	5.42	4.78	5.22
Textiles and Clothes	1.89	1.73	1.78	1.75	1.85
Medicines	0.89	0.89	0.88	0.95	0.99
Chemical Products	2.59	2.56	2.77	2.81	2.88
Wood and Wood Products	0.38	0.34	0.39	0.37	0.40
Jewellery	1.67	1.37	1.22	0.95	0.45
Base Metals and Metal Articles	2.87	2.35	2.38	2.54	2.66
Electrical Machines, Equipment and Tools	6.00	6.73	6.67	6.42	7.09
Transportation Equipment	5.53	4.06	5.35	6.76	7.13
Other	3.39	3.17	3.41	3.85	3.61
Total	**29.91**	**28.01**	**30.27**	**31.18**	**32.28**

Source: Central Department of Statistics, Ministry of Planning (2003).

The principal source of imports was Western Europe, which maintained its share at 44 percent for much of the 1980s. The United States supplied 17 percent of Saudi Arabia's imports, whereas Japan's share was 15 percent, having decreased from around 20 percent in the mid-1980s. Saudi Arabia brought only 3 to 4 percent of imported goods from the rest of the Middle East (Azzam, 2002). Table 3 shows Saudi Arabia’s top trading partners in imports and exports during year 2000.

Table 3 Saudi Arabia’s Main Trading Partners (2002)

Main destinations of exports	% of total	Main origins of imports	% of total
USA	18.6	USA	11.3
Japan	15.6	Japan	8.9
South Korea	10.1	Germany	7.4
Singapore	5.1	UK	4.9
China	4.5	France	4.9

Sources: Foreign Trade Statistics (2003); Country Report: Saudi Arabia (Q2: 2004).

EXPORTS TO SAUDI ARABIA

While imports of consumer goods into Saudi Arabia are duty-free, some Saudi industries are protected by the imposition of 20% import duties on certain commodities. Other items carry duties of 5% of the total cost, which includes insurance and freight. Another point worth mentioning is the policy followed by Saudi government to assist Saudi nationals. In accordance with the government directives all purchases are to be made from a Saudi importer. this too can be made only if the product is not made locally. Where there is a need for import of products due to deficiency in local production, imports are subjected to tariffs. For example, aluminum or wooden frames, which are also produced locally, are assessed at an import tariff of 20%.

As for clearances, goods are usually cleared quickly through customs at Saudi seaports. Original export documents should be stamped and attested to by Saudi consular authorities in the country of origin. This will make clearing customs far easier.

IMPORTING STANDARDS AND PROCEDURES

Import Standards

A foreign company interested in the Saudi Arabian market needs to comply with standards set by the Saudi Arabian Standards Organization (SASO). SASO formulates national standards for all commodities and products as well as standards concerned with metrology, calibration, marking and identification of commodities and products, methods of sampling, and inspection and testing.

Importing Procedures: SASO Certificates Of Conformity for Imported Goods

The Saudi Ministry of Commerce has implemented the International Conformity Certification Program (ICCP) since 1995. As this has been done in coordination with Saudi Arabian Standards Organization (SASO), there is a heavy reliance on international standards. SASO specification conformity is applied to all products, both locally produced and imported, this is to provide the necessary consumer protection. All of the approved SASO procedures are within the guidelines set by the International Standards Organization. Saudi Arabia has been implementing the Brussels Harmonized Commodity Description and Coding System since 1991 (SASO, 2004).

The SASO-ICCP requires a Certificate of Conformity for every shipment of SASO regulated products destined for Saudi Arabia. Three different methods exist to obtain the Certificate of Conformity. These methods depend on the product type and frequency of export of the product to Saudi Arabia. Before a Certificate of Conformity can be issued, each shipment must provide evidence of conformity to SASO requirements. Shipments arriving without a Certificate of Conformity will be rejected at the Saudi port of entry. SASO has appointed Country Offices in locations throughout the world that perform a conformity verification on each shipment prior to its leaving the port of export. In addition, SASO has authorized Regional Licensing Centers to administer the registration process, carry out verification of conformity, and issue SASO Type Approval Licenses. In some cases, the SASO Country Office will also require random sampling of the products and testing.

Other requirements for imports to Saudi Arabia include compliance with packaging and container requirements; commercial documents that include commercial invoice, certificate of origin, bill of lading (or airway bill), steamship (or airline) company certificate, insurance certificate (if goods are insured by the exporter), and the packing; certification of export documents; shipping documents that include commercial invoice, Certificate of Origin, bill of lading, insurance certificate ; and payment of customs duties where applicable.

Key Success Strategies for Exporting to Saudi Arabia

Several studies (Harrell and Kiefer, 1993; Gianluigi, 1991; Bowman, 1993) suggest that a company can ensure smooth and orderly exporting endeavor by assessing export potential of its products, enlisting expert counseling on the legal and procedural matters, selecting the target markets carefully, formulating an export strategy vis-à-vis the competition, and pursuing effective selling techniques.

Subsequently, to achieve success in the international markets, the company should ensure effectiveness, efficiency, and its competitive strength (Bowman, 1993). Effectiveness is characterized by the acquisition of market share abroad and by increased sales. Efficiency is manifested later by rising profitability. Competitive strength is achieved by strong company's position compared to other companies in the market, and is, due to the benefits of international market experience, likely to grow. In this connection, the company must consider the time and performance dimensions associated with going abroad in order to overcome short-term setbacks for the sake of long-term success (Harrell and Kiefer, 1993).

Decades of experience shows that with realistic assessment and by carving to some fairly clear-cut strategies and guidelines, the exporting companies can do successful business in Saudi markets. Possible methods for entering the Saudi market such as direct marketing, franchising and joint venturing are explained by a number of agencies such as NovaStars Information Services (2004) and Pacific Gulf (2004).

Examination of a number of reports and analyses (EPCCI; RCCI) reveal that the important success factors for Saudi markets include clear understanding of the local market dynamics and size, technological edge vis-à-vis the competition, superior quality and customer service, compliance with the culture, use of effective selling methods, and tactful pricing.

Market dynamics and size

The exporter needs to explore, identify, and focus on a well-defined group of customers in Saudi Arabian market such as by geography, class, or business segment. Secondly, the exporter should start small, and build incrementally. Almost without exception, Saudi Arabia's markets are too small and too price-sensitive to justify huge up-front exporting. The companies that are doing best are those that started with a relatively small trade, then ramped up volume in response to, rather than in anticipation of, increased demand.

In many product classes, exporting to serve only the Saudi markets may not be feasible. Since Saudi Arabia excels as a location for low-cost re-exporting, because of its flexible rules for trade and lower costs of the trading activity, the exporter may well utilize the country as a transitory route for re-exporting to even other markets. Bowman (1993) finds that despite being overcrowded by oil and big international companies, overseas distribution centers located in the United Arab Emirates, Singapore, an elsewhere can provide the exporters many services including marketing services, administrative services, product-handling services, and delivery services.

Technological advantage

The exporter needs to assess his true technological advantage. If he does not have one, it is probably not worth selling to Saudi Arabia. The market is rather competitive as superior products with latest technical features are marketed with highly competitive offers. Any sort of appliance that can be assembled from standard components-white goods, personal computers, televisions and consumer electronics- will not have much potential. Fast-moving consumer goods whose main value is their brand (e.g., a detergent) also have poor prospects since local consumers are generally willing to pay only a tiny premium for an expensive brand.

Superior Quality and customer service

As noted above, buyers in Saudi Arabia are generally sophisticated and with high disposable incomes continuously seeking good quality and well-designed products. Exporters should ensure that they can provide steady stream of superior quality products to the Saudi markets.

Exporters are also advised to focus on the service aspect. With further opening of key services sectors to foreign participation, exports of pure services to Saudi Arabia several opportunities. While services have several advantages, like difficulty in copying, removing protectionist barriers and ceilings on tariffs, and improved intellectual property rights protection services are other very potential products. However, exporters must follow a cautious approach as services rely more on experience of the provider and that it cannot be assembled out of standard components. Services exports to Saudi Arabia also rely on "soft" infrastructure, such as a customer-relationship ethic, that is the product of long-term cultural development. Moreover the effective delivery of services often depends on highly sophisticated back-office operations (e.g., sourcing, warehousing and logistics).

Culture friendliness

Exporters must focus on developing relationship and acquainting with the local culture. Patience and persistence is required as time is a contentious issue in Saudi Arabia. Family commitments are of paramount importance to Saudis, and it would not be unusual for a negotiator to disappear for days at a time to attend a family function. Foreign businessmen are likely to take offence at such conduct, but it is crucial to understand that this is not considered rude or insulting in the Saudi society. Companies that take steps to understand these differences are the ones most likely to succeed in Saudi Arabia.

Czinkota and Ronkainen (2000) suggest that cultural differences in themselves can be a selling point suggesting luxury, prestige, or status as examples. In the past, some American companies succeeded in exports using domestic marketing approaches and believing that an American look product will sell in the overseas market. The Japanese, on the other hand, followed a different strategy, for instance, Borden sells its ‘Lady Borden ice’ cream and ‘Borden’ cheese by deliberately packaging and labeling in English, in exactly the same manner as they are in the United States. However, changes in consumer behavior, attitudes towards western countries and customs must be carefully monitored, especially in cases that seem to indicate a narrowing of cultural differences among peoples. While McDonald’s and Coke have met with success around the world, this does not mean that the world, particularly the Arab world is becoming westernized. Al-Mobaireek (1998) noted that modernization and westernization are not at all the same, as can be seen in Saudi Arabia, for example.

Effective selling approach

The chances of success increase when the exporter provides substantially higher value against its competitors. The required marketing effort usually is high due to wide geographic area of the Saudi marketplace, use of innovative selling techniques and promotional campaigns by the competitors. To achieve economies in selling budgets, direct marketing has an enormous potential for the Saudi Arabian markets with the fast spreading of Internet technology and advanced banking system (Al-Shumaimari, 2001).

Tactful Pricing

Pricing is another important issue to be considered carefully. Saudi markets are price-sensitive with respect to virtually all types of goods and services. The exporter, in providing products to its own sales offices abroad, may have to adjust its transfer prices according to foreign exchange fluctuations. Three general price-setting strategies in international marketing (Aggarwal and Soenen, 1989; Harper and Caldwell, 1983; Robinson, 1984) are: standard worldwide pricing, dual pricing which differentiates between domestic and export prices, and market differentiated pricing. The first two methods are cost-oriented pricing methods that are relatively simple to establish and easy to understand. The latter price-setting strategy is based on demand orientation and may thus be more consistent with the marketing concept. However, even the third approach has to acknowledge costs in the long term.

In preparing a quotation, the exporter must be careful to take into account and, if possible, include unique export-related costs. These are in addition to the normal costs shared with the domestic side. Appropriate export pricing requires establishing accounting procedures to assess export performance (Clague and Grossfield, 1974). Without such a process, hidden costs may bring surprises. For example, negotiations in the Middle Eastern countries or Russia may last three times longer than the average domestic negotiations, dramatically increasing the costs of doing business abroad (Bowman, 1993). Furthermore, without accurate information, a company cannot combat phenomena such as price escalation.

These factors are the key elements to selling goods and services successfully in Saudi Arabia. Failure on any of these factors are likely to doom the exporting endeavor and provide a set back to entrepreneurs.

CONCLUSION

Saudi Arabia's lucrative marketplace presents both challenges and opportunities for the exporting companies. In view of failure and success of many companies in the Saudi market, there are lessons to be learnt by the exporters on how to do business successfully in Saudi Arabia.

The paper has presented a thorough profile and salient features of the Saudi marketplace, explored key factors for succeeding in exporting with particular focus on the highly competitive Saudi Arabian market. In addition, general procedural guidelines for the exporters have been presented.

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