Viewpoints
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The Kingdom's Capital: An IPO and an Ambitious Prince

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Saudi Arabia is planning the largest initial public offering in history—the partial privatization of oil behemoth Aramco. If successful, the IPO could bring in up to $100 billion and help catalyze an economic modernization plan, but palace intrigue in Riyadh—engineered by an ambitious if erratic Crown Prince—could undermine the Kingdom's needed reform plans.

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Few initial public offerings (IPOs) have generated the breathless coverage as that of the partial privatization of Saudi Aramco planned for 2018. The state-owned colossus is the largest energy company in the world; it alone is responsible for supplying about 12 percent of the world's daily oil consumption. The proposed listing of five percent of Aramco's shares in a public offering would likely make the issue the largest IPO in history, raising about $100 billion (according to official statements). This would dwarf the $25 billion raised from the IPO of China's Alibaba in 2014, then history's largest. If managed well, a successful Aramco IPO not only could generate funds for domestic investment but accelerate more economic diversification, most loudly promoted by Crown Prince Mohammed bin Salman (MbS). In a tumultuous age of palace dynamics, however, nothing is guaranteed, and the Aramco IPO could either become the loudest trumpet of a new economic reform plan or fall victim to the chaotic micromanaging of a future king.

The massive proceeds from an Aramco IPO could go a long way toward helping Riyadh's finances, as it and other oil-exporting countries continue to lock in alternative revenue sources after years of lagging oil sales. Much of the focus of the potential IPO is its sheer size and the hesitance on the part of foreign money managers about Aramco's transparency and balance sheets. One aspect missing from the broad discussion is the degree to which this IPO could ignite a broader economic reorientation in Saudi Arabia and promote more interest in domestic investments. For example, the Public Investment Fund (PIF), the Kingdom's sovereign wealth fund (SWF), invests the majority of its funds in overseas investment vehicles and assets. Other SWFs in the Gulf have too long preferred overseas investments, where returns are higher and investment options more extensive. Traditionally, this has meant an investment orientation toward the US and Europe and more recently in China. This is because SWFs have managed tens of billions of dollars of oil revenues but have had no viable investment options in their domestic economies.[i]

Although accurate data on investment sizes and destinations often are difficult to obtain, a study in 2009 by the US National Bureau of Economic Research, Middle Eastern SWFs invested mostly outside of their region (only 16.5 percent of investments in the MENA region and only 9 percent of investments in the home country).[ii] This is not surprising since SWFs in the MENA region are very large relative to their local economies. For steady and diversified growth not only Saudi Arabia but in the rest of the Gulf, the long-held vision of investing excess revenues overseas instead of at home will need to be reversed.

The Saudi government has repeatedly announced that the IPO will take place in 2018, deflecting rumors that bookbinding exercises for such a large listing would be incomplete and that the viability of listing on a major foreign exchange with stringent reporting requirements would cause delays. The royal palace, with MbS at the helm, has issued conflicting statements about where or how the IPO will be listed. In October officials underscored that the Saudi Arabian

Stock Exchange (Tadawul) would serve as the primary listing exchange, but an IPO of that size would swamp the large but still underdeveloped and illiquid stock market. Saudi Basic Industries Corp (SABIC), the largest Saudi company listed to date with a market capitalization of about $80 billion, represents 18 percent of total market capitalization, an indication of how Aramco's listing would further concentrate the market.

Major overseas exchanges almost certainly will be pulled in for a dual listing to widen the pool of investors, but as in the case of the London Stock Exchange, institutional investors are rightly dismayed by the apparent pusillanimous approach of the regulatory bodies whom they believe are easing the listing requirements for Aramco for the sake of the inflated fees that would come with the listing.[iii] Similar issues could arise with a listing on the New York Stock Exchange, which could also prove problematic given that it could open the company to US corporate governance and jurisdictional concerns, not least of which are lingering 9-11 legal issues that could re-emerge. [iv]

Legal issues notwithstanding, in October some fund managers told CNBC that investors might not be all that interested in the first place.[v] They highlighted that the IPO falls short on three key issues for large investors: growth, an attractive dividend, and solid corporate governance. To be sure, Aramco managers are in the process of attempting to answer those questions and mollify the concerns of skeptics. As with any long-held state entity, incentivizing a culture of efficiency and profit motive will take time. Relative to many other state-owned companies in the developing world, however, Aramco's management and business model are better than most. Nonetheless, when 95-percent ownership remains in the hands of officials who view the company as the literal extension of the nation's wealth, investors' questions of control and transparency will be hard to answer.

Governments in oil-exporting countries in the Middle East and North Africa have held near monopoly control of energy resources in the region for decades. Such is the political and emotional connection to these resources that the thought of selling the nations' natural resources would have struck many long-time observers of the political economy of the Middle East—this writer included—as ludicrous. Privatizing even a small slice of Aramco is the center piece of an economic reform program. For an economic reform package to take hold, markets, not to mention the public itself, must be convinced that the state is fully committed to the effort, and giving up even minimal control of such a critical asset could be the spark.

But even the hottest sparks can be snuffed out by parochial and impractical decisions at the top. MbS has pushed forward proposals to modernize the Kingdom's economy and begin to at least discuss easing some social restrictions (Saudi women have now been given the right to drive). Ambition and vision can also breed impulsiveness.[vi] Recently, MbS further consolidated control with the sudden and high-profile arrests of prominent officials and businessmen following the launch of a new anti-corruption commission.[vii] Would-be investors (foreign and domestic) looking to cash in on the Aramco IPO or longer-term investment in the Kingdom might not know how to view these developments.

Might these moves be exactly what the Kingdom needs to modernize itself away from its near total dependence on the carbon economy and toward accountability and transparency? Or might they be viewed as the impetuous policies of a young prince looking to settle scores, amass power, and sprint toward overly ambitious goals without the requisite follow-through? If the latter, then the hesitance on the part of foreign investors especially will be reinforced. Barely six months into his tenure as being named Crown Prince, it is too soon to tell if the roadmap for economic diversification (the partial IPO of Aramco only the most obvious of reform proposals) laid out by this 32-year old will take hold because of him or despite him.

The author is an employee of the United States Government (USG), which is funding his fellowship at the Wilson Center. All statements of fact, opinion, or analysis are those of the author and do not reflect the official position or views of the USG.

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[i] Yi-chong, Xu and Gawdat Bahgat, *The Political Economy of Sovereign Wealth Funds*, 2010.

[ii] http://www.nber.org/papers/w14861.pdf

[iii] https://www.economist.com/news/business/21730469-it-suffering-whims-capricious-crown-prince-saudi-aramcos-ipo-mess

[iv] http://www.foxbusiness.com/markets/2017/11/06/saudi-aramco-ipo-nyse-listing-faces-challenges-even-with-trump-push.html

[v] https://www.cnbc.com/2017/10/19/saudi-aramco-ipo-saudi-arabia-oil-giant-faces-investor-doubts.html?recirc=taboolainternal

[vi] https://www.politico.com/magazine/story/2017/06/29/saudi-arabias-crown-prince-trump-foreign-policy-215321

[vii] http://foreignpolicy.com/2017/11/06/saudi-arabias-crown-prince-cracks-the-whip

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