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SMARTLESSONS

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ELIMINATING MINIMUM CAPITAL REQUIREMENT AND FACILITATING BUSINESS START-UP IN SAUDI ARABIA

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How do you make reform happen quickly in a country where it used to take an entrepreneur 125 days to get a construction license and 39 days to start a business? An obvious answer is to let the most influential person give the first instruction. However, this is not enough. Well-organized efforts aimed at delivering results must follow. This case began in 2006. Having seen that Saudi Arabia was not the best in the Middle East and North Africa, and was also doing poorly compared to the rest of the world, Saudi King Abdullah had a clear vision to enhance Saudi Arabia's competitiveness and prosperity. The first brick in the creation of the 10-by-10 initiative – to place Saudi Arabia among the 10 most competitive countries by 2010 – was laid.

Background

With the 10-by-10 initiative's inception, the Saudi Arabian General Investment Authority (SAGIA) created the National Competitiveness Center (NCC) in June 2006. Monitoring, assessing, and supporting the simplification of the business entry process were among its main roles.

The NCC observed in June 2006 that entrepreneurial activity in Saudi Arabia was low. One of the reasons was the fact that the process for starting a business was lengthy – exceeding 5 weeks – and costly, with one of the highest minimum paid-in capital (MPIC) requirements in the world – US$125,000. Businesses still started and were registered, but only 12,194 were limited liability companies, versus 646,900 sole proprietorships. Starting a limited liability company was simply too costly.

The risks of not acting were great. Unlike other rich countries, small and medium enterprises (SMEs) do not contribute significantly to Saudi Arabia's gross domestic product. The oil sector makes up more than half of the GDP but employs only 2 percent of the workforce. However, even if oil were to maintain its current high price, the sector would not generate the significant number of new jobs needed to accommodate the growing supply of the Saudi labor force. The country's population is young: 49 percent is under the age of 20, and a large share will soon enter the labor market. Without the creation of more businesses and jobs, rising unemployment will be hard to avoid.

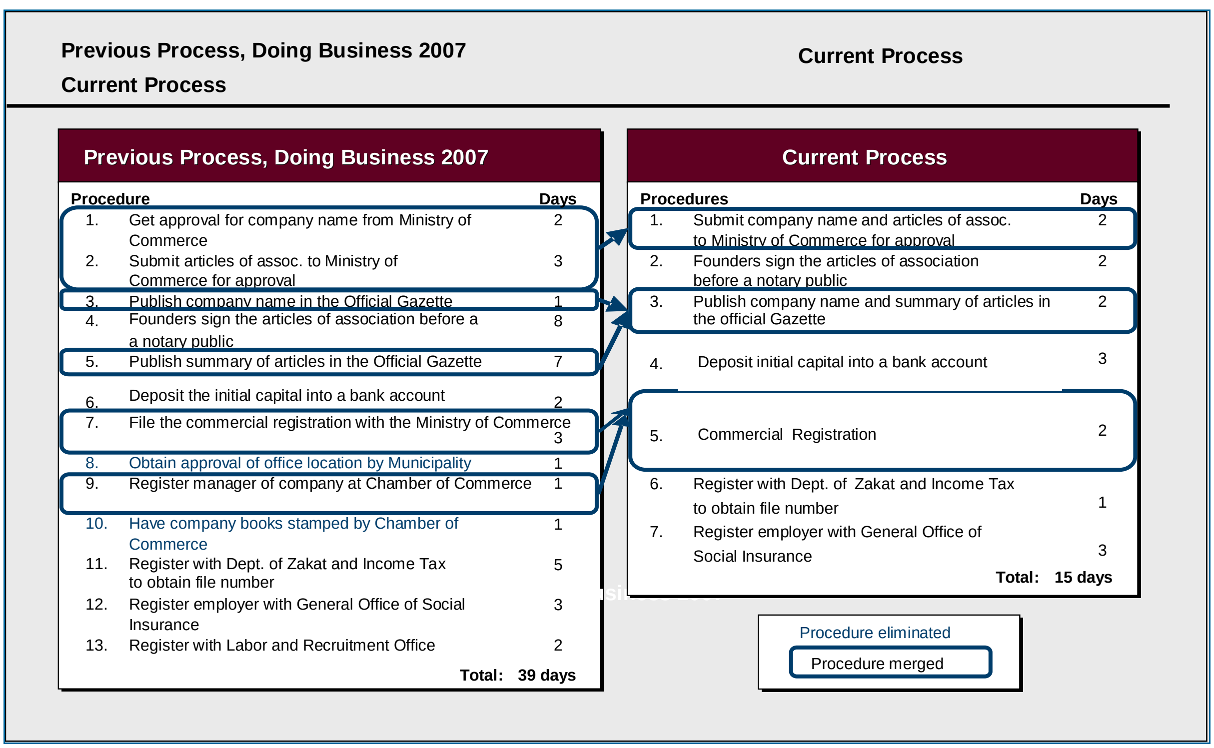
So we took action. Saudi Arabia boldly eliminated the minimum capital requirement, which was 1,057 percent of income per capita. And it was done in four months, reversing the common belief that dropping the minimum capital requirement entails years of legal procedures and debates. We also cut other start-up formalities, decreasing the number of procedures from 13 to seven. In one year, the country's rank in the ease of starting a business soared from 159 to 36 in Doing Business 2008. Last but not least, new business registrations jumped 81 percent.

How did Saudi Arabia turn visions into actions and results? As Deputy Governor of SAGIA, I suggest there were three key factors: (1) Disregard the argument that this is the way it was always done, and go for quick wins to create momentum; (2) Use a results-based incentive system, with credit for the ones that deliver; and (3) Use facts to build coalitions and speed up the process.

Lesson 1: *Reforming more by changing less. (Disregard the argument that "this is the way it was always done" and go for quick wins to create momentum.)*

In coming up with a strategy for reform, SAGIA first opted to aim for quick wins to gain momentum by showing early results. For every formality, we asked ourselves, "Do we really need this? Why are we doing it this way?" Procedures with little or no function that could easily be eliminated without much objection came first. Stamping company books at the Chamber of Commerce was one such example. Other steps were merged (see Figure 1). Previously, the company name and a summary of the articles of association were published separately in the Official Gazette. Other than historical protocol, there was no reason for this.

Figure 1



But the main bottleneck remained: the minimum capital requirement. So the governor of SAGIA and I met with the leadership of the Ministry of Commerce to discuss this problem. In January 2007, the Ministry of Commerce and SAGIA addressed the King with the recommendation to eliminate the minimum capital requirement. The Experts Council was then given the mandate to study the legal aspects of removing the minimum capital requirement in February 2007.

SAGIA could now have chosen to take the regular route by trying to amend the draft of the new Company Law, which was already being reviewed by the Council of Ministers. Instead, we pursued a fast-track approach. Article 164, which sought to eliminate the minimum capital requirement, was pushed through the legislative process on its own, separate from the new Company Law.

Working with the Shura Council, a legislative body that advises the King on issues that are important to Saudi Arabia, we studied and approved the amendment in May 2007. As soon as the Council of Ministers approved the amendment of the new article in July 2007, a Royal Decree signed by King Abdullah was issued on July 17, officially eliminating the minimum capital requirement. This showed that major changes could be made quickly. For reformers, the lesson is to focus on what works, and act accordingly.

Lesson 2: *What Gets Measured Gets Done! (Use a results-based incentive system with credit for the ones that deliver results.)*

After the announcement of the 10-by-10 program, SAGIA immediately formed a group to rethink its current vision and mission. The task was to create a pro-business environment, provide comprehensive services to investors, and foster investment opportunities in energy, transportation, and knowledge-based industries. But having a mission statement is not enough. It was imperative to ensure that the vision would lead to clear, measurable results.

So SAGIA set up a system of key benchmark indicators. Targets were set for each year based on an aggressive approach to be among the top 10 countries by 2010, and bonuses and promotions were directly linked to achieving those results. The goal was not only to improve, but to improve compared to others. Therefore, international benchmarks were chosen as targets. The end-of-year bonuses of the executive staff at SAGIA were dependent upon achieving or surpassing these targets:

- Achieving a Doing Business overall rank below 40 in 2006
- Achieving a Doing Business overall rank below 30 in 2007
- Achieving a Doing Business overall rank below 25 in 2008
- Achieving a Doing Business overall rank below 15 in 2009
- Achieving a Doing Business overall rank below 10 in 2010

SAGIA reports directly to King Abdullah every quarter on the progress of the initiative. The King wants to know not only the successes of collaboration with other ministries, but also the obstacles that SAGIA encounters as it seeks to upgrade the Kingdom’s business environment. This system is quite effective, as everyone is accountable, and this creates an additional urgency and sense of responsibility.

To maximize publicity about the 10-by-10 project from the start, SAGIA officially announced the initiative at the National Competitiveness Forum with the participation of Bill Gates, founder of Microsoft. It was his first visit to Saudi Arabia, and we received tremendous national and international media coverage.

Lesson 3: *Use hard facts to build coalitions and speed up reforms.*

As in many other countries, getting rid of the MPIC requirement was not simple in Saudi Arabia. This reform can be among the hardest to deal with, as it is a legislative reform rather than a regulatory or administrative one. Although only one article had to be amended, the Shura Council, the Ministry of Commerce, and the Council of Ministers all had to approve the legislative change.

From November 2006 until January 2007, SAGIA prepared factual arguments and tailored business cases to support the abolition of the minimum capital requirement. When the time came for the Council of Ministers to approve the amendment, SAGIA presented indicators such as SMEs' contribution to GDP in Saudi Arabia compared to other countries, the relationship between the MPIC requirement and business formality in various countries, and the ratio of registered businesses to unregistered businesses in Saudi Arabia. France, with its similar civil code tradition, was used as an example to follow. France had successfully reduced the minimum capital requirement to a symbolic one euro in 2003. The Council approved the amendment in less than three weeks. SAGIA did the same with Parliament, and four months later, the minimum capital requirement was legal history.

Conclusion

Today, Saudi Arabia is setting the stage for continued business reforms in the upcoming years, and it should not take long before the effects can be felt by all businesses: small and large, domestic and foreign, public and private.

We are not just content to rest on the accomplishments I discuss herein. We know there is more work to be done to achieve our 10-by-10 objective, but we like to look at our goal as Michelangelo did when he said: "The greatest danger for most of us is not that our aim is too high and we miss it, but that it is too low and we reach it."

About the Author

Dr. Awwad al-Awwad is head of the 10-by-10 program and chairs the Saudi negotiating team for bilateral investment treaties. He represents Saudi Arabia in the OECD-MENA Committee on Investment and Arab Invest Promotion Association. He is a member of the government's Anti-Trust Committee, the Commission for Resolution of Commercial Papers Disputes, the United States/Saudi Arabia Strategic Dialogue, the Saudi-American Investment and Trade Board, the Regional Arab Investment Authorities Committee, and the Arab Investment Court.

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