A lot more is at stake in the restructuring of Saudi Aramco than just its corporate strategic success. The future viability of the state of Saudi Arabia depends on the national oil company (NOC) cultivating a vibrant industrial sector. At the same time, the government’s success in achieving its broader economic development goals will guarantee the NOCs’ strategies are sustainable. Globally, most NOCs have failed to meet strategic objectives, either because their governments undermined their efforts or because the NOCs were unable to deliver the necessary support to their owners. The challenges are great for Saudi Aramco, but it has a developed skills base, global experience and, of course, large resources to exploit.

Understanding NOC-state relations: observations from around the world

Typically, governments set the strategic goals for their NOCs in line with their country’s energy needs, which are dependent on broader national development goals. Development objectives are not static: They change over time as economies shift away from oil revenue dependence towards diversification and productivity.

It is, therefore, crucial that energy sector strategies are re-aligned to fit within countries’ development plans. In large oil producing nations, the NOC is the primary energy sector actor and is usually instructed by its dominant shareholder - the state - to support new development objectives. Usually, the NOC is the local organization with the greatest institutional capacity, not only in the oil sector but also other areas, notably infrastructure and finance. In fact, it is called upon to be the vanguard of change in helping transform the economy.

In order to play this new role, NOCs usually require greater operational resources and strategic autonomy. In practical terms, obtaining the former requires the NOC to retain more investment funds for itself. The budget issue is critical. In an ideal virtuous cycle, as development of the new productive economy progresses, the state can tap into its new tax base and lessen its dependence on the NOC, thereby allowing the oil company sufficient resources to build its own capacity. That enhanced capacity, in turn, reinforces the economy’s productive development.

Typically, however, the government’s success in developing the tax base is never a smooth process and, therefore, NOCs rarely obtain the optimal level of resources. Similarly, increasing strategic autonomy is also difficult to achieve, as it requires deploying a new set of management skills for the purpose of meeting the company’s goals. Given the oil producing government’s past near total dependence on the NOC for revenues and critical investments in the economy, giving greater leeway
Saudi Aramco: strategic success means more than meeting corporate goals

to its most important institution has always been challenging.

Saudi Aramco in the development plans of Saudi Arabia

Saudi Arabia’s population explosion since the 1970s, the instability of its oil revenue base and competing fiscal demands from various key domestic and international constituents made its oil-based development strategy unsustainable. For the last three decades, the government has sought an economic diversification strategy. Crown Prince Mohammed bin Salman’s Vision 2030 is the most comprehensive and ambitious of these initiatives. It requires fundamental changes to the state’s competence and capacity, the role played by the local and foreign private sector, and the strategic ties that Riyadh forges with new global partners.

Saudi Aramco is at the center of this change process and its success will be instrumental for the government’s plans.

There are three broad parts to the oil company’s strategy: The first involves tying down captive refining capacity overseas – particularly in the dynamic economies of Asia, where most of the new demand for oil will come from – and ensuring these ventures help the NOC maximize its value-added per barrel through petrochemical investments. The second is to ensure it becomes a critical catalyst for spawning a domestic oil and gas service sector through joint ventures with key international players; the use of its capital expenditures budget; and mobilization of global capital to fund these ventures. The third component involves providing the intellectual and financial resources to help build an alternative economy.

Acquiring captive refining and petrochemical capacity will ensure revenue maximization, while local industrialization; job creation; retention of capital expenditures at home; and creation of an export platform beyond the kingdom will be key to developing a local services sector. Saudi Aramco’s prospective IPO is a critical part of its contribution to the alternative economy, both in terms direct funds and the overall credit worthiness of the state and the country.

NOC’s success is necessary but not sufficient

Because economic development requires capacity building at the state level, Saudi Arabia’s first order of business is to create a more effective state apparatus so it can foster change and growth. Beyond that, the kingdom needs to build confidence in its plans and initiatives, particularly within the local
and foreign private sector. This will depend upon effective management and coherent plans as well as financial and macroeconomic stability.

Saudi Aramco has demonstrated over the last several decades that it has broad shoulders to help with state capacity building. However, given its own ambitious plans, its capacity will at times be stretched. The company’s financial role in the development and transformation process is critical, but so is the state’s success in managing its resources and not forcing funds to be diverted so Saudi Aramco cannot follow through on critical investments. The NOC has a proven track record in delivering economic and financial success to its economy. Given the wider role it will play in the kingdom’s development, this time around the state’s performance itself will be an important factor in Saudi Aramco’s strategic success.