Aramco IPO: It’s Not About the Money

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Is the proposed sell off of Aramco the start of a Thatcherite revolution in Saudi Arabia?

“Welcome to Aramco…the government’s pampered baby”. Those were the exact words I heard from my scholarship manager upon joining the Saudi oil empire twenty years ago. Back then, the prospect of selling any part of the Saudi piggy bank was more science fiction than science fact. But the rationale behind contemplating such a move today is far from an apparent desire to raise money despite twelve-year low oil prices.

Some commentators have pondered whether talk of a sale is an indication that falling oil prices have left Saudi Arabia strapped for cash. That’s unlikely. The Saudi sovereign wealth funds are some of the world’s biggest, and the Saudi Government has substantial holdings in publicly listed companies. The ‘verifiable’ worth of Saudi investments is over $800 billion. This would be enough to cover its fiscal deficits for several years, even if oil prices remained below $30 a barrel.

If the country really needed to raise money, it could also consider selling land and property, the value of which is unknown, but expected to be in the billions of dollars. The government could also consider raising debt on international markets given today's low interest rate environment, borrow domestically (either directly or through a bond issue). To support its spending in strategic areas like education and healthcare, the government could choose to tighten the purse strings on **non-essential lavish spending** or introduce additional economic reforms (such as **energy subsidy cuts** that have been recently implemented).

Nor should we underestimate the strong leverage the country has on global oil markets. While many analysts associate the current decline in oil prices with the ill-timed Saudi desire to drive shale oil producers from the market, it should be remembered that Saudi Arabia could utilise its unmatched power to unilaterally snap oil prices back at its will. Selling off equity in the country's crown jewel to random investors will erode these powers. It would make Aramco, nevertheless, a more business-oriented entity that operates at arm's length from the oil ministry.

What is the rationale?

The idea of an Aramco's IPO, particularly with regard to selling shares in downstream assets, is **not a new one**. The aim of popularising these intentions is essentially to entice the appetite of foreign investors for the Saudi stock market, which has been plummeting in line with the burgeoning oil slide. **This fall has continued** despite the market being opened up to foreigners for the first time in June 2015. The Saudi stock market also wishes to upgrade from **frontier to emerging market status** by 2017. Listing Aramco is not about raising money as such; it is more a bold political message that no sector is immune from privatisation. Announcing these plans – irrespective of whether they bear fruit or not – is part of an unprecedented economic overhaul that has been enthusiastically labelled a **'Thatcherite revolution' for Saudi Arabia**.

But would it work?

While Saudi Aramco claims to own reserves of over 260 billion barrels of oil, a prevailing culture of secrecy prevents any independent verification of this figure. Outsiders have questioned how Saudi's reserve estimates could rise by fifty per cent in 1988, while many experts dismissed the figures as 'political reserves', the amount claimed to justify demands for higher production allocation within OPEC. Beyond possible political interference, the process of estimating oil reserves remains more a matter of probability and guess-work than certainty. In fact, it is impossible to place any firm confidence in any estimates of oil reserves, especially when they are exclusively controlled by one national oil company. This means that if Aramco's much-touted initial public offering (IPO) does go through, it will be difficult to put a reliable dollar figure on its value. Back-of-an-envelope calculations of potential market capitalisation, even with current bearish oil prices, suggest this could be as high as **$10 trillion**, which would make Aramco the most valuable publicly traded company on earth.

Aramco will, of course, never float all of its shares on the stock market. The company's chairman of the board **recently confirmed** that while the oil giant is looking into going public in some form, the Saudi Government will always retain a controlling share. Speaking arbitrarily, if Aramco floated just four per cent of its shares it could raise some $400 billion in what would be the largest IPO in financial history. This would have the additional effect of almost doubling the value of the Saudi stock market, which has been underperforming lately. Listing any slice of the business would however require Aramco to become more transparent about its operations and revenues, and exposed to external auditing.

Regardless of its 'famously' secretive nature, Saudi Aramco is considered the most efficient and least corrupt Saudi corporation, so it is often tasked with the design and construction of **key infrastructural projects** outside the energy industry.

History tells us that going public is not a panacea for government-controlled oil companies. For example, privatising Petrobras in Brazil exposed the corporation to the threat of corruption and greedy organisations seeking to **exploit the country's assets** for their personal gains. Elsewhere, shares in the Russian oil giant 'Rosneft' have behaved irrationally since they were first made public a decade ago. Part of the poor financial performance has been attributed to inferior corporate governance arguably due to Putin's iron grip on the company's management which fuelled a wave of negativity against both the corporation and Russia's ruling regime.

With this in mind, one may wonder why a successful company like Aramco would ever consider exposing itself to the potential risks associated with a public listing.

Greasing the wheels of change

A listing of Aramco could pave the way for a new era. The Saudi leadership should, therefore, pay closer attention to policy success and failure with regard to implementing economic reforms. In fact, it could learn a lot from New Zealand, the south Pacific nation historically dependent on heavily-subsidised agriculture and food exports. Faced with severe fiscal constraints in 1984, the New Zealand government implemented a courageous deregulation programme which included the removal of subsidies, the devaluation and subsequent floating of the currency and liberalisation of capital markets. Productivity levels rose and business performance is now substantially higher than during the period of high subsidies. While it’s true the success of New Zealand’s economy-wide reforms was partly due to factors like transparency and early-involvement of relevant stakeholders, securing a widespread acceptance was largely attributed to the bold leadership and swift execution on the part of the government.

It may be time for the Saudi Government to fast-track the pace of its economic reforms before short-sighted internal resistance rises to a level that hampers the government’s efforts to maintain political, economic and social stability in the oil kingdom.

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