BUSINESS CASE STUDY

Global corporate competitiveness: Opening the 'black box' of knowledge transfer in Saudi Arabia

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Background: The Kingdom of Oil

The Kingdom of Saudi Arabia (KSA) is an international leader in oil production with over 11.6 million barrels per day.[1] Its global behemoth, ARAMCO, is the second largest oil producer in the world, and it is forging partnerships with energy companies throughout the region including recent joint ventures in China and South Korea. Also, SABIC[2] is rapidly expanding its 'downstream' production of specialized petroleum byproducts in the Kingdom for domestic use and international export while becoming one of the most dynamic corporations in the Middle East. Together with a rapidly expanding domestic network of niche refiners and industry suppliers, new 'desert' cities have emerged that provide the manpower and support services for Saudi Arabia's energy economy, including the recent development of alternative sources of energy (solar, wind, and nuclear).

With capital reserves soaring from less than $30 billion USD in 2004 to over $800 billion USD in 2013 and rapidly growing construction, housing, religious tourism, and domestic consumption markets, Saudi Arabia is making major strides in diversifying its economy's reliance on the petroleum industry. Although the country's balance-of-trade has been very favorable over the last decade (averaging nearly $111 billion USD per year) until its steep decline in 2015, the rapid

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[1] The Top Ten oil producing countries ranked by number of barrels produced per day in 2014: [1] United States (13.97 million), [2] Saudi Arabia (11.62 million), [3] Russia (10.85 million), [4] China (4.53 million), [5] Canada (4.38 million), [6] United Arab Emirates (3.47 million), [7] Iran (3.38 million), [8] Iraq (3.37 million), [9] Brazil (2.95 million), and [10] Mexico (2.81 million).

2 SABIC (Saudi Arabia Basic Industries Corporation) is a diversified petrochemical manufacturing company that focuses on refining intermediate industrial products such as polymers, fertilizers, and metals. It is the Kingdom's largest public company (70% owned by the Saudi Government) and it is the largest company listed in the Middle East stock exchanges. In 2013, it was ranked the world's fourth largest chemical producer.

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growth of domestic household consumption is primarily based on imported products that are financed by the nation's petroleum-based wealth. Indeed, Saudi Arabia has become a highly desirable consumer market due to its dramatic rise in national income, rapid growth of its middle classes, and extraordinary wealth of its most prosperous families.

Over the past 20 years, the population of KSA has jumped from $17.8 million in 1993 to $28.3 million in 2013 while Gross Domestic Product per Capital has more than tripled in this period.[3] The replacement of local consumer markets with massive, multi-level malls is symbolic of the dramatic rise of the purchasing power of the Saudi middle-classes, as well as its unquenchable thirst for the material lifestyle of modern, Western society. With hundreds of thousands of Saudis enrolled in colleges in the US and UK over the last two decades,[4] the demand for the newest Western consumer products and lifestyle accoutrements has soared. These new consumer preferences are reinforced by the coordinated mass marketing of these products by Multi National Corporations (MNCs) and their partners in KSA. For example: global corporations such as Procter and Gamble (P&G), General Electric, Halliburton, Master Foods, Nestle, and Unilever dominate the Kingdom's logistical/distribution infrastructure, while popular American restaurants such as Burger King, KFC, McDonald's, TGIF, Dunkin' Donuts, and Starbucks dominate the Saudi public landscape with popular culture images from the United States.

Like most developing countries, domestic protectionist trade policies were designed historically to limit competition between Saudi and MNCs. The 'terms of entry' for MNCs required the creation of Joint Ventures (JVs) with Saudi firms. For both JV partners, the effective shield from international competition produced profitable monopoly 'rents' in domestic pricing structures that simultaneously reduced incentives for Saudi firms to invest in more innovative and

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[3] National income per person soared from US$7,462 in 1993 to US$25,962 in 2013. This is primarily due to the rapid increase in petroleum prices and growth of export production than advances in labor productivity which are primarily provided by foreign contract workers.

4 In 2014, the number of Saudi students enrolled in US education institutions totaled 53,919 while 9,060 Saudis were enrolled in the United Kingdom.

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efficient operations. This contrasts sharply with their MNC partners, which continually review and innovate their production, distribution, and servicing divisions in order to maintain competitive advantages in the global marketplace.

In an attempt to improve the efficiency of the KSA's economy, Saudi Arabia joined the World Trade Organization (WTO) as its 149th member in 1997. The purpose of the WTO is to promote free-trade based (unsubsidized), market-driven competition with the goal of reducing consumer prices, increasing labor productivity, attracting foreign investment capital, introducing innovative technologies, and modernizing distribution networks in developing economies. A secondary goal is to enhance corporate 'knowledge transfers' that incentivize domestic investment in modern business operational practices through JVs and eventually direct competition with MNCs. The final 'barrier to entry' of MNCs into the KSA markets was eliminated with the end of mandatory JVs with Saudi partners in 2005. Tenuous business marriages (JVs) can now be dissolved while MNCs are allowed to court new partners that are more receptive than JVs to adapting to their modern operational practices.

In most cases, this new business investment policy--as shaped by the WTO--poses the greatest threat to Saudi distributors. This is because these companies are struggling to satisfy the MNCs' more stringent operational and business standards. This tension has intensified due to the division of labor within the KSA economy that has been largely shaped by the legacy of JV relationships; MNC partners have concentrated on capital-intensive 'upstream' manufacturing and coordinated cross-marketing strategies, while Saudi partners have specialized in labor-intensive 'downstream' sales and logistics which build on longstanding social and business relationships. Hence, the underlying issue is the divergent attitudes toward investing and innovating in order to successfully compete in rapidly changing markets. For example, MNCs are obsessed with improving efficiency, optimizing production processes, and thus reducing operational costs, whereas Saudi distributors are much less receptive to investing in continuous operational improvements and prefer to squeeze labor costs by employing low-paid foreign workers. This reflects the distributors' unique organizational culture (traditional family-owned businesses), lack of experience with sophisticated management technologies, and limited access to investment capital. Together with high barriers of entry into the Saudi economy before 2005, Saudi distributors had little incentive to invest in operational enhancements in order to satisfy the more stringent standards of their MNC clients.

MNCs and Global Knowledge Transfer

This case study is based on primary research conducted on several Saudi distribution firms whose clients include major MNCs in KSA.[5] These Saudi distribution firms serve a wide-range of industries: fast-moving consumer goods (FMCG), pharmaceuticals, medical equipment, and automotive supplies. During this current phase of globalization, the success of these Saudi distributors is based on their ability to innovate and satisfy the rising performance standards of their MNC clients, regardless of the business sector. The key to the success or failure of these Saudi distributors is their ability to facilitate and rapidly incorporate 'knowledge transfers' from their MNC clients. This includes adapting the standard operational policies (SOPs) of the MNCs as well as integrating MNCs' information/data flows into the distributors' sales and logics operations. Also, by providing distributors with their key performance indicators (KPIs), MNCs enable them to continuously evaluate the gap between 'expectations' and actual 'performance' which determines the likelihood of their contracts being renewed. Not surprisingly, the smaller the expected-actual performance gap, the greater the incentive of distributors to invest limited resources into improving their operational efficiency.[6]

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[5] Halawani, E. A. (2014). *Exploring the impact of transferring procedural knowledge from MNCs on Saudi distributors' competitive advantage: A process-based approach,* unpublished doctoral thesis, The University of Sheffield, United Kingdom. Available at http://etheses.whiterose.ac.uk/6652/.

[6] This analytical lens of organizational "mutuality" throughout the product distribution supply chain differs sharply from the scholarly research literature on strategic corporate alliances and international knowledge transfer. The traditional perspective tends to concentrate on the MNC perspective and the challenges of efficiently utilizing their domestic distribution partners in foreign markets. This approach focuses on "what" MNCs need to penetrate and expand into foreign markets rather than "how" distribution partners of MNCs can sustain profitable, symbiotic business relationships-- especially in socially embedded, small ethnic and regional markets.

According to this research, the key to Saudi distributors retaining their MNC customers is the ability to transfer business knowledge from MNCs so that they can effectively incorporate and 'hybridize' this information.[7] Furthermore, this process is highly context dependent since Saudi companies tend to be family-owned, and are reluctant to sacrifice short-term profits by investing in new operational processes and more costly human capital. This Saudi emphasis on minimizing corporate investment in current operational processes reflects different perceptions of investment risk, access to capital markets, and corporate time-horizons even when operational improvements are necessary for maintaining long-term competitiveness. This is an important finding in understanding how developing countries respond to their incorporation into global markets and the underlying logic of their culturally-embedded business calculus as expressed in short-term versus long-term business time horizons.

How Transfer of Business Knowledge Enhances Corporate Value in Saudi Arabia

The importance of corporate knowledge transfers between MNCs and Saudi companies underscores these evolving symbiotic business relationships in Saudi Arabia. Under the provisions of WTO membership, MNCs have unfettered access to lucrative Saudi markets. Their penetration of previously protected Saudi markets also improves the global competitiveness of those domestic firms that successfully hybridize information transfers from their MNC clients. Indeed, MNCs seek to consolidate and expand their positions in the rapidly growing consumer markets of Saudi Arabia (aided by global economies of scale and ongoing R&D) while Saudi companies seek to consolidate their 'legacy' niches in the KSA economy by improving the competitiveness of their operational processes as demanded by their MNC partners. This

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[7] It is important to recognize the distinctiveness of the business relationship between MNCs and their Saudi distributors. The objective of MNCs' forging local partnerships arises from their past failed experiences in foreign markets. MNCs require specialized knowledge and partners for customizing their products and sales campaigns for distinct national and ethnic/regional markets. This process of business knowledge 'hybridization' requires exceptional access to the host country's social capital which constitutes a major obstacle for MNC expansion in national markets. Hence, the crucial role performed by Saudi distributors is incorporating transferred knowledge from MNCs and creating their own hybrid knowledge for advancing the business interests of their MNC clients in Saudi markets.

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complementary business relationship generates value for both international and domestic companies in Saudi Arabia. When Saudi distribution firms develop and incorporate hybridized knowledge to more efficiently conduct their sales campaigns and logistics operations, this enables their MNC partners to optimize their operations and long-term invest/planning strategies.

Contingency Factors That Influence the Process of Knowledge Transfer

Many factors influence the successful transfer of business knowledge from MNCs to Saudi distributors. The process can be classified into three distinct stages: (1) Preparation; (2) Transfer/Exchange; and (3) Sustainability. The initial preparation stage hinges on the ability of Saudi distributors to embrace new practices that are received from MNCs (e.g., sales/marketing knowledge) or from third-party participants such as consultants (e.g., logistics/supply chain). This three-stage process has important implications for the Saudi distributors. In order to reap their potential rewards, Saudi distributors must possess sufficient absorptive capacity (organizational knowledge-base, intensity of effort, time, and capital) and self-motivation to build on transferred information for creating hybridized business knowledge. The success and sustainability of this knowledge transfer process increasingly determines whether a Saudi distributor remains profitable while satisfying the stringent demands of its MNC partners. As a result, the competitive advantage of Saudi distributors lies in their ability to effectively utilize transferred knowledge and their willingness to invest in customized business practices that enable them to provide more efficient services the in the Saudi market. The value proposition offered by MNCs to Saudi distributors is based on transforming their function from an instrumental "zombie" service implementer to a dynamic, self-directed service provider guided by innovative knowledge creation. In sum, the greater the value generated by Saudi distributors to the MNC distribution system, then the greater the reward as reflected in their share of the profits.

Conclusion: Sharing the Fruits of the KSA Oil Economy

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A unique feature of the KSA economy is that Saudi distribution firms are family-owned business. These private companies are notoriously proud of their corporate heritage, and are loathe to change their longstanding business practices. In fact, maintaining their decision-making autonomy is often more important than pursuing new profitable business opportunities. Therefore, the dilemma confronting Saudi distributors is how to balance the desire to retain their traditional business practices or corporate “ethos”, while satisfying the increasing demands of their MNCs partners. Since MNCs are renowned for rapidly developing new business practices and strategies to gain competitive advantages over their rivals, it is the Saudi distributors’ ability to satisfy these changing demands that sustains their position in the MNC business alliances.

Typically, MNCs exert unrelenting pressure on Saudi distributors to improve their services while squeezing their profit margins. In order to retain their role in the partnership, Saudi distributors are expected to increase their investments (time, technology, and capital) and effectively utilize their hybridized business knowledge to maintain their profitability. This results in culturally based, institutionalized conflicts over the investment time-horizons required for complying with the dictates of MNC partners. As a result, the diminution of protectionist trade policies in the Kingdom is increasing tensions over the distribution of the fruits of the KSA oil economy, as the balance of business power stealthily shifts from privately-owned Saudi families to publicly-owned global MNCs. Intriguingly, this trend could accelerate the diversification of the Saudi economy and its global competitiveness. The intensifying pressure on Saudi distributors is forcing them to continually evolve and enhance their knowledge-based competences and services, in order to satisfy the steadily rising standards of their international partners.

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