

The Role of Multinational Companies in the Middle East: The Case of Saudi Arabia

Mamarinta P. Mababaya

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THE ROLE OF MULTINATIONAL COMPANIES IN THE MIDDLE EAST: THE CASE OF SAUDI ARABIA

MAMARINTA MABABAYA

**A thesis submitted in partial fulfilment of the requirements
of the University of Westminster
for the degree of Doctor of Philosophy**

**Westminster Business School
(Department of Economics & Quantitative Methods)
University of Westminster
London**

April 2002

UNIVERSITY OF WESTMINSTER

19 September 2002

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Dear Dr Mababaya

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I am pleased to inform you that the University of Westminster has accepted the recommendation of the Examiners that you be awarded the degree of **Doctor of Philosophy** with effect from August 2002 in recognition of a programme of work entitled:

The Role of Multinational Companies in the Middle East: The Case of Saudi Arabia

which you have carried out successfully at the University of Westminster.

Your certificate will be prepared and sent to you as soon as it is ready.

The Academic Council and Graduate School Board of the University of Westminster have asked me to express their interest in the programme of work which you have completed and to offer their congratulations on your success.

Yours sincerely



Dr G M Copland
Vice-Chancellor and Rector and Chair of Academic Council

cc: **Professor M Hodd**
Dr S Motamen-Samadian



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Glossary

<i>Ahadith</i>	The plural of the Arabic term <i>Hadith</i> , which means saying of the Prophet Muhammad ﷺ (<i>Sallallaahu 'alayhi wa sallam</i> — may the peace and blessings of Allah be upon him).
CIHED	Northeastern University Center for International Higher Education Documentation
Culture	Customs, traditions and practices. In Islam, culture embraces all facets of life – economic, political, social, religious, etc.
DFI	Direct foreign investment or foreign direct investment (FDI)
Feedstock	Raw material like gas or any hydrocarbon resource
GDP	Gross domestic product, which is the total value of goods and services produced in a nation's economy in one year.
GFCF	Gross fixed capital formation
GNP	Gross national product, which is equal to GDP plus payments from overseas investment and labour income, minus similar payments to foreigners.
Islam	Peaceful and complete submission to the Will of Allah and obedience to His Law (the <i>Shari'ah</i> , which is based on the Qur'an and the Sunnah and the right deductions from these two revealed sources of knowledge and guidance).
JV	Joint venture
MBA	Multinational business activities
MNCs, MNEs	Multinational companies or corporations, which refer to any of the following: foreign firms or multinational enterprises (MNEs) operating in Saudi Arabia whose parent companies are located abroad, and joint-venture companies or corporations, which are partially owned by Saudi Arabian people or government.
Multinational customers	Consumers of multinational products or services who were selected for the pilot study by convenience sampling, according to their ability to understand and answer the questionnaire. Most of the customer respondents have obtained college degrees and are holding key positions — managers, engineers, architects, medical doctors, advisers or consultants, accountants, professors, instructors and administrative officers. A pretty good number of

the respondents have masters and doctoral degrees.

Multinational managers	Include key managers and executives with authorities and responsibilities for MNCs planning, business operation and decision-making.
Muslim	One who peacefully and sincerely submits to the Will of Allah.
NOI	Net outward investment
R&D	Research and development
<i>Radhiallahu anhu</i>	 May Allah be pleased with him (referring to a companion of the Prophet )
SABIC	Saudi Basic Industries Corporation
SAGIA	Saudi Arabian General Investment Authority
SAMA	Saudi Arabian Monetary Agency
SEC	Supreme Economic Council, chaired by the Crown Prince and First Deputy Premier of Saudi Arabia.
<i>Shari'ah</i>	Islamic Law according to the Qur'an and the Sunnah and those deduced from these two revealed scriptures.
Social capital	Refers to features of social organization such as trust, social networks and social norms that facilitate coordination and cooperation for mutual benefit.
SPSS	Statistical Package for Social Sciences – a comprehensive statistical software of SPSS Inc., Chicago, USA.
Sunnah	The teachings, sayings and traditions of the Prophet Muhammad  <i>Sallallaahu 'alayhi wa sallam</i> — may the peace and blessings of Allah be upon him)

Abstract

This study investigated whether known economic and international business theories available in the literature are meaningful enough to explain the nature, existence and role of multinational companies (MNCs) in the Middle East, particularly Saudi Arabia. Two sets of questionnaires were distributed in major cities of Saudi Arabia — one set for 100 multinational managers and another for 280 multinational customers. 234 questionnaires were collected — 45 from multinational managers and 189 from customers. This represents a total response rate of 62 percent, which is adequate for this study.

The empirical results, supported with comprehensive secondary data, confirmed virtually all of the research hypotheses. The study found that joint ventures are the dominant form of multinational business in Saudi Arabia, both in manufacturing and service industries. The core roles of MNCs in the Saudi-foreign ventures are evident in the cross-border value-adding activities of marketing, trading, manufacturing, consulting, contracting, project management, insurance, hotel operation and banking. Likewise, MNCs provide licensing, franchising, financing services and various auxiliary roles in the Kingdom. Therefore, the multinationality of a firm or a group of firms operating across national boundaries is not necessarily synonymous with international production — the main subject of contemporary multinational theories.

The respondents generally perceived the competitiveness of MNCs operating in Saudi Arabia as a function of a number of economic, management, marketing, technological and other variables. They also perceived the contributions of MNCs to the Kingdom's socio-economic developments as significant and positive.

The study also found that understanding Islamic values and ethics is important for MNCs. In this regard, the researcher looked at some objective indicators of business success and related them to selected measures of MNCs' local cultural awareness and responsiveness. The results indicate that the business success of multinationals operating in Saudi Arabia is positively related to their local cultural awareness and responsiveness. Along this line, this study covers some vital elements of Islamic culture, which will help MNCs understand further the cultural needs, values and sensitivities of the Saudi people and Muslims in general.

Chapter 1 - Introduction

Many contemporary theories and paradigms on multinational business operations have emerged in the past few decades or so, beginning mainly to explain post-war U.S. manufacturing or direct investment in West Europe, rather than services such as banking.¹ In recent times until today, various multinational business theories and paradigms (based on economic and management perspectives) have continued to emerge with emphasis on the existence and growth of international production.² Approaches to other cross-border business modalities are taken for granted as alternatives to multinational enterprise (or more specifically international production). Accordingly, firms choose to pursue direct foreign investment (or wholly owned production subsidiary across national borders) in the light of their ownership-specific advantages, location-specific advantages, as well as internalisation incentives. Thus, multinational enterprise can emerge by virtue of these advantages, and in response to imperfections or externalities in the goods or factor markets. There is a common view among international business scholars that market imperfections (such as tariff and other import barriers) prevent the efficient operation of international trade, hence the emergence of multinational companies.

In attempting to explain the existence and growth of multinational companies (MNCs) as a response to market imperfections, some scholars emphasise structural market imperfections (e.g. monopolistic and collusion tendencies). Others emphasise endemic or transactional imperfections.³ For instance, the internalisation theory supposes that higher transaction costs prompt firms to internalise markets across national boundaries. Internalising a market means the establishment of a multinational firm or a multinational group of interdependent firms. This view, as well as the other alternative theories or paradigms available in the literature, is analysed by the researcher in this study, considering the multinational business operations in Saudi Arabia.

The tendency of contemporary international business scholars to argue that MNCs exist and grow, by virtue of their advantages, and in response to market imperfections is not surprising. In reality, national and international firms operate under all sorts of

imperfect market conditions. After all, no market is ever perfect, recalling perfect information as one of the key assumptions that underlie the theory of perfect competition. The presence of imperfect conditions no doubt put some companies in better competitive positions (or greater competitive advantages) than others for certain products or services locally or internationally.

This research work investigates the role of multinational companies in the Middle East, with Saudi Arabia as the case in point. The researcher's interest has been driven by the common knowledge concerning the roles or contributions that multinational companies have made to every field of human endeavour. In one way or another, products or services of multinational corporations affect every society on earth. MNCs have served as vehicles of international production, international trade, economic development, human resource development and industrialisation across national boundaries. They have served as agents of technology transfer, advanced technology research and development, as well as product applications research and innovation across national boundaries. To pro-multinationals, all of these benefits mean increased human welfare, as more and more products and services become available for the satisfaction of human wants and needs.

Multinational companies have been largely responsible for uplifting almost all spheres of business life across the globe. They are the world leaders in automation and high-technology advancement, which have made extraordinarily efficient manufacturing, commerce and services around the world. They are the leaders in all commercial endeavours, such as manufacturing, banking, travelling, tourism, distribution, transportation and so on. They are the forerunners of new inventions and innovations in satellite communication, space technology and electronic information network services (like the Internet). They are actively engaged in logistic services, agricultural and food industries, car and aeroplane manufacturing, petrochemical industries and many more. All of these have phenomenally progressed to a magnitude never seen before, and multinational companies have been in the forefront in these developments.

In the Saudi Arabian setting, the roles of multinational companies are quite numerous, and they are the main thrusts of this research work. The contributions of MNCs are

quite evident in the cross-border value-adding activities of marketing, trading, international production, joint venture, consulting, contracting, project management, licensing and financing. MNCs are recognised not only in terms of their diverse cross-border business activities, but also in terms of the size of their assets and annual sales. For instance, several multinational giants like General Motors, SHELL, MITSUI, MITSUBISHI, IBM, or Exxon have annual sales, which are larger than the gross national products of many countries.⁴

In pursuing this research work, the researcher has likewise been motivated by his observations and a priori information concerning multinational businesses in Saudi Arabia. Multinational firms in the Kingdom are enjoying an excellent business environment that is devoid of problems that the same companies might have experienced in many parts of the world. Particularly in developing countries, some individuals, groups or even institutions view the emergence of multinational companies with dismay, suspicion and scepticism. There are those who see multinational companies as a manifestation of the hegemonic tendencies of the developed countries to continuously subjugate the developing and poorer countries. They see multinationals as agents of global capitalism, materialism and secularisation. As a result, they resort to strikes, boycott, rebellion, violence and the like; and governments have discouraged multinationals. Likewise, there are those who perceive the western values brought in by the presence of multinational companies as threats to their indigenous cultural values. Thus, this study attempts to investigate, among others, whether this view holds true to the Middle East setting, particularly Saudi Arabia where Islamic culture prevails.

Many studies have been conducted on multinationals, but only a few have relevance to the Middle East setting. By the same token, none of those studies has ever investigated deeply the importance of understanding Islamic culture and the underlying implications to multinational business. As such, this research endeavours to study the role of multinationals in the Middle East, particularly Saudi Arabia, with an in-depth coverage of Islamic culture and its implications to multinational business. It is hoped that it will contribute positively to the current stock of knowledge on the subject of international business.

This study comprises seven chapters. Chapter 1 highlights the research objectives, significance and contributions of the study, as well as the scope and limitations of the study. Chapter 2 discusses the Saudi environment for multinational investment. Chapter 3 reviews selected multinational theories and paradigms found in the literature, and discusses some empirical studies relevant to the Middle East setting. Given the limitations of these theories and paradigms, this survey includes some culture-related studies on Saudi Arabia.

Chapter 4 presents the conceptual framework and research methodology, as well as the research design and statistical methods employed to test the hypotheses of the study. Chapter 5 discusses the multinational business in Saudi Arabia based on data and information gathered from secondary sources. Chapter 6 presents and analyses the empirical results of the study. The last chapter contains the study's summary and conclusions.

1.1 Research Problems and Objectives

This study presents an analysis of the role of multinational companies in the Middle East, with Saudi Arabia as the case in point. Starting with a review of multinational theories and studies available in the literature, it assesses whether they are meaningful enough to explain the nature, existence and role of MNCs in Saudi Arabia. Another key research issue investigated is the degree to which understanding Islamic culture is important for multinational companies doing business or planning to invest in Saudi Arabia. This work also addresses the following questions: Which economic and non-economic problems are generally viewed by the respondents as caused by multinational companies? What are the constraints to multinational operations in the Middle East particularly Saudi Arabia? What are the primary sources of MNCs' competitiveness in the Middle East? Do multinational companies contribute significantly to the host country's socio-economic developments as perceived by the respondents? What influences the success of multinational companies operating in Saudi Arabia? Chapter 4 further discusses the details of these research problems and issues.

Based on the above problems, this work endeavours to achieve the following research objectives:

- To review and understand the role of multinational companies (MNCs) in Saudi Arabia.
- To look deeply into the key Islamic cultural factors (based on the Qur'an and the Sunnah) and analyse their implications to the business operations of MNCs in the Middle East, particularly Saudi Arabia.
- To define and analyse the problems attributed to the multinational companies operating in Saudi Arabia and to identify the key constraints to their business activities in the Kingdom, as perceived by diverse groups of respondents.
- To identify and analyse the primary sources of MNCs' competitiveness in Saudi Arabia, as perceived by the respondents.
- To identify and analyse the variables influencing the success of MNCs operating in Saudi Arabia, as perceived by the respondents.

1.2 Significance and Contributions of the Study

This study, as its main contribution, has gathered and consolidated data, information and knowledge concerning Saudi Arabia, which for the first time have been used to define clearly the roles of the Kingdom-based multinational companies. The very comprehensive data presented in this study show that joint ventures are the dominant form of international business in Saudi Arabia. However, the study also found that international business activities in the Kingdom are quite broad — covering both manufacturing and service-oriented ventures from small to world-scale in size.

Another contribution of the study is that it has shown, based on the underlying conceptual framework, logical reasoning and factual information presented, that multinational firms in today's business world play multi-faceted roles domestically and internationally. Like a domestic firm, a multinational company operating across national borders considers its competence and advantages to do any business activity within its value chain that helps sustain or enhance its profitability and/or competitive position. This research has, in fact, clearly demonstrated that the multinationality of a firm or a group of firms operating across national boundaries transcends the scope of cross-border manufacturing activity.

In reality, international production and multinational firm are not always identical. Multinational firm has a broader scope of activities or value functions that include international production. In other words, multinational firm is more of an international corporate institution that earns its “multinationality”, by virtue of its cross-border business operations that include both manufacturing and non-manufacturing activities. On the other hand, international production is more of a business function, which is an essential component of the value chain. International production, *per se*, as clearly seen in the case of the petroleum industry, as well as in many other industries, is only one of the strategically relevant functions. As commonly known, the petroleum value chain covers exploration, development, production, shipping, refining, pipeline, terminal operation, trucking, other support services and retail operation.⁵

International production is no doubt evident in the existence of a wholly owned company beyond the national border, but this holds true also for a manufacturing or service joint venture between a multinational firm and an enterprise in the host country. In practice, some multinational giants wholly own manufacturing or service subsidiaries across national boundaries. The same multinational giants are partners in joint ventures in countries where they have or do not have wholly owned subsidiaries. Thus, the degree of ownership or control is clearly the main source of difference between wholly owned subsidiaries and joint ventures of multinational firms across national borders.

Ownership-based and internalisation theories, as well as their variants including the eclectic paradigm, are indeed meaningful insofar as they attempt to explain the international production aspect of any multinational business. These theories and paradigms may hold true in the light of the respective authors’ perspectives, objectives and geographical scope of their research subjects. So, they are not quite meaningful to explain the international business in Saudi Arabia as they are in the American or European setting.

This study found that various multinational business activities in Saudi Arabia are evident in the fields of international trade, strategic alliances, consulting, licensing and others. Thus, equating the so-called multinational theory to the various theories or paradigms of international production is not universal at all. At best, existing theories of