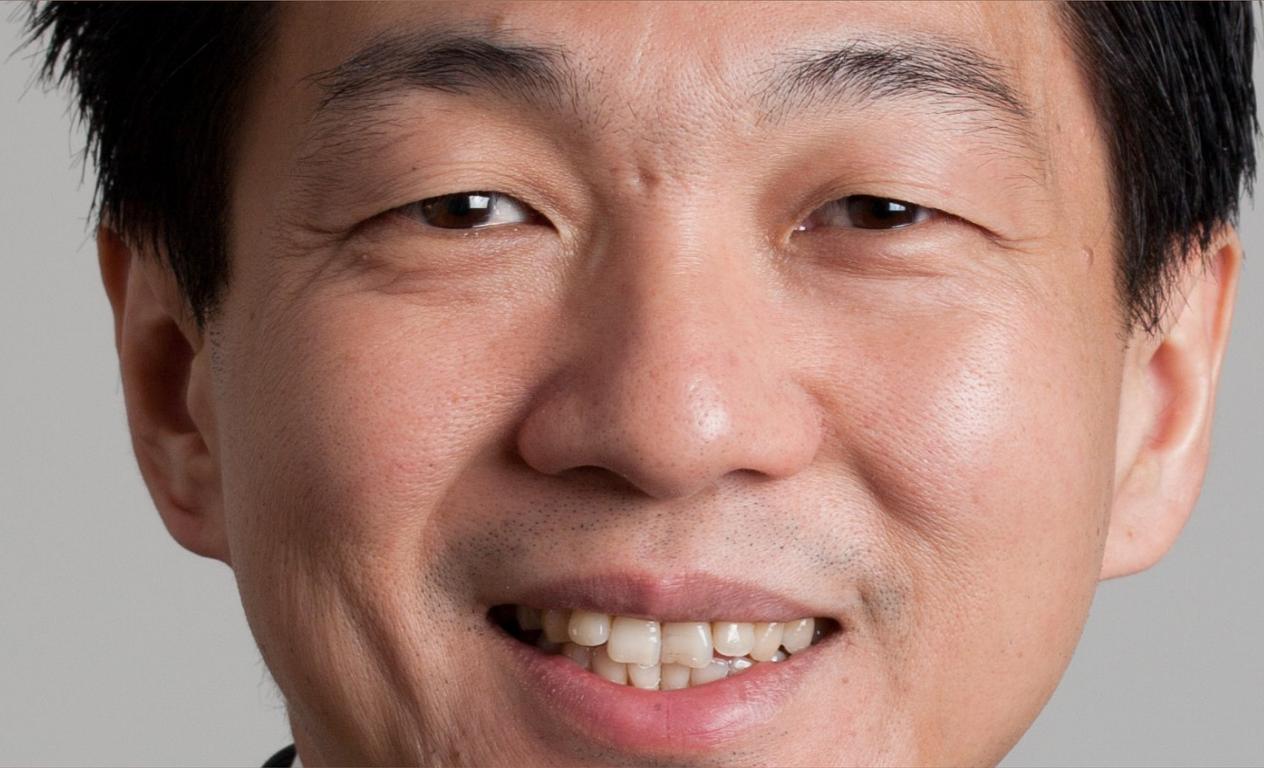


# IF A \$2 TRILLION SAUDI ARAMCO GOES PUBLIC, WILL IT WITHSTAND OUTSIDER SCRUTINY?



**Simon C.Y. Wong**

Independent Advisor, Northwestern University and  
London School of Economics and Political Science

The Saudi Arabian government's potential plan to take the oil giant Saudi Aramco public has generated considerable excitement as well as concern. Once listed, Aramco will face the herculean challenge of answering to the differing priorities and demands of private shareholders and the Saudi government.

Whether it lists in New York or London – favored destinations for an initial public offering that could put Aramco's market value at an astounding \$2 trillion or more – the company will need to elevate its governance practices to retain the support of Western institutional investors, many of which have become increasingly activist on governance and sustainability.

This article first appeared in the New York Times

[https://www.nytimes.com/2016/07/23/business/dealbook/if-a-2-trillion-saudi-aramco-goes-public-will-it-withstand-outsider-scrutiny.html?\\_r=0](https://www.nytimes.com/2016/07/23/business/dealbook/if-a-2-trillion-saudi-aramco-goes-public-will-it-withstand-outsider-scrutiny.html?_r=0)

It is especially pressing in Aramco's case because the World Bank has found that the governance of national oil companies "typically compares unfavorably to private sector standards or other state-owned enterprises, whether it is regarding transparency, accountability, commercial oversight or management structures." Crucially, according to the multilateral institution, governance weaknesses hinder national oil companies' ability to "create value."

To its credit, Saudi Aramco has taken steps to bolster its governance by appointing experienced independent directors to its board and signaling that once Aramco is listed, projects it undertakes on behalf of the Saudi government will be "delineated."

Besides its core petroleum activities, Saudi Aramco operates hospitals, runs schools and provides other social services. Given Aramco's reputation for efficient management, several years ago the Saudi government even tasked it to build a new university. Recently, the government assigned the company a major role in helping develop the kingdom's non-oil economic sectors.

Once Saudi Aramco becomes a publicly traded company, however, outside shareholders will probably insist on a stronger commercial focus.

While it is understood that state ownership of commercial enterprises typically means that they will not focus exclusively on generating profits, there is growing support for the view – already adopted by countries

"While it is understood that state ownership of commercial enterprises typically means that they will not focus exclusively on generating profits, there is growing support for the view – already adopted by countries like New Zealand and Finland – that social and public policy objectives should be explicitly agreed upon and the costs borne by the controlling government."

like New Zealand and Finland – that social and public policy objectives should be explicitly agreed upon and the costs borne by the controlling government.

The Saudi government's recent announcement that activities carried out by Aramco for the government will be delineated – but not eliminated – suggests that noncommercial objectives will remain a part of Aramco's remit.

Ideally, those noncommercial objectives should be defined narrowly and be closely related to its sector and competence, with the Saudi government committing to pay the costs of pursuing them. Upon listing, information should be published regularly on how these obligations have been carried out and their costs, which should be independently verified.

Aramco's chairman recently declared that one objective of going public is to "remove this notion that Saudi Aramco is not transparent."

While this is an encouraging signal, Aramco and the Saudi government should not underestimate the intensity of scrutiny that will come their way – particularly given the significance and prominence of the oil sector – or the demands for sunlight on wide-ranging areas, which could create considerable tension and discomfort given Saudi Arabia's reputation as a highly secretive society.

Aramco has become more transparent in recent years. It has, for example, published an annual review in English for around a decade. But it has not furnished to the public detailed, audited financial figures, including independent verification of its declared oil and gas reserves.

"In many countries, there have been meaningful efforts to strengthen the autonomy of boards of state-owned enterprises from government, including through professionalizing the nomination process, introducing independent directors, and limiting the appointment of government officials and politicians."

Furthermore, disclosure on Saudi Aramco's governance arrangements is sparse and clarity is limited on the respective responsibilities of the Supreme Council and board of directors, membership of the Supreme Council, whether any board committees exist and how top executives are remunerated.

Lastly, outside investors are likely to demand detailed information on related-party transactions, particularly Aramco's transfers to the Saudi government and royal family.

In many countries, there have been meaningful efforts to strengthen the autonomy of boards of state-owned enterprises from government, including through professionalizing the nomination process, introducing independent directors, and limiting the appointment of government officials and politicians.

Given Aramco's history and role in the Saudi economy, it is not surprising that its top governance bodies – the Supreme Council and board – are dominated by government representatives. At present, Aramco's nine-member board comprises three government ministers – including the Minister of Energy, Industry and Mineral Resources as chairman – and an adviser to the Royal Court.

Although Western investors will probably be pleased that Saudi Aramco has appointed Royal Dutch Shell's former chairman, Mark Moody-Stuart, and the former chairman of BG Group, Andrew Gould, as independent directors, the

dominance of government representation on its board – if it persists after an I.P.O. – is likely to spur concern among Western investors that the company will not be sufficiently independent of government.

In Norway, active politicians, government ministers and state secretaries are not permitted to sit on the boards of state-owned enterprises to “avoid problems of partiality and conflicts of interest” that could arise “when the interests of the shareholders as a whole are not fully in harmony with the interests of the state.”

In the past, Aramco’s board appeared to have played a limited supervisory role. Ultimate responsibility for the company’s strategy, planning, budget, policy and major appointments was handed to the Supreme Council for Petroleum and Mineral Affairs, the predecessor of the current Supreme Council for Saudi Aramco, which came into being a year ago. Going by the announcement last September that Aramco’s current chief executive was appointed by the new Supreme Council – rather than by its board – this demarcation of authority looks to have stayed in place.

By contrast, some countries such as New Zealand and Singapore have granted the boards of listed state companies full authority for direction and management, and confine their intervention largely to voting at shareholder meetings.

The listing of enterprises that were previously wholly state-owned alters the power dynamics in ways that few governments fully appreciate at the outset.

For state-owned enterprises with Western institutional investors on their shareholder registers, the state’s control can weaken – particularly regarding the pursuit of social and public policy objectives – to a greater extent than its remaining equity stake, even at 95 percent as is likely to be the case with Aramco, would suggest.

If Saudi Aramco feels unable to align its governance to international norms, it may be better off to remain private or list a subsidiary where these considerations can be taken fully into account.