

REPORT

Unlocking Saudi SMEs' Growth Potential: IPOs as Catalysts for Growth and Innovation



EXECUTIVE SUMMARY

- 1 SMEs are contributing around 30% to Saudi Arabia's GDP. SME-sized companies, which are portfolio companies of larger family-owned conglomerates in the Kingdom, increase that GDP contribution even more.
- 2 IPOs provide SMEs with access to capital for expansion. Also, they typically add to an organization's reputation in the market and society. Specifically Nomu offers a lighter listing platform with reforms like direct listing to increase accessibility.
- 3 While IPOs offer immediate cash, readiness is crucial for maintaining a competitive edge. Leaner, adaptable companies with enhanced governance and strategic planning tend to excel.
- 4 SMEs need to select the right market, evaluate their corporate structure and tax implications, plan post-IPO dividends, and ensure comprehensive financial data.
- 5 Sidra Capital offers tailored financial advisory services to SMEs, aiding in navigating complex transactions and preparing for IPOs.
- 6 Saudi Arabia's transformation depends on SME innovation and sustainable growth. IPOs support Vision 2030's goals, fostering a thriving business ecosystem within a well-regulated environment.



THE INCREDIBLE SURGE OF SMEs IN SAUDI ARABIA

The launch of Saudi Arabia's Vision 2030 has significantly boosted investor confidence in the country. The country's global competitiveness has improved, female labor participation has risen significantly, and new business sectors are emerging. Businesses are now more open to innovative ways of raising capital, and technological advancements are creating opportunities for smaller companies. This optimism is reflected in growth forecasts from CBRE Research and Oxford Economics, which project an annual GDP increase of 5.5-6 percent by 2025. The rising number of small and medium enterprises (SMEs) in the country further underscores this positive outlook. While definitions vary, broadly these are enterprises that employ between 50 to 249 employees and generate annual revenues between SAR 40 million to 200 million. A report by the country's National Transformation Program pegs the growth of SMEs at over 200 percent since the launch of Vision 2030. According to the Small and Medium Enterprises General Authority, Monsha'at, the number of such companies in Saudi Arabia has surged from 752,560 in Q1 2022 to over 1.3 million by Q4 2023. This sector now contributes approximately 30 percent to Saudi Arabia's GDP, a notable rise from 21 percent in 2013, highlighting the rapid expansion of the SME sector over the past decade.

This growth in the SME sector has been significantly bolstered by government initiatives designed to support them. These initiatives include the Kafalah program, which offers loan guarantees to SMEs, helping them secure financing by reassuring banks. Additionally, the Tamweel platform acts as an online hub that connects SMEs with financiers, creating growth opportunities. Moreover, the Saudi Venture Capital Company, a state-owned entity, plays a crucial role by investing in startups and SMEs with high growth potential.

IPOs: THE NEXT FRONTIER FOR RAISING CAPITAL

However, unlocking an SME's full growth potential often hinges on effective capital raising, and one powerful avenue for this is an Initial Public Offering (IPO). This is where companies can turn to Nomu to access the Saudi capital market. Nomu is a parallel equity market with lighter listing requirements, making it easier for SMEs to list and secure the capital needed for growth.

Listing Requirements	Main Market	Nomu market
Minimum market cap	SAR 300 million	SAR 10 million*
% Offering size	at least % 30	at least % 20 or SAR 30 million whichever is less
Public shareholders	at least 200	at least 50
Continuous obligations	quarterly financial statements and an end of the year annual financial statement	semi-annual financial statements and an end of the year annual financial statement
Daily fluctuation limits	10%+-	20%+-

Figure1: Listing requirements of Main Market vs. Nomu

Since its launch in 2017, Nomu has expanded to feature over 90** listed enterprises, underscoring the increasing interest from investors. Among the top IPO performers, Future Care Trading Co. stands out with a cumulative price return exceeding 1,800%** within the first 250 trading days post-IPO. Similarly, NBM achieved a return of over 1,200%**, and Mohammed Hasan AlNaqool Sons Co. saw a 345%** increase within the first 250 trading days post-IPO.

A major appeal of the Nomu market is its potential to serve as a gateway to Tadawul's main market. The top five companies on Nomu now each boast a market capitalization exceeding SAR 3 billion*** (See table below). The average market capitalization on Nomu is approximately SAR 590 million***. This trend indicates that more Nomu-listed firms are becoming eligible to transition to the main market, showcasing Nomu's effectiveness as a bridge between private markets and Tadawul's main market. For instance, in July 2024, Jahez International submitted a request to transfer to the main market. Over the years, companies like Sumou Real Estate Co., Abo Moati for Bookstores Co., Raydan Food Co., and Arab Sea Information System Co. have successfully made this transition.

*Note: Except where shares of the same class are already listed on the Parallel Market, at the date of listing on the Parallel Market the expected aggregate market value of all shares to be listed must be at least SR 10 million for an issuer seeking to offer on the Parallel Market, and SR 100 million for an issuer seeking direct listing. After obtaining the approval of the Authority, the Exchange may allow the listing of shares of a lower aggregate market value if the Exchange is satisfied that there will be a sufficiently liquid market for the shares concerned.

** Data source: Bloomberg Terminal

*** As of 9 July 2024, approximate figures. Data Source: Saudi Exchange.

Nomu is still a crucial platform for supporting smaller companies until they are ready to move to the main market. The market capitalization of firms on Nomu starts at approximately SAR 73.6 million**.

Companies	Market Capitalization ****
Future Care Trading Co.	6.5bn
Jahez International	5.5bn
NBM	2.6bn
Armah Sports Co.	2.3bn
Balady Poultry Trading Co.	2.0bn

For wealthy individuals and institutional investors, a parallel market featuring listed SMEs presents a fantastic opportunity to invest in early-stage companies with significant growth potential. This also promotes greater sector diversification, steering away from the main market's blue-chip stocks, which are predominantly banks and hydrocarbon-related companies. The performance of the top-listed companies on Nomu underscores this potential.

IPO READINESS CRITICAL FOR COMPETITIVE ADVANTAGE

Going public offers several benefits for businesses, with immediate access to cash, more transparency from financiers' perspective, and healthier separation of the firm from shareholder matters being the foremost. However, to capitalize on the market, IPO readiness is crucial, especially for private companies in Saudi Arabia, which are predominantly family owned. Historically, these family businesses have grown during the first generation with lower competition and using access to financial institution lending with personal guarantees. Now, the region is shifting towards the need for non-oil sector growth, more banking/financing options, increased competition, digitalization, and new laws and regulations for stronger corporate governance. In this evolving business environment, companies that are leaner and more adaptable will hold a competitive edge. Second and third generation shareholders are appreciative

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of such change, but this needs to be implemented through a well structured process and transition period.

A key aspect of IPO readiness is corporatization and improved governance. For family businesses, more than other entities, embracing IPO readiness is not only a reaction to changing times but a proactive step to sustain business continuity. Identifying challenges, actionable steps, and strategies to bridge identified gaps is vital for this process. Regularly tracking progress as strategies are implemented is also essential.

For companies willing to take the leap, there is significant potential for transformation across several key indicators. These include enhanced governance through better-organized structures and streamlined policies, a robust financial structure due to accurate financial reporting, and strategic transformation achieved through better business planning and roadmap development.

Taking proactive steps well in advance is crucial to identifying and addressing potential issues early on, alleviating pressure on management during the IPO, and ensuring readiness to undertake an IPO when market conditions are favorable. Based on experience, several key areas require early attention. These include having the right equity story and strategy, evaluating corporate and capital structure, planning for post-IPO dividends, preparing comprehensive historical financial data, developing detailed financial projections, setting up financial reporting procedures, reviewing compensation schemes, ensuring the management team's preparedness, and streamlining administrative processes.

THE CRITICAL ROLE OF FINANCE ADVISORY FOR GROWING SMEs

Firms like Sidra Capital offer guidance and support in critical areas to streamline the path to IPOs. The firm operates as a middle market investment bank serving medium-sized companies through offering a broad spectrum of financial advisory and arranging services.

For over 10 years, Sidra Capital's Corporate Finance Advisory function has provided tailor-made arranging and financial advisory services to corporate clients and family offices, leveraging its local presence in Jeddah, internal financial expertise, network of specialist partners, and agile corporate structure.

Sidra Capital leverages its extensive multi-sector and multi-asset class experience to provide top-tier advisory services tailored to the unique needs and challenges of different stakeholders. The firm has been involved in various mandates within different contexts, such as advising on the transformative Saudia City project to help maximize its

revenue potential. Recently, Sidra Capital was appointed as the shareholder financial advisor for a holding company, assisting with IPO readiness and execution for one of its subsidiaries. Additionally, the firm has executed a phased, Shariah-compliant debt arrangement and restructuring transaction exceeding SAR 3 billion for a major family office, facilitating their transition to a more corporatized business structure and sustainable capital structure.

Speaking on the potential for IPOs to catalyze growth for Saudi-based SMEs, the firm says, *"Second and third generation shareholders should look at the IPO process as a structured and audited way to better prepare the company for business continuity. With an IPO, the firm would build its own strengths through leveraging family and non-family resources in the best way that serves the business."*

It adds, *"First-generation business owners should consider the Nomu market as a way to raise the capital needed for expansion and scaling, post capital injections from personal investments, family, friends, and venture investors. The Nomu market can REPORT 6 facilitate further capital raising through an IPO and additional funding rounds as a listed company. An IPO not only helps in generating funds but also boosts the firm's publicity and enhances transparency for financiers."*

CONCLUSION: TIME FOR SMEs TO HARNESS THE POWER OF VISION 2030

Saudi Arabia is undergoing a remarkable transformation. Bold policies and visionary leadership are driving the kingdom to revamp its economy, empower its society, and diversify away from oil on an unprecedented scale. At the heart of this transformation are millions of entrepreneurs, startups, and SMEs, innovating to meet local and national needs through groundbreaking solutions. To realize this vision in an ESG-focused world, adherence to sustainable financial reporting norms and robust corporate governance will enhance the credibility and visibility of Saudi-based SMEs. Looking ahead, IPOs will provide opportunities to leverage positive market dynamics, allowing investors to engage in a thriving business ecosystem. These IPOs are also key contributors to Vision 2030's goals, accelerating business sustainability within a well-regulated environment bolstered by strong governance and control structures.

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