

# In-Focus Report

## Saudi Tourism Sector Review

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### Executive Summary

- The Kingdom's tourism industry earnings from international travelers and tourism services is poised to hit SAR80 billion by 2015.
- The overall share of the tourism sector of nominal GDP grew from 3.8% to 4.5% between 2006-2009.
- The number of direct employees within the tourism sector has steadily increased to 479,000 in 2009 from 355,000 in 2006.
- During 2009, religious inbound tourism trips accounted for 47.1% of all trips to the kingdom.
- The y-o-y average growth rate of inbound tourists and visitors through 2012 is expected to be 7%, reaching around 16.2 million people.
- Domestic tourism is forecasted to grow through 2012 at a y-o-y average growth rate of 6%, where the total number of tourists and visitors will reach around 40 million people.
- The y-o-y average growth rate of outbound tourists and visitors through 2012 is expected to be 10%, reaching around 8 million people.
- International hotel groups have increasingly targeted the kingdom by investing in hotel projects despite the global economic downturn.
- There has been a recent shift in banks' interests towards lending for pay-back periods of around seven years for hotel projects and four to five years for entertainment related projects.
- Diversified funding options such as public private partnerships (PPP), hospitality funds and a combination of equity financing and bank loans have recently been implemented.
- Although religious tourism represents the majority of issued visas, there is still room for reopening visas for the purpose of recreational and cultural tourism.

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## Introduction

The tourism industry in Saudi Arabia has witnessed an increasing level of growth in recent years and is seen to continue this trend moving forward. The industry has undergone a major transformation led by the commitment to upgrade the Kingdom's infrastructure as well as improving its hospitality sector. Despite being the 22nd highest inbound market in the world, the Kingdom is still a long way from fully unleashing the potential of its tourism industry. A strong emphasis has been placed on the tourism industry, benefiting from the ambitious goal to place Saudi Arabia as one of the top-ten most business competitive nations in the world.

In an effort to achieve its economic diversification, the government of Saudi Arabia established the Saudi Commission for Tourism and Antiquities (SCTA) in 2008 (previously named as Supreme Commission for Tourism in early 2000). The SCTA was established for the purpose of the development, promotion and enhancement of the tourism sector in the Kingdom. The main goal of the SCTA is to develop initiatives such as Vision 2020 with the aim to attract more than 88 million visitors by the year 2020 and to create 900,000 new jobs in the industry. This will almost double the number of current jobs, of which 478,979 is direct and 495,000 is indirect.

Moreover, a focal point of the SCTA is to attract investments into the tourism industry by developing strategies that will, among others, support the national economy, enhance its role in developing local communities, economically and socially, and expand the tourism sector towards achieving its 2020 goals. We forecast the Kingdom's tourism industry earnings from international travelers to reach SAR80 billion by 2015.

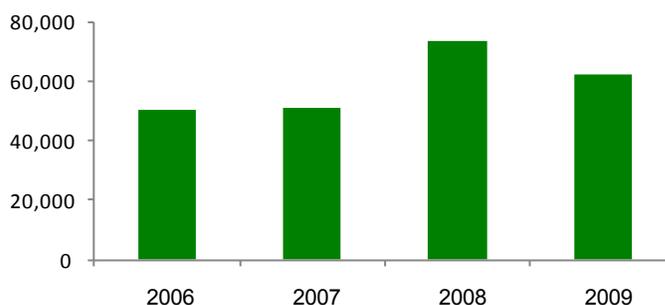
Plans to further develop the Holy cities as well as the Kingdom's cultural tourism industry is seen as a major objective. Saudi Arabia has a rich history and newly created projects are aimed to exploit its heritage through the development of cultural sites. Among these are the walled city of Diriyah, the capital of the first Saudi state, as well as the Nabatean city of Madain Saleh, which was added to the UN educational, Scientific & Cultural Organization's World Heritage list in 2008.

## Market Developments

Tourism expenditure steadily increased between 2006-2009, growing at a CAGR of 7.1%. However, expenditure in 2009 dipped compared to 2008 as a result of the global economic crises and the H1N1 virus fears. Furthermore, the tourism sector increased its share of the Kingdom's nominal GDP from 3.8% in 2006 to 4.5% in 2009 representing a CAGR of 5.8%, and outpacing the growth of nominal GDP during the same period. The tourism sector's share in non-oil nominal GDP minimally grew from 8.4% in 2006 to 10.7% in 2008, but then fell

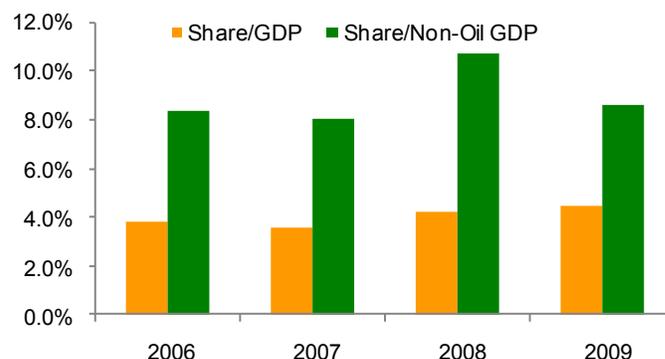
to 8.6% in 2009, signifying the impact of the global economic crises and the H1N1 virus on tourism. The number of inbound tourists dramatically decreased between 2008-2009, (Chart 1), (Chart 2).

Chart 1: Tourism Sector Expenditure



Source: SCTA (MAS)

Chart 2: Tourism Sector's Share of GDP



Source: SCTA (MAS)

The number of direct employees within the tourism sector has steadily increased to 478,979 in 2009 from 355,555 in 2006, which represented a CAGR of 10.4%. Consequently, 25.7% of the workforce were Saudi nationals in 2009, placing the tourism sector as one of the leading sectors in saudiazation, (Chart3).

Chart 3: Tourism Sector's Saudiazation



Source: SCTA (MAS)

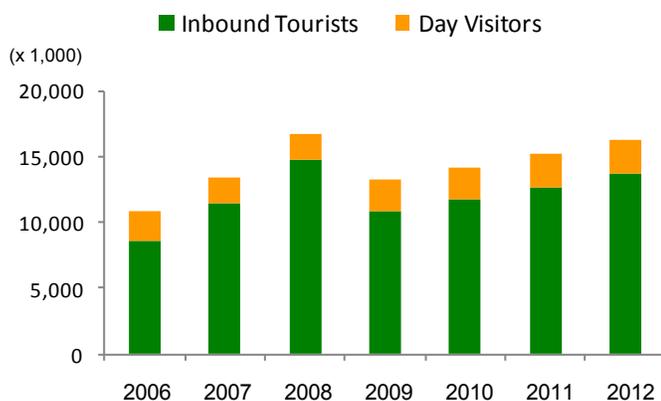
## Market Determinants

The tourism sector is defined by three main categories of traveling. Therefore, the market determinants will be examined across these three categories; inbound tourism, domestic tourism and outbound tourism.

### Inbound Tourism

Inbound tourism is defined as travelers living abroad who visit Saudi Arabia to conduct tourism related activities. This report will focus on activities of overnight visitors (those staying longer than one day) whereas same-day visitors will be excluded as their purpose of travel is not tourism related. The number of inbound visitors (not including same day visitor trips) has steadily increased from 8.6 million in 2006 to 10.9 million visitors in 2009, representing a CAGR of 8.1%. However, the number of inbound tourists decreased by nearly 4 million visitors in 2009 compared to 2008, mainly attributed to the pervasiveness of the H1N1 virus coupled with the global economic crisis. Similarly, the amount of inbound tourism expenditure decreased to SAR29.2 billion in 2009 compared to SAR36.5 billion in 2008. Despite the slip, total expenditure grew at a CAGR of 16.2%, (Chart 4).

Chart 4: Total Number of Inbound Tourists



Source: SCTA (MAS), NCB Estimates

The increase in inbound tourism during recent years is attributed largely to growing religious and business tourism, owed to more flexible visa arrangements. The largest share of inbound tourism is religious tourism as people from across the world visit the kingdom's two holy cities of Makkah and Madinah to perform Hajj and Umrah. During 2009, religious tourism trips accounted for 47.1% of all trips to the kingdom. The government's decision during 2009 to relax Umrah and Hajj visas to cope with demand has allowed more visitors to perform religious rituals. In 2010, the Ministry of Hajj increased the number of Ramadan visas for foreign pilgrims by 16%, reaching 911,000 visas versus the planned 792,000.

The tourism market is expected to continue expansion over the next three years and beyond as the government has declared its commitment to develop the industry. The number of inbound tourists is expected to remain high. The y-o-y growth rate is expected to be nearly 7% through 2012, where we project the total number of tourists to reach 16.2 million people.

Saudi Arabia ranked 62 out of 139 countries in the World Economic Forum's Travel & Tourism Competitiveness Index for 2011. Specifically, in the business environment and infrastructure area, the kingdom's scored relatively well, putting it in the 41st place. However, it scored low in the regulatory framework area and ranked 81st. In an effort to improve its tourism sector, the Saudi government initiated the issuance of group visas to further bolster the number of inbound tourists. The group visa's initial aim is to provide visas to citizens of approximately 65 non-Arab countries. Additionally, the growing business opportunities in the Kingdom has created stronger demand for business tourism.

During 2009, the modes of transport that inbound tourists utilized most were airplanes and vehicles, which accounted for 97.3% of all forms of transport. Inbound tourists from the Middle East represented the majority of inbound arrivals with an 80% share, followed by visitors from South Asia, which represented a 10% share. The preferred mode of transport by inbound tourists from the Middle East was vehicles, which represented 61%, while air travel accounted for the remaining 37%. Approximately 40% of inbound tourists arrivals occurred during the pilgrimage season.

In recent years, the General Authority of Civil Aviation (GACA) along with local airline carriers, mainly Saudi Arabian Airlines, have invested in the expansion and maintenance of airports and increasing the number of flight routes to and from the Kingdom, respectively. The level of expenditure towards these activities is estimated to be greater than SAR2 billion between 2008-2009. The level of expansion is expected to increase as the number of pilgrims is projected to increase every year. Recently, Saudi Arabian Airlines reported a 20% increase in passengers during the first half of 2010, which accounted for both, international and domestic travel.

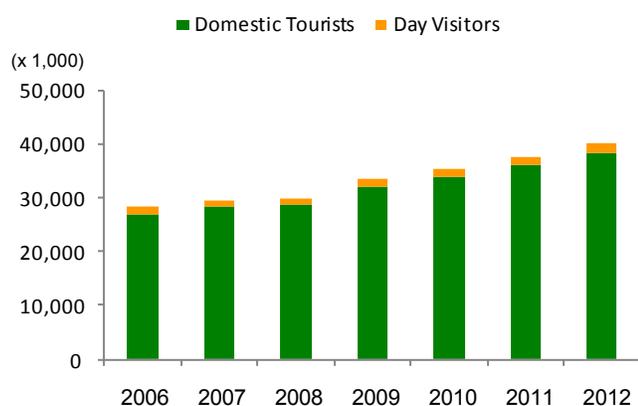
### Domestic Tourism

Domestic tourism is defined as travelers living within the kingdom who travel to different destinations outside of their own areas of residence for the purpose of tourism. Domestic tourism in the kingdom steadily increased from 26.7 million tourist trips in 2006 to 32 million in 2009, growing at a CAGR of 6.25%. Possibly attributed to the H1N1 virus spread during 2009, many residents deferred international travel and elected to travel domestically instead. This is evident from the growth of domestic

tourist trips, which increased by nearly 4 million trips in 2009 from the prior year.

Despite rising domestic tourist trips, tourism expenditure narrowly increased from SAR32 billion in 2006 to SAR33 billion in 2009. However, the level of expenditures in 2009 sharply decreased compared to 2008, which saw expenditures reaching SAR37.5 billion. Domestic tourism is forecasted to grow through 2012 at an expected y-o-y average growth rate of over 6%, where the total number of tourists will rise to 40 million people, (Chart 5)

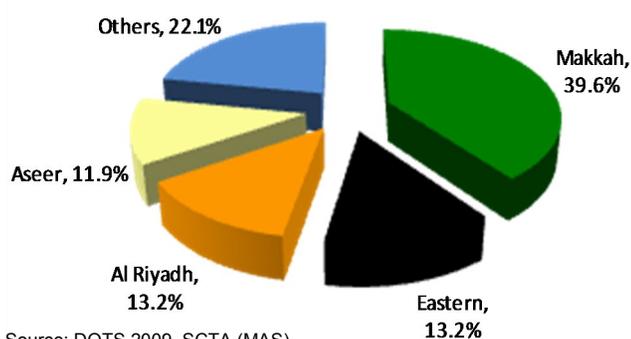
Chart 5: Total Number of Domestic Tourists



Source: SCTA (MAS), NCB Estimates

The two main drivers of domestic tourism are holiday and religious festivals. The summer months along with the Eid Al-Adha and Eid Al-Fitr holidays comprised 40% of domestic travel in 2009 as many residents flocked to the kingdom’s popular holiday retreats such as the Makkah/Jeddah region. Accordingly, the Makkah province, which also includes Jeddah commanded 40% market share as the preferred destination region. Jeddah’s location on the red sea makes it an attractive city to visit as many activities are initiated by the SCTA such as the Jeddah Summer Festival. There were approximately 3.8 million visitors during the months of August and September in 2009, which coincided with the holy month of Ramadan, (Chart 6).

Chart 6: Domestic Trips by Province



Source: DOTS 2009, SCTA (MAS)

A major component that facilitates domestic travel is the development of road networks. The Ministry of Transportation has been aggressively expanding the network of roads that link the different regions of the kingdom. The value of contracts awarded in the roads construction sector during 2008 and 2009 reached SAR12 billion.

With the focus on expanding its highway system as well building roads in rural areas, both passenger and commercial transportation has benefited. The trend of investing in the road sector has continued into 2010 as approximately SAR8.7 billion worth of contracts were awarded. Additionally, there has been a focus on domestic high-speed railways. A contract of SR6.8 billion was signed for the development of a railway project that will link the two holy cities of Makkah and Madina. The Public Investment Fund has also been involved in the development of building passenger railways as it funded approximately SAR2.7 billion in 2009 to develop a railway passenger line in Riyadh, (Table 1).

Table 1 - Investment in Transportation (millions)

Sector	2008	2009	2010
Roads	6,528	5,347	8,693
Passenger Railways	100	11,210	1,283
Total	6,628	16,557	9,976

Source: MEED, SES, NCB Estimates

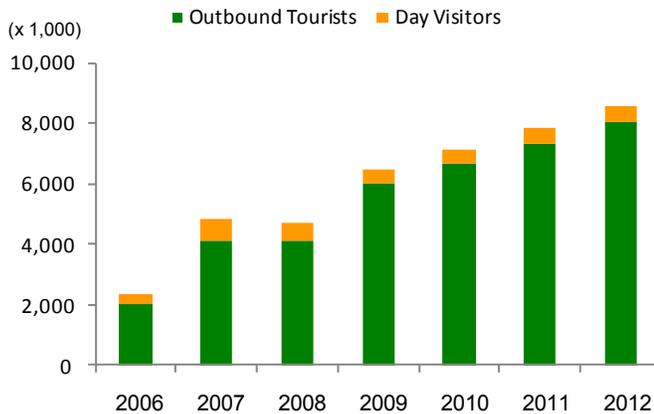
### Outbound Tourism

Outbound tourism is described as residents who travel outside of the country. There has been a growing trend of traveling abroad for tourism by Saudi nationals. Although the tourism sector within the kingdom has been growing recently, the level of attraction has yet to reach the level of more popular international destinations. In 2009, approximately 80.5% of outbound tourists traveled for leisure, while those visiting family and friends was around 13%. Traveling during the summer season represented 30% of the total outbound tourism.

Outbound tourism has been growing at an increasing rate in the last few years as the number of outbound tourists between 2006 and 2009 tripled from 2 million to over 6 million, respectively, representing a CAGR of 44.5%. The number of outbound tourists is expected to increase as many of the initiatives that are aimed at increasing domestic tourism are still in their early stages and will not impact outbound tourists in the short-term, Outbound tourism expenditure has also significantly increased between 2006 and 2009 where it grew from SAR6.8 billion to SAR28.4 billion, respectively. The average daily expenditure by each outbound tourist was

SAR520 and the average length of stay was 9.1 days, (Chart 7).

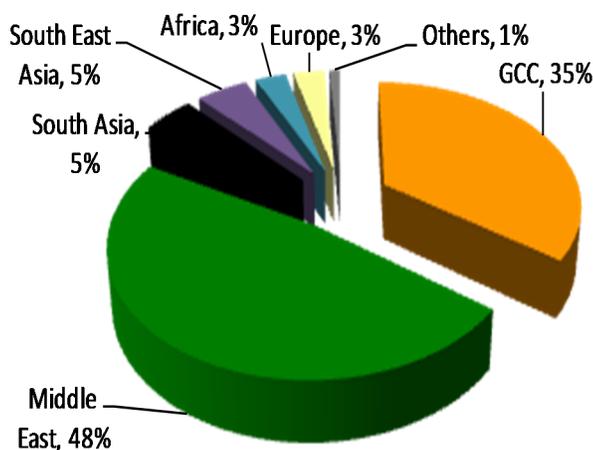
Chart 7: Total Number of Outbound Tourists



Source: SCTA (MAS)

Furthering the growth of outbound tourism is the increase in international flights and carriers to and from the kingdom. Germany's national carrier, Lufthansa, recently added 20 additional flights per week from the three main cities of Riyadh, Jeddah and Dammam. Additionally, British Airways has resumed its service to the kingdom after suspending it due to commercial performance. Other international carriers have also steadily increased their services to the kingdom to meet growing demand. Saudi Arabian Airlines has also expanded its international flight services to major destinations with a primary focus on the Middle East & GCC were approximately 83% of outbound tourists traveled to, (Chart 8).

Chart 8: Outbound Tourists by Region

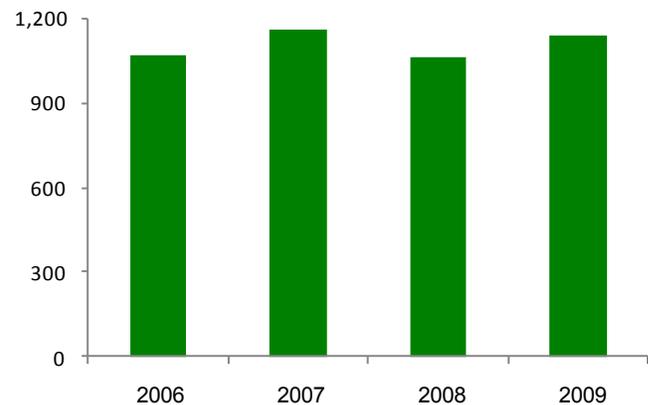


Source: SCTA (MAS)

### Accommodation Sector

The combination of inbound and domestic tourism (internal tourism), relies heavily on the accommodation sector since there is an overlap between the two segments. The total number of internal tourists reached approximately 43 million in 2009, while spending a total of approximately 355 million nights. Given the heavy demand for accommodation by tourists, key players in the accommodation sector have taken strategic initiatives to expand the supply of hotels. Between 2006 and 2009, the number of hotels have grown from 1,070 to 1,140, representing a CAGR of 2.1%, (Chart 9).

Chart 9: Total Number of Hotels



Source: Ministry of Commerce

The Ministry of Finance has taken an assertive role in the development of hotel industry by providing loans worth 50% and up to SAR50 million of the construction cost of a hotel project. These projects are granted licenses by the Ministry of Commerce and are subject to inspections to ensure the quality of the projects are strictly maintained. More recently, the Ministry of Commerce issued licenses to hotel projects in underserved areas that merit the need for increased hotel accommodation.

International hotel groups have increasingly targeted the kingdom by investing in hotel projects despite the global economic downturn. Known hoteliers such as Rotana, Hyatt, Raffles Hotels & Resorts Group and Accor Group have recently opened or are in the process of opening hotels and resorts across the kingdom. The area of focus has been Makkah where megaprojects such as Abraj al-Bait's development of the Makkah Clock Royal Tower and a 76-story five star hotel is due to be completed by 2012. Also, the Saudi Binladen Group was awarded the contract to build the SAR10 billion Jabel Omar project in Mecca, which will include six five-star hotels, (Table 2).

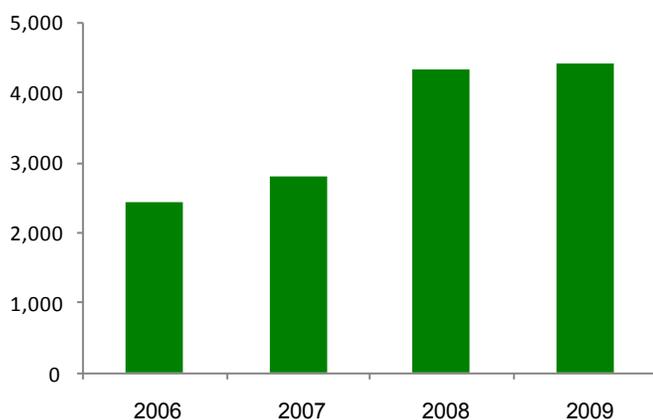
Table 2 - Anticipated Supply- Major Projects

Projects	Rooms
Marriot Courtyard (2011)	300
Four Points Sheraton (2011)	300
Novotel (2012)	160
Kempinski Hotel Jeddah (2012)	250
Rocco Forte Hotel (2012)	159
Cop Hotel (2013)	600
Ritz Carlton (2013)	140
Granada Centre Hilton (2013)	830
Rafal Tower Kempinski (2013)	300

Source: Jones Lang LaSalle

Another component of the accommodation sector is furnished apartments. The number of furnished apartment buildings rapidly grew from 2,437 in 2006 to 4,423 in 2009. The demand for furnished apartments increased with the growth of domestic tourism in the kingdom. However, the influx of religious tourists plays a major role in the supply of furnished apartments. The Makkah province currently accounts for nearly 35% of all furnished apartments in the Kingdom. Although occupancy peaked in November of 2009, which coincided with the pilgrimage season, it only reached 54%. This low occupancy rate possibly reflects the over supply of furnished apartments in the kingdom, (Chart 10).

Chart 10: Total Number of Furnished Apartments



Source: Ministry of Commerce

Beside the organized market, and “informal market” exists that offers accommodation facilities during the pilgrimage season in Makkah and Madinah. The exact size of this “informal market” is not determined, but has been progressively decreasing due to the competitive prices that hotels and furnished apartments are offering along with their respective amenities, facilities and services.

### Tourism Sector Financing Alternatives

To promote tourism investment, SCTA has taken an active role in assisting entities that seek financing for tourism projects. The incentives offered by the SCTA are mainly through direct financial support programs (grants, soft loans, allowances). The SCTA provides such incentives that are within its powers and jurisdictions or in cooperation with other authorities.

The government has various development funds and financing resources that were established for supporting the development of economic activities. Funds that can be used as a source of funding for the tourism sector include:

- Saudi Credit & Savings Bank
- The Centennial Fund
- Saudi Industrial Development Fund
- Public Investment Fund
- Human Resources Development Fund

In an effort to assist Small and Medium Enterprises (SMEs) and actively participate in promoting the tourism sector, the establishment of the Kafalah program by the Saudi Industrial Development Fund has provided needed support. The Kafalah program’s goal is to cover a percentage of a lender’s risk in the event of a default whereby a partial repayment (up to 75%) by the fund is granted. Consequently, the program is supposed to encourage local banks to finance SMEs that are unable to provide guarantees to prove their merit for funding.

The Public Investment Fund (PIF) has also been involved in financing of the tourism sector. The PIFs chief role is to provide financial support to productive projects, which are commercial in nature and are strategically significant for the development of the national economy. It seeks projects that cannot be implemented by the private sector alone because of insufficient experience or inadequate capital resources. The total amount of loans committed by the PIF by the end of 2009 totaled SAR86.7 billion of which SAR54.2 billion was disbursed to finance projects across many sectors including tourism. As of 2009, the Ministry of Finance has an outstanding 103 loans worth SAR2.4 billion that was granted for the establishment of hotels and tourism related projects.

Saudi Banks are generally not prepared to advance funds for the long duration required for hotel financing. The continued reliance of commercial banks on short-term deposits to finance long-term projects present the banks with an asset-liability mismatch. However, there has been a recent shift in banks’ appetites towards lend-

ing for pay-back periods of around seven years for hotel projects and four to five years for entertainment related projects. This change has allowed major players with successful track records in the tourism industry to raise their debt-to-equity ratios to within a range of 50-60%.

Another financing option was that of Jabal Omar Development Company (JODC), which consisted of equity financing through an IPO and bank loans. After its successful IPO of 200 million shares worth SAR2 billion, JODC sought a bridge loan from five major local banks in the amount of SAR1.35 billion. More recently, JODC is in talk with interested banks to secure a syndicate loan worth SAR5 billion.

Other forms of financing include SHUAA Capital's creation of the SHUAA Saudi Hospitality Fund I, which has an aggregate target size of SAR2 billion invested to date in three hotel/resort projects in partnership with Rotana Hotel Management Corporation. Additionally, a more diversified funding option of public private partnership (PPP) is opted for the Al Uqair development project worth an estimated SR50 billion in the Eastern Province. Concessions in the form of significantly reduced land prices will be provided by the government, which will be represented by the Ministry Of Municipality and Rural Affairs. Other government entities including GOSI and PIF, will be investing in this project. It is also planned that private placement will be pursued with key investors, followed by an initial public offering (IPO).

## Conclusion

The focus to grow the tourism sector in the Kingdom in recent years with the help of the establishment of the SCTA has created larger investment opportunities. The ambitious goals set forth by the SCTA will allow the tourism sector to expand its contribution to the national GDP and to be one of the leading sectors in employing Saudi nationals. There are numerous projects in the pipeline that will give the kingdom's residents and incoming tourists alike, the touristic options that have not been previously available. An example of this is the plan to build a touristic coastal city in the Eastern Province. The tourist city will be located in the eastern city of Al Uqair and will create more than 80,000 employment opportunities for young Saudi men and women.

Although religious tourism is the main attraction for inbound tourists and will continue to be so for the foreseeable future, the government has taken steps to increase domestic tourism and persuade potential outbound tourists from vacationing abroad. However, large investment in the sector is required to bring these ambitious plans to fruition. Insufficient bank lending as well as limited funding alternatives through the capital markets puts a heavy burden on the government to provide the financing needed to support the sector.

The tourism sector comprises only 2% of government funding compared to the industrial sector, which received 88%, while agriculture received the remaining 10%. Despite this, the tourism sector led other sectors in generating employment opportunities. The hospitality sector is a major contributor in employing people since it represents 5% of the total workforce in the kingdom.

Although religious tourism represents the majority of issued visas, there is still room for reopening visas for the purpose of recreational and cultural tourism. With all signs pointing towards heavy investment in the tourism sector, the amount of both ongoing and future projects will allow the sector's expenditures to become a growing share of the kingdom's GDP in the medium to long-term.



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