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Company Types in the Kingdom of Saudi Arabia

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Knowing which corporate vehicle to use is a key concern in any commercial enterprise. This article will summarise the different types of corporate entity used within the Kingdom of Saudi Arabia and the key differences between them.

Regulation of Companies

The formation and operation of corporate entities in the Kingdom is regulated by the Companies Law (the CL) which came into effect on 2 May 2016.

The five forms of companies which can be established in the Kingdom are:

- joint liability companies (the equivalent of general partnerships);
- limited partnership companies (the equivalent of limited liability partnerships);
- joint ventures;
- joint stock companies (JSCs); and
- limited liability companies ("LLCs").

In addition, the CL permits foreign companies to establish branches or representative offices in the Kingdom. Foreign investment in the Kingdom is also regulated by the Foreign Investment Law of 2000 and its Implementation Regulations of 2013 (as amended), which prohibits foreign investors from engaging in certain activities in the industrial and service sectors and requires foreign investors to obtain an investment licence from the Ministry of Investment (MOI) before establishing any type of corporate structure in the Kingdom.

LLCs, JSCs and branches are the most common vehicles used by foreign investors in the Kingdom, although investors' choices are generally driven by factors such as shareholder numbers, management structure and the business activities permitted. Industrial and certain types of service companies can be wholly-owned by foreign investors.

Other vehicles in the Kingdom include general partnerships, limited partnerships and joint ventures. Joint ventures do not have legal personality, are not subject to registration formalities and are not entered into the commercial register.

Characteristics of LLCs

LLCs are the equivalent of private limited companies and are the most common form of corporate vehicle in the Kingdom. Main characteristics of LLCs include:

- **Partners**: Minimum of one and maximum of 50 partners. A sole partner may only form one single partner LLC; a single partner LLC may not own another single partner LLC.
- **Capital and Reserves**: No minimum capital requirement, except for certain categories of companies licensed by the MOI or the Capital Market Authority which must have the required minimum capital. Capital contributions in kind must be independently valued. LLCs must annually set aside a minimum of 10% of net profits to form a statutory reserve. The LLC may stop this allocation when the statutory reserve reaches 30% of the LLC's paid-up capital.
- **No public subscription**: The LLC may not offer its participation interests (shares) for public subscription. To do so, the LLC must be converted to a JSC.
- **Liability of Partners**: Partners' liability is limited to the value of their participation interest. Article 155 of the Companies Law provides for an exception to the limited liability of partners in the case of a sole partner LLC. The sole partner will be liable to the extent of its own property for the obligations of the LLC towards third parties with whom such owner has dealt in the name of the LLC if such sole partner:
    - has, in bad faith, liquidated the LLC or suspended its activities before expiration of the LLC's term or before achievement of the objects for which the LLC was formed;
    - makes no separation between the activities of the LLC and its other activities;
    - carried on business for the account of the LLC before it has acquired its legal personality.
- **Directors**: The LLC is managed by a sole manager or a board of manager.
- **Confidentiality**: A duty of confidentiality applies to all partners in respect of company information they receive in their capacity as partners.
- **Share Transfers**: Transfers to third parties are subject to a statutory pre-emption right. Transfers must be (i) recorded in the LLC's share register lodged with the Ministry of Commerce (MOC) and (ii) reflected in the LLC's articles of association through

execution of amended articles of association of the LLC before a Saudi notary public. Partners are able to specify a valuation method for their interests in the LLC in the articles of association.

Characteristics of JSCs

JSCs are the equivalent of public limited companies. Certain types of business must be carried out through a JSC, including banking, insurance and finance business. There are two types of JSCs: "closed" JSCs, which are unlisted JSCs and "public" JSCs, which are listed as JSC-listed. All companies listed on the Saudi Stock Exchange are "public" JSCs and are subject to a higher degree of oversight, including by the Capital Market Authority. JSCs are incorporated on the basis of a resolution of the MOC; further authorisation by royal decree is required if the JSC is to receive state assistance or intends to undertake public sector projects, banking or insurance activities. JSCs are subject to more regulation than LLCs and compliance costs are significantly higher. Other characteristics of JSCs include:

- **Shareholders**: Minimum of two shareholders. A closed JSC may be incorporated with a single shareholder if, for instance, such shareholder is owned by a government-related body or such shareholder is a company with a capital of not less than SAR 5 million.
- **Capital and Reserves**: Minimum capital requirement of SAR 500,000, except for certain categories of companies licensed by the MOI, the Saudi Arabian Monetary Authority or the Capital Market Authority which must have the required minimum capital. 25% of a JSC's capital must be paid up at the time of incorporation and the balance must be paid up within five years. Share contributions in kind must be independently valued. Like LLCs, JSCs must set aside a minimum of 10% of net profits until the statutory reserve reaches 30% of the JSC's paid-up capital. The shareholders of a JSC enjoy statutory pre-emption rights on issue of new shares.
- **Liability of Shareholders**: Shareholders' liability is limited to the value of their shares.
- **Directors**: Minimum of three and maximum of 11 directors.
- **Minority Interests**: The CL strengthened the position of minority interests in the following ways:
  - introducing cumulative voting for the election of members of the board. This allows shareholders to cast all of their votes to a single nominee for the board, rather than having to divide the total value of their votes amongst different candidates for

board membership. As a result, depending on how majority shareholders allocate their votes, minority shareholders may still be able to appoint their own board members, thereby improving their representation;

    - imposing a requirement to establish an audit committee independent from the board;
    - providing that the position of the chairman may not be combined with any other executive position; and
    - granting the right to nominate board members in accordance with the shareholder's ownership percentage.

- **Debt Issuance**: JSCs may issue sukuks and other debt instruments; these may be converted into negotiable shares.
- **Dealing in Shares**: JSCs are permitted to buy-back or pledge their shares.
- **Transfers**: The shareholders of a JSC do not enjoy statutory pre-emption rights on share transfers.
- **Conflicts of Interest**: Rules prevent JSC board members who have a direct or indirect interest in any of the JSC's business from voting at board or shareholder meetings in respect of the same. Where a board member fails to disclose such interest, the relevant contract could be nullified and the board member may be required to repay any profits received. JSC board members may not compete with the business of the JSC without the approval of JSC shareholders.

Both LLCs and JSCs are permitted to be holding companies, provided none of their subsidiaries hold shares in the holding company.

Branches and TSOs

Foreign investors may establish branches and Technical and Scientific Offices (TSO) in the Kingdom. All branches and TSOs must be licenced by MOI.

Branches are considered an extension of the parent company. The main advantage of branches and TSOs is that they can be established relatively quickly compared to LLCs and JSCs. Branches:

- can be used for a full range of activities permitted in the MOI licence of the branch;
- can engage in projects in both the public and private sector; and
- may promote and solicit its MOI -licensed business throughout the Kingdom.

Branches are not allowed to conduct promotion, marketing and trading activities. TSOs do not have minimum capital requirements. A TSO cannot engage in commercial activities. Its activities are limited to providing technical information and assistance regarding the foreign company's products to its Saudi distributor(s) and to end users of the products, studying and reporting on the market and conducting research.

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