Spending efficiency in Saudi Arabia's public sector

Cultivating an investment mindset

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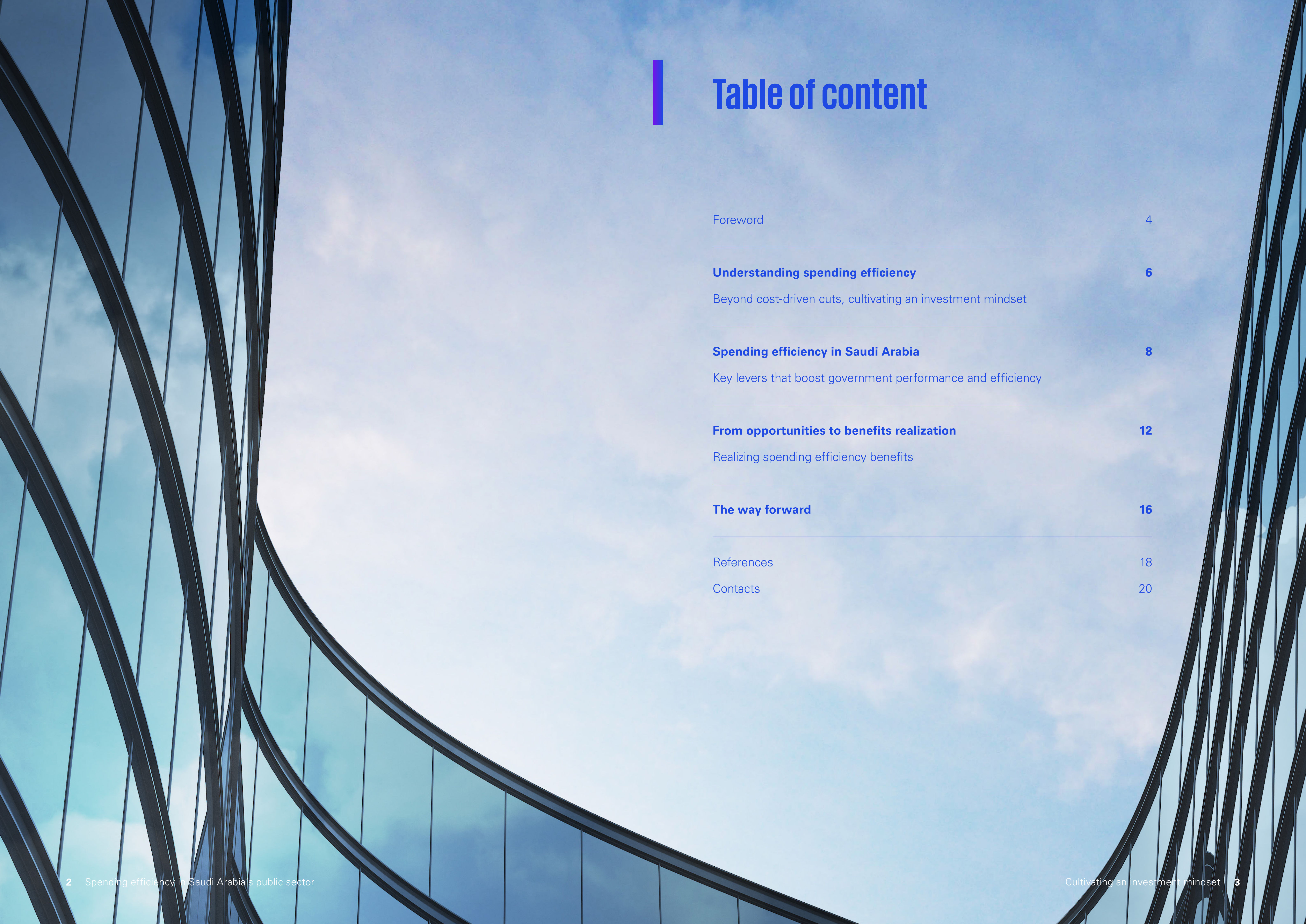
KPMG Professional Services



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Foreword

The pursuit of efficiency in government spending has become a critical global concern due to mounting pressures from rising debt levels to the growing demands of an aging population, increasing the need to improve public sector spending efficiency.

Saudi Arabia is no exception. According to the IMF, Saudi Arabia's expenditures in 2023 amounted to 32.3 percent of GDP which increases the expectations that spending on programs is efficient and effective, and that investments have good value for money.[1] As part of Vision 2030, Saudi Arabia has set an ambitious strategic objective to enhance effectiveness of financial planning and efficiency of government spending. It has done this through the launch of its Fiscal Balance Program to reform the Kingdom's financial framework to ensure sustainable government spending by diversifying revenue sources and reducing reliance on oil.

This effort and focus have paid off. The Kingdom is now becoming a benchmark in areas such as government procurement and digitalization. It has improved its rank in the World Bank Government Effectiveness Index and been recognized by the IMF on the significant progress in enhancing transparency in government procurement through the implementation of digital Etimad platform. According to the Digital Government Authority, the Kingdom has jumped 25 places in the UN E-Government Development Index (EGDI) 2024, achieving fourth position globally and first regionally and second among the G20 countries on digital services index.

Furthermore, Saudi Arabia advanced to the sixteenth place in the IMD World Competitiveness Ranking 2024, issued by the International Institute for Management Development (IMD). Specifically, Saudi Arabia advanced from the thirteenth rank to the twelfth in business efficiency, while it maintained its previous 34th place in infrastructure. In addition, the Kingdom remained among the top 20 countries in economic performance and government efficiency. However, there is space for improvement for Saudi Arabia to speedup the execution pace of its capital projects.[2]

This paper builds on the leading practices we have implemented to drive spending efficiency impact and deliver value to our clients. It aims to explore a transformative concept where cultivating an investment mindset in the public sector is key to maximizing the benefits from public spending, as it represents a shift from the traditional, cost and spend-focus to a more holistic and investment-focused approach. Such a shift has the potential to transform public sector operations, resource allocation, service improvement, and as a result, deliver greater value and impact.

This concept sets the stage for a deeper understanding of the spending efficiency ecosystem in Saudi Arabia and highlights the levers that boost government performance and to become more sustainable and efficient. Working on these levers is vital to improving the maturity of spending efficiency practices in public sector organizations and hence increasing efficiency. Understanding these levers is the first step toward effectively finding sustainable solutions to increase efficiency.

In this paper we introduce the key steps needed to build a culture of holistic evaluation and implementation of spending efficiency opportunities and we conclude by highlighting the way forward for government entities to embed an investment mindset in their vision, strategy, culture, capabilities, operations, technology, and decision-making process.

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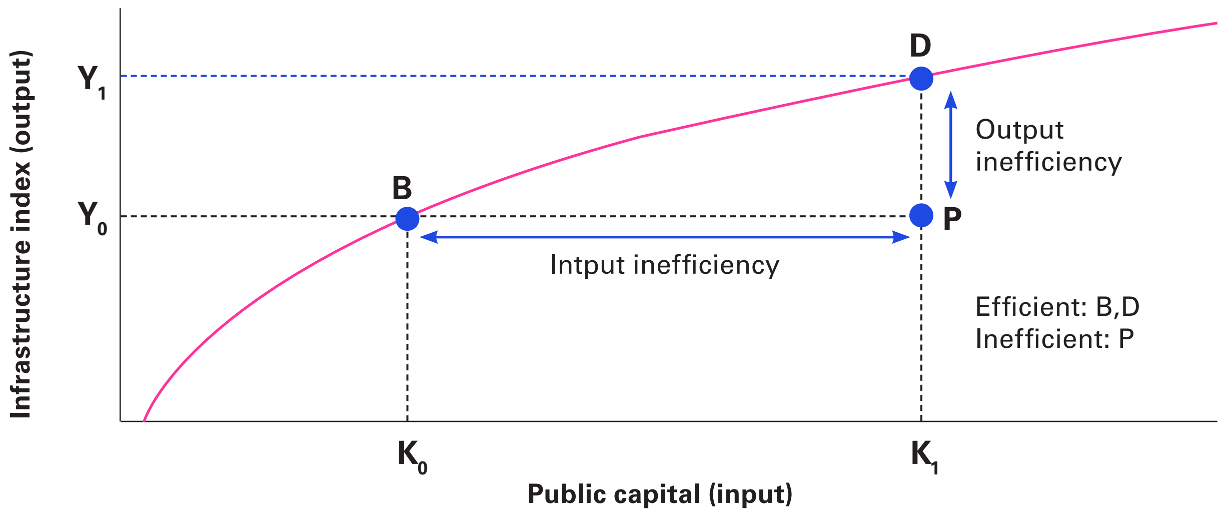
Understanding spending efficiency

Typically, efficiency is defined as the maximum attainable output for a given level of inputs. Inefficiencies can be attributed to input-inefficiency (excess input consumption to achieve a level of output) and to output-inefficiency (output shortfall for a given level of inputs).[3]

According to the IMF, a country's public investment efficiency is benchmarked relative to an **efficiency frontier.**[4] The efficiency frontier is based on the best performers in terms of output for any given level of input. A country on the efficiency frontier is considered "efficient" and assigned a score of 1, whereas a country below the frontier is considered "inefficient" and given a score of less than 1. The further a country is from the frontier the more inefficient it is.

Figure 1: Efficiency frontier



According to the British economist Michael James Farrell, it is key to consider not only technical efficiency, which is the ability to produce a given level of output with a minimum quantity of inputs under a certain technology, but also to consider allocative efficiency, which is the ability to use inputs in optimal proportion for given price factors and according to government priorities.[5]

So, the product of technical and allocative efficiency is economic efficiency, which is defined as the ability of an organization to produce a given output at minimum cost. If an organization has achieved technical and allocative efficiency levels of production, then it is economically efficient and new investment may be critical for new development.

Further, timing of spending is key to efficiency. Two independent studies by World Bank have found that the timing of public investment is a crucial determinant of its efficiency. Investing too early or too late sharply reduces economic returns.[6] An example of this happens when governments massively spend on infrastructure projects without carrying out proper supply-demand studies that can shed light on the timing and size of the needed investment.

The concept of efficiency has evolved later to include eco-efficiency.[7] As defined by the World Business Council for Sustainable Development (WBCSD), "eco-efficiency is achieved by the delivery of competitively priced goods and services that satisfy human needs and bring quality of life, while progressively reducing ecological impacts and resource intensity throughout the life cycle to a level at least in line with the earth's estimated carrying capacity." In short, this implies creating more value with less negative impact.

Beyond cost-driven cuts

There is a common misconception that spending efficiency is the same as cost-cutting, which primarily aims to reduce expenses to meet budget requirements. Saudi Arabia's Minister of Finance clarified the concept of spending efficiency as below.

> Spending efficiency is not cutting or limiting spending, rather it is the optimal utilization of money and resources, and it is ensuring that we spend what we need and when we need it at lower competitive prices to realize a return.[8]
>
> **His Excellency Mohammad Al-Jadaan**
> Minister of Finance

In accordance with this definition, we may add that achieving organizational efficiency in some cases requires strategic investments (spending). In other words, becoming more efficient requires more upfront funding while saving governments money in the long-term. Therefore, focusing solely on cost-cutting can cause government entities to miss opportunities for long-term savings and improved service delivery, preventing them from realizing the full benefits of a balanced approach to spending efficiency. Further, leaders need to encourage spending on opportunities that either have a reduction impact on their budget or avoid costs. Both types of savings are necessary to build an efficiency and effectiveness culture in their organization.

Cultivating an investment mindset

An investment mindset in the public sector means considering public expenditures as investments, ensuring alignment with strategic objectives, and giving priority to initiatives and projects that offer long-term benefits over quick fixes. This shift in thinking emphasizes sustainability and the delivery of better outcomes and services for citizens and the country, while also mitigating any associated risks, and emphasizing transparency and accountability in resource allocation. This not only enables government decision-makers to evaluate different options and scenarios and accordingly decide on the right investment, but also gives decision-makers a logical argument when reviewing budget requests.

To enhance spending efficiency and fully capitalize on investment opportunities to maximize returns, it is often essential to proactively identify and engage key stakeholders—such as relevant entities and authorities. By fostering strategic collaboration, organizations can distribute investment costs more effectively, expand the pool of beneficiaries, and ultimately enhance the overall return on investment.

According to research by the Economist Intelligence Unit, rather than thinking of Sustainable Development Goals (SDGs) initiatives as a cost, they might be better regarded as an investment that can bring more and better economic growth.[9] For developing countries, which often urgently need to expand public services, there is also the opportunity to leapfrog past practices. In certain cases, sustainable approaches – such as energy efficiency and attention to inclusive employment opportunities – can be introduced while bypassing resource-intensive technologies and phases of development.

Saudi Arabia's Ministry of Finance has put in place regulations and policies to ensure that capital project budget requests are supported by strong business cases that include strategic, economic, commercial, financial, and management studies. This sets an important foundation for the public sector to move towards an investment mindset with efficient and effective public spending.

Viewing public expenditures as investments allows for a mindset shift towards long term sustainable impact.

Spending efficiency in Saudi Arabia

Vision 2023 adopted strategies to enhance the sustainability of public finances by raising the efficiency of government spending on capital and operating expenditures and diversifying the country's sources of income.

> We commit ourselves to providing world-class government services which effectively and efficiently meet the needs of our citizens.[10]
>
> **His Royal Highness Prince Mohammed bin Salman Al Saud**

In 2016, Saudi Arabia embarked on a transformative and ambitious plan to unlock the Kingdom's vast efficiency improvement potential. To achieve the objectives of balancing the budget and achieving sustainable economic growth, the Bureau of Capital and Operational Spending Rationalization was established with the mandate to support government entities to identify and implement opportunities for optimization of efficiency in both capital and operational expenditure through the development of mechanisms and policies needed to improve spending efficiency and to ensure sustainability of implementation.[11]

In 2018, the Bureau of Capital and Operational Spending Rationalization evolved into the Spending Efficiency Center, becoming more focused on how to transform government procurement into a strategic process through the establishment of the Strategic Procurement Unit.

In 2021, the cabinet approved merging the National Project Management, Operation and Maintenance Organization (Mashroat) with the Center of Spending Efficiency and renaming it the Expenditure and Projects Efficiency Authority (EXPRO).[12] EXPRO's primary focus became to contribute to enhancing the efficiency of government entities' expenditures, improving the quality of projects, assets, and facilities, improving infrastructure planning, overseeing programs, initiatives, and operational processes funded through the government's general budget, and monitoring the implementation of these entities' programs and initiatives to attain the Kingdom's efficiency objectives.

This effort has culminated in the realized savings that were channeled to priority areas.

> Since the launch of the Vision 2030, government institutions have contributed to releasing savings of more than SAR530 billion, including SAR120 billion of savings in 2021. These savings have been redirected to expenditures that serve the development targets and priority schemes for the benefit of citizens and the homeland, reducing the implementation time for projects by over 3,500 days overall.[13]
>
> **Eng. Abdulrazzaq Al-Aujan**
> CEO, EXPRO

Key levers that boost government performance and efficiency

Although Saudi Arabia's spending efficiency effort has culminated in the realized savings that were channeled to priority areas, some challenges still remain. Public officials face immense pressure to deliver immediate results, which often leads to a bias towards quick wins and short-term solutions. This is exacerbated not only by pressing issues that require immediate solutions, but also by having limited resources which necessitates prioritizing projects with rapid payoffs over long-term projects.

To foster an investment mindset with an eye on sustainable impact, the utilization and integration between the below levers can notably improve the maturity of public sector spending efficiency practices and as a result deliver bigger impact.

Clear vision

Articulating a vision for the organization's future aligned with the country's vision to justify investments and spending.

Accountability and decision-making process

Improving governance and having clear accountabilities for spending and investment decisions allows for more careful study of opportunities and projects, embedding investment thinking into the strategic planning, budgeting, and resource allocation processes, and adopting measures that reward long-term performance over short-term spending.

Collaboration and coordination

Improving transparency and building a culture of knowledge sharing among entities allows for more integration and learning from leading practices and therefore reduces duplication of effort and increases efficiency.

Capacity and capacity-building

Focusing not only on setting up the legal and regulatory aspects and governance, but also on readiness for implementation allows for better planning to build capacity and capabilities in the right time and emphasizing the hiring and training of staff in areas such as cost-benefit analysis, data analysis, and project management.

Project appraisals and timing

Project appraisal is technically difficult, and the process is often rushed, resulting in shortcuts being taken to get to the procurement stage. Further, major public investment projects are typically implemented over multiple years, and this presents challenges for budgeting, especially when decisions to fund those projects do not take into consideration the Vision 2030 priorities of implementing those projects in the right time. Effective budgeting and commitment procedures can make it more likely that funds are available when needed during the construction cycle of major projects. Using stage gates for key decisions ensures fund availability matches project milestones, reducing the risks if projects are delayed or canceled. This approach to long-term project budgeting improves spending efficiency and prevents unexpected issues from prolonged projects.

Maintenance of assets and infrastructure

Few public sector entities consistently track the number of buildings and assets they have, their status and utilization, and the maintenance backlog. As a result, inadequate information on the status of assets and infrastructure undermines maintenance planning. Adopting an asset lifecycle management approach that considers the entire lifespan of assets and proactively implementing the maintenance process as well as investing in a state-of-the-art asset management system and tools improves efficiencies.

Quality data and technology

Capturing quality data and ensuring that it is governed and maintained allow for calculating spending efficiency baseline and final impact. Investing in technology solutions that leverage AI to improve operational efficiency such as the use of AI-powered robotics process automation, the use of blockchain and AI in contracts where payment terms and compliance checks are automated, the use of AI to forecast supply and demand, and provide predictive maintenance analytics for smarter spending.

Performance and incentives

Studying the performance management and rewards system in the organization and updating relevant policies to foster a culture that values strategic thinking and creating an environment that values innovation, creativity, and resilience.

From opportunities to benefits realization

Having supported governments across the world and in Saudi Arabia to improve their efficiency, we formed a clear understanding of the challenges that public sector entities face when moving efficiency opportunities from identification to benefit realization.

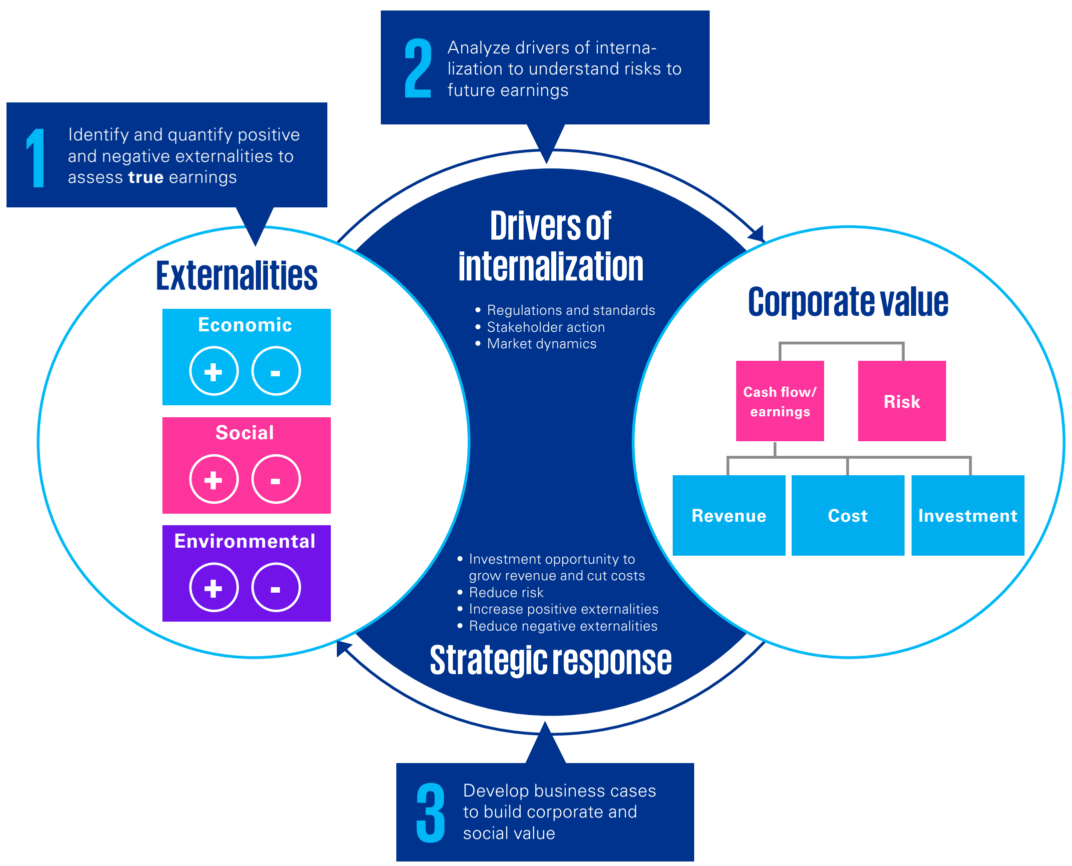
Research and expert analyses indicate that public sector organizations often are better at identifying spending efficiency opportunities than at converting those opportunities into meaningful and sustainable impact. Most of those opportunities usually require spending or rather investment for efficiencies to be realized. Therefore, for those opportunities to be converted into initiatives or projects, budgets need to be approved and allocated. For budgets to be approved, it then becomes necessary to develop clear business cases for impact of these initiatives to serve as key input to the budgetary decision-making process.

Utilizing the levers we presented in the previous section improves the realization of benefits and impact that come out as a result of investing in implementing spending efficiency opportunities. According to KPMG's True Value Methodology, external environments including its economic, financial, and societal impact need to be studied alongside the drivers of internalization such as regulations, stakeholders' actions and market dynamics. This allows entities to quantify and strategically position their efficiency investment opportunities, and to form a holistic view of quantifying the negative and positive impacts of investments on entities and society.[14]

Saudi Arabia has adopted a similar framework to evaluate projects based on the five case model which includes: strategic case, economic case, financial case, commercial case, and management case.

Further, EXPRO issued two detailed guides to Project Management and Asset and Facilities Management which were prepared in accordance with the best local and international standards and practices. By following the standards set forth in those guides, some government entities have been able to achieve success in the speedy implementation of government projects by 40 percent.[15]

Figure 2: KPMG's True Value Methodology



Realizing spending efficiency benefits

On these pages, we suggest key steps to be considered when entities embark on their spending efficiency journey and to build an investment mindset culture and support the new ways of working.

Opportunity Identification

To ensure a good spending efficiency opportunities pipeline, entities should set spending efficiency KPIs and targets and carry out periodic spending reviews on all critical budget categories where areas with efficiency potential are flagged.

Objectives and scope Setting

Once a potential efficiency opportunity is flagged, it is important for entities to first articulate the case for the spending efficiency opportunity, highlighting potential improvements and savings and clearly defining the problem and root causes and align key stakeholders on the objectives and scope.

Baselining

Once the efficiency opportunity objectives and scope are defined and agreed upon, the data gathering methodology is defined and the required data and information is gathered to establish the current state and calculate a baseline. Aligning key stakeholders on the baseline calculation is crucial.

Designing

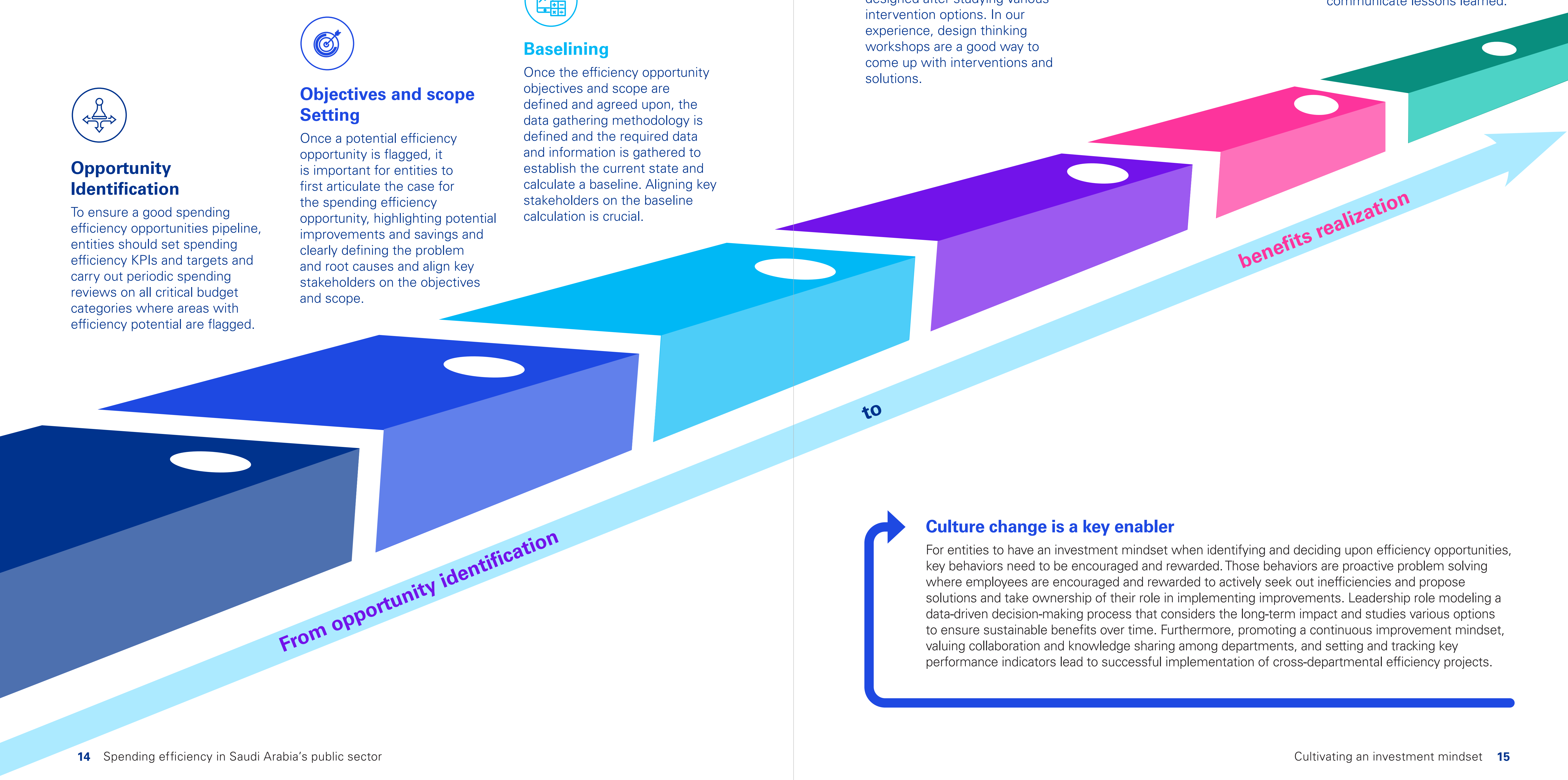
Based on the defined root causes of the inefficiency, a fit-for-purpose intervention is designed after studying various intervention options. In our experience, design thinking workshops are a good way to come up with interventions and solutions.

Implementation

Obtaining the right budget and resources based on a robust business case as well as having the right plan and governance in place are prerequisite to successful implementation.

Measurement of Impact

Once the entity is successful in implementing the intervention, the financial and non-financial benefits are calculated and quantified, and success story is communicated to stakeholders. If benefits are not realized, it is crucial to study root causes, recommend actions, and communicate lessons learned.



Culture change is a key enabler

For entities to have an investment mindset when identifying and deciding upon efficiency opportunities, key behaviors need to be encouraged and rewarded. Those behaviors are proactive problem solving where employees are encouraged and rewarded to actively seek out inefficiencies and propose solutions and take ownership of their role in implementing improvements. Leadership role modeling a data-driven decision-making process that considers the long-term impact and studies various options to ensure sustainable benefits over time. Furthermore, promoting a continuous improvement mindset, valuing collaboration and knowledge sharing among departments, and setting and tracking key performance indicators lead to successful implementation of cross-departmental efficiency projects.

The way forward

Embedding an investment mindset—in culture, operations and decision-making processes—in government entities requires targeted actions that foster a culture focused on long-term value creation and operational efficiency. Below are key takeaways to help instill an investment mindset to unlock value and accelerate organizations spending efficiency transformation journey.

Raise awareness and educate employees on the true meaning of efficiency, emphasizing the importance of reducing waste and improving operational and capital expenditure processes. This foundational understanding is crucial for fostering an investment mindset.

Leadership to role-model and enforce the right behaviors through long-term thinking decision-making and incentives. By modeling the desired behaviors, leaders can set the tone for an investment-focused culture.

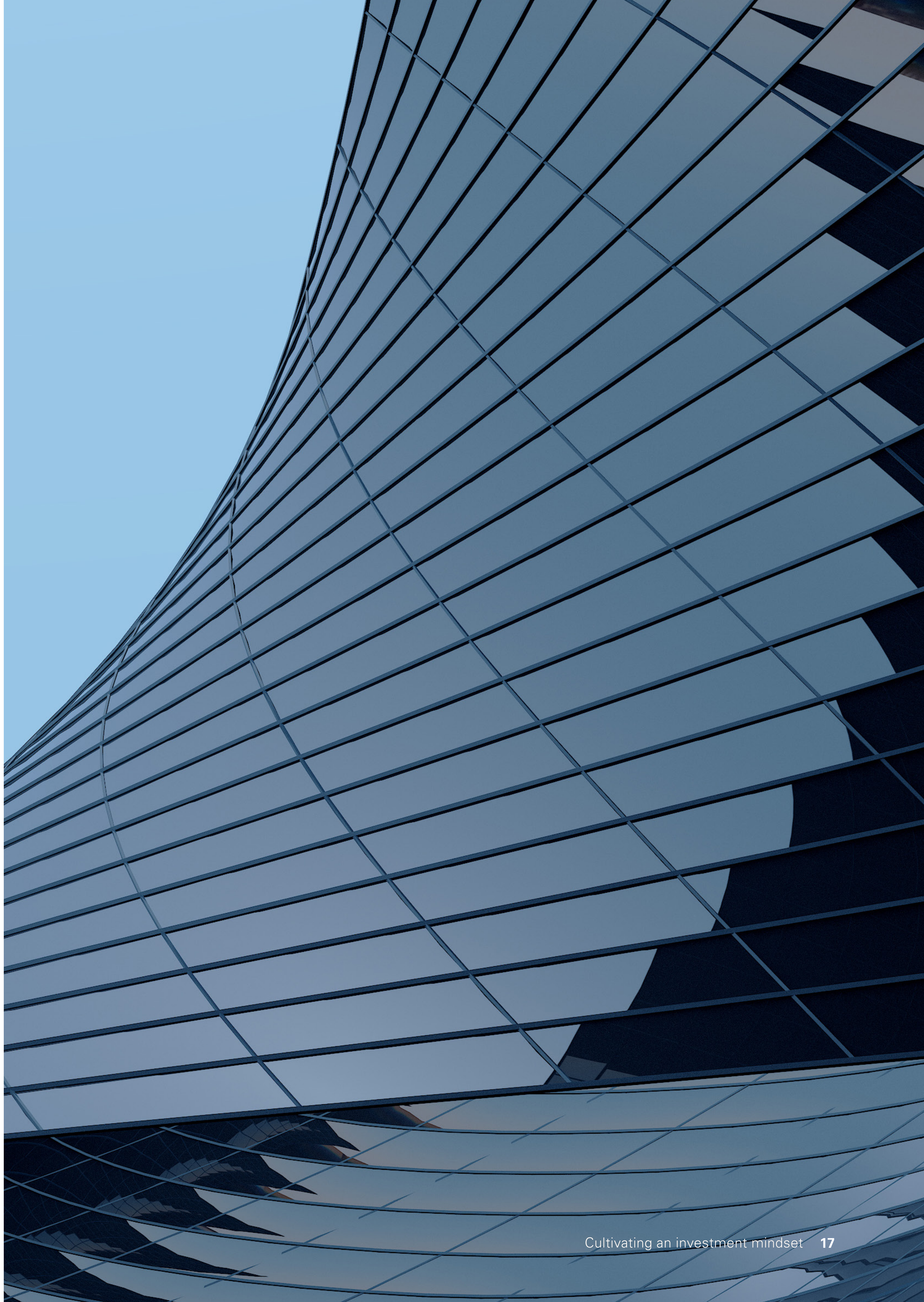
Build people capabilities in developing business cases and prioritization of efficiency opportunities. Training programs and workshops can equip employees with the necessary tools and knowledge.

Have a clear process to harvest efficiency opportunities across organizational levels and stakeholders and through innovative top-down and bottom-up approaches. This ensures a continuous pipeline of efficiency opportunities.

Have quality data and the AI-powered technologies to transform the organization's operations through improving data quality and through automation, minimizing waste via predictive insights and enhancing transparency and accountability, all while improving agility and competitiveness.

Establish oversight and governance to ensure that efficiency opportunity's objectives, scope, baseline, data requirements, implementation plan are in place and performance is tracked. Have the right governance where impacted stakeholders' roles and responsibilities are clarified and their contribution of realized efficiency benefits are agreed upon.

These actions, when implemented effectively, can help government entities start to shift towards an investment mindset, driving sustainable improvements and long-term benefits for the organization, its stakeholders, and the country at large.



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