The Structure of SMEs in the GCC and How are they Promoted

By

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Satisfaction

Arab – EU Event
The Importance of SMEs

- SMEs contribute significantly to the development and growth of efficiency, particularly to innovation, job generation, and international competitiveness. They are therefore the main drivers for growth and economic diversification.
- SMEs are the backbone of any successful and sustainable economy.
- They are the blood cells behind successfully diversified economies and large corporations.
- They have local roots and provide local jobs, but can also exploit the opportunities from globalization.
- It is generally agreed that economic diversification and job creation for Gulf nationals will not succeed if SMEs do not play a substantial role in the process.
In what way did SME help

<table>
<thead>
<tr>
<th>Economic Activity</th>
<th>Number of firms</th>
<th>Employment</th>
<th>Innovation</th>
<th>Entrepreneurial opportunities</th>
</tr>
</thead>
</table>

Economic Activity

Examples cited from major economies in the world:
According to an investigation conducted by the U.S. Bureau of the Census:

1. SMEs accounts for more than 40 percent of known U.S. merchandise exports.
2. Much of the growth in SME merchandise exports was attributable to an increase in the number of new market entrants.
3. The services sectors were the most important for SME economic activity, accounting for 79.0 percent of SMEs’ contribution to GDP
According to the census:

1. SMEs accounted for 99.9 percent of the 27 million employer and non-employer private nonfarm businesses in the United States in 2006.

2. The vast majority of SMEs are firms with fewer than 20 employees.
The Census states that:

1. SMEs employed roughly half of the 120 million nonfarm private sector workers in the United States in 2006.

2. Employment within SMEs and larger firms grew by comparable rates between 1998 and 2006, and was largely fueled by employment growth in services and construction sectors.
SMEs are an important source of innovation processes, products, and services and can be more efficient at producing innovation than large firms.
Entrepreneurial opportunities

1. SMEs provide important opportunities for all citizens to develop entrepreneurial skills
2. The potential of SMEs to promote domestic-led growth in new and existing industries and to strengthen the resilience of the economy in a competitive and challenging environment is inarguable.
3. According to Department of statistics of Malaysia, the economic growth in developed countries such as Japan, Korea, Taiwan and many others, was significantly generated by SME activities.
4. The percentage contribution of SMEs to Gross Domestic Product (GDP)/total value added ranges from 60.0 percent in China, 57.0 percent in Germany, 55.3 percent in Japan and 50.0 percent in Korea, compared to 47.3 percent attained by Malaysia.
5. The SME growth is assessed by SME contribution to the three (3) main sectors of the economy; manufacturing, services and agriculture.
This shows that small and medium enterprises (SMEs) have been the backbone of economic growth and driving industrial development.

Due to their sheer numbers, size and nature of operations, the role of SMEs in promoting endogenous sources of growth and strengthening the infrastructure for accelerated economic expansion and development has to be recognized.
Are SMEs living to their full potential
In the Gulf Region

Despite the importance, the large size of SME sector in the Gulf, SMEs have not lived up to its full potential

Only limited research has been done about the challenges that Gulf SMEs face

The belief that SMEs growth is not desired at all cost. Only if it leads to diversification, innovation and the creation of employment for Gulf nationals

It is not even clear how exactly an SME is defined
How SMEs are defined in the Gulf

There are three main criteria used to define when a company is considered a small or medium enterprise:

- The number of employees
- The annual turnover
- The assets of a company
How SMEs are defined in the Gulf

- Most public and private bodies dealing with SMEs base their definitions on the number of employees.
- However, there is no consistent definition of the thresholds which define whether a company is considered small, medium or large within the Gulf countries.

According to a research conducted by Dr. Steffen Hertog who conducted a Survey of challenges and opportunities to benchmark the SME Policies in the GCC, he came up with the following definitions.
How SMEs are defined in Bahrain

The Ministry of Commerce and Industry (MOCI) considers

- **Micro-enterprises** to have up to 10 employees,
- **Small enterprises** up to 50, and
- **Medium-size ones** up to 150 employees.

An exception is made for the labor-intensive textiles and garment sector, where companies are still considered medium-size with up to 300 employees.

MOCI also differentiates companies by investment levels, with the thresholds being 20,000, 500,000 and 2 million Dinars for micro, small and medium-size enterprises respectively.

It is doubtful, however, that MOCI has reliable data on invested capital for all local companies.
The Kuwait Small Projects Development Company, a state-financed fund that takes equity shares in small and medium projects considers projects with capital up to

- 150,000 Kuwaiti Dinar (520,000 $) as small
- Those with less than 500,000 Dinar (1.7 million $) as medium-size.
- The number of employees does not appear to be used as size criterion.
According to the Omani Ministry of National Economy, *companies with*

*Up to 5 employees* are micro-enterprises,
Up to 20 are considered small,
Up to 100 are medium.

According to the Ministry of Commerce and Industry, however, companies with

Up to 10 workers are small
Up to 50 are considered medium size

Banks in Oman have yet different definitions, sometimes based on company turnover
There seems to be no consensual definition of small and medium enterprises in Qatar, where SME support policies are still in their infancy and the sector is relatively undifferentiated.
In Saudi Arabia, there are again several institutions using different definitions. The Saudi Arabian General Investment Authority has in the past classified
Small enterprises as having less than 60 employees, while Medium-size companies as having less than 100

According to other bodies,
Small companies are those with less than 5 million Saudi Riyals (1.3 million $) of capital, while Medium-size ones have capital between 5 and 20 million SR (5.3 million $) – similar to the capital criteria of Bahrain’s MOCI.
In the UAE, different definitions have been used by government and by banks.

Dubai Chamber of Commerce considered companies with less than 10 employees micro, those with less than 20 or 25 small, and those with less than 100 medium-size, provided turnover is less than 100 million Dirham/year.

UAE banks usually consider companies small if their turnover is below 10 million $/year (37 million Dirham) and medium-size if it is under 25 million $ (90 million Dirham).

In late 2009, the Dubai government set a general definition for SMEs, which is differentiated by sector and takes both turnover and workforce size into account.
How SMEs are defined in the Gulf

Official definition of SME categories in Dubai

<table>
<thead>
<tr>
<th>Category</th>
<th>Trading</th>
<th>Manufacturing</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employees &amp; Turnover</td>
<td>Employees &amp; Turnover</td>
<td>Employees &amp; Turnover</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt;= 9 &amp; &lt;= AED 9 mn</td>
<td>&lt;= 20 &amp; &lt;= AED 10 mn</td>
<td>&lt;= 20 &amp; &lt;= AED 3 mn</td>
</tr>
<tr>
<td>Small</td>
<td>&lt;= 35 &amp; &lt;= AED 50 mn</td>
<td>&lt;= 100 &amp; &lt;= AED 100 mn</td>
<td>&lt;= 100 &amp; &lt;= AED 25 mn</td>
</tr>
<tr>
<td>Medium</td>
<td>&lt;= 75 &amp; &lt;= AED 250 mn</td>
<td>&lt;= 250 &amp; &lt;= AED 250 mn</td>
<td>&lt;= 250 &amp; &lt;= AED 150 mn</td>
</tr>
</tbody>
</table>

Source: Mohammed Bin Rashid Establishment for SME Development
Definitions outside of the Gulf

The most important criteria, which differentiate small businesses from large ones, include:

1. Invested Capital;
2. Number of employees;
3. Volume of sales;
4. Net profit;
5. Value added;
6. Degree of delegation of authority and responsibility; and
7. Type of technology used.

Some studies rely on the number of employment and the amount of capital to define small businesses, however, big differences amongst countries in deciding on the exact limit of these criteria.
The SME definition that is the most widely shared in the developing world – adopted among others by UNIDO – is based on the headcount of the workforce using the following thresholds

### The EC Enterprise SME definitions

<table>
<thead>
<tr>
<th>Enterprise category</th>
<th>Headcount: Annual Work Unit (AWU)</th>
<th>Annual turnover (or)</th>
<th>Annual balance sheet total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medium-sized</td>
<td>&lt; 250</td>
<td>≤ €50 million (In 1996 ≤ 40 million)</td>
<td>≤ €43 million (In 1996 ≤ 27 million)</td>
</tr>
<tr>
<td>Small</td>
<td>&lt; 50</td>
<td>≤ €10 million (In 1996 ≤ 7 million)</td>
<td>≤ €10 million (In 1996 ≤ 5 million)</td>
</tr>
<tr>
<td>Micro</td>
<td>&lt; 10</td>
<td>≤ €2 million (previously not defined)</td>
<td>≤ €2 million (previously not defined)</td>
</tr>
</tbody>
</table>
Bahrain:
The SMEs are facing challenges to growth because they lack access to finance and specialized advice.

A leading businessman and economist Dr Yousef Mashal said:

1. Bahrain did not have financial services to support SMEs.
2. Without access to finance, SMEs were held from expanding, updating their technology and management and advancing their marketing campaigns.
3. Bahrain Development Bank was established to support the SMEs, but it has to distribute its services across all sectors, not just the industrial sector," Dr Mashal told the GDN.
4. There should be financial services just for SMEs to help them improve and advance.
5. SMEs in Bahrain were growing but their full potential would only be reached with the full effort of the EDB, government, banks and the private sector.
6. The economic vision 2030 has growth through industrial development, so everyone needs to work on this," said Dr Mashal.
Qatar:

Recent programs to support SME development have focused on key objectives of promoting diversification and competitiveness.

According to the IMF report, the standing of SMEs in Qatar’s economy is “weak” by regional and global standards. Why? This is because:

- Banks are reluctant to lend to Qatar SMEs because of high risk.
- Bank lending to SMEs as a share of total lending is 0.5%, substantially lower than the GCC (Gulf Co-operation Council).
- SMEs in the country contributed about only 15% of non-oil GDP in 2010 and less than 20% of total employment in 2011,
Qatar (Cont):

However,

- Challenges to the development of SMEs in Qatar have been identified and the obstacles to SME development are comparable globally.

Financing of the obstacles persist, despite the credit guarantee scheme, as commercial banks are still reluctant to lend to SMEs, due to:

I. the small size of the market,
II. its high risk and set-up costs,
III. the absence of a legal structure for quick arbitration, and
IV. lack of SME-specific credit rating in the credit bureau.
UAE:

SMEs contributed 60% to UAE GDP in 2011 according to the Ministry of Economy

- The contribution of SMEs in the UAE GDP grows 100% in comparison to 2010
- Gulf Capital, one of the largest and most active alternative investment firms in the Middle East, recently launched a $300 million Fund to meet the financing needs of fast growing companies as part of its strategy to support top performing SMEs.
- Mohammad Saleh Shelwah, Assistant Undersecretary for Economic Policy Affairs, told Gulf News: new SMEs law has been developed to boost economic output and to reduce the unemployment pressure in the private sector as it creates a lot of job opportunities.”
- The new law will be issued this year as part of ongoing economic reforms. This is aimed at attracting investment and ensuring sustainable growth by strengthening the non-oil sector and reduce the country’s dependence on volatile oil prices
The sectoral structure of Gulf SMEs is skewed towards simple contracting and trading operations.
According to official sources, there were some 40,000 SMEs in Bahrain in 2007, indicating a high density of business: one company for about 25 inhabitants of the country (or for about 12 Bahrainis)

- 98.6% of companies have less than 100 employees, hence qualifying as SMEs.
- 77.2% have less than 10 workers
- 49.5% are micro-enterprises with less than 5 workers;
SMEs are most active in manufacturing (14%) and TRADE AND REPAIRS is the dominant sector, with almost 43%.
In Kuwait, the number of SMEs was estimated at 33,000 companies in 2007, representing about 90% of the total of registered companies.

The sectoral distribution of SMEs is similar to that in Bahrain, i.e.

- Enterprises with around 10 employees are highly concentrated in two sectors:
  - wholesale/retail trade and hotels and restaurants (40% of SMEs), and
  - construction and industry (33% of SMEs)
  - The remaining 27% of SMEs are distributed in finance, industry, and services
The Qatari statistics for the private sector is broken down by size of company for some sectors, but only dividing companies into those with less than 10 and those with 10 and more employees.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number of Companies</th>
<th>Number of workers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>&lt; 10 Worker s</td>
<td>10 + workers</td>
</tr>
<tr>
<td>Trade</td>
<td>6521</td>
<td>1044</td>
</tr>
<tr>
<td>Restaurants &amp; Hotels</td>
<td>1560</td>
<td>1344</td>
</tr>
<tr>
<td>Industry</td>
<td>1950</td>
<td>826</td>
</tr>
<tr>
<td>Construction</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Transport</td>
<td>182</td>
<td>149</td>
</tr>
<tr>
<td>Finance &amp; Business Services</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Agriculture</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Oman

- According to 2008 figures, SMEs constitute over 90% of Oman’s 48950 companies. A sectoral breakdown is not available.
- The statistics about national employees include only individuals who are registered with the national social security system, hence significantly understating the contribution of SMEs relative to larger companies.

<table>
<thead>
<tr>
<th>Number of Insured</th>
<th>Employees</th>
<th>Registered Establishment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>Number</td>
</tr>
<tr>
<td>1</td>
<td>3.4</td>
<td>4,501</td>
</tr>
<tr>
<td>2 to 5</td>
<td>8.4</td>
<td>11,080</td>
</tr>
<tr>
<td>6 to 10</td>
<td>4.4</td>
<td>5,832</td>
</tr>
<tr>
<td>11 to 20</td>
<td>5.8</td>
<td>7,585</td>
</tr>
<tr>
<td>21 to 100</td>
<td>20.8</td>
<td>27,344</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>131,775</td>
</tr>
</tbody>
</table>
Sectoral breakdown of Saudi SMEs
UAE

Sectoral breakdown of UAE SMEs

Source: Standard Chartered
SMEs constitute more than 90% of businesses in every country of the region.

A large share of SMEs is active in the trade sector; other important sectors include small-scale workshops, hotels and restaurants as well as contracting.

In some, but not all cases, the data allow us to distinguish micro, small and medium enterprises.
Where the distinguishing is possible, it is clear that despite their numerical dominance, the contribution of micro-enterprises with up to 10 employees to formal employment is rather modest.

SMEs with up to 100 employees, tend to employ between 40 and 63% of the insured private labor force.

The data about SMEs’ contribution to the national economy GDP is very little. However, it is known that SMEs on average pay lower wages and run less capital-intensive and lower-margin operations than larger companies.
Bahrain

- Eased rules on non-GCC firms to own buildings and lease land
- Established a one-stop shop to facilitate licensing procedures
- Permitted foreign ownership to increase from 49 to 100 percent of businesses in all but a few strategic sectors (e.g., oil and aluminum).

Kuwait

- Passed a law allowing foreigners to own 100 percent of Kuwaiti companies
- Reduced corporate taxes from 55 percent to 25 percent.
- Established Foreign Investment Capital Office to process foreign direct investment applications.
Promotion of Foreign Direct Investment

- **Oman:**
  - Allowed 100 percent foreign ownership of companies in most sectors
  - Reduced income tax disparity between Omani and foreign companies by raising the single rate for the former from 7.5 percent to 12 percent and lowering the rates for the latter from 15–50 percent to 5–30 percent
  - Redefined "foreign" company as one with more than 70 percent foreign ownership instead of currently 49 percent
  - Allowed foreign, non-GCC, firms to own buildings and lease land.
  - Opening up the service sector to full foreign ownership in line with WTO agreements, starting in 2003 with the information technology sector.

- **Qatar**
  - Allowed 100 percent foreign ownership in agriculture, industry, health, education, and tourism sectors,
  - Streamlined investment approval procedures.
  - Reduced maximum corporate tax from 35 percent to 30 percent.
Promotion of Foreign Direct Investment

- **Saudi Arabia:**
  - Enacted a new Investment Law and established the associated investment authority (SAGIA) to facilitate foreign direct investment processing.
  - Establishment a one-stop shop.
  - Allowed for 100 percent foreign ownership of business in most sectors, including gas, power generation, water desalination, and petrochemicals.
  - Cut the highest corporate income tax on foreign investment from 45 percent to 30 percent.
  - Permitted non-Saudis to own real estate for their business or residence, except in the two holy cities.

- **United Arab Emirates:**
  - Launched several new free trade zones intended to establish the emirate as a global center for trade in gold bullion, Research and development of technology, and financial activities.
  - Relaxed restrictions for foreign investment in specific real estate projects.
Challenges for Gulf SMEs
For SMEs to provide more quality jobs and for genuine entrepreneurship to spread more widely, a number of important challenges need to be tackled.

These include both generic problems that SMEs everywhere in the world have to struggle with, and a number of issues that are more specific to the GCC.
Finance is a key challenge for SMEs worldwide.
• Banks in the Gulf are generally reluctant to lend to SMEs.
• According to a study by Dun and Bradstreet, banks in the UAE in 2008 rejected 50-70% of credit applications from SMEs due to the higher risk.
• SMEs need finance to grow and to test new business models.

An important limiting factor to SME lending, is arguably the accounting practices of most small companies in the region.
• 95% or more of enterprises in the GCC are single proprietor companies, and the distinction between company and private assets is often hazy.
Generic Challenges

Innovation, business planning and management issues

- The delegation of daily operations to expatriate managers – especially in the smaller and richer Gulf countries – limits innovation and the acquisition of skills among SME owners.
- As long as a regular stream of income can be created with low-margin activities and very low effort from the owner’s side, reluctance to innovate and take risks will remain widespread among small companies.

Human resource issues

- Access to talented manpower for Gulf SMEs is limited.
- This has to do with the better salaries that larger companies can often afford to provide, but also with the lack of career plans and long-term prospects for SME employees.
Generic Challenges

- A study conducted by the SME Center at the Riyadh Chamber of Commerce and Industry, indicated that
- 44% of SME managers see workforce issues as an important obstacle to their development
- The most important obstacle identified by the study, is bureaucracy
- The phenomenon is not specific to the GCC. worldwide reports also indicate the existence of problems with access to governmental information

Bureaucracy

- Globalization and international trade integration are often perceived as a threat to small business, not only in the Gulf, but everywhere in the world.
- The sectors and activities that are likely to be most affected by bilateral trade and investment agreements or WTO rules most notably finance, commercial representation and agencies

Challenges and opportunities of internationalization
Companies registered under the name of a national, but are financed and run by an expatriate
The role of the national is usually limited to collecting a monthly fee
It is widespread among SMEs than among large companies
They have come into being because specific sectors are officially barred to foreign investors
It creates a significant problem for targeted support policies

According to both surveys and labor market statistics, the majority of young job seekers continues to prefer a government post to private sector employment
As a result of this, private employment continues to be dominated by expatriates
In the SME sector, there is the compounding factor that wages on average are even lower than with large companies, work conditions often less attractive, and employment even less secure
This is why the contribution of micro-enterprises to (formal) national employment appears far smaller in the GCC than in Europe
Most important obstacles to SME development according to Riyadh Chamber of Commerce and Industry survey
GCC governments have been eager to develop long term sustainable economies diversified away from oil.

Recent international research by global management consultancy (A.T. Kearney) highlighted crucial role in the successful development of sustainable domestic economies.

The approach for diversification in the GCC has so far primarily been concentrated on the development of free-zones, to grow the GDP and attract international investment.

This has been done successfully and is fine as a first step. But the next step is to create a long term growth.

This is done by developing a strong SME sector.
Developing the competitive skills required for growing an entire new industry can take years to achieve and typically demands large capital injections.

Tactically supporting the SME sector is less capital intensive, quicker to execute, and generates added value faster.

A.T. Kearney experience from Europe shows that successful SMEs grow three times faster than SMEs on average, and create jobs up to six times faster than SMEs on average.

The GCC is ideally placed to leverage the key learning from Europe to create a successful SME sector in the GCC.

The total potential for GCC is an additional USD 100 Billion to GDP and up to 2 million jobs in the coming years. (This number is based on A.T. Kearney analysis of benchmarks of SME job creation and contribution to GDP from across the world)

Therefore, SMEs deserve an adequate public policy to help them get their ideas off the ground and grow.
Thank You