



KUWAIT INVESTMENT AUTHORITY,  
KUWAIT FUND FOR ARAB ECONOMIC DEVELOPMENT &  
OLIVER WYMAN JOINT COMPANY

# POST OIL GULF: SMEs TO THE RESCUE?

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## ABSTRACT

The SME sector is a key pillar of the global economy and it is the main driver of employment and economic growth. Gulf governments are hoping to develop the local SME sector into a major force to diversify their economies, and counter the economic slowdown that stemmed from the 2014 oil price collapse. To be successful, governments need to take a holistic approach to develop an environment conducive to SMEs. This will require decisive and swift actions in the areas of regulation, financing, skills and innovation, and internationalization.

# 1. SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs): A KEY DRIVER OF THE GLOBAL ECONOMY

Small and Medium-sized Enterprises (SMEs) play a crucial role in the global economy. Although they are small individually, as a group they are by far the most common type of business. Their contribution to economic activity is at par with that of large companies, and their dynamism drives growth at both international and local levels. Furthermore, they constitute the largest source of employment globally, providing livelihood for more than two-thirds of the world's population.

are even higher, with SMEs constituting 99.8% of all businesses, generating €3.6 TR, or 58%, of the value added in the economy<sup>1</sup>.

SMEs also contribute to innovation and development. For example, 20% of European patents in biotechnology-related fields are filed by SMEs<sup>2</sup>. Furthermore, SMEs are highly active in global trade. In China, the world's largest exporter, SMEs account for 41.5% of the total export value<sup>3</sup>.

## DRIVERS OF ECONOMIC ACTIVITY

Over 95% of all companies in the world are SMEs, and together they generate around half of global GDP. In geographies such as the European Union the numbers

### SME DEFINITION

There is no universally recognized definition for SMEs. The European Union defines an SME as a firm that employs 250 people or less. Some countries place the upper limit at 200, while the United States sets it at 500 employees for the manufacturing sector and has lower limits for other sectors.

The upper limit for small companies is typically 50 employees, while the limit for micro enterprises is 10 employees.

Financial assets and turnover are other criteria which are frequently used to define SMEs by different institutions. The European Union defines SMEs as follows:

	<b>MEDIUM -SIZED (50-249 EMPLOYEES)</b>	<b>SMALL-SIZED (10-49)</b>	<b>MICRO-SIZED (&lt;10)</b>
<b>BASED ON FINANCIAL ASSETS:</b>	<b>€50 MN</b>	<b>€10 MN</b>	<b>€2 MN</b>
<b>BASED ON TURNOVER:</b>	<b>€43 MN</b>	<b>€10 MN</b>	<b>€2 MN</b>

**Source:** OECD, European Union

1. World Economic Forum "SMEs and global markets: The missing link for inclusive growth", 2015

2. OECD "Meeting of the OECD council at Ministerial Level", June 2017

3. Integrating SMEs into Global Value Chains : Challenges and Policy Actions in Asia, 2016

## DRIVERS OF EMPLOYMENT

The half-billion SMEs around the world employ 60–70% of the global workforce<sup>4</sup>. In geographies as diverse as the European Union, Latin America and South-East Asia, employment contribution by SMEs stands at around 67%<sup>5</sup> (See Exhibit 1). SMEs are thus crucial to socio-economic development across the world.

It is worth noting that the high rate of employment is also a symptom of a lack of productivity among SMEs. Indeed, SME contribution to GDP averages only 35% in developing countries and 50–60% in developed countries, although the sector employs a much higher share of the workforce<sup>6</sup>. The underperformance in productivity translates into lower salaries which in turn limit the attractiveness of SMEs to an increasingly educated global workforce and acts as a barrier to growth.

Nevertheless, countries such as Germany, where SME productivity is a high 70% of that of large corporations, demonstrate that it is possible to develop a strong performing SME sector that can generate attractive job opportunities for a skilled workforce<sup>7</sup>.

## DRIVERS OF SUSTAINABLE ECONOMIES

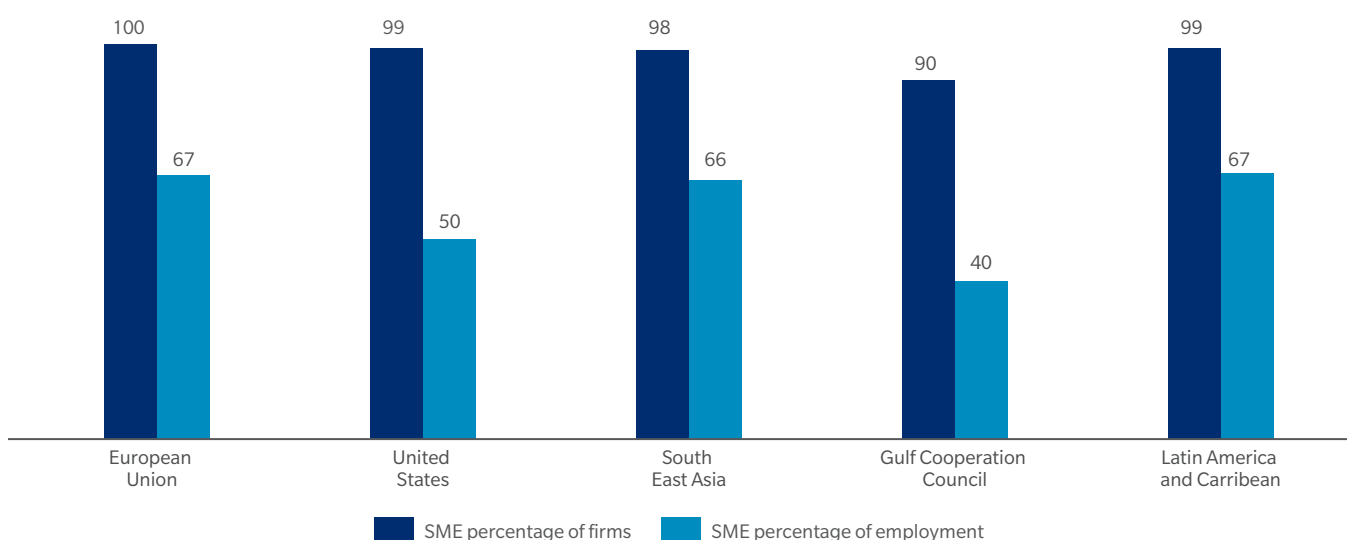
In the future, the role of SMEs as leaders in job-creation could become even more critical. There is already evidence that the corporations of the digital age generate significantly less jobs than those of the industrial age. For example, Facebook generated a profit of US\$ 15.9 BN in 2017 with 25,000 employees, compared to Ford that generated half the profit (US\$ 7.6 BN) with eight times more employees<sup>8</sup>.

Furthermore, the so called 4<sup>th</sup> industrial revolution is expected to lead to significant job destruction through sophisticated automation supported by Artificial Intelligence (AI). The potential for automation could affect 40–55% of all jobs and it is a growing concern among workers and policy makers<sup>9</sup>.

While large businesses can use these new technologies to reduce workforce and optimize their operations, innovative small businesses have an opportunity to leverage technology to punch above their weight, grow faster and increase their impact on the economy.

### EXHIBIT 1: SME SHARE OF COMPANIES AND JOBS (2015)

SMEs AS PERCENTAGE OF FIRMS AND EMPLOYMENT  
%, 2015



Source: World Economic Forum, 2015

4. World Economic Forum “SMEs and global markets: The missing link for inclusive growth”, 2015

5. Cernat et al., 2014; Harvie, 2015; ADB, 2014; OECD-UNECLAC, 2013

6. WTO World Trade report, 2016

7. World Economic Forum “SMEs and global markets: The missing link for inclusive growth”, 2015

8. Facebook Q4 2017 report, Ford Q4 2017 report

9. Chui, M., J. Manyika, and M. Miremadi, “The Countries Most (and Least) Likely to be Affected by Automation”, Harvard Business Review, 12 April 2017

## CONCLUSION

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SMEs are a key driver of economic activity and the largest contributor to global employment. Advanced economies such as Germany have also proven that a strong performing SME sector can provide attractive job opportunities for a skilled workforce.

After a decade-long road to recover pre-crisis levels of employment, it is no wonder that governments all over the world are looking to boost their SME sectors to drive the development of their labour markets and achieve sustainable economies.

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## 2. SMEs IN THE GULF – THE WIND OF CHANGE

*“This [SME] sector is a basic source for job opportunities in the country and is also one of the main pillars to diversify the income sources for the national economy”*

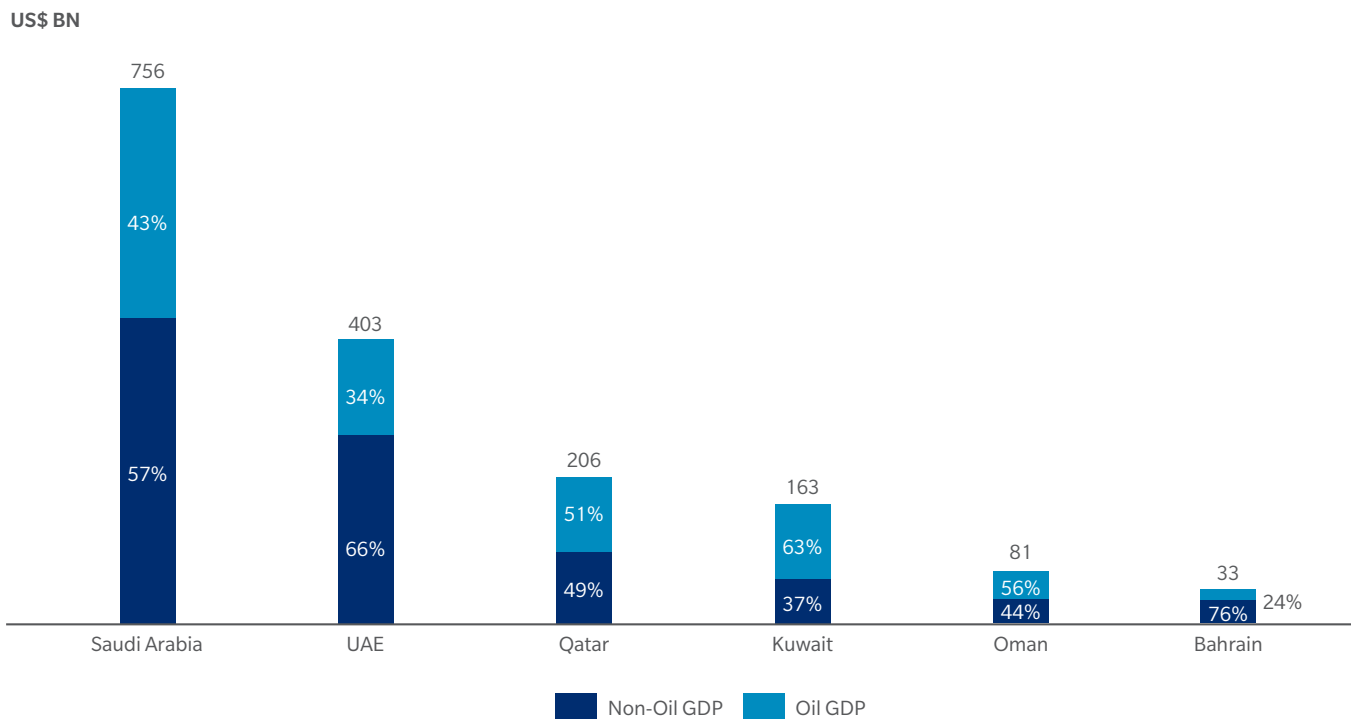
— DR. GHASSAN AL-SULAIMAN,  
GOVERNOR OF THE GENERAL AUTHORITY FOR SMEs  
IN KSA, SEPTEMBER 2017

Following the 2014 oil price slump, which caused the Gulf economies to incur large budget deficits, national governments launched ambitious plans to reform their economies. These plans share the common objectives of creating a more sustainable economic and social model for the region in the long term, while reducing the fiscal deficit in the short term.

The reform plans brought about a renewed interest in developing the SME sector as a key driver for the change that the region is seeking. In particular, Gulf governments are counting on SMEs to:

- Support the development of the private sector to diversify the economy from governments’ dominant position as drivers of economic activity

### EXHIBIT 2: NOMINAL GDP DECOMPOSITION INTO OIL AND NON-OIL SECTORS



Source: IMF - Economic Diversification in Oil-Exporting Arab Countries. The World Bank GDP data, 2014

- Provide attractive job opportunities for the increasing cohorts of national job seekers, and shift civil servants from the over-staffed civil service to private sector employment

## NEED FOR DIVERSIFICATION

A massive 45% of the GDP of the Gulf countries is derived from oil<sup>10</sup>. KSA, the UAE and Bahrain are the only Gulf countries with non-oil GDP representing more than 50% of total GDP<sup>11</sup> with 57%, 66% and 76% respectively. In Qatar, Kuwait and Oman on the other hand, non-oil GDP represents less than 50% of total GDP with 49%, 37% and 44% respectively **(See Exhibit 2)**.

In terms of public finances, the dependence on oil is even bigger: 90% of state revenue in Kuwait and 63%<sup>12</sup> in KSA were derived from oil in 2017<sup>13</sup>.

Currently SMEs only contribute between 8% (Kuwait) to 40% (UAE) of the non-oil GDP in the Gulf economies. In order to become a true driver for economic development, the regional SME sector needs to develop significantly.

On one hand the region would benefit from the addition of more SMEs, as the share of SMEs among companies is lower than the global average. On the other hand, the sector would also need to increase its value added to the economy. For example, SMEs in UAE would need to improve their value added by 25% on aggregate to reach the global average of 50% contribution for the sector.

The low value added by Gulf SMEs can largely be attributed to a concentration of SMEs in low value generating sectors, primarily trading and construction. In Saudi Arabia 74% of SMEs operate in these sectors, and in UAE 57%<sup>14</sup> of SMEs are related to trading operations.

*“[...] the ministry seeks out more key industrial investments to boost the growth of Emirati industrial companies and generate new jobs for UAE citizens”*

— HE SULTAN BIN SAEED AL MANSOORI,  
MINISTER OF ECONOMY OF THE UAE, 2017

Despite the high share of trading companies, exports are relatively limited. In the UAE, only 14% of SMEs export 75% or more of their goods and services. If only UAE national-owned SMEs are considered, this number goes down to 4%<sup>15</sup>.

There is also a lack of investment outside of the trading and commercial sectors. For example, the SME loan guarantee program “Kafalah” in Saudi Arabia extended only 8% of loans to finance and business sectors and 10% to the industrial sector in 2016<sup>16</sup>. Only 17% of the ventures financed by the Kuwait National Fund for SMEs (KNF) were related to industrial projects. One survey of Emirati entrepreneurs found that 100% of new businesses run by UAE nationals are in no or low-tech areas<sup>17</sup>.

Nevertheless, Gulf government’s national reform programs aspire to increase the value added by SMEs to the economy. One of the objectives of Saudi Arabia’s Vision 2030 is to increase the contribution of SMEs to non-oil GDP from current 20% to 35% by 2030.

Similarly, one of the key performance indicators in the UAE Vision 2021 is the increase of SME contribution to non-oil GDP: Dubai alone targets an increase in SME contribution to local GDP from current 40% to 45% by 2021. In order to contribute meaningfully to the economy and non-oil private sector development, the SME sector needs to grow significantly both in terms of numbers of SMEs, and in the value that each SME generates.

10. IMF, Annual Meeting of Arab Ministers of Finance, 2016

11. IMF, Annual Meeting of Arab Ministers of Finance, 2016

12. Ratios used to be overwhelmingly above 85% across the Gulf countries, but this trend has been reversed due to the oil-price slump of 2014

13. Bloomberg, Key Figures in Saudi Arabia’s 2018 Budget, 2017 fiscal data

14. Dubai SME report, 2013

15. Dubai SME report, 2013

16. Saudi Industrial and Development Fund

17. Zayed University 2013

## NEED FOR PRIVATE SECTOR JOBS

The Gulf governments are by far the largest employers of their nationals. With the exception of Bahrain, only 20–40% of Gulf citizens work in the private sector. By comparison, in the EU only as high as 76.3% of employment is in the private sector.

The bias towards civil service in the Gulf is the result of an implicit social contract, where citizens receive a share of the region’s oil wealth through well-paid and comfortable public sector jobs, while the private and semi-government (state-owned companies) sectors are dominated by expatriate workers. In Kuwait and Qatar, expatriate workers represent more than 75% of the private sector workforce<sup>18</sup> (See Exhibit 3).

Gulf citizens have high incentives to seek employment as civil servants. In a survey conducted in Qatar only 38% of unemployed nationals expressed their willingness to work in the private sector. Factors discouraging them

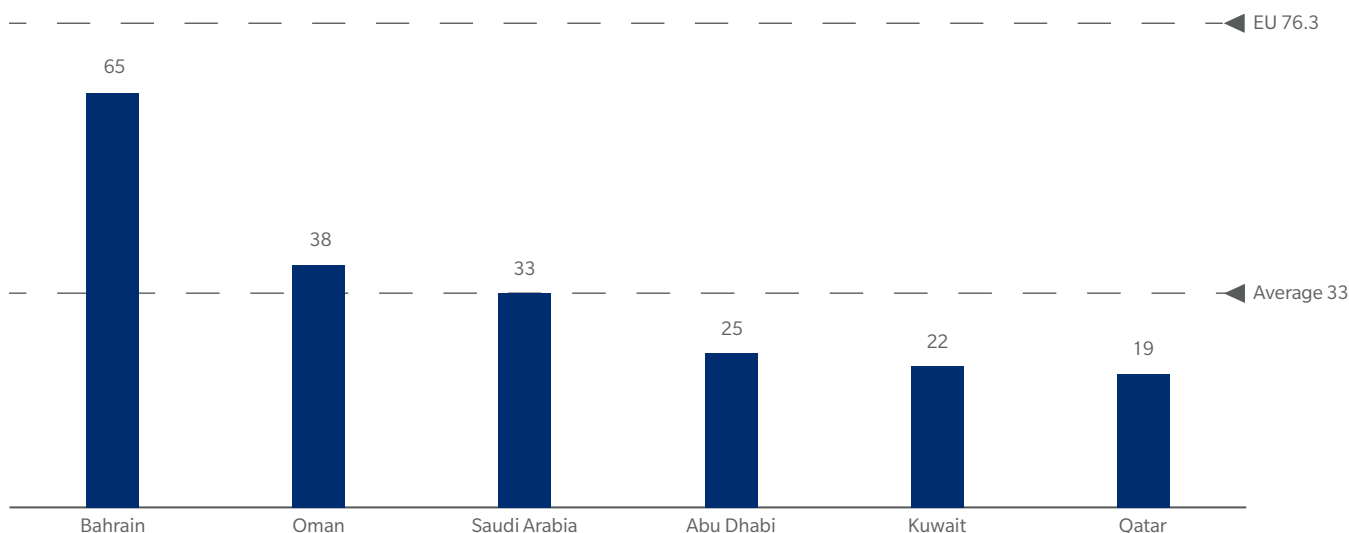
from private sector work included lower wages (30%), longer working hours (30%), more working days (20%) and lower retirement benefits (20%)<sup>19</sup>.

This unwillingness to work in the private sector is proving a substantial obstacle in the Gulf. Indeed, the unsustainable combination of accumulated fiscal deficits and increasing numbers of nationals entering the workforce is forcing Gulf governments to look for ways to develop the private sector to create more private sector jobs for nationals. The model of providing public sector work to almost all citizens is rapidly becoming obsolete.

In that spirit, Gulf governments have initiated programs to shift citizens from the public to the private sector. In Kuwait, boosting the private sector contribution to the economy is one of the four overarching goals of the National Program for Economic and Fiscal Sustainability “Istidama”. One of the ways the Kuwaiti government is looking to develop the private sector is through an initiative to promote and finance SMEs, spearheaded by the Kuwait National fund.

### EXHIBIT 3: EMPLOYMENT OF GULF NATIONALS IN PRIVATE SECTOR

PERCENTAGE OF LABOUR POPULATION



**Source and year of data:** Kuwait Central statistics Bureau 2016; Kuwait Public Authority for Civil Information 2016; Qatar Ministry of Development Planning and Statistics 2014; Statistics Centre Abu Dhabi, 2017; Saudi Ministry of Labour and Social Development 2016; Oman National Centre for Statistics and Information 2017; Bahrain Labour Market Research Authority 2014; Eurostat 2016, “Public administration, defense, education, human health and social work activities”

18. Saudi Arabia Labour Market Report 2016, Kingdom of Saudi Arabia; Central Statistical Bureau of Kuwait; Labour Force Sample Survey 2016, Ministry of Development Planning and Statistics, State of Qatar

19. Labour Force Sample Survey 2016, Ministry of Development Planning and Statistics, State of Qatar



Despite of the ambitions for the SME sector to absorb an increasing share of job seekers, the reality today is that only a small fraction of nationals are employed by SMEs. For example less than 7% of the Kuwaiti national labour force works in the SME sector, a number which is likely inflated due to the phenomenon of “phantom” employees – nationals declared on payroll with the sole purpose of receiving government subsidies for working in the private sector. This is not surprising, as the current low-value added SME sector primarily offers low-skilled jobs with pay packages below what is needed to sustain the living standard of the region.

Governments can also not count on nationals becoming entrepreneurs themselves to alleviate the economic burden of the public sector. Actually, one survey found that 82.5% of national entrepreneurs in Abu Dhabi combine their entrepreneurship with salaried work, the large majority in government<sup>20</sup>.

## CONCLUSION

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Gulf countries have grasped the importance of SMEs for their respective economies and formulated ambitious development goals for the private sector. Across the region, measures promoting a strong SME ecosystem are starting to see the day.

However, governments face challenges in developing the kind of high value added and strong performing SME sector that the region needs. Most SMEs operate in low-value added areas of the economy, and there is little incentive for nationals to leave comfortable public sector jobs for employment in the more demanding and uncertain private sector.

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*“We aim for the National Fund [for SMEs] to be a major driver (of Economic progress) in the near future and would be a factor in increasing the employment of Kuwaitis in the private sector”*

— HE KHALED NASSER ABDULLAH AL-ROUDAN,  
MINISTER OF COMMERCE AND INDUSTRY OF  
KUWAIT, 2017

### 3. DEVELOPING A HIGH PERFORMING SME SECTOR IN THE GULF

In order to meet their targets for diversification and national employment, Gulf countries need to increase the number of high value added SMEs - companies that have real potential to contribute to the ambitious reform objectives.

This will require a shift away from current policies, which still largely focus on providing soft financing and entrepreneurial training to nationals, to bolder strategies aimed at enabling the regional SME sector to compete in the global market place.

These strategies need to take a holistic approach across four areas that have proven critical in developing an environment supportive of innovation, international market integration and growth<sup>21</sup> (See Exhibit 4).

None of the areas are individually sufficient to guarantee a strong SME sector. However, by combining best

practices and creative solutions across all of them, governments can enable an SME environment able to catalyze growth of the private sector.

#### REGULATION

The objective of regulation is to create a productive, fair and safe environment for businesses and consumers. However, it can be difficult to balance the interests of different stakeholders, as they are frequently not aligned. Introducing regulation to support a dynamic SME sector thus proves challenging, as this could be viewed as a threat by larger, established market players. This is why forward-looking policy makers consider SMEs their prime customers for regulation. For instance, the European Union applies the principle of “Think Small First”, with the objective to establish regulations that are easy to follow for companies with limited resources to deal with bureaucracy and regulatory compliance.

#### EXHIBIT 4: KEY ENABLERS FOR CREATING A HIGH PERFORMING SME ENVIRONMENT



Source: TICG Analysis

21. UN, OECD, World Economic Forum, G20 SME and Entrepreneurship Taskforce, TICG analysis

To assess the complexity of regulations and bureaucracy in local markets, the World Bank's Doing Business index is a good place to start. **Exhibit 5** below represents the scores of the Gulf countries in four key areas of the index

compared to the OECD high income countries' average. Several Gulf countries underperform across all of the index's key areas related to regulation.

## EU SMALL BUSINESS ACT: "THINK SMALL FIRST"

The definition of the "Think Small First" principle implies that policy makers give full consideration to SMEs at the early stage of policy development. Ideally rules impacting business should be created from the SMEs point of view. In other words, SMEs should be considered by public authorities as being their "prime customers" as far as business regulation is concerned.

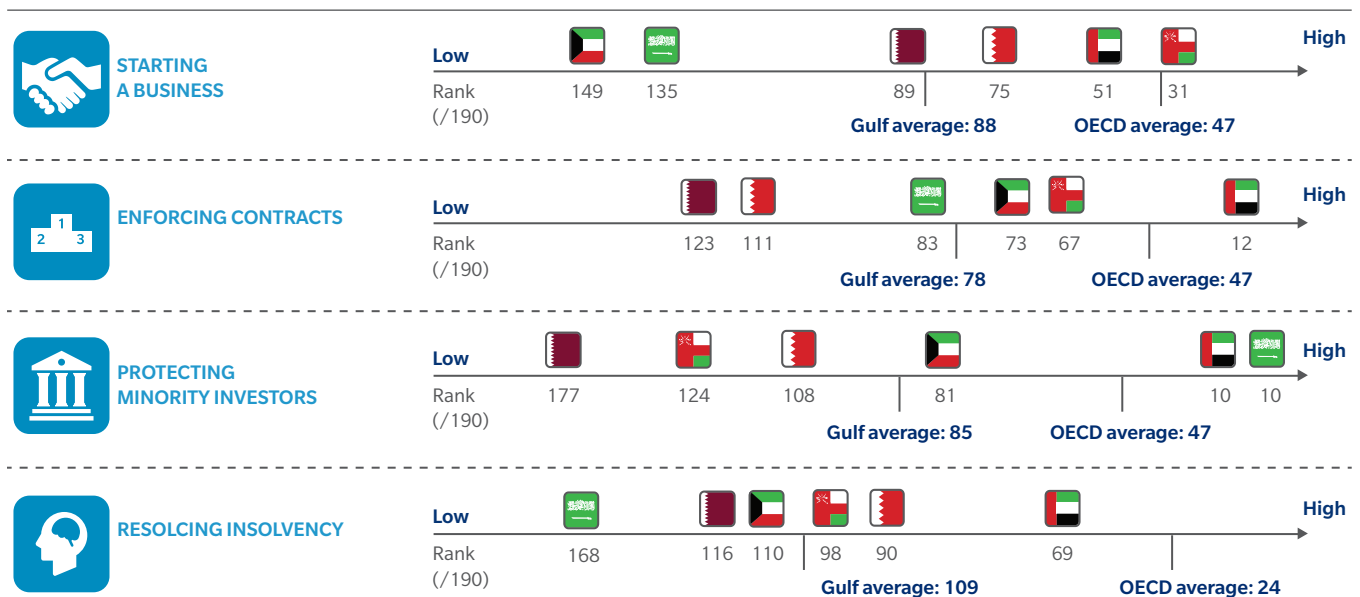
This principle relies on the fact that "one size does not fit all", however a lighter touch approach can also be beneficial to larger businesses. Conversely, rules and procedures designed for large companies create disproportionate, if not unbearable burdens for SMEs as they lack the economies of scale.

The principle aims to ensure that SMEs voices are heard, that their interests are taken onboard by policy makers, and that the business environment is favourable to their development.

The European Commission stated that the Small Business Act would mean "more responsive public administrations, less late payment of invoices, access to more help with finance, innovation and training, lower VAT for services supplied locally and better access to public procurement contracts. The package will also give SMEs access to a European Private Company Statute to cut bureaucracy and increase clarity".

**Source:** European Commission, 2009

### EXHIBIT 5: GULF COUNTRIES' RANK VS. HIGH INCOME OECD COUNTRIES FOR SELECTED INDICATORS, 2018



**Source:** World Bank Doing Business, 2018

## STRENGTHENING THE REGULATORY INSTITUTIONS

The relative weakness of the indicators related to regulation points to the need to take a more holistic view of the regulatory environment. Strong, independent institutions are critical to ensure that regulations are defined in an objective way and that they are implemented in a fair and effective manner. In **Exhibit 6** below, we propose a set of principles for ensuring solid institutions.

It is often challenging to implement an effective regulatory framework across the government as there are typically several different regulators and other government bodies involved. Successful implementation requires assigning cross-functional teams that can work across different regulators, and reporting to a central executive forum of the government, such as a Council of Ministers or Executive Council.

## RESOLVING INSOLVENCY

The Gulf countries are particularly underperforming in the area of insolvency regulation. As an extreme case Saudi Arabia does not have any bankruptcy law. The UAE and Qatar have two insolvency regimes in place – one for their free zones (DIFC in UAE and QFC in Qatar) and another for businesses in the remaining “onshore” areas. The free zone regulation is similar to the UK law, whereas the ordinary regulation shares the same challenges with other Gulf countries. It is thus no wonder that Gulf countries underperform on the time it takes to go through insolvency procedures, and on the recovery rate of capital (**See Exhibit 7**). The fragile insolvency regulation has direct impact on the willingness of entrepreneurs and financial institutions to invest.

The UAE took a big step to modernize its bankruptcy law in 2017, prompting it to jump from 26<sup>th</sup> to 21<sup>st</sup> position in the 2018 Doing Business index.

### EXHIBIT 6: DESIGN PRINCIPLES FOR REGULATORS

#### DESIGN PRINCIPLES FOR REGULATORS



##### LONG TERM FOCUS

- Regulator has unique objectives and distinct duties, clearly defined, communicated and not subject to change based on third-party short term goals



##### INDEPENDENCE

- Political: Regulator takes decisions autonomously from any political influence or the short-term goals of third parties
- Financial: Funding provides the organization with autonomy in use of its annual budget and with sufficient human and financial resources
- Operational: Regulator must be legally and functionally independent from all other public and private entities



##### EFFECTIVENESS

- Regulator should be proactive in creating and reviewing policies
- It must also undertake an effective design of its policies to minimize unnecessary red tape and avoid hampering of economic growth



##### TRANSPARENCY

- Regulator must be transparent and timely in communicating policies
- It must also be non-discriminatory in its approach to both supervision and enforcement



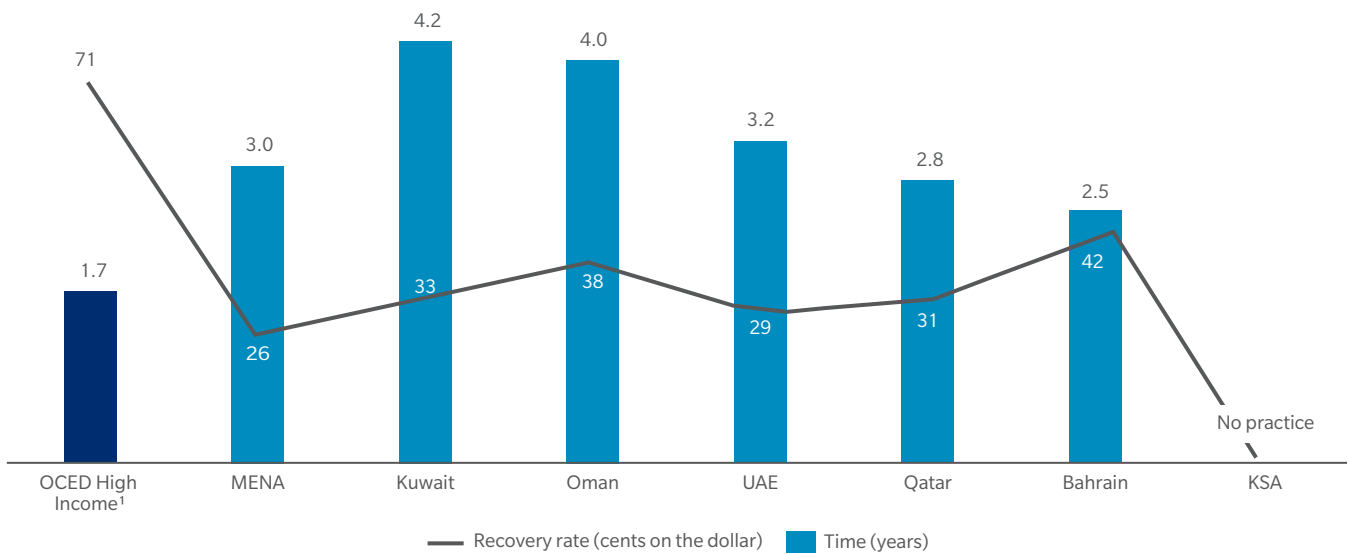
##### PROPORTIONAL ENFORCEMENT

- Regulator must have the undisputed mandate to enforce its policies, or have a clear process for enforcement
- It must impose balanced requirements while avoiding unnecessary reaction in enforcement

Source: TICG Analysis

## EXHIBIT 7: RESOLVING INSOLVENCY ACROSS THE GULF

TIME IN YEARS, RECOVERY RATE IN CENTS ON THE DOLLAR



1. New Zealand, Denmark, Republic of Korea, United States, United Kingdom, Norway, Sweden, Estonia, Finland, Australia, Ireland, Canada, Latvia, Germany, Austria, Iceland, Poland, Spain, Portugal, Czech Republic, France, Netherlands, Switzerland, Japan, Slovenia, Italy, Hungary, Belgium, Israel, Chile, Luxembourg, Greece

Source: World Bank, Doing Business 2018

## GUIDELINES FOR A SOUND BANKRUPTCY LAW

According to Joseph Stiglitz, former senior vice president and chief economist of the World Bank, a sound bankruptcy law should follow three principles:

- ▶ **Encourage reorganization of the business.** Bankruptcy need not result in liquidation or a transfer of ownership from debtor to creditor, but rather in a recovery process with restructuring that benefits all stakeholders
- ▶ **Offer several ways of conducting insolvency.** For example, if financial distress is evident at an early stage, a “soft” insolvency procedure with debt restructuring would be most beneficial
- ▶ **Adjust the regulation to work with local laws, traditions and financial system.** There is no universal bankruptcy code suitable for all countries

Source: “Resolution of Financial Distress. An International Perspective on the Design of Bankruptcy Laws”, World Bank Institute Development Studies, 2001

## UAE NEW BANKRUPTCY LAW



In 2016 bankruptcy was still considered a criminal offence which could lead to imprisonment. As a result, 814 expat entrepreneurs facing bankruptcy fled from the UAE between Q3 2015 and Q4 2016.

In December 2016, the UAE enforced a new law, which decriminalized bankruptcy and introduced three main legal procedures for businesses in financial difficulty:

- ▶ **Protective composition** establishes the proceedings for protecting a business in financial difficulty but which is not yet insolvent
- ▶ **Formal restructuring** procedure that arranges to restructure an insolvent business if the debtor is willing to continue the business and the court judges the business can become profitable again within a specified time period
- ▶ **Insolvency and liquidation** governs a closure of an insolvent company with appointment of “trustee”, an independent agent managing the liquidation process

The new law was initially viewed favorably by the private sector and by consultancies in the field of restructuring. However, since its introduction the law has had limited or no testing in court, and law practitioners point out that it has flaws including that it does not decriminalize the bouncing of cheques.

**Source:** UAE Ministry of Finance, 2016

## CONCLUSION

The shortcomings of the regulatory environment in Gulf countries pose legal risks for investors and financial institutions, limiting the willingness to take on the business risks of launching and financing SMEs. This particularly hurts the development of businesses which require external capital to finance innovation and growth – the very kind that the region desperately needs.

Policy makers need to set up comprehensive regulatory frameworks that work for SMEs not only on paper, but which can be successfully implemented and executed by the judicial system.

## FINANCING

Commercial bank lending is the most prominent form of financing for SMEs, estimated at US\$3.2 to 3.6 TR globally<sup>22</sup>. However, bank lending to SMEs only represents 0.5–4% of all loans in the Gulf, compared to around 30% in the OECD<sup>23</sup>. In Abu Dhabi, SMEs face rejection rates of 50–70% from banks, compared to 10–20% in OECD<sup>24</sup>.

The lack of private sector SME funding has forced governments to step in and create funds to support the creation and development of SMEs. **Table 1** summarizes some of the most important government SME funds in the Gulf.

Although government funds are filling an important role in providing finance to credit strapped national entrepreneurs, they have had limited success in moving their customers onto private sources of capital in subsequent financing rounds.

Bahrain’s Tamkeen is an exception. Instead of providing full funding directly to the SMEs, it focuses on mitigating the risk for commercial banks funding SMEs. This approach forces the involvement of commercial and development financial institutions from the start of the process, and it helps the financed companies to move to fully commercial financing as they mature.

22. IFC 2015

23. Jeddah Chamber of Commerce; Value Partners 2016

24. ECB 2013; Entrepreneurship, SMEs and local development in Abu Dhabi, OECD 2016

The Kuwait National Fund has also committed itself to involve the private sector in its approach, and it recently announced that it aims to include private capital in at least 60% of new loans until 2021.

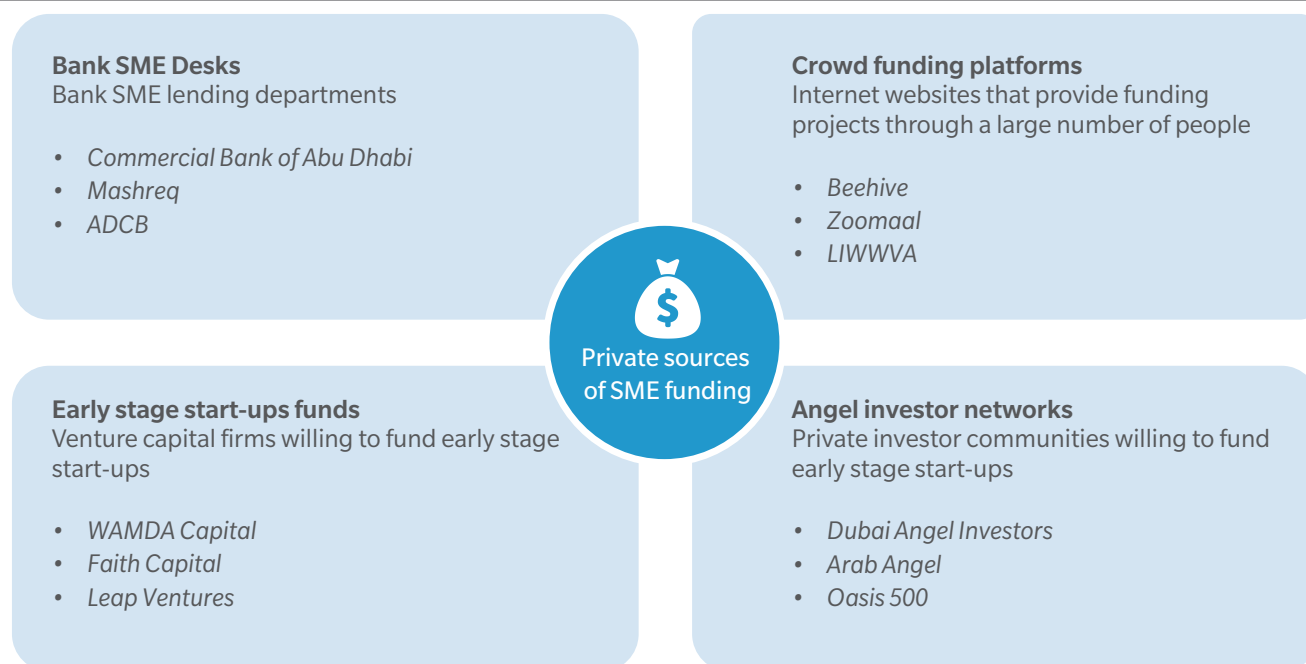
There are also strong signs that the private sector is stepping up its efforts to fund promising SMEs, and there is an emerging ecosystem of private institutions and platforms willing to invest in entrepreneurial ventures (See Exhibit 8).

**TABLE 1: GOVERNMENT BACKED SME FUNDS**

FUND	COUNTRY	YEAR OF ESTABLISHMENT	FUND SIZE AT INCEPTION (USD MN)	MANDATE
Kuwait National Fund	Kuwait	2013	6,700	Finance up to 80% of capital for feasible SME projects submitted by Kuwaiti Citizens
Khalifa Fund for Enterprise Development	UAE (Abu Dhabi)	2007	545	Develop local enterprises in Abu Dhabi
Centennial Fund	Saudi Arabia	2003	53	Encourage young entrepreneurs between the ages of 25–35
Tamkeen and Bahrain Development Bank	Bahrain	2006	27	Mitigate the risks of SME financing borne by commercial or development banks, rather than provide full financing to SMEs
The Sanad Program	Oman	2011	13	Help young Omanis aged 18–40 start their own business
Dubai SME <sup>25</sup>	UAE (Dubai)	2002	n/a	Encourage entrepreneurship and support UAE national citizens to contribute to economic development of the Dubai Emirate
Enterprise Qatar and Tasdeer	Qatar	2014	n/a	Assist SMEs by providing training courses, advice, and support to export

Source: Fund Websites, TICG Analysis

**EXHIBIT 8: EXAMPLES OF PRIVATE SOURCES OF FUNDING FOR SMEs**



Source: Company websites, TICG analysis

25. Also known as the Muhammed Bin Rashid Establishment for SMEs

## BAHRAIN TAMKEEN



Tamkeen, Bahrain private sector development organization, launched the Finance Scheme for SMEs in 2007. The main principle of the Finance Scheme is to mitigate risks of SME financing borne by commercial or development banks, rather than provide full financing. Hence, Tamkeen subsidizes 50% of the profit charged by the bank and provides 50% of the principal as a guarantee to the financing bank. Tamkeen partners with a number of Bahraini banks and Kuwait Finance House, which lend to SMEs in Bahrain under the Finance Scheme program.

By end of 2015 Tamkeen cumulatively spent only BD 22 MN (\$58 MN) for Finance Scheme in profit and guarantee payments, while partner banks provided more than BD 350 million (\$925 MN) of financing. Financing was provided to 6,250 enterprises.

**Source:** Tamkeen

## CONCLUSION

Allowing companies to depend on public “soft” financing over prolonged periods of time is counterproductive to building a vibrant and self-sustained SME sector.

Governments need to establish clear objectives for increasing the role of commercial financial institutions in SME lending. Joint public-private efforts to finance early investment stages is a good starting point. However, it is also critical to allow the emerging ecosystem of private capital to independently fund promising ventures, thus reducing the dependency on public financing.

## SKILLS AND INNOVATION ECOSYSTEMS

Globally, the lack of skilled labour has proven to be a showstopper for otherwise sound development programs. For example, when Malaysia’s Multimedia Super Corridor failed against its objective to attract high tech investment in the late ‘90s, lack of access to local workforce with the required ICT skills was cited as the main barrier for investments<sup>26</sup>.

Similarly, Gulf countries face several challenges in terms of human capital to support SMEs:

- ▶ First, they lag in education, as exposed by low scores on the education and skills pillar of the Global Competitiveness Index. This index takes into consideration multiple aspects of current workforce training such as the quality of vocational training, the skillset of graduates as well as the digital skills among the population (**See Exhibit 9**). The average rank of Gulf countries is 41 in Quality of education systems, 51 in Quality of math and science education, and 52 in Quality of management schools. The region largely lags behind the OECD on each of the dimensions. Within the Gulf, Kuwait and Oman are ranked well behind their peers<sup>27</sup>.

26. David Conkin, Richard Ivey School of Business  
27. Global Competitiveness Index Report 2017



- ▶ Additionally, in terms of labour market efficiency, an indicator partly based on efficient use of talent, Kuwait and KSA respectively rank 119<sup>th</sup> and 80<sup>th</sup> worldwide in 2017, lower than their Gulf peers<sup>28</sup>.
- ▶ Finally, with 60–80% of the local workforce employed in the public sector, a large portion of the national talent pool lacks the practical experience and skills to develop an entrepreneurial business.

Both short-term and long-term opportunities are available in order to improve the access to skills and develop the local innovation ecosystems.

## HARNESS LOCAL TALENT

There are already several training programs in place across the Gulf that provide training in entrepreneurship to local talent, such as the Qotuf program in Saudi Arabia, and Rowad Training in Bahrain.

However, a frequently overlooked issue is the need for specialist training to develop deep talent pools in different technical fields. One interesting example in this direction is the UAE’s project to educate a million Arabs in coding through a free online platform<sup>29</sup>.

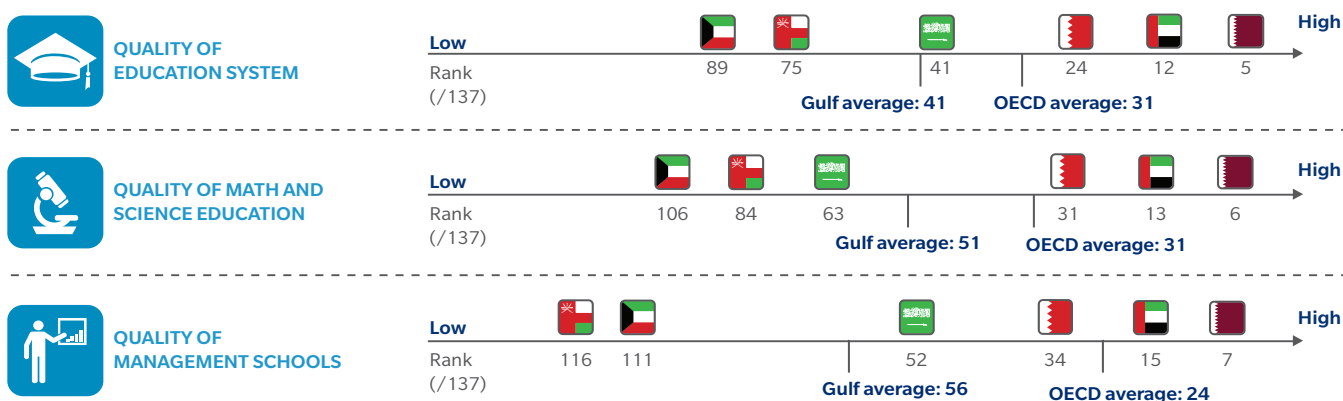
Governments also need to consider strategies to unlock the entrepreneurial potential of public sector employees. One possibility is to offer employees paid leaves to develop their own entrepreneurial projects, an idea that has already been successfully implemented by some technology and consulting companies, including VM Ware, Genentech and Deloitte<sup>30</sup>.

## TRANSFER KNOWLEDGE FROM SKILLED EXPATS

Gulf countries have traditionally solved the capabilities gap through the import of expat workers with the desired skillsets and experience. However, this is not enough on its own to create a sustainable solution. In order to build an extensive talent pool it is necessary to create scale within a specific sector cluster.

Dubai has extensively leveraged this strategy. Its first cluster, the logistics cluster Jebel Ali Free Zone, catapulted the Jebel Ali port to become the sixth largest port in the world<sup>31</sup>. Since then, Dubai has established clusters in almost every industry, including media, construction, science and education, among others.

### EXHIBIT 9: QUALITY OF EDUCATION INDICATORS, 2017



1. OECD countries: Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States

Source: WEF, Global Competitiveness Report 2017

28. Global Competitiveness Index Report 2017

29. <https://www.thenational.ae/uae/uae-to-train-one-million-young-arab-coders-in-the-language-of-the-future-1.669868>

30. <http://fortune.com/2015/03/16/paid-sabbaticals/>

31. ITC working paper 2015

## QOTUF PROGRAM IN KSA



Qotuf is a private sector-led non-profit program established with the objective of helping aspiring Saudi entrepreneurs through specialized initiatives focused on:

1. **Economic stability and diversity;** to emphasize the importance of distinctive economic activities in a self-sustainable fashion
2. **Youth engagement via innovation;** to instigate the youth in developing the necessary skills for pursuing innovative solutions to problems which they have identified themselves
3. **High quality job creation;** to create the type of jobs which offer opportunities for career-building, meaningful engagement in the industry, and a positively profound impact on the future of the economy

Qotuf is working in partnership with Flat6Labs, a seed-stage startup accelerator. Qotuf and Flat6Labs jointly provide three-month programs to upskill aspiring entrepreneurs and guide them to launch their startups and attract investments.

**Source:** Qotuf Program Website

## ROWAD TRAINING IN BAHRAIN



In Bahrain, the Bahrain Development Bank has put in place a 'Rowad' training program to help start-ups enhance their skills and upscale their businesses to attract funding. The program consists of a set of different workshops and classes tailored to different audiences and developing different skillsets:

1. **Entrepreneurship orientation program – An introduction to the world of entrepreneurship;** to acquire the basic tools for entrepreneurship which include business idea generation, business planning, marketing, financial planning and how to start and manage one's business
2. **Takween – Entrepreneurship program for high-schools;** to provide both academic and practical experiences related to on-the-job training for students in secondary schools (hosted by the Ministry of Education)
3. **Technopreneur Bahrain – Technology accelerator program;** to support and facilitate the growth of the ICT sector in Bahrain, and offer a comprehensive platform that includes capacity building, mentorship, coaching, and funding
4. **Specialized workshops –** Multiple workshops covering a multitude of topics (e.g. Pitching, Franchise and Scale, Financial Management, etc.)

**Source:** Rowad Program Website

## ONE MILLION ARAB CODERS INITIATIVE



As a part of the Mohammad Bin Rashid Al Maktoum Global Initiatives (MBRGI) foundation, one million young Arabs will receive free coding education to develop fluency in computer programming. The enrollment period began on January 1<sup>st</sup>, 2018.

Speaking at the launch of the program, Sheikh Mohammad framed the objective of this initiative saying, “Coding is the language of the modern era. Our goal is to teach it to one million young Arabs, in order to prepare them now for the requirements to excel in the future”.

The program consists of three stages:

1. Register online to join as a student or a tutor
2. Complete several virtual coding programs over a period of three months. The top 1,000 students will be selected to proceed to the next stage
3. Compete in the Coder Challenge. Top ten students will receive cash prizes; a grand prize of US\$1 MN for first place, and US\$50,000 for each of the remaining nine. The students will then vote for the top four tutors who will receive US\$200,000 each

With 80 million jobs projected to be available in the IT sector by 2020, the initiative will look to empower young Arab innovators in the fields of Smart Government, e-commerce and IT.

**Source:** Mohammad Bin Rashid Al Maktoum Global Initiatives

For this model to develop the required skills within the national talent pool, it must be combined with deliberate strategies for mixing nationals and skilled expat workers, and incentivize knowledge transfer between them. Indeed, attracting foreign labour was one of the key initial successes of the Jebel Ali Free Zone. It was done by permitting overseas investors to have full ownership of businesses despite the UAE law restricting foreign ownership to 49%. A vast pool of foreign talent was consequently attracted to the UAE to establish businesses.

## IMPROVE EDUCATION AND RESEARCH CAPABILITIES

The long-term solution to develop a skilled and educated local workforce is to invest in education on a large scale. However, the Gulf region is lagging in quality of education, especially in the fields sought after by the private sector. For example, as of 2016 there were only two Saudi universities in Academic Ranking of World Universities top 200 ranking. Saudi Arabia aims to increase the figure to 5 universities by 2030.

In addition to the lag in education equality, there has been a noticeable decrease in rankings of some Gulf countries. Indeed, Kuwait went from a rank of 81 in 2010 to a rank of 89 in 2017 out of 137 countries in the quality of education index<sup>32</sup>. This decrease showcases the scarcity of efforts made to improve the education sector in the Gulf.

Establishing a world-class education locally would enable more people to get enrolled in high-quality programs and hence to grow a better educated youth. Besides that, local universities can better adapt to the market needs inside the country and teach students necessary disciplines.

On the one hand, without the presence of universities with strong research faculties, it is difficult to build local innovation ecosystems. On the other hand, building up a world class research university takes decades. In order to reduce the time to get results, some governments have initiated collaborations with renowned universities. This collaboration strategy was successfully implemented by Abu Dhabi.

32. World Economic Forum Global competitiveness report, 2017

## ABU DHABI INNOVATION ECOSYSTEM



Abu Dhabi well recognized the importance of having a skilled and educated workforce to allow efficient functioning of both local enterprises of all scales and government entities.

It succeeded in positioning itself as a regional education and research hub, having established local universities and attracted campuses of international universities.

The emirate developed a previously unexplored feature in the Gulf to boost R&D through research collaboration between industry/government entities and universities, such as:

- ▶ **Masdar Institute of Science and Technology** was set up by the Massachusetts Institute for Technology (MIT) and Masdar (a subsidiary of Mubadala). The Institute set up several research centers related to clean energy R&D, involving major transportation and energy companies
- ▶ **Aerospace Research and Innovation Center (ARIC)** was established in partnership with Mubadala Aerospace to conduct innovative research in aerospace engineering
- ▶ **Petroleum Institute** is a collaborative project between the Abu Dhabi National Oil Company (ADNOC) and Colorado School of Mines aimed at developing innovative projects in the energy field

To address the lack of entrepreneurship skills of Abu Dhabi citizens, universities began offering entrepreneurship courses and programs. As of 2016, there were 5 educational programs in entrepreneurship offered by universities in Abu Dhabi.

**Source:** Entrepreneurship, SMEs and local development in Abu Dhabi. Boosting the entrepreneurial ecosystem, OECD, 2016

## CONCLUSION

Access to talent pools with private sector experience and the right skillsets remains a key obstacle for large-scale SME development in the Gulf countries.

To bridge the skills gap, governments need to implement strategies that balance short-term and long-term measures, build deep talent pools and develop innovation ecosystems. Such an environment would be both necessary and conducive to boost the SME sector in the Gulf.

## INTERNATIONALIZATION

In a recent study, a group of small Egyptian rug makers were given the possibility to start exporting their goods. The companies saw a 26% increase in profits and showed substantial improvements in productivity during the course of the study. By interacting with foreign buyers, the rug makers learned new skills, became more efficient and raised the quality of their products<sup>33</sup>. In another study, 26% of exporters ranked as high performers as opposed to only 13% of purely domestic firms<sup>34</sup>. Other

studies confirm that participating in exports increases profits, facilitates the transfer of knowledge and helps develop trade skills.

The Gulf is in a good position to benefit from internationalization. With its strategic location between Europe, Asia and Africa, the Gulf is already a global trading hub. Several countries have built excellent infrastructure, with modern seaports and airports, good road networks and connected logistics parks. Furthermore, the large shares of expats in the population

33. Atkin, D., Khandelwal, A. and Osman, A. (2017). Exporting and Firm Performance: Evidence from a Randomized Experiment. Quarterly Journal of Economics, 132(2), 551–615

34. World Economic Forum, "SMEs and global markets: The missing link for inclusive growth", 2015

provide potential to build connections with international markets all over the world.

How can this advantage be translated into higher value trade and non-oil exports?

First, one must recognize that despite its long trading tradition and world class logistics infrastructure, a large

portion of the Gulf’s international trade has low added value. In the UAE for example, 22% of trade is re-exports. There is thus a need for policies and initiatives to increase the value-add in the local economies, e.g. through more advanced assembly or manufacturing activities. The expansion of the Jebel Ali free zone in recent years to provide space for more manufacturing industries is a good step in this direction.

## THE MAKER MOVEMENT

The past few years have seen many advances in 3D printing and other technologies that enable small-scale production. These technologies are re-writing the rules of manufacturing, effectively democratizing access to high-end production tools.

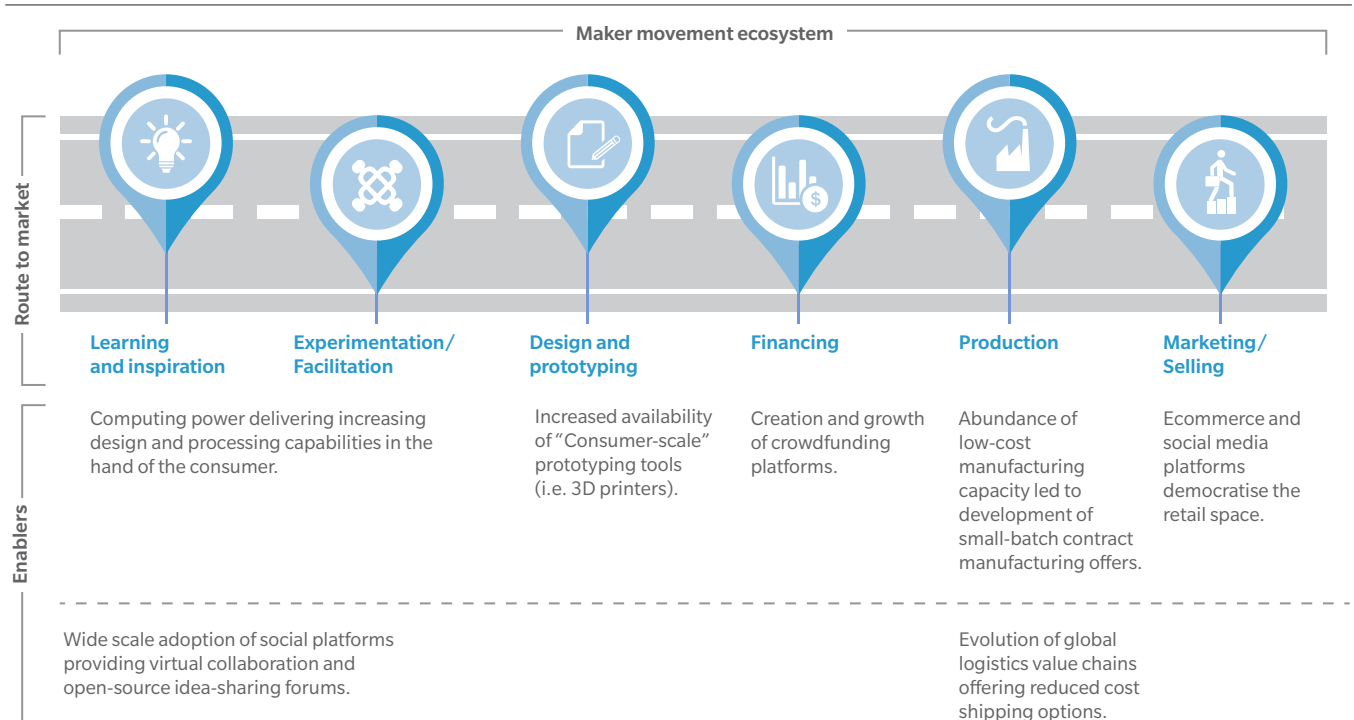
In addition to that, options such as crowdfunding and online retail platforms now allow individuals to take ideas from concept to funding to production and to market all on their own (See Exhibit 10).

This movement, dubbed “the maker movement”, is presenting young companies with a value chain that enables them to create a high-value add industry with minimal funding or large-scale manufacturing capabilities.

The Gulf countries have an opportunity to cut the development path of SMEs short by supporting the maker movement at a regional level. This would especially benefit the youth, who are the driving force behind this step-change in production and commercialization of goods.

**Source:** Oliver Wyman PoV: How can nations prepare for the industries of tomorrow?

### EXHIBIT 10: MAKER MOVEMENT ECOSYSTEM



**Source:** Oliver Wyman PoV: How can nations prepare for the industries of tomorrow?

This shift towards more value-add activities can also be achieved without complex policy and structural changes. Indeed, the region has started to experience a surge in startup-like manufacturing through an approach called the “Maker Movement”. Over the past decade, the fast-growing “Maker Movement” has enabled individuals and startups to bypass traditional industry and rapidly bring-to-market compelling products and services better suited to consumers’ growing thirst for customization, innovation, and creativity.

Second, there is a need to build on the opportunities arising from regional cooperation. By combining product development, process, manufacturing and logistical capabilities across the region, the Gulf can promote the development of Regional Value Chains (RVCs). This would allow the region to further localize production, reduce imports and increase non-oil exports. RVCs could also be readily integrated with International Value Chains (IVCs), further increasing the region’s non-oil presence in the global economy.

While building such integrated value chains take time, there are other more short-term initiatives that governments should consider to support exports by the

existing SME base. For example, Qatar’s export agency Tasdeer has made great progress in creating linkage between local companies and international markets. This kind of support significantly reduces the barriers for SMEs to build their networks with potential international partners and customers.

Another area where governments can help is to ensure affordable support for SMEs to prepare for meeting international certification criteria. Certification is frequently a minimum requirement to be considered in international tenders and thus a necessary license to play. For example, Singapore’s SPRING agency supports SMEs with consulting services for certification and productivity improvements. These services are frequently provided by third party consultancies, themselves SMEs.

Finally, good logistics infrastructure and competitive time and cost for exporting are fundamental requirements for SMEs to be able to compete in the international marketplace. In particular, KSA and Kuwait need to invest in improving their export processes and infrastructure in order to unlock the exporting potential of their SMEs (**See Exhibit 11**).

## QATAR TASDEER



Qatar Development Bank (QDB) set up Tasdeer to promote exports by local firms. The CEO of QDB highlighted the agency’s mission as: “Through Tasdeer, we aim to strengthen the presence of Qatari companies on prestigious global platforms, linking Qatari specialists to international experts across the world’s production industries”.

For example, Tasdeer provides support to Qatari SMEs that want to be present at exhibitions worldwide. In 2017 alone it helped more than 250 Qatari companies reach over 28 international markets, generating export revenue of QR 500 MN (\$ 137 MN).

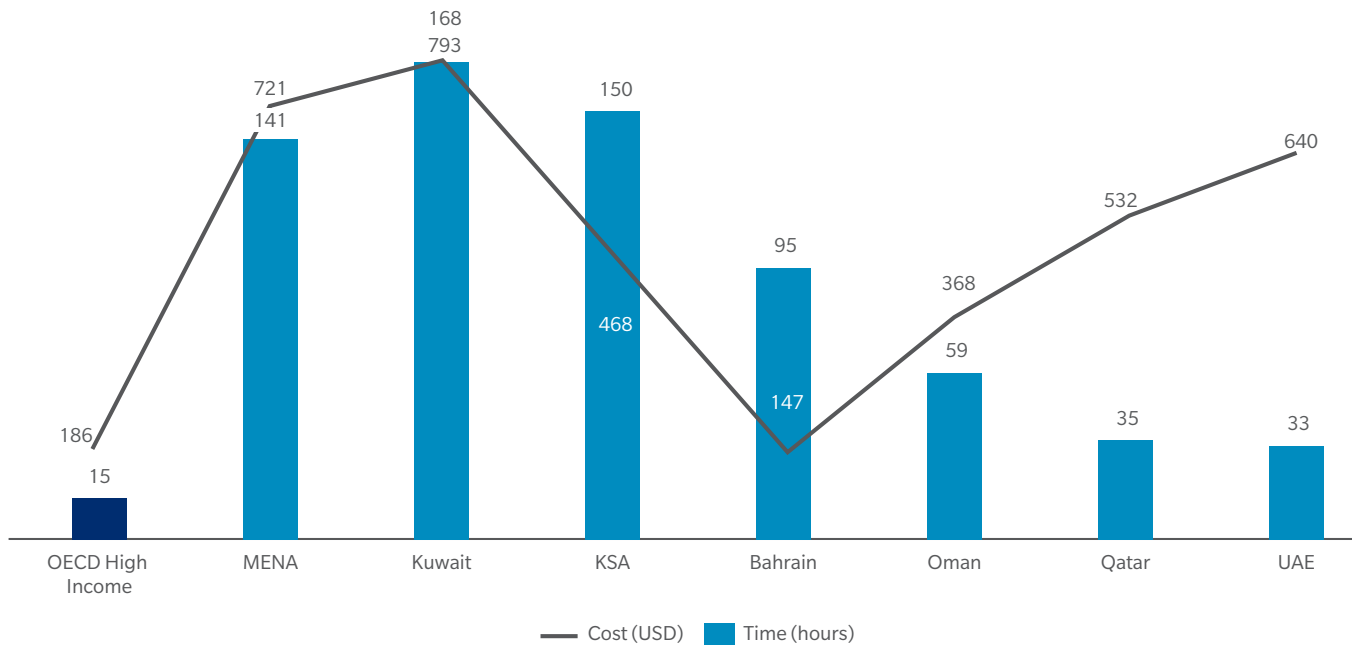
In October 2017 Tasdeer became the first Gulf export agency member of the Enterprise Europe Network (EEN). EEN is an entity set up to help SMEs trade internationally both within EU and in other member countries of EEN. Among other benefits, this membership allowed Qatari companies to access a database of business requests submitted by EEN members and hence to find more trading partners<sup>35</sup>.

**Source:** Qatar Development Bank (QDB)

35. Gulf Times, October 2017

## EXHIBIT 11: EXPORTING GOODS ACROSS MENA: TIME AND COST

TIME IN HOURS, COST IN USD



Time and cost spent on border compliance and documentary compliance

Source: World Bank, Doing Business, 2018

## CONCLUSION

With its tradition of international trade and its strategic position between three continents, the Gulf has a clear opportunity to develop into a favored location for exporting SMEs. In order to benefit from this opportunity, the region will need to increase its cooperation around trade and logistics in order to facilitate the creation of more sophisticated regional value chains, and boost exports of high value added goods.

By harnessing the creativity and entrepreneurship among the youth and positioning the Gulf economies towards developing a local 'maker movement', the region can leapfrog traditional learning and go-to market chains and gain faster development of local manufacturing and international trade.

## 4. WAY FORWARD

To build a successful SME strategy, it is necessary to take a holistic approach across the different levers enabling a high performing SME environment. Below is a summary of the recommendations that we have discussed in the previous section (**See Exhibit 12**).

Many of the ideas that we are putting forward in this paper conflict with established modus operandi, while others will require long-term commitment and investment to be successful. Thus, countries which are serious about building high performing SME sectors with

the potential to drive economic growth and diversification, need to be prepared to ask themselves challenging questions and take bold action to implement reforms.

Below we outline an approach to closing in on the region's ambitions for SMEs, and some key questions that need to be addressed.

### EXHIBIT 12: SUMMARY OF RECOMMENDATIONS

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#### REGULATION

- Apply "think small first" for regulation
- Identify and address regulatory gaps, in particular as related to bankruptcy, enforcement of contracts and shareholder protection
- Strengthen regulatory institutions



#### SKILLS AND INNOVATION

- Harness local talent and support life long learning on public and private platforms
- Transfer knowledge from skilled expats
- Prepare a serious plan for upgrading the national education system and institutions
- Consider partnering with international institutions to accelerate development



#### FINANCING

- Define clear requirements for receiving public financing, such as meeting milestones, participation of private capital etc.
- Focus policy measures on enabling private sector financing SMEs



#### INTERNATIONALIZATION

- Encourage high value activities which can compete in the global market place, e.g. by supporting in the "maker movement"
- Promote Gulf cross-border collaboration and formation of regional value chains
- Reduce barriers to trade by upgrading infrastructure and streamline processes

Source: TIGC Analysis

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## SET A VISION AND MAKE AN HONEST ASSESSMENT

An SME vision needs to align with the national ambitions, and ensure that a holistic approach is taken to develop the sector:

- ▶ Does the current SME ambition meet the national objectives of economic growth, diversification and employment opportunities for nationals?
- ▶ Does the vision adequately include objectives for the enabling areas of regulation, financing, skills and innovation, and international export-driven trade?
- ▶ What are the dependencies on other national policies, including labour market, education, competition, environmental and trade policies?
- ▶ Which of the SME environment enablers are strong today and which areas need to be bolstered to meet the vision?

## IDENTIFY EXISTING STRENGTHS, MULTIPLIERS AND BARRIERS

A national SME strategy should push beyond generic guidelines, to leverage existing strengths and identify specific initiatives that can multiply the impact on the sector:

- ▶ Which are the national and regional strengths that could be further leveraged by the SME sector?
- ▶ Which are the specific barriers whose removal would unlock the greatest development for the sector?
- ▶ How can the characteristics of the region be turned into competitive advantages, such as a young and highly diverse population, strategic location, or hot sunny climate?

## PREPARE A PLAN AND EXECUTE IT

An SME plan needs to accelerate the development of the sector by establishing a focused, coordinated approach with adequate governance mechanisms, to ensure execution and remove any barriers to implementation:

- ▶ How can the plan be structured to ensure focused implementation and continuous impact, as opposed to resulting in a long-list of underperforming initiatives?
- ▶ What are the delivery constraints such as resource capabilities and capacity, and external dependencies, which need to be adequately planned for and mitigated?
- ▶ Does the governance model provide empowerment to execute necessary changes in all of the areas identified in the vision?
- ▶ How can different stakeholder interests be managed to ensure that the SME vision is not diminished or corrupted by any individual interests during implementation?

## BUILD ON SUCCESSSES

Successes set positive examples and contribute to scaling resources and building ecosystems. Although the regional SME sector is underdeveloped in an international context, it is full of success stories that should be leveraged to accelerate its development:

- ▶ How to build on the success of companies such as Souq.com, Careem and Talabat.com, and benefit the larger entrepreneurial start-up community?
- ▶ How can the success of the petrochemical industry be translated into larger industry clusters, with a greater SME participation and dynamism?
- ▶ How can the success of the UAE as a trading hub benefit the greater region?

## CONCLUSION

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Countries that fail to develop their SME sectors will miss out on an opportunity to reform their economies and create valuable jobs. SMEs have indeed been proven to be drivers of employment and sustainable economies and disregarding them as a crucial part of the economy could spell worrying times ahead for the Gulf.

By taking decisive actions to build a stronger enabling environment for SMEs, Gulf governments can unlock the potential of the sector to lead the economic diversification and private sector development that the region aspires towards.

Those who are successful will be able to build an additional growth engine which will ultimately prove crucial in the process of reducing oil dependency and building new income sources to secure prosperity for generations to come.

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# APPENDIX: DIFFERENT DEFINITIONS OF SMES

**TABLE 2: DEFINITIONS OF SMEs ACROSS THE GULF**

COUNTRY	MICRO ENTERPRISE	SMALL ENTERPRISE	MEDIUM ENTERPRISE	SOURCE
<b>Kuwait</b>	N/A	[0,5] employees & startup capital [0,25k] KD	[5,50] employees & startup capital [25k, 500k] KD	Kuwait National Fund
<b>KSA</b>	[1,5] employees & turnover [0,3] MN SR	[5,50] employees & turnover [3,40] MN SR	[50,249] employees & turnover [40,200] MN SR	Small and Medium Enterprises Authority
<b>UAE (Abu Dhabi)</b>	[1,5] employees	[5,20] employees	[20,49] employees	Abu Dhabi Executive Council on 30 June 2013
<b>UAE (Dubai - trading)</b>	[0,10] employees & turnover [0,9] MN AED	[10,35] employees & turnover [10,50] MN AED	[35,75] employees & turnover [50,250] MN AED	Dubai SME
<b>UAE (Dubai - manufacturing)</b>	[0,20] employees & turnover [0,10] MN AED	[20,100] employees & turnover [10,100] MN AED	[100,250] employees & turnover [100,250] MN AED	Dubai SME
<b>UAE (Dubai - services)</b>	[0,20] employees & turnover [0,3] MN AED	[20,100] employees & turnover [3,25] MN AED	[100,250] employees & turnover [25,150] MN AED	Dubai SME
<b>Qatar</b>	[0, 250] employees ([0,100] for creative sector) & turnover [0, 100] MN QR			Qatar Development Bank

**Source:** SMEs, trade and development in GCC countries: A development perspective, TICG analysis

## ABOUT TICG

Tri International Consulting Group (TICG) is a world-class management consultancy that combines extensive industry knowledge and deep Kuwaiti market understanding with specialised expertise in strategy, operations, risk management, and organisation transformation. Our professionals help clients optimise their businesses, improve their operations and risk profile, and accelerate their organisational performance to seize the most attractive opportunities.

TICG was founded as a joint venture between the Kuwait Investment Authority (KIA), the first sovereign wealth fund in the world, the Kuwait Fund for Arab Economic Development (KFAED), the first Arab international development institution, and Oliver Wyman, a leading global management consulting firm.

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