



Qatari entrepreneur and founder of the Q-Talent company, Maryam al-Subaiey (L), and Caroline Carpentier, French author of “Qatar Success Stories - Inspiring Women,” stand at Subaiey’s boutique in Doha on 23 February 2015 selling “Made in Qatar” items.

## Unleashing Small-to-Medium Enterprises in the Gulf States

by *Fadi Farasin & Cihat Battaloglu*

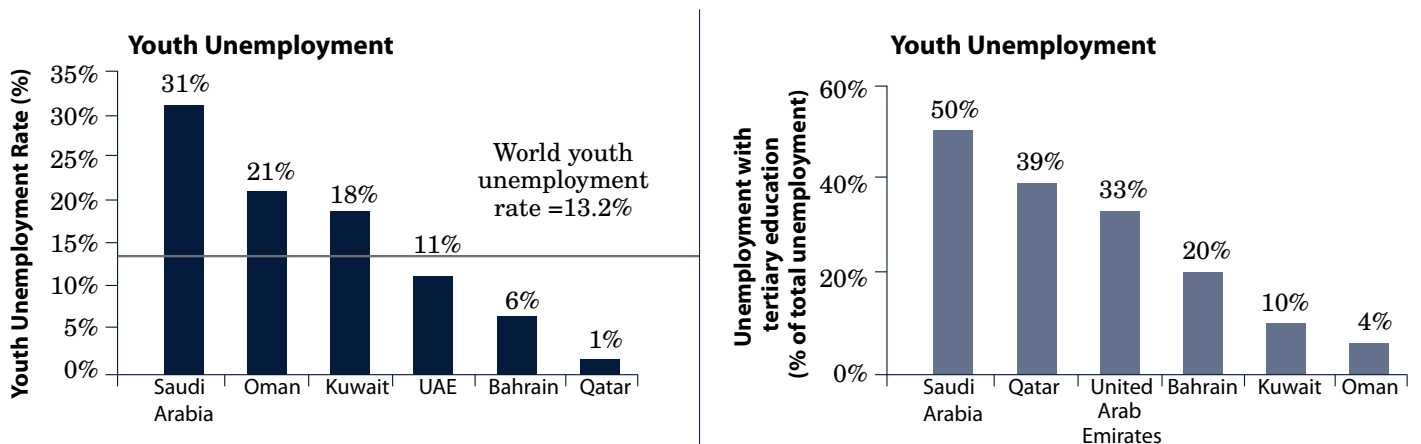
**T**he Gulf region is one of the most youthful areas of the world. Fifty percent of the region’s people—nationals and foreigners alike—are under the age of 30.<sup>1</sup> While this demographic gift holds great promise for the Gulf states in terms of economic development, it also carries many threats. Widespread youth unemployment in particular can serve as a catalyst for instability, radicalism and conflict.

The youth unemployment rate in Saudi Arabia, Oman and Kuwait is already much higher than the global average (see Figure 1, left). Moreover, unemployment is highest among the most educated segment of the youth populations in various Gulf states (Figure 1, right). These facts have opened up space for disgruntled citizens to register their discontent at the direction of government policies.

Historically, Gulf states have relied on their hydrocarbon wealth to increase salaries and jobs in the public sector in order to quell social discontent. Yet times are now changing—the public sector is bloated and the drop in oil prices since mid-2014 is straining government budgets (the region’s cumulative fiscal deficit is forecasted to top \$475 billion between 2016 and 2021).<sup>2</sup> This is forcing Gulf states to reduce hiring, cut subsidies and halt infrastructure projects. As such, the region needs new tools and approaches; fortunately, entrepreneurship and small-to-medium enterprises (SMEs) can fill much of this void as engines for job creation.<sup>3</sup>

## II. Analysis

**Figure 1: 2017 unemployment projections in the Gulf states**



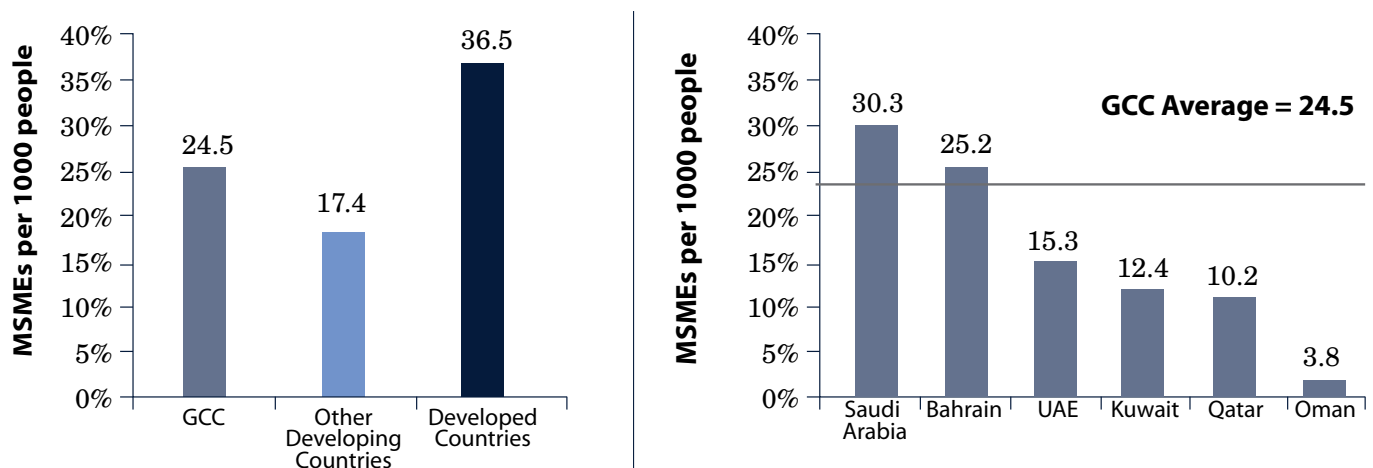
Source: Authors' analysis is based on the International Labour Organization's (ILO) Key Indicators of the Labour Market (KILM), 9th edition, 2016.

### SMEs in the Gulf states

People of the Gulf region have high labor and employment expectations, but increasingly socio-economic realities are failing to meet these expectations.<sup>4</sup> While the role of micro, small and medium enterprises (MSMEs)<sup>5</sup> cannot be over emphasized in terms of its contribution to GDP and employment generation (particularly in emerging economies), there is room for substantial improvement.<sup>6</sup>

The number of MSMEs per 1000 people (also known as MSME density) in the Gulf region stands at 24.5. This figure is better than in other developing countries, but remains significantly lower than in developed countries (Figure 2, left). In fact, MSME density is very low in most Gulf states and ranges from a high of 30.3 in Saudi Arabia to a low of 3.8 in Oman (Figure 2, right). This low density of MSMEs shows that there is much room for improvement. The region's governments can help by promoting entrepreneurship and creative business ideas among people, as well as establishing an environment conducive for MSMEs to do business and thrive.

**Figure 2: MSME density**



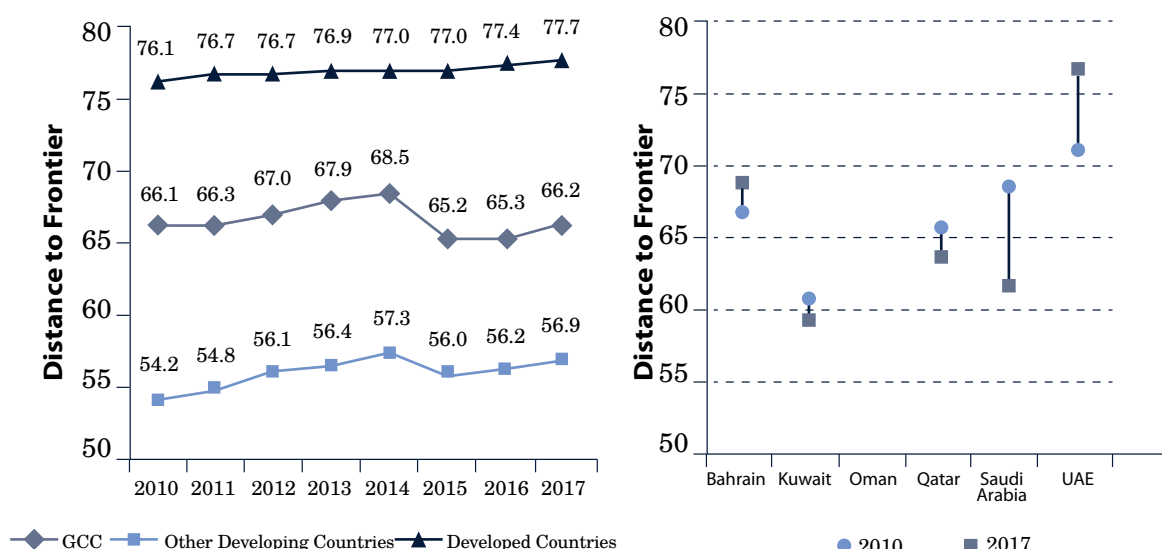
Source: Authors' calculations are based on the International Finance Corporation's (IFC) MSME country indicators, 2010.

### Ease of doing business

Much like MSME density, the Gulf states perform better on the World Bank’s Doing Business indicator than other developing countries, but worse than developed ones (Figure 3, left).<sup>7</sup> What is worrisome is that, unlike other developing countries, the Gulf region has failed to materially improve its score in recent years (66.2 in 2017 compared to 66.1 in 2010). In fact, the Gulf region experienced a significant drop in 2014 from which it has yet to recover. The main reasons for this include the increased difficulty in starting a business and in getting electricity. (In Saudi Arabia, trading across borders became more difficult in 2014, which also contributed to the drop in the region’s Doing Business indicator.)

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**Figure 3: Doing Business Indicator**



**Source: Authors’ calculations are based on the World Bank’s 2017 Doing Business indicator.**

At the country level, the Gulf states exhibit wide differences (Figure 3, right). The UAE is the top performer and the country that increased its Doing Business score the most between 2010 and 2017, from 70.8 to 76.9. Oman and Bahrain are the other two Gulf states that have also improved their score during the same period. On the other hand, Kuwait, Qatar and Saudi Arabia all recorded drops in performance. In particular, Saudi recorded a decline from 67.9 to 61.1, the largest fall in the region.

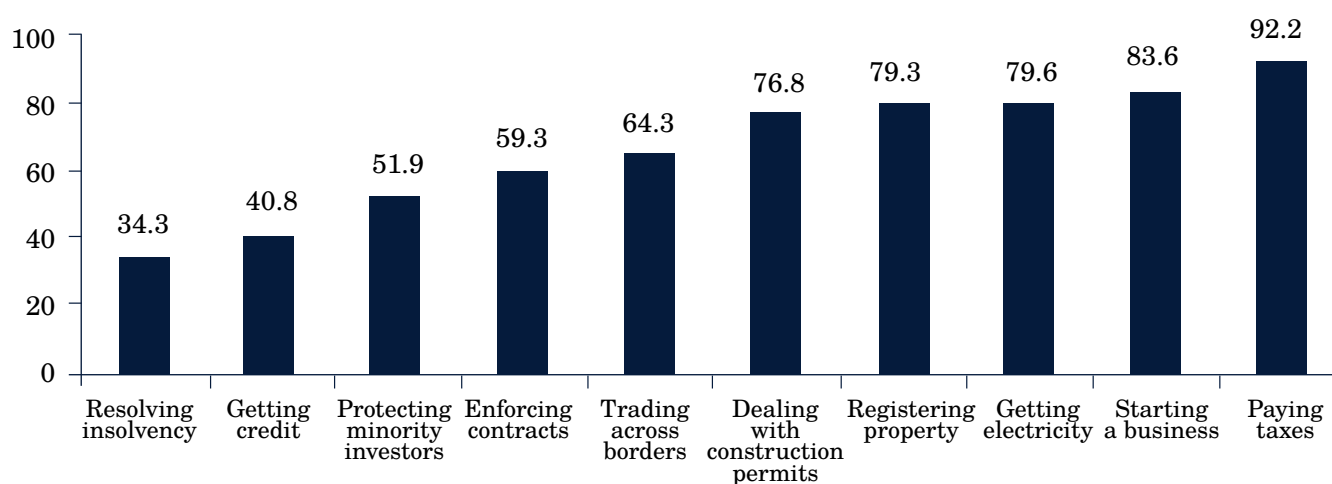
### Obstacles facing SMEs

The Doing Business indicators reveal two areas (see Figure 4) in particular where the Gulf states need to improve upon. The first relates to insolvency, and entrepreneurs rank the risk of going bankrupt as the greatest fear associated with starting a business.<sup>8</sup> If SMEs are to flourish, Gulf states need to free would-be entrepreneurs from this fear. This would require making it easier to resolve insolvency by incorporating good practices. Specifically, this could include: 1) introducing new restructuring procedures; 2) revising bankruptcy laws to provide updated provisions for dealing with bounced checks and 3) improving provisions on treatment of contracts during insolvency proceedings.

## II. Analysis

The second biggest obstacle for SMEs is obtaining credit, which is exacerbated by religious beliefs. A 2009 Gallup poll showed that the overwhelming majority of adults in the Gulf states deem religion to be an important part of their daily lives (95% in Qatar, 94% in Bahrain, 93% in Saudi Arabia, 91% in Kuwait and 91% in the UAE).<sup>9</sup> This leads many SMEs to voluntarily exclude themselves from formal financial markets due to sharia requirements related to banking. Indeed, sharia-compliant products are simply not as widely available in the market—of the 36 percent of banks in the Middle East that offer SME products, only 17 percent offer Islamic borrowing options.<sup>10</sup> Encouraging the development of more Sharia-compliant products and instruments can play a key role in eliminating the barriers to getting credit faced by many SMEs.

**Figure 4: The Gulf region’s performance across ten regulatory areas**



**Source: Authors’ calculations based on the 2017 World Bank’s Doing Business indicator.**

While reforming insolvency and access to credit rules can improve the ease of doing business in the Gulf states, other factors also play a role. Protecting minority investors, easing cross-border trade and amending property and contract laws are other potential reform areas. Focusing on all of these aspects would help Gulf policymakers realize their goal of developing a sustainable private sector rooted in robust MSME activity.

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<sup>1</sup> Authors’ calculation is based on the 2015 UN World Population Prospects.

<sup>2</sup> “Economic Prospects and Policy Challenges for the GCC Countries.” IMF, Riyadh, 2017. <https://www.imf.org/external/np/pp/eng/2016/102616b.pdf>.

<sup>3</sup> Thurik, Roy and Sander Wennekers. “Entrepreneurship, Small Business and Economic Growth.” *Journal of Small Business and Enterprise Development* 11, no. 1 (2004): 140-149.

<sup>4</sup> Farasin, Fadi, Battaloglu, Cihat and Adam Atauallah Bensaid. “What is Causing Radicalism in the MENA?” Arab Center for Research and Policy Studies, Doha, 2017. <http://english.dohainstitute.org/file/get/be8a57a1-4bd4-471b-9bbb-840c20ecdbf5.pdf>.

<sup>5</sup> MSMEs are generally defined as follows: micro enterprises: 1–9 employees; small: 10–49 employees and medium: 50–249 em-

ployees. Some countries define MSME categories differently. Please see the IFC's "Companion Note for the MSME Country Indicators" for more information: <http://www.ifc.org/wps/wcm/connect/624b8f804a17abc5b4acfddd29332b51/MSME-CI-Note.pdf?MOD=AJPERES&CACHEID=624b8f804a17abc5b4acfddd29332b51>.

<sup>6</sup> Saleem, Qamar. "Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance." IFC Advisory Services in the Middle East and North Africa, 2013. [https://smefinanceforum.org/sites/default/files/post/files/457586\\_ifc\\_sme\\_report\\_final.pdf](https://smefinanceforum.org/sites/default/files/post/files/457586_ifc_sme_report_final.pdf).

<sup>7</sup> The Doing Business indicator looks at regulations that impact SMEs in the largest business city of an economy. Zero represents the lowest possible score and 100 the highest.

<sup>8</sup> "A second chance for entrepreneurs." European Commission, Brussels, 2011.

<sup>9</sup> Crabtree, Steve. "Religiosity Highest in World's Poorest Nations," *Gallup*. August 31, 2010. <http://www.gallup.com/poll/142727/religiosity-highest-world-poorest-nations.aspx>.

<sup>10</sup> "Islamic Banking Opportunities Across Small and Medium Enterprises in MENA." International Finance Corporation, 2014. <https://www.ifc.org/wps/wcm/connect/7ab5500045503ad09e619ec66d9c728b/Executiv+Summary+final+31-8-2014+.pdf?MOD=AJPERES>.