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Helping hand

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Developing countries are still in the early stages of establishing business environments that support the SME sector. In the OIC region, governments must face the challenges of developing SME supportive business environments by implementing specialised, dedicated and targeted efforts reports the Capitas Group International.

Undoubtedly, small and medium enterprises play a significant role in growing, diversifying and strengthening a country's economic base. They create employment, enhance competitiveness, and contribute positively to socioeconomic indicators such as GDP growth and the number of middle-income households in an economy.

The big picture

The World Bank estimates that by 2020, up to 100 million new jobs will need to be created in order to keep employment levels where they are today. This poses a major challenge for the Arab world with regards to job creation as young individuals begin to enter the workforce.

Conversely, in developed economies, SMEs are a major contributor of national employment. According to a study by Shandong University of Technology in China, 60-80% of new jobs are created solely by the SME sector in the USA annually; and in Europe 75% of the workforce is employed by SMEs. The opportunity for SME growth in OIC markets is considerable. For example, in Arabic speaking countries SME contribution to employment is only estimated at 33%.

The contribution of SMEs to macroeconomic growth is widely recognized. Studies have established a strong correlation between a nations' GDP and the percentage of its population employed by SMEs (Table 1). SMEs in Arab countries vary considerably in terms of their contribution to GDP.

SME contribution to employment

Region	SME Contribution
USA	70%
Europe	75%
Arab Countries	33%
Singapore	62%
Malaysia	56%

Sources: Shandong University of Technology, research report for the EU-GCC Chamber Forum project, Munich Personal RePEc Archive, Petra University Malaysia, Spring Singapore

Some countries like Yemen and Algeria rely heavily on SMEs for economic growth. Through a number of government initiatives to facilitate micro enterprise development; their contribution to GDP is 95% and 77% respectively. Whereas in Egypt and Saudi Arabia SMEs contribute 33% and 25% of the country's GDP, respectively. Research by the International Finance Corporation has shown that in high-income countries like the USA, 51% of GDP is attributable to SMEs, whereas in medium- and low-income countries SME contribution to GDP has been measured at 39% and 16%, respectively.

Government policies focused on increasing the economic contribution of SMEs also assist in the overall diversity and stability of an economy. For example, in Korea – which has been very active in creating and promoting SME policies for numerous sectors including mining, construction, manufacturing and transportation – SMEs represent 99% of the total number of companies, and correspond to 43% of the country's exports.

In certain developing countries economic diversification is essential. For many Gulf Cooperation Council (GCC) countries, the main engine for growth has been the oil and gas industry, whose produce represents 80% of total exports. This lack of a diversified economic base makes the region's welfare susceptible to changes in global oil demand. This imbalance presents measurable opportunities for Small & Medium Enterprises in the region to play a key role in diversifying employment sources and overall economic expansion.

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Critical issues faced by SMEs

In developed markets, the social and economic contribution of SMEs is supported by business environments that facilitate the sector's growth. Focused funding/financing programs, as well as training and support mechanisms, target the specific needs of SMEs and their management.

In the developing markets of the OIC however, SMEs are prone to face challenges in three areas:

Access to finance
Training and development
Business support services
As a small business moves through the various stages of its life cycle, it requires different support programs that are suited to its specific needs at the time. For example, at the early stages, access to equity financing is essential to support the initial development of the enterprise as it refines its initial business model and builds market share. Once the business has proven its presence in the market, it will likely require access to short term financing to fuel its growth with working capital or lines of credit. As it reaches maturity, small business will begin to access long term debt financing or the capital markets for major expansion projects. Eventually, as SMEs mature in their life cycle, their funding requirements change as well.

SMEs are generally perceived as high in credit risk even in mature SME environments. In developing markets this risk is even higher since the uncertainty of a new business, coupled with the general lack of credit history prevents investors and financiers from creating SME financing programs. Lending institutions are also hesitant to provide financing unless the business is backed by significant assets or government guarantee programs. Thus, access to finance proves to be more difficult for SMEs than for established businesses, limiting the ability of entrepreneurs to innovate and grow.

Many Arab countries rank low in the World Bank's Ease of Doing Business rankings particularly when it comes to securing financing. As demonstrated in the table below, Qatar and Oman are ranked at 135 and 127 out of 183 countries for securing credit. Conversely Saudi Arabia and the UAE have established relatively efficient systems for businesses to access credit.

Table 2 - GCC – World Bank Ease of Doing Business Rankings

Economy	KSA	Bahrain	UAE	Qatar	Kuwait	Oman
Ease of Doing Business Rank	13	20	33	39	61	65
Starting a Business	13	63	44	68	137	62
Employing Workers	73	13	50	68	24	21
Getting Credit	61	87	71	135	87	127
Paying Taxes	7	13	4	2	11	8

Source: World Bank

Training, educational and business support services are critical to SMEs success. Similar to financing, SME training and development needs also differ in each stage of the life cycle of the new enterprise. New SMEs require more basic skills such as business plan development and accounting which allow entrepreneurs to develop their initial ideas into a proper business model. However, as the SME advances in its life cycle training and development needs become more complex for example. information systems integration and knowledge of legal requirements for international trade. In developing countries, entrepreneurs find it difficult to access targeted training programs at each stage of development due to a lack of centralised programs to mentor and give entrepreneurs the correct guidance for enterprise development.

Business support services are a major challenge for SMEs when the business environment itself does not facilitate the process for start-ups. For example, services which simplify business registration and payroll processing ease the burdens of administrative tasks on entrepreneurs allowing them to focus on developing their businesses. In addition, the support of other SMEs in similar or related industries or the mentorship of an established business can greatly improve SME performance if facilitated through targeted programs.

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Global case studies in SME development

Fortunately, developing economies in the OIC can benefit from the example of several global success stories in SME sector development. Each example highlights how governments tackled a specific issue facing SMEs and created relevant solutions for the sector's long term improvement.

For example, Singapore highlights the virtues of effective SME support services. In 1989, the Government of Singapore developed an SME Master Plan to create a pro-enterprise environment encouraging competition and SME sector growth. Singapore faced a unique challenge at the time – a growing economy characterised by high employment, high salaries and a workforce culture based around job security. These factors undermined the 'push' factor needed to propel graduates and professionals to start business of their own.

The SME Master Plan for Singapore focused on free trade and globalisation, wherein Singapore encouraged local firms to set up joint ventures with European companies and made Singapore prominent in various global forums to attract foreign investment and facilitate exports from local SMEs.

In addition, the government's master plan encouraged multinationals to serve as mentors to local enterprises by creating monetary incentives for them to improve SME operating efficiencies, widen product ranges, introduce new processes and undertake joint product or process development with those multinational companies.

Today SMEs in Singapore make up about 90% of the establishments in manufacturing and commerce sectors, employ 44% of the workforce and contribute to 42% of Singapore's GDP.

In the area of training and development, the United States has created an effective scheme under the Small Business Administration (SBA) called SCORE. SCORE acts as an advisor to entrepreneurs through over 350 walk-in offices across the country. Advisors are retired individuals with experience in various industries who provide free guidance to entrepreneurs on all aspects of business, starting from creating a business plan and company registration procedures to financial advisory and export documentation requirements. Since its establishment in 1964, SCORE has advised more than 8 million SMEs.

Finally, Korea has been one of the most successful countries in creating an active SME sector especially when it comes to financing. The government supports SMEs through a variety of funding programs starting from government grants and guarantee programs to helping to establish national guidelines for SME financing such as the obligatory SME loan ratio system and the import/export financial support system. The government also created the Industrial Bank of Korea in 1961 as a specialised bank to extend SME loans that meet various SME needs like capital support for stabilisation and restructuring and facility funds with low-term interest rates.

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Looking forward

OIC member countries are faced with rapidly expanding populations, high levels of unemployment, and a lack of broad based economic activity. As they look to the future, policy makers can and should plan for SMEs to play an integral role in alleviating some of these critical issues. In addition, governments should incentivise established private sector players to support the growth of the SME sector.

SME growth can be focused through targeted and specialized regulations and policies. As a first step governments should consider the following as key determining factors for SME development:

Identify key industries through which they can achieve competitive advantage. Strategies can then be put in place to provide new businesses in these sectors with the right types of funding programs as well as training and business support that address their specific needs. In addition, these programs should be sensitive to the requirements of SMEs at every stage of their life cycle – not just start up.
Incentivise the private sector by creating incentives and guarantee programs that encourage institutions to support local SME sector development. For example, a government financing program for SMEs in specific sectors will focus bank lending to these industries. These programs should be coupled with training curricula which help staff at lending institutions to manage SME relations and better understand clients in order to contribute to SME growth and lower their institutions' lending risk.
Incentivise multinationals through government subsidies or reductions in certain taxes/costs. They will in turn contribute valuable skills and training to local SMEs to meet higher international standards and enhance their global competitiveness.
OIC governments need to play the leading role to facilitate the development of their SME sectors. This is especially important in OIC member countries as they address the issue of a young unemployed work force. A developed SME sector will also help to diversify their economies and enhance global competitiveness, especially GCC countries where GDP contribution is reliant on the oil sector.