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**A “SME” Authority for Saudi Arabia
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Editor’s Note:**

Small and medium sized enterprises (SMEs) are “considered the most efficient instrument to accelerate the pace of economic and social development,” according to Saudi Monetary Agency chief Dr. Muhammad Al-Jasser. Speaking to a group of bankers in November he said, “small and medium enterprises provide a fertile environment for training workers and developing their skills; and help in speeding up the turnover of small amounts of invested funds.”

Saudi Arabian Monetary Agency (SAMA) Governor Mohammad Al-Jasser. (SUSRIS Archive Photo)

The SAMA Governor’s position on SMEs was the subject of Elizabeth Pfister’s article on this important sector in SUSRIS in December and noted the main challenges for these enterprises to get up and running was access to adequate financing and “weak capacities to facilitate governmental procedures.” That assessment was recently cited in a paper by Capitas Group International (CGI), which argues for creation of a central authority for small and medium enterprises. An authority for SMEs, it is argued, will unlock the sector’s true potential. “The Shoura Council has recently given its approval for the creation of an SME Authority in Saudi Arabia,” said Naveed Siddiqui, CEO of CGI. “This is a critical development for the Kingdom. Today there is no single body responsible for policy formulation and coordination within this vital sector. The launch of an SME authority will be the most effective means to enhance the contribution of SMEs to Saudi Arabia’s economy.”

The CGI paper calls for the level of SME participation in Saudi Arabia’s economy to be higher. The paper lays out the practical and structural reasons that inhibit adequate lending and notes that the government has acted to support SMEs, but the programs are uncoordinated. CGI calls for an agency to serve as a steward to define the needs, develop enabling policies and coordinate services and programs to the SME sector. The paper goes on to outline basic functions of a Saudi SME Authority.

Today we are pleased to provide Capitas Group International’s paper on SMEs for your consideration. We thank CGI for permission to share it with you in SUSRIS and look forward to providing a forum for their assessments and policy papers in the future.

**A SME Authority for Saudi Arabia
A paper by Capitas Group International**

Small and medium enterprises (SMEs) are the key to unlocking the vast potential of the Saudi Arabian economy. SMEs can provide valuable employment opportunities to a growing young population, improve productivity and help diversify the economy. SMEs have a strong footing within the Kingdom in that they currently make up 90% of all businesses, however, their contribution to GDP remains low. Considering the vast number of competing SME programs and initiatives throughout the Kingdom, the need for a new SME support organization in Saudi Arabia may seem redundant. The reality is that the only effective way to expand the true economic potential of SMEs in Saudi Arabia is to launch a national SME Authority.

Challenges for SMEs in Saudi Arabia

Saudi Arabia is the largest economy in the GCC. During the last eight years, the country's budget has grown from \$69 billion to \$170 billion, a near threefold expansion. Despite this growth SMEs contribute to only 25 percent of total employment and only 33 percent to the country's GDP. This is in stark contrast to most developed economies. For example, in Spain SMEs contribute to 64.3 percent of GDP, or even Austria where SMEs contribute 44 percent. Given the current gaps, the size and growth of Saudi Arabia's economy and the nation's focus on economic diversification, SMEs should contribute to more than 50 percent of the country's GDP.

Within the current economic environment SMEs in the Kingdom face formidable challenges which limit their ability to remain competitive and maintain sustained growth. The absence of targeted and continuous support services and financing programs which meet the needs of SMEs across their development stages has led to short life spans for SMEs in the Kingdom where the average SME is only seven years old.

Foremost among SME challenges is their inability to access capital (equity and debt) that is relevant to their particular stage of development. Equity investment is critical for a venture's survival, especially in its early stages. However, in Saudi Arabia there is a dearth of venture capital and angel investor funds that support young companies in a variety of sectors.

With regard to debt capital, less than 2% of Saudi banks' total lending is going to SMEs compared to over 14% in non-GCC countries. Despite the sector's size, financiers avoid lending to SMEs for a number of reasons. Overall, there is a general lack of reliable and accessible information about them. In addition, there is no proven legal environment that allows for collateral registry and legal enforcement in case of default. Finally, most SMEs do not have audited financials and are largely with respect to finance. This requires financial institutions to spend greater time and resources in servicing them which increased their operating costs, either causing lenders to charge premiums to SME customers, or overlook them entirely.

All of these issues increase the risks of lending. Without the correct incentives for lenders to increase the flow of credit to the SME sector, or the proper policy tools to manage their risks, banks cannot be expected to give SMEs a larger share of their lending portfolios. Other challenges for SMEs include a lack of skilled human resources in business and technical fields, bureaucratic red tape, a lack of market information, and a generally weak policy/regulatory environment.

The Saudi government as well as the private sector has recognized the potential of SMEs and their need for a wide base of support including capital (debt and equity), training and business services. In fact within the GCC, Saudi Arabia has the largest number of public and private sector SME support programs. The recently announced Ninth Economic Plan seeks to expand SME support further by increasing the ability of specialized funds and financial institutions to provide credit to SMEs, along with providing various forms of technical assistance.

However, more is not always better. Although their numbers are large and some of the programs are well funded and effective, the existing SME support programs work in a fractured and uncoordinated environment. There is a fundamental lack of strategic coordination which prevents a holistic approach to developing the sector. As a result valuable lessons are lost and efforts are often duplicated leading to higher costs and unnecessary redundancies. Since existing institutions have not effectively addressed the needs of SMEs, a new approach must be developed.

An SME Authority for Saudi Arabia

Many countries have failed to properly promote their SME sector by relegating public sector support institutions to simple service providers. In most successful global examples the SME Authority is an independent public sector body which coordinates closely with the Ministries of Business and Trade/Commerce and is granted certain policy making, enforcement and delega-

An SME Authority for Saudi Arabia

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Hence, in the case of Saudi Arabia, the SME Authority should be allocated clear oversight powers with designated areas of focus in the areas of policy setting and services allocation.

Policy and Intelligence Functions

Within the realm of policy the SME Authority must be the steward of SME interests by advocating policy matters and developing regulatory frameworks which lower barriers to SME development and foster an overall enabling environment for SME growth. The Saudi SME Authority's stewardship function should commence with setting a national SME definition. A single SME definition provides a common starting point on which stakeholders can develop programs and services for SMEs. Among some of the key effects of a national SME definition are:

1. Facilitating the development of policies that encourage SME sector growth.
2. Enabling the accurate evaluation of the sector so that the impact of regulatory reform and financial and non-financial programs can be monitored and assessed.
3. Developing a better understanding of the impact of SMEs in economic development.
4. Helping the collection of data on the sector in order to make inter-country and inter-regional comparisons
5. Coordinating multi-stakeholder approaches, as needed, to ensure all are targeting the correct client group.

In countries without an SME Authority multiple definitions are used by the market, leading to the type of fractured SME service landscape currently seen in Saudi Arabia. A standard definition develops uniformity and reducing redundancies in the market's approach.

In Saudi Arabia, information on SME formation, employment, financial performance and survival, etc., are extremely scarce, illustrating the lack of leadership and coordination within the sector. Such information is critical to understand the development impact of SMEs in specific sectors, and to measure the impact of general and SME-specific policies on small companies. Accordingly, the Saudi Arabian SME authority will have a primary intelligence gathering function. It will conduct surveys, monitor SME development, and interact daily with entrepreneurs to develop critical insights which are used to develop programs for the sector.

Service Functions

Along with its policy functions, the Saudi SME Authority must serve as "traffic control" for coordination of services in the multi-stakeholder SME landscape. The programs it develops will leverage existing services in the public and private sectors and package them for SMEs. This happens on several tracks to create a seamless set of services for SMEs at all stages of their business lifecycle.

For example, in the area of capital (debt and equity) the Saudi SME Authority will collaborate with fund managers and banks to develop SME-focused equity investment or debt programs to support startups or enhance access to credit for existing SMEs. The Authority will also cooperate with development and training institutes to facilitate programs which enhance the competitiveness of the Saudi workforce and facilitate the path to entrepreneurship for individuals. Finally, the Authority will ensure that SMEs have access to basic business services which support the creation and survival of knowledge-based ventures and increase existing SME

efficiency and productivity.

Looking Ahead

Given the recognized challenges facing the SME sector in the Kingdom, the launch of a national SME Authority is the most effective means to enhancing the contribution of SMEs to Saudi Arabia's economic development.

In the GCC, several governments have recognized the importance of the SME sector and are taking progressive steps to bolster it through focused policy initiatives. For example, Qatar recently announced the launch of a complete SME authority – Enterprise Qatar – to champion SME policies while coordinating debt, equity, training, and business services programs. The UAE, already at the leading edge of SME sector development with various programs in place targeting SMEs at various stages of their lifecycle and in different sectors, is now considering a national SME promotion law. Finally, members of Kuwait's parliament have presented a draft bill on the establishment of an independent SME authority as the country seeks to create new channels for employment and to diversify its economic base.

Many other developed and emerging economies in Europe and Asia have established successful SME Authorities that can serve as guiding examples for the Kingdom. While these initiatives can provide insights into best practices and can help develop a framework for an SME Authority in Saudi Arabia, the Saudi SME Authority must be localized and tailored to meet the unique needs of the Saudi market.

About Capitas Group International:

Capitas Group International is a joint venture between the Islamic Corporation for the Development of the Private Sector (ICD), a member of the Islamic Development Bank Group, and Capitas Group, LLC, a US based Shari'ah compliant holding company. CGI's mandate is to focus on initiatives that are of strategic importance to the SME and housing sectors. CGI emphasizes a pragmatic, holistic approach based on extensive experience launching and managing multiple specialty firms and working with regulators, government institutions, and the private sector. The company's capabilities span the range of multi-disciplinary functions including product development, marketing, operations and technology. In addition to the Enterprise Qatar project, CGI has been entrusted with the development and launch of a \$533 million financing company in Saudi Arabia to provide financing to small and medium sized developers and middle income homebuyers.