FINAL REPORT

SMEs IN KUWAIT: SUMMARY REPORT

SMALL AND MEDIUM ENTERPRISES IN KUWAIT: THEIR IMPACT AND THE WAY FORWARD

VOLUME I

TE051C

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ABSTRACT (SUMMARY OF NOT MORE THAN 300 WORDS) **المستخلص (ملخص لايزيد عن 300 كلمة)**

تاريخياً، أكد الاقتصاديون على أهمية دور المشاريع الصغيرة والمتوسطة الحجم وتأثيرها الإيجابي فى النمو الاقتصادي وزيادة الانتاج وخلق فرص العمل في كل من الدول النامية والمتطورة. ولكن في دولة الكويت لم يتم دراسة هذه المؤسسات من خلال التحليل النوعي أو الكمي. وعليه هدف هذا المشروع البحثى (TE051C) إلى دراسة المشاريع الصغيرة والمتوسطة من حيث التركيبة والأداء ومدى المساهمة في الاقتصاد المحلي. يتكون التقرير النهائي من أربعة أجزاء، يقدم الجزء الأول ملخصاً لأهم مخرجات الدراسة، في حين تم في الأجزاء (2-4) تحقيق الأهداف التالية: 1) إنشاء قاعدة بيانات إحصائية للمشاريع الصغيرة والمتوسطة على مستوى المنشأة في خمس قطاعات اقتصادية للفترة (2002- 2013). 2) تحديد و تقييم التعريفات المناسبة للمشاريع الصغيرة والمتوسطة. 3) توصيف كامل لتركيبة المشاريع الصغيرة والمتوسطة. 4) قياس أداء المشاريع الصغيرة والمتوسطة ومدى مساهمتها في الاقتصاد الكويتى. 5) تقييم لوضع المشاريع الصغيرة والمتوسطة في دول مجلس التعاون الخليجي. 6) مراجعة السياسات العامة والمؤسسات السابقة والحالية المتعلقة بتطوير المشاريع الصغيرة والمتوسطة فى الكويت. 7) تقديم التوصيات للسياسات والمؤسسات المطلوبة لخلق بيئة تساهم في نمو المشاريع الصغيرة والمتوسطة وذلك طبقاً لأفضل الممارسات العالمية.

KEY WORDS: **أهم المصطلحات:**

المشاريع الصغيرة والمتوسطة، النمو الاقتصادي، قاعدة بيانات إحصائية، تعريفات ، دول مجلس التعاون الخليجي، السياسات العامة، الانتاج.

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ABSTRACT (SUMMARY OF NOT MORE THAN 300 WORDS) المستخلص (ملخص لايزيد عن 300 كلمة)

Economists worldwide have corroborated the positive influence of small and medium enterprises (SMEs) on economic growth, output, and job creation in developed as well as developing economies. This role, however, has not been investigated quantitatively or qualitatively in Kuwait. Therefore, this project aims to examine SMEs in Kuwait in terms of structure, performance, and contribution to Gross Domestic Product (GDP). The final report of this study consists of four volumes; volume one presents a summary of the project's main findings, and the remaining volumes (2-4) have achieved the following specific objectives: 1) developing SMEs' statistical database for the State of Kuwait at the firm level in five economic sectors over the period (2003-2012); 2) assessing the appropriate SMEs' definitions; 3) building a comprehensive profile of SMEs in Kuwait; 4) measuring the SMEs' performance and contribution to the economy (2003-2012); 5) assessing SMEs' status in the Gulf Cooperation Council (GCC) countries; 6) reviewing Kuwait's past and existing SMEs' public policies and institutions; 7) recommending required policies and institutions by focusing on best international practices that will bolster an enabling business environment for SMEs' expansion.

KEY WORDS: أهم المصطلحات:

SMEs, Economic Growth, Statistical Database, SMEs Definitions, , Output, GCC, Public Policies

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Introduction

Economists worldwide have validated the positive influence of small and medium enterprises (SMEs) on economic growth and job creation in developed as well as developing economies. This role, however, has not been investigated quantitatively or qualitatively in Kuwait. As far as Kuwait is concerned, information on neither the structure nor the performances of SMEs is available. Thus, there is little known about SMEs in Kuwait at present. This has prompted the Techno-Economics Division (TED) at Kuwait Institute for Scientific Research (KISR) in collaboration with the Kuwait Foundation for Advancement of Science (KFAS) to address this concern and conduct the project TE051C “Small and Medium Enterprises in Kuwait: Their Impact and the Way Forward”. Specifically, the project aimed to achieve the following objectives:

1. Creating a SMEs’ statistical database for the State of Kuwait (2003-2012).
2. Assessing and identifying an appropriate SMEs’ definition.
3. Building a comprehensive profile of SMEs.
4. Measuring SMEs’ performance and contribution to the economy (2003-2012).
5. Assessing the status of SMEs in the GCC countries.
6. Reviewing Kuwait’s past and existing SMEs’ public policies and institutions.
7. Recommending required policies and institutions.

The final report consists of four volumes. Volume I aims to highlight the work accomplished by the project team and the international consultant, and to summarize the major outcomes, findings, and conclusions of the completed project. Volume II has been devoted entirely to the process of developing a comprehensive SMEs’ statistical database for the period 2003-2012 and, based on empirical analysis, suggesting a proper SMEs’ definition for Kuwait that is comparable to global standards. Volume III has successfully attempted to profile and characterize SMEs in Kuwait, measure their performance, and examine their contribution to the economy. Volume IV assesses the status of SMEs in the GCC, reviews Kuwait's past and existing SMEs' public policies and institutions, and presents required policies and institutions that will enable SMEs to move forward. The following sections will present a description of each volume and summarize the major findings and conclusions. The first section will present the main findings of Volume II, followed by the second section, which will present the main findings and results of Volume III, finally, the third section will present the results and conclusions of Volume IV.

SMEs' Definitions in Kuwait: Revisited

The availability of statistical time series and cross sections collected from all economic establishments operating in Kuwait was very important for achieving the objectives of this project. This project has achieved and established for the first time a statistical profile of SMEs in Kuwait based on available statistical data at the Central Statistics Bureau (CSB). The statistical database of SMEs in Kuwait consists of quantitative data on a number of variables such as output, value added, capital and managerial skills, among others, at the firm level. It covers establishments operating in all economic activities according to International Standard Industrial Classification (ISIC) over the period 2003-2012.

Kuwait's CSB conducts an Annual Economic Establishment Survey. There are six surveys covering all economic sectors, i.e., manufacturing, construction, trade, non-finance services, finance, and non-profit organizations. These surveys covering the period 2003-2012 contain most of the data required for the execution of this project. In collaboration with the Information Technology (IT) data specialists at CSB, a project-relevant statistical database was selected consisting of desired variables. Next, CSB re-configured the final digital format from the Government Establishment Survey data for the years 2002 to 2012 at the firm level into MS Excel sheets for flexible manipulation and data analysis. The objective was to determine sector classification, firm size, the number of SMEs, value added, output, wages paid to each labor category, and employment by gender and nationality, among other attributes. More importantly, the firm-based time series is listed according to ISIC classification to enable aggregation and presentation of SMEs according to the nature of their economic activities. Moreover, knowledge of CSB sampling techniques and weights (especially at micro level) was essential for the project team to generate approximate generalization of the entire population of all firms operating in Kuwait.

The project team selected 52 variables for analysis and classification. The team worked closely and intensively with the senior and technical CSB staffs to obtain the required dataset. Once the initial dataset was obtained, the team ran several checklists to ensure the consistency and reliability of the database. This process was tedious, iterative, and time consuming but necessary. The lengthy process acquainted the team with the way data are collected, entered, and verified at CSB. The main components of the database consist of the following:

1. A refined dataset (master file) containing a *list of the 52 variables at the firm level for each year over the period 2003-2012*. The master file consists of all five economic sectors (manufacturing, construction, trade, non-finance services, finance). The list includes all establishments with employment of >20 workers, and samples of firms with employment of ≤ 19 workers. It is listed at the firm level with the number of firms varying from one year to another. In brief, the dataset's dimensions are 5,817 firms x 11 y x 50 variables. By using different filters, the data reveal a rich statistical description of SMEs for the first time in Kuwait.
2. Considering that a very large number of micro and small firms have to be sampled, the project team obtained the sampling techniques and weights followed by CSB. The data described before were extrapolated using the sampling coefficients used by CSB to generate their *pre-sampled population dataset*. The result is an aggregated statistical database of the SMEs sector as a whole.
3. The same dataset is aggregated according to the ISIC system at the three-and two-digit levels. These provide a profile based on the detailed nature of their economic activities instead of firm-specific data.
4. The team also sought and obtained data from the Ministry of Commerce and Industry to fill in a gap in CSB's data regarding the age (maturity) of firms. The project team was able to obtain a list of firms' entry and exit from the market annually.

Presently, KISR is the only institution that possesses a detailed and refined dataset on micro-, small-, and medium-sized enterprises in Kuwait. The efforts invested and experience gained in working with CSB staff as well as handling their raw data are invaluable in designing and generating a standard SMEs registry, on an annual or periodical basis. It should be emphasized that the current Establishment Survey is tuned towards generating gross domestic product (GDP) estimates rather than capturing SMEs' performance. For this reason, a SMEs-focused survey is recommended to be conducted and SMEs-related information to be collected to assist policy makers in formulating a long-term strategy designed specifically to promote this important sector.

Furthermore, Volume II also aims at conducting a number of statistical analyses to profile the SMEs sector and characterize its structure in 2012. The outcome of this task would be the first look at the structure of the SMEs sector in Kuwait, based on the most recent official data, and covering all sectors of the economy, except agriculture and fisheries, which are not included in the CSB's databases. The operability of the SMEs' definitions that are specified in the SMEs Law 98/2013 was tested based on actual data from different economic sectors, in order to find if they produce homogeneous clusters of enterprises (small vs. medium vs. large) rather than heterogeneous clusters that defy the meaning of SMEs (the National SMEs Fund defines 'small' as having less than 5 nationals with 'capital' less than KD250K). The selection of operational definitions for SMEs was also examined in reference to a number of criteria such as definitions suggested by international organizations and common definitions adopted in similar economies, and most importantly, the specific benefits the government of Kuwait expects to generate from SMEs in response to their support programs, for example job creation for Kuwaitis more than growth consideration.

An extensive quantitative investigation was carried out to ascertain the neutrality, universality, and practicality of the newly issued definitions that were embedded in the SMEs Law 98/2013. The results show that the definitions suffer serious shortcomings as evidenced from applying the definitional criteria onto the establishment survey results, described earlier. An empirical assessment of the appropriateness of the stipulated definitions of SMEs in the Law reveals several pitfalls as follows:

- The law conflated SMEs definitions with eligibility conditions.
- A large percentage of operating SMEs would be excluded from the class of SMEs.
- Some very large enterprises will be defined as small.
- The incremental cost of becoming eligible is inconsequential.
- The practical implementation of the Law may derail the SMEs' initiative into becoming an employment incentives scheme.
- Other benefits (that is, economic diversification and innovation) are marginalized by limiting government support to job creation for nationals.
- Micro enterprises are excluded, which normally require special support.

Alternative definitions are suggested and their respective impacts on the number of enterprises, employability of Kuwaiti nationals, and value added are measured, enhanced, and filtered in order to reach the most suitable set of definitions for Kuwait. Hence, the project team proposed new definitions and eligibility conditions without modifying government's objectives. After exploring a number of alternative definitions and assessing their impact quantitatively, the following definitions were recommended:

- A new "micro enterprise" category is to be introduced, defined as employing 1-10 workers with paid up capital or annual sales < KD150K.
- Small firms are to be defined as employing 11-49 workers with paid up capital or annual sales < KD250K.
- Medium firms are to be defined as employing 50-249 workers with paid up capital or annual sales <KD500K.
- No differentiations are to be made based on economic activities.

Next, the issue of eligibility, which was separated from the issue of definitions in the study, is examined and, again, a more practical condition is suggested. Eligibility will be defined as having a 15% ratio of nationals in total employment in place of the modest number of nationals as in the Law. Concerning the eligibility condition, it is recommended that:

- A ratio of the national work force in the total workforce be employed in place of the absolute number of nationals per firm as promulgated in the Law. This will have the effect of discouraging perfunctory additions of a single or a few Kuwaiti employees to become eligible. It puts teeth into the law and rewards only firms that are serious about reconsidering their old hiring models.
- In view of the percentage of the national workforce in total employment as well as the ratio of Kuwaitis in the private sector in 2013 (19.4% and 5.1%, respectively), a ratio of 15% is the midpoint. It is selected to qualify firms. For micro enterprises, this means, on average, hiring 0.75 Kuwaitis per 5 employees, 4.5 Kuwaitis per 30 employees for small firms, and 22.5 Kuwaiti workers per 150 total employments for medium firms. These limits seem reasonable, albeit difficult to achieve in the absence of the SMEs' promotion act.

Whereas the new definitions are more inclusive, the eligibility condition is more exclusive to push back against SMEs' expending inconsequential effort to access generous public pecuniary and non-pecuniary benefits, especially access to finance and land availability. Hence, it was suggested to delink definitions from eligibility conditions. The recommended ratio is intended to usher in a new paradigm, which qualifies only micro, small and medium enterprises (MSMEs) that are seriously committed to raising the ratio of young Kuwaiti adults in their employment. The new scheme yields critical benefits, specifically:

- It conforms to SMEs' definitions elsewhere while preserving the government of Kuwait's strict eligibility condition.
- SMEs' sector would consist of 39,197 firms in contrast to only 4,016 under the Law.
- The number of eligible MSMEs would be 1,992 compared to 4,016 under the Law.

Over time, if only the sampled 4,000 MSMEs out of 39,197 do meet the eligibility condition, they would generate 22,385 new jobs, exceeding the total number of unemployed nationals in 2013 (19,218). It is suggested therefore that the new definitions replace the old regime to side step the problems that will be encountered when they are applied.

SMEs in Kuwait: An Empirical Survey (2003–2012)

One of the basic ingredients required to design an effective SMEs' development strategy in all cases is the availability of a 'base knowledge' of the sector's characteristics: structure, capabilities, strengths, and weaknesses. Historically, the government of Kuwait supports to SMEs focused on the provision of subsidized loans only. This resulted in the implementation of an incomplete SMEs' promotion plan, especially when compared to the universal gambit of assistance schemes offered elsewhere. Partially contributing to this outcome has been the lack of a deliberate, long-term SMEs' development strategy, which itself stemmed from the absence of reliable knowledge about the SMEs' sector. Until today, very little is known about SMEs' in Kuwait, and hence, volume III aims to negate this void by identifying SMES characteristics, structure, and capabilities in Kuwait

The diagnosis of the SMEs' sector in this study is fundamentally statistical in nature. It is based on the CSB's official dataset. The results of the smaller-sized firms, which are sampled, are enlarged based on their sampling coefficients. The *business sector* is defined to include micro, small, medium (MSMEs), large and straddler firms; the latter consists of firms that meet the MSMEs' employment but not the capital condition. Due to the dominant influence of the oil sector, the results often differentiate between oil and non-oil enterprises. The base dataset is immense because it encompasses data on more than 8,500 firms each year for 10 y covering 50 variables in each. A summary of the salient features that emerged from the analyses of the enlarged MSMEs sector is given subsequently.

- Number of MSMEs: There were 41,265 registered non-oil firms in 2012, most of which (39,198 firms or 95%) are MSMEs. Among MSMEs, 93.4% are micro enterprises, with most of the micros (64.8%) engaged in the trade sector. In comparison, MSMEs in the Organization for Economic Cooperation and Development (OECD) countries make up about 99% of registered firms.

- Growth of the number of MSMEs: In 2003, there were 38,636 registered non-oil firms, of which 37,197 or 96.3% are MSMEs. Of the latter, 34,190 or 91.9% are micro enterprises. From 2003 to 2102, the number of registered firms had increased by 2,628 firms. Of those, 2,001 firms or 76% belonged to MSMEs. The growth in the size of MSMEs is not uniform, however, in that micros expanded by 2,415 firms while small and medium firms shrank by 367 and 47 firms, respectively. Nor is the growth uniform among sectors, for 93% of it emerged from two sectors only: 85% from the trade sector and 13% from the manufacturing sector. Contemporaneously, non-oil large enterprises (LEs) doubled their numbers from 161 to 327 firms and straddlers grew by 36% from 1,279 to 1,740.
- Employment of MSMEs: MSMEs employed 243,799 workers in 2012. The largest employer is the trade sector at 101,975 followed by non-finance at 71,886. Between these two typically retail-oriented activities, they make up almost three fourth (71.3%) of all employees in the MSMEs sector. MSMEs' share in the workforce of the non-oil business sector in 2012 is 35.7%, which represents a decline of 11.2% from its previous share in 2003. Between 2003 and 2012, the size of the workforce expanded by 164,921 (from 517,260 to 682,181), of which MSMEs contributed only 1,247 new jobs or 0.76% of the total. While LEs nearly doubled their employment and micros expanded by 9.1%, small and medium enterprises were engaged in job destruction to the tune of 11,684 jobs.
- MSMEs' contribution to job creation: MSMEs' share in the country's total employment was estimated at 10.6% in 2012. If, however, the unusually large personal household employment is excluded for the sake of international comparisons, MSMEs' share in total employment would rise to 16.4%, which is still quite modest by international standards. By contrast, MSMEs' employment share in national employment in other countries in 2012 ranged from 86.5% in Greece, 79.3% in Malta, 73.9% in Spain, 62.5% in Germany, 53% in the United Kingdom (UK), to 48.4% in the United States (US). Available evidence shows that even among 99 developing countries,

MSMEs (2006-2010) employed 66.8% of the national full time labor force.

- Structure of output: MSMEs generated output (in current prices) is worth KD 1.94 billion in 2003, which represented 26.4% of the non-oil business sector's total output. In 2012, their output rose to KD 2.6 billion but their corresponding share fell to 15.3%. Of the change in total output from 2003 to 2012 (KD 9.658 billion) in the business sector, MSMEs contributed only KD 659 million or 6.8%. During the same period, LEs tripled (3.03 times) and straddlers doubled their output (1.87 times). Within MSMEs, micro and medium firms' output grew by about 42% compared to only 8% in small firms over the 9-y period. Also, manufacturing and non-finance accounted for most of the output growth in MSMEs. The clear disparity in output expansion levels between LEs and straddlers, on the one hand, and MSMEs, on the other, points to the existence of a dual economy with distinct patterns of growth.
- Output growth: The compound annual growth rate of nominal output from 2003 to 2012 is 13.3% for the business sector, which ranges from a negative 1.37% in micros to 4.59% in MSMEs and to 14.09% in LEs. However, when output values are deflated by the wholesale price index, the real growth rates fall to 9.82% in the business sector, - 4.85% in micros, 1.11% in MSMEs, and 10.61% in LEs.
- MSMEs' contribution to GDP: Economists gauge the relative importance of MSMEs in an economy by measuring their contribution to GDP. In Kuwait in 2012, they contributed only 8.6% of non-oil GDP, a substantially low level by international standards. In contrast, MSMEs' contribution to GDP in the EU-27 countries in 2012 was 58.1% vis-à-vis 41.9% for LEs. In the US, the average share of SMEs in private nonagricultural GDP from 1998 to 2004 was around 50%.
- Value added: A purer measure of a firm's real business growth is its value added. As in the results of output, value added results show a similar profile: MSMEs' share in total non-oil value added fell from 25.9% in 2003 to 14.5% in 2012; and its contribution to the net

increase in value added of the non-oil business sector over the same period is only 4.1%. LEs, once again, expanded their value added by 177.5% in contrast to only 17.4% for MSMEs; and within MSMEs, micros expanded by 26.5%, medium firms, by 18.9% whereas small firms contracted by -9.3%. Manufacturing activities realized the highest growth among MSMEs, and the finance sector, dominated by commercial banking, topped the growth in LEs.

- Investment, wages, profits and access to finance: Similar outcomes and patterns of growth are also obtained when the analysis is extended to cover the composition and evolution of other important economic aspects such as investment and capital accumulation, wages and wage rates, profits and profitability rates, and access to finance. These results lend credence to the notion that there is i) a clear dichotomy between MSMEs, on the one hand, and the rest of the business sector and especially LEs, on the other, and ii) MSMEs, and especially small enterprises and medium are under stress, albeit at a more modest level. Indeed, there is overwhelming evidence showing a prosperous large (and straddlers) establishment sector side by side with a sizable MSMEs sector that is struggling to stay afloat, all of which affirm the signs of a dual economy with its known attendant negative impact on the process of economic development.
- MSMEs are stagnant: The combination of MSMEs' anemic growth of capital (1.6%) and employment (0.5%) over the 9-y period indicates the presence of a sluggish growth of their two principal factors of production: labor and capital. Output, *when adjusted for price inflation over the same period*, yields a real growth rate of 1.11% annually, which is commensurate with the growth of labor and capital, reinforcing the notion that the MSMEs' sector in Kuwait is stagnant.
- MSMEs lack rudimentary managerial skills: An important source of MSMEs' difficulties lies within their inadequate managerial skills and practices. Quantitatively, the evidence shows that out of 39,198 MSMEs, only 150 firms provided training opportunities, 998 had their accounts audited externally, 80 conducted marketing studies, 84

used computer applications/programs, 2,554 had access to the internet, and only 2 had patents. The number of MSMEs that had access to the internet *and* had audited accounts *and* provided training *and* used computer programs are only one micro, two small and six medium firms. This reflects that basic elements of must-do managerial practices are severely lacking. A comparison with the same managerial capacities in 2003 yields a similar pattern, implying a lack of tangible upgrading of managerial skills and techniques during the decade. The findings influence, and are influenced by, the anemic growth to which the author alluded to in the preceding paragraphs.

- Kuwaitization of jobs: Kuwait accords a high priority to raising the participation rate of nationals in total employment, especially in the private business sector. The project team's findings show an MSMEs' trend that is moving in the opposite direction. Of every 100 workers in MSMEs in 2003, only 3.1 jobs were held by Kuwaitis; this low percentage fell even further to 2.5 in 2012. In 2003, MSMEs employed 28.2% of all Kuwaitis in the non-oil business sector; in 2012, the percentage fell to 16.2%. While the number of employed nationals in the non-oil business sector (78.8% of whom are employed in 100% privately owned enterprises in 2012) increased by 10,591, MSMEs *eliminated* 1,453 Kuwaiti-held jobs. Even though the percentage of nationals in total employment is size-dependent within MSMEs, the fact that it is only 7.1% in LEs attests to the presence of more structured factors in play besides size. These include technical competencies, soft skills, job security, compensation packages, and the allure of government jobs.
- MSMEs' ownership affects the share of nationals in the labor force: Another reason for the imbalanced Kuwaiti participation rates has its roots in firm ownership. While 100% state-owned enterprises retain 63.3% Kuwaitis in their total employment, 100% private sector enterprises employ only 3%. When the government owns enterprises jointly with the private sector, firms with a government

majority employ 21.9% Kuwaitis while firms with private sector majority employ 12% Kuwaitis.

- Money wages affect the share of Kuwaitis in total employment: The money wage rate is an important index of the disparity of Kuwaiti ratios in employment. Wage rates of Kuwaiti workers in LEs are 6.4 times higher than their Kuwaiti cohorts in MSMEs. The same is true in respect of non-Kuwaitis: those in LEs receive 1.7 times the wage rate of non-Kuwaitis in MSMEs. Overall, a Kuwaiti/non-Kuwaiti wage ratio in LEs is 5.8 compared with 1.5 times in MSMEs. These findings clearly indicate that nationals (and non-nationals) are better off working for LEs (or straddlers) than for MSMEs, which explains nationals' preference to seek employment in LEs rather than in MSMEs, holding other things equal.
- MSMEs' dilemma: Firms without Kuwaiti employees: The wide spread phenomenon of Kuwaiti firms without any national workers is unique to Kuwait and perhaps other GCC countries. In 2012, 87.8% of the business sector firms had no Kuwaiti workers, up from 83.9% in 2003. The absence of Kuwaiti workers varies among firm sizes, ranging from 91.8% in micros, 68.9% in small, 34.3% in medium, 55.3% in straddlers, to 8% of LEs. Moreover, 70 to 78% of jobs, value added, capital investment, output, and profits are generated in firms without national workers. This clearly signifies the crucial role of foreign workers in shaping Kuwait's business sector. Over time, the relative economic weight of the Kuwaiti-employee-free firms expanded among micro enterprises and contracted (improved), in varying degrees, among the other size categories.
- Top ranked activities with high ratios of Kuwaiti employment: Employing a three-pronged technique to identify activities that stand out as being *naturally attractive* to hiring nationals, the following subsectors maintain the highest Kuwaitization rates among (i) other activities in the same economic sector category, (ii) across different size categories, and (iii) over time: manufacture of machinery and equipment; publishing and printing; travel agencies; real estate; computer and information and communication technology (ICT);

manufacture of chemicals; sales of motor vehicles; health and insurance. The most common characteristic among these diverse activities is that they are typically skill and technology intensive, conditions that, obviously, advantage nationals over foreign workers. They also corroborate the central recommendation that came out of the extensive 1989 economic strategy study for Kuwait (the Harvard-MIT-KISR CMT report), which advocated the pursuit of a *high value added* strategy to elevate the participation rates of nationals in the country's workforce.

- The straddlers: An in-depth analysis of the 1,740 straddler firms in 2012 indicates that they consist mostly of economic activities that require large sums of capital assets, a condition that disqualifies them from becoming part of the MSMEs. In 2012, there were more than 600 straddlers with a labor force of ≤ 10 laborers in each. Other countries dealt with this anomaly by providing different accommodating definitions that are unique to their circumstances. The project team recommends that Kuwait follow suit by keeping the employment categories as is while raising the capital thresholds. Not only would this provide a level playing field for straddlers, Kuwait would also benefit greatly because straddlers have a proven record of doing more than MSMEs in meeting the national priorities set by the government. The team recommends the following definitions for the group of straddlers:

  1. *Micro:* Employment of ≤ 10 workers and capital ≤ KD 10 million;
  2. *Small*: Employment of 11-49 workers and capital ≤ KD 25 million; and
  3. *Medium*: Employment of 50-249 workers and capital ≤ KD 50 million.

  By so doing, 770 of 799 micros (96.4% of all straddler micros), 436 of 474 small (92.0%), and 366 of 384 (95.3%) of medium firms would qualify for inclusion among MSMEs, thereby reducing the 951 straddlers to only 79 firms or 8.3% of all straddling MSMEs.

- The missing middle: The phenomenon of the ‘missing middle’ is quite visible in Kuwait’s business sector in that there are only 450 medium-sized firms or 1.15% of all 39,198 MSMEs in 2012. Natural progress is gauged by the extent to which small firms expand into medium and medium into large. This process is likely to be stifled by not only the mortality rates of small and medium MSMEs but also by the hollowness of middle, which forms the likely candidates to expand into large firms, thereby nurturing the economic development process.

In sum, Kuwait is endowed with abundant oil reserves and has long managed its wealth to eliminate illiteracy, improve health care, establish basic social and economic institutions, and maintain well-defined property rights. Kuwait’s economy is robust. It exhibits an educated national manpower, stable macroeconomic policies, vast financial accumulations by individuals, institutions and the central government, and a generous, all- inclusive, national welfare system. Economies that are similar to Kuwait’s would ordinarily show a vigorous MSMEs sector with major contributions to job creation, economic growth, and entrepreneurship, all of which is powered by a friendly business environment conducive to competition and private sector growth. The statistical evidence presented thus far points to a markedly different performance of MSMEs.

This conclusion may lead to questioning the rationale for subsidizing MSMEs since not only many of the standard objectives pursued in emerging nations are less urgent in the Kuwaiti context (for example, economic growth, job creation, poverty alleviation, regional development and gender equality), but also since MSMEs’ performance so far has been suboptimal. The answer to this, however, ought not to abandon the MSMEs sector, for its performance should be judged in light of the following influences:

- Despite the presence of entangled restrictions and government regulations from inception to operation to termination, private investors have taken the risk and invested their private funds in the Kuwaiti economy to the tune of some 40,000+ enterprises, KD805 million in invested capital and created value added of worth KD1.3 billion, and

- Had MSMEs received similar financial and technical support, which their counterparts in OECD or Asian economies had received, their contribution to non-oil GDP would have probably been much bigger, the economy more diversified, and the unemployment rate among nationals lower.

There are two overriding benefits or objectives that stand out above all others in Kuwait: i) *job creation for nationals* and ii) *economic diversification*. The other soft objectives such as innovation, self-employment, and the encouragement of private, individual initiatives and entrepreneurship are important but would follow naturally from the attainment of the previous objectives. Given the very limited scope of public policy and institutional support offered to MSMEs and based on the compelling successful experiences of MSMEs globally, discernible improvements in the performance of MSMEs could, and would, take place if a cohesive and well-targeted set of policies and institutions are put in place. Towards this end, there are some *necessary conditions* that must be met such as lowering entry and exit barriers, promoting modern managerial skills and practices, and formulating a well-designed set of incentives to meet the country's two top priorities. Additionally, institutions that are tasked to help MSMEs at different phases of their project cycle, from startup to operation, marketing, risk mitigation, micro-financing and credit bureaus, among others, are required. The *sufficient conditions* that guarantee the effective implementation of public policies consist basically of *strict adherence to fairness and transparency in policy implementation*.

Status of SMEs in the GCC: Policies, Institutions and the Way Forward

This section aims to achieve the following: i) examine the present status of SMEs in the five GCC countries; namely Kingdome of Saudi Arabia, United Arab Emirates, Oman, Bahrain, and Qatar, ii) review past and existing public policies regarding the establishment, promotion and development of SMEs in Kuwait, and iii) suggest forward strategies that integrate reforms with support policies that are contained in the SMEs Law No. 98/2013 by putting forth a list of policies and institutions that are currently lacking.

Globally, SMEs vary in sizes, nature, and may operate in different markets and in a variety of business activities. They embody different levels of skills, capital, sophistication, and growth orientation, depending upon the size and markets they serve. Within the GCC, little is known about SMEs' structure and their contribution to the economies. Hence, the aim is to examine the status of SMEs in five members of GCC and assess Kuwait's SMEs with respect to the GCC. For each member, the focus is to identify their respective latest SMEs' definitions, the existing or the lack of a SMEs' law, SMEs' business environment, SMEs structure and indicators, and the important initiatives and programs taken in each country to support SMEs' growth. In the case of Kuwait, these issues are elaborated extensively in volumes II and III. The available data on SMEs' structure, profile, and economic contribution in the GCC are incomplete and only partially comparable across cases. This limitation affects the ability of a complete and thorough comparison among all the indicators. Considering this limitation, the main findings of the assessment of SMEs status in the GCC can be summarized in the following:

- All GCC members have enacted some form of law(s) to encourage the development of a vibrant SMEs sector. The only exceptions are KSA and Qatar.
- All members have selected an appropriate definition for SMEs, and these definitions where not stated in the SMEs' laws. Kuwait is the only exception where the law (98/2013) clearly defines small and medium enterprises.
- All members used three segments enterprises (micro-small-medium), except for Kuwait, which uses, as stated in the law, two segments only (small and medium).
- All members categorized the three segments according to two criteria, number of employees and annual sales/revenues. Again, Kuwait is the only exception where the two segments (small and medium) are categorized according to number of Kuwaiti employees (nationals) and capital.
- UAE and Qatar are the only two countries that further categorize the three segments (micro-small-medium) according to economic sectors (three sectors in UAE and five sectors in Qatar).
- Kuwait and Oman are the only two members that have an overarching government institution that is wholly and singularly

responsible for the development and protection of SMEs, the National Fund for the Promotion and Development of SMEs in Kuwait and the Public Authority for Development of SMEs in Oman. UAE has a unique situation where at the federal level, the Council for Projects and SMEs is responsible for the formulation of SMEs policies and strategic plans, rules and coordination between all concerned governmental bodies, and monitoring of SMEs performance indicators. The National Program for Projects and SMEs' will be responsible for the effective execution for all required mechanisms of the SMEs development. However, each emirate has its main authority such as Mohammed Bin Rashid Dubai SMEs in Dubai and Khalifa Fund in Abu Dhabi.

- The lack of a single SMEs authority in KSA, Qatar, and Bahrain has induced a multi-structure of SMEs-related agencies and programs. The extent of conflict or competition between these programs is beyond the scope of this study.
- All GCC members lack a detailed database for SMEs to support quantitative analysis that can enhance proper assessment and decision-making process. Data such as number of firms, employment (nationals vs expats), output, value added, profitability, etc., distributed according to segments (micro-small-medium) and economic sectors are very limited. While few variables can be found for some members for different years, the lack of detailed time series data over a period of years hinders both the appropriate profiling of SMEs and the scientific assessment of their contribution to the overall economy. The Kuwait SMEs' database developed by TED at KISR and presented in this study for the period (2003-2012) is by far the most advanced and pioneer initiative toward an effective SMEs database.
- The available limited data on the SMEs sector within the GCC show that, on average, SMEs constitute more than 90% of private businesses in all GCC members. SMEs are largely active in the trade sector; other important sectors include small-scale workshops,

hotel, restaurants, and constructions. They are less important in industry and other capital-intensive sectors.

- In terms of contribution to total employment in the private sector, despite micro and small (with up to 10 employees) firm's dominant numbers, their contribution to formal employment is rather modest.
- The data related to SMEs' contribution to the domestic economy GDP or non-oil GDP is very limited.
- In most developed economies, official data on MSMEs include many important variables that are not covered by GCC statistical sources, such as profitability, survival rate, turnover, etc. These indicators are essential for informed policy-making and monitoring of SMEs' sector.

Overall, the recent SMEs support programs in the GCC have shifted significantly from the traditional approach of distributing loans and grants indiscriminately without appropriate follow-up to targeting eligible beneficiaries, with more emphasis on providing business services and infrastructure for SMEs to thrive in a sustainable process and environment. However, at least in some countries there seem to be issues of scale and overlapping redundancy, with too many mid-size programs operating in parallel. The existence of most of the SMEs support programs within the public sector induced limited coordination and exchange of information between different institutions. Clearly, there is a lack of systematic evaluation of program successes and identification of recurrent problems.

The review of policies and institutions related to the development of SMEs in Kuwait over the last three decades showed that the government has introduced different initiatives, programs, and policies to promote the role of SMEs. The first major effort was the establishment of the National Investment Fund Portfolio (NIFP) in 1997, by the Kuwait Investment Authority (KIA), with a capital of KD100 million for the purpose of increasing investment opportunities and promoting SMEs. The portfolios aimed at attracting talented and motivated young Kuwaitis to develop their entrepreneurial skills and enhance their ability to succeed. To achieve the NIFP objectives, few institutions and programs were established both by public and private initiatives such as the following:

- The Kuwait Small Projects Development Company (KSPDC): Established in 1997, with a government paid up capital of KD1 million. Its major mission was to provide access to finance (up to KD 500,000) for young Kuwaitis seeking to establish small local businesses. Only 209 projects were accepted during the period (1998-2013). In anticipation of being absorbed by the 2013 National SMEs Fund, KSPDC suspended its operations in December 2013.
- Al-Raeda Enterprises Company: Established in 2006 with a capital of KD 3 million as a subsidiary of the Industrial Investment Company. The company is specialized in venture capital and private equity, and in restructuring existing under-performing companies. Al-Raeda was dissolved in October 2013.
- KAMCO[1]: Appointed by KIA to manage a fund with a capital of KD 15 million, allocated from the NIFP fund, for the purpose of financing SMEs. Administratively, it reported to the Kuwait Projects Company (KIPCO). In 2014, KIA requested KAMCO to end its operations capital.
- Industrial Bank of Kuwait (IBK): To extend its role in supporting SMEs, IBK created Al-Senai (Industrial) Portfolio for Small Enterprises. The portfolio, which was established in 1998 by the Law no. 10/1998, had a capital of KD50 million and was mandated to last for a period of 20 y. Its major mission is to provide financial assistance in compliance with Islamic Sharia'a to encourage young Kuwaitis to have their own projects with an investment not exceeding KD500,000. Over the period 2000 to 2012, the portfolio provided financing in the amount of KD 44.5 million representing or 68.7% of the total capital (KD64.7 million) for 593 projects. Al-Senai portfolio operations and financing as per its original Law no.10/1998 ends in 2018.

[1] KAMCO Stands for KIPCO Assets Management Company; it was established in 1998 as a subsidiary of United Gulf Bank (UGB) – the investment banking subsidiary of Kuwait Projects (Holding) Company. KAMCO specializes in asset management and financial services in Kuwait and the Middle East and North Africa (MENA).

- National Fund for the Promotion and Development of SMEs: The National Fund for the Promotion and Development of SMEs (SMEs Fund) is the most recent public SMEs institution in Kuwait. It was established in April 2013 (Law no. 98/2013) as a specialized institutional entity to consolidate all SMEs activities, with a capital of KD2 billion (about USD7 billion). Unlike its predecessor, it will provide access to finance for promising projects; it does not exclude investments in specific sectors; it does not interfere in the management of the financed projects; it will provide land; it is mandated to provide incubators in several districts within Kuwait; it will assist the infant project's dealings with government approvals and licenses within pre-assigned time limits.

The SMEs Fund's priorities are set in the law: first priority goes to projects that maximize value added, diversify the economy, and create jobs for nationals, followed by projects that inspire innovations, promotion of self-employment spirit, usage of locally produced goods, and employing environment-friendly technologies. The SMEs Fund program was officially launched in March 2016. It has approved 245 projects in the financial year 2016/2017. Approved projects are expected to provide more than 850 jobs for Kuwaitis. The approved projects were distributed according to the following sectors: commercial (107), services (78), light manufacturing & handicraft (41), and agriculture (19). With regard to the training program, as of March 2017 the total number of trainees for all programs reached more than 1,833 trainees. The total number of graduates from the training programs reached 1,282.

A significant feature in SMEs Law 98/2013 is its intended plan to make the SMEs Fund as the "central focus" of government support to SMEs at the national level, as evidenced by its directives to dissolve KSPDC, the IBK activities (in 2018), and all other SMEs institutions and merge them into the SMEs Fund. As such, the Fund is decreed to coordinate, customize, and institute a sustained model of support for all SMEs, especially startups without the multiplicities, conflicts, and wasted efforts and resources observed in other MENA countries in the presence of a multitude of SMEs support schemes and organizations, local and international. However, a closer look at the law reveals some internal inconsistencies that will require future amendments such as the present definition of SMEs as stated in the law and the complete overlooking of micro enterprises all together. Additionally, while the law intends to rid SMEs of existing red tape by mandating the Fund to complete all required licensing and registration procedures for the firm within 30 days, the law does not give the Fund the legal authority to implement it. All things considered, the several attempts made during the last four decades, as briefly outlined earlier, have lacked coordination, unity of objective, effectiveness, and adequacy. More importantly, lack of information and actual data on these entities activities precluded the possibility of providing a thorough evaluation of government's policies on SMEs public support.

The recent National Fund for the Promotion and Development of SMEs (SMEs Fund) was established as a specialized institutional entity to presumably consolidate all SMEs' activities. However, the SMEs Fund faces many challenges and obstacles that will hinder its ability to achieve the objectives of SMEs' development as stated in the law. For SMEs to provide more quality jobs and for genuine entrepreneurship to spread more widely, a number of important challenges need to be addressed. Based on this project's main findings, the following issues and concerns must be addressed by the SMEs Fund as well as key policy makers in the country:

- Employment of nationals: One of the main goals of the SME law is to promote and ensure the employment of nationals in the private sector both as entrepreneurs and laborers. SMEs' projects that would achieve the highest rate of Kuwaitization must receive the highest priority and preference. Therefore, preferential financial and non-financial schemes must be developed and adopted to achieve this goal. The proposed MSMEs' definitions and eligibility conditions suggested in this study should provide the guiding principles towards promoting employment of nationals in MSMEs. SMEs' policies should target firms that contribute more to national development in qualitative terms such as technological modernization, training, provision of attractive job opportunities for national, diversification, etc. Effective public policies in this regard will lead to diversification, technological upgrading, and spread of capable business models and processes that so far have often been limited to larger companies.

- The definition of SMEs: The SMEs definition as stated in Law no. 98/2013 is inadequate and limited. The SMEs Fund will face the challenge of generating a common and intuitive definition of SMEs that address all the segments (MSMEs) with clear criteria that is in line with global and regional definitions. The applicable MSMEs definition will emphasize uniformity, eligibility for funding, and facilitate entitlement for non-financial programs. In sum, new definitions must be introduced to redress the many drawbacks associated with current definitions stated in the SMEs' law.
- SMEs database: Kuwait at the present time is seriously lacking a detailed database that addresses MSMEs within divergent size-class definitions and sector classifications that can enable useful policy analysis. CSB in Kuwait is the central, official authority responsible for data collection in the country. The collection and dissemination of MSMEs' data is similar in nature to CSB's current Annual Establishment's Surveys. Because the objectives of producing MSMEs dataset are different than those of the establishment surveys, a newly developed questionnaire is required to serve the specific purpose of promoting MSMEs. Data such as number of firms, employment (nationals versus expats), output, value added, profitability, longevity, managerial skills, etc., classified according to definitions (micro-small-medium) and economic sectors is urgently needed. Hence, either the CSB should expand its MSMEs data collection and expedite publication of data or the SMEs Fund should, preferably in cooperation with and in pursuit of exploiting relevant experiences of CSB and KISR, design a new framework and present new targeted methodologies for sampling, data collection, data entry, data verification and the eventual timely publication of the structure and characteristics of the SMEs sector in Kuwait. The SMEs' database, prepared by TED and presented in this study for the period 2003-2012, is by far most advanced and pioneer initiative

toward an effective SMEs database. It can be used as a starting point for the establishing a complete MSMEs dataset.

- Provision of loans: The SMEs Fund should avoid being the sole provider of loans to new SMEs. It must enhance the level of co-ordination and involvement between commercial banks and the various SMEs support initiatives. As is the case in other countries, the Fund ought not to administer the lending process. Rather, it should delegate and regulate this function to local commercial banks. Selecting more than one bank is preferred to having only one bank to promote competition among them. Banks would be responsible to judge the feasibility of the proposed projects.
- Venture capital: The main role of the public SMEs institutions in supporting venture capital and other types of risk financing should be to reduce the risk and cost of private equity finance. The government should complement and encourage the development of the private-capital industry, including enhancing the skills of the people involved in undertaking this assignment. Direct government measures and policies to encourage and support the provision of risk capital include development banks, loan guarantee schemes, fiscal incentives, regulations regarding the treatment of innovations, rules regulating investment by insurance companies, and the provision of loans at preferential rates. Indirect measures (structural and supportive policies) include market support and regulation; training; communication; and support for R&D.
- Venture capital: Is an important financial arrangement structured to reducing financial risks associated with establishing new firm. Public programs to supports SMEs should aim to reduce the cost of private equity finance and any types of risk financing. Such programs must boost the development of private capital industry through harnessing the required skills of the people involved in risk financing. Direct measures to facilitate the provision of risk capital include specialized credit banks, loan guarantee schemes, fiscal incentives, innovation culture, and the provision of loans at preferential rates. Indirect

measures include market analysis, regulation, applied training, and R&D support.

- Loan guarantee schemes: To overcome problems associated with borrowing, many countries have introduced loan guarantee schemes. A percentage of the SMEs loan or all of it is guaranteed by the insurance company whose revenues are collected from borrowers. Here, the extra charge paid by the borrower on such loans would be higher than under normal arrangements since an additional premium is paid to cover expected losses. In addition, in the event of default and the subsequent loss to financial institution, the State may provide protection to the involved bank up to a certain percentage of the loan. This is particularly suitable if the central bank requires that commercial banks channel a certain percentage of their loans to MSMEs. The loan guarantee schemes will allow the new SME firm to access funds from a financial institution without the need to provide verifiable collaterals. The loan guarantee schemes should have guidelines and criteria to ensure that its funds are not used by banks as a substitute for their own loans.
- Credit bureau: Banks in Kuwait are generally reluctant to lend to SMEs due to the associated credit higher risk. Reluctance to provide finance will hinder SMEs ability to grow and to test new business models. An important limiting factor to SME lending is the assumed accounting practices of most small companies in the region. Another important factor that complicates SME lending is the issue of enforcement and collateral. Most companies do not possess enough valuable assets that can be used as a as collateral for significant loans. Banks usually require 150% of the loan value to be in the form of collateral assets. This percentage is extremely high in comparison to international required rates. Hence, Kuwait needs a *comprehensive credit reporting system* that permits credit banks to access all financial information of loan applicants for proper evaluation of credit worthiness.
- Qualifications of loan applicants: Loan applicants must exhibit enough experience to prove their capacity to manage their new

companies adequately. As shown in Vol. II, most MSMEs lack the rudimentary managerial skills required to sustain and grow. In this respect, the Fund can assist them through training, providing appropriate software packages to manage finances, quality control, sales and marketing. The Fund may assist them in enhancing labor productivity levels, streamlining their production, inventory, and managerial skills by providing and facilitating effective education and training programs.

- Operational dependency on expatriate managers: Kuwaiti owners of SMEs mostly depend on expatriate managers to run the daily operation with minimal participation of national labor. Such dependency limits innovation and the acquisition of skills among SME owners. Most of the SMEs 'initiatives and programs target and encourage nationals (entrepreneurs) to be owners. Hence, new policies with proper incentives are required to encourage firms that employ nationals in top managerial positions.
- Limitations of Kuwait's economy: Kuwait's economy suffers from many structural imbalances such as the dominance of the public sector and the dichotomy in the labor market. This economy offers a rather unique combination of challenges and opportunities that require tailor-made policy approaches. Hence, dynamic planning model and policies are required to remedy the imbalances and the dichotomy in the labor market. Policies should aim to strengthen the quality of human resources in the labor market (both nationals and expats) and reinforce attributes required for the introduction of innovation and enhanced productivity.

In conclusion, growing and sustaining a private sector that is robust, competitive, and efficient in the context of rapidly changing global forces is a challenging task for Kuwait. SMEs must participate effectively and be an integral part of the transformation process, along with government institutions searching for ways to increase efficiency, productivity, and global competitiveness. This will require interconnected enterprises along value chains that are more complex but will yield better results. Public sector agencies should improve their service standards to assist SMEs, and means of enabling environment have to be put in place.