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Towards a Sustainable Growth – An Analysis of Small and Medium Enterprises' Performance in the Gulf Cooperation Council Countries

Abstract

On the surface, the Gulf Cooperation Council (GCC) member states are one of the most developed countries in the world. Income coming from these countries' vast reserves of oil and gas helped to realize most of the infrastructure projects as well as investments within the healthcare and education sectors. Nevertheless, this model cannot last forever, as it is unsustainable because that natural resources are limited. The aim of this article is to analyse the structure of the GCC companies' ownership, their performance and contribution to GDP so as to examine patterns shaping particular economies. It describes the business environment in the region paying special attention to small and medium enterprises (SMEs), which in the West are deemed to be the cornerstone of a truly sustainable economy. It points main obstacles towards enterprises development and discusses economic policies of the Gulf States in order to propose the best solutions facilitating SMEs' operations, especially in the field of finance.

Keywords: Small and medium enterprises, the Gulf Cooperation Council, the Middle East, development, economy, business environment

It is a widely known fact that small and medium enterprises are a stepping-stone towards a truly sustainable economic development, as they boost growth and job creation. According to the OECD data, at the turn of the 21st century the SMEs contributed to over 55% of GDP and over 65% of total employment in high-income countries, over 60% of GDP and over 70% of total employment in low-income countries and 95% of total employment and about 70% of GDP in middle-income countries¹.

Putting it in the simplest possible way, the SMEs give a chance to live a decent and independent life. It is so because companies of micro or small size may be established and run equally by a merchant, a farmer, a hairdresser as well as an engineer, an artist, an architect etc. Furthermore, they may operate both in the city and countryside, offering their products and services on the local, regional and sometimes even on the global market. As a result, they are suitable literally for everybody, including those short of high qualifications and capital.

Insight into Performance of the GCC Enterprises

On the whole, SMEs constitute more than 90 per cent of enterprises in the Gulf Cooperation Council, an organisation comprising six countries located in the Middle East, namely Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates. In 2007 40,000 SMEs operated in Bahrain alone (one company for about 25 inhabitants of the country). Nearly 50 per cent of total

¹ Organisation for Economic Co-Operation and Development, *Promoting Entrepreneurship and Innovative SMEs in a Global Economy: Towards a More Responsible and Inclusive Globalisation*, Istanbul, Turkeym 3-5 June 2004, <http://www.oecd.org/cfe/smes/31919278.pdf>, accessed: 17.02.2014, p.11.

workforce was hired in firms with up to 4 employees that is a micro-enterprise. In the same period in Kuwait estimated number of the SMEs was about 33,000. In 2008 nearly 45,000 Omani companies were considered as small or medium ones. As for Saudi Arabia, a country with the biggest territory and population in the GCC, 785,000 enterprises fell into this category².

It is essential to note that the Gulf SMEs are a very heterogenous group. In 2008 almost half of Saudi Arabian SMEs operated in the commercial and hotel sector, while a third of them dealt with construction and 12 per cent was active in industry. In 2006, about 65 per cent of small and medium Qatari businesses dealt with trade, almost 20 per cent operated in industry and 15 per cent run hotels and restaurants.

Notwithstanding a large number of the SMEs, the GCC market is dominated by huge state-owned enterprises (the SOEs). It is hardly possible to find any truly private businesses among the top 100 GCC companies - government is either their major shareholder or simply appoints its representatives as members of the board³. One of the best examples is Saudi Basic Industries Corporation. A company that ranked first on the list (in 2013 its market capitalization reached 75bn dollars) is controlled by Saudi Arabia's

² Data from S.Hertog, *Benchmarking SME Policies in the GCC: a survey of challenges and opportunities*, A research report for the EU-GCC Chamber Forum project, 2010, http://www.europolitique.info/pdf/gratuit_fr/270047-fr.pdf, accessed 17.02.2014, p.13-20.

³ *Special Report: Top 100 GCC Companies 2013*, Gulf Business, November 24, 2013, accessed 31.03.2014. <http://gulfbusiness.com/2013/11/special-report-top-100-gcc-companies-2013/#.UxtOyud5PJA>

government owning 70 per cent of the enterprise's shares⁴. The chairman of the firm is a member of the ruling family (interestingly, at the same time he acts also as chairman of the Royal Commission for the Industrial Cities of Jubail and Yanbu). Other members of the board include one current and one former deputy minister.⁵ In the case of Etisalat, situation looks oddly similar. Sixty per cent of the telecommunication giant's shares, whose market value is approximately 22bn dollars, are in the UAE government's hands⁶.

Given their size and abundance of capital stemming chiefly from the state subsidies, the SOEs play a significant role in shaping the GCC economic environment. In 2006, the private sector investment was only 50 per cent of total investment in oil-rich countries. It was considerably lower than that of East Asia and Pacific Europe (70 per cent), Europe and Central Asia (80 per cent) and Latin America and the Caribbean (95 per cent) for 2006. Even in non-oil-rich MENA economies the level of private investment was higher (62 per cent).⁷

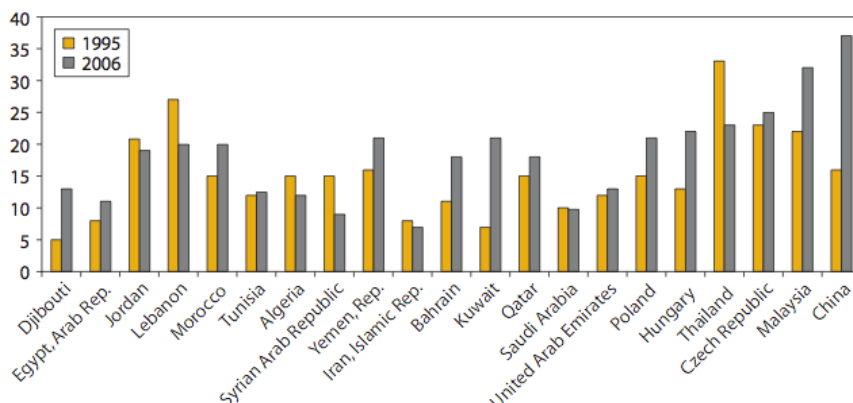
⁴ Website of SABIC <http://www.sabic.com/corporate/en/ourcompany/>, accessed 31.03.2014.

⁵ S. Hertog, *How the GCC did it: formal and informal governance of successful public enterprise in the Gulf Co-operation Council countries*, in OECD, *Towards New Arrangements for State Ownership in the Middle East and North Africa*, 2012, <http://dx.doi.org/10.1787/9789264169111-5-en>, accessed: 08.03.2014, p.82.

⁶ Website of Etisalat, <http://www.etisalat.com/en/about/history/history.jsp>, accessed 31.03.2014.

⁷ D. Al-Kuwari, *Mission impossible? Genuine economic development in the Gulf Cooperation Council countries*, Kuwait Programme on Development, Governance and Globalisation in the Gulf States, London School of Economics and Political Science, Number 33, September 2013,

Chart 1 – Private Investment as a Share of GDP, 1995-2006 (per cent)



Source: The World Bank, *From Privilege to Competition. Unlocking Private-Led Growth in the Middle East and North Africa*, 2009, p.53.

It's worth noting that the SOEs are also a main source of employment for the nationals. Approximately/about/something like 90 per cent of Saudi Arabia, UAE, Bahrain and Oman's citizens are employed in the public sector (in case of Kuwait and Qatar this ratio is lower, about 75 and 55 per cent respectively). As a result, private sector is literally dominated by expatriates. In Kuwait, Qatar and UAE almost 100 per cent of employees come from abroad⁸.

Reasons behind the SMEs' failure

Why the SMEs do not contribute to GDP and to the job creation as one may think? It's not because the SMEs are defective in their nature but because

http://eprints.lse.ac.uk/55011/1/_Libfile_repository_Content_Kuwait%20Programme_Al-Kuwari_2013.pdf, accessed: 18.02.2014, p.20.

⁸ This situation directly results from a tremendous earnings gap between public and private sectors. In 2008 a pay of UAE citizen working in public institutions and entities was generally 30 per cent higher than his counterpart's from the private enterprise (on average they earn 5500 and 3700 dollars per month).

their operations in the Gulf region face serious challenges precluding their full development.

Firstly, there is the issue of modern technology and necessary infrastructure within companies. Technological innovation is undoubtedly a vital tool to enhance efficiency and competitiveness. Thanks to cutting-edge innovations, it's possible to produce more using the same (or even lower) amount of resources. That is called an intensive growth. In factories, modern production lines streamline production, making it both faster and cheaper. In trade, better trucks, well-equipped warehouses (such as cold stores with well functioning cooling systems) improve merchants' capabilities. The same happens with services where tools of higher quality help to save time and thus make it possible to serve more consumers.

Nevertheless, as far as the GCC countries are concerned, research and development (R&D) in the region is still a fledging area. Technology clusters around specific industries have not yet developed, and links between business and local universities are weak. In 2009, R&D expenditure was 0.11 per cent of GDP in Kuwait, 0.08 per cent in Saudi Arabia and less than 0.1 per cent in the UAE⁹.

Secondly, there is a problem of human resources. One doesn't need a specialised knowledge to notice that educated staff facilitates daily operations. Not only is it able to use more advanced technology and solve problems

⁹ S.Hertog, *The private sector and reform in the Gulf Cooperation Council*, London School of Economics and Political Science, July 2013, <http://www.lse.ac.uk/IDEAS/programmes/kuwait/documents/The-private-sector-and-reform-in-the-GCC.pdf>, accessed: 09.03.2014, p. 27.

quickly and easily, but it may also innovate and propose its own solutions. Well-qualified employers are not simply labour, they are a human capital.

Yet again, plenty of problems appear. Companies operating in the Gulf region are considerably short of skilled human resources. Employees in the Arab SMEs are generally weak in terms of their knowledge and skills of market analysis, marketing and product innovation as well as business planning and financial management. More qualified people prefer to work in the SOEs where wages are higher. Private sector is literally dominated by often lacking basic education expatriates. According to a study conducted by the SMEs Center at the Riyadh Chamber of Commerce and Industry, 44 per cent of the SMEs' managers see workforce issues as an important obstacle to their development¹⁰.

Undoubtedly, it is the access to financing that is the most important factor in the development of a business, as no investment can be made without money. Raising workforce's qualifications, creating and implementing new solutions enhancing companies' efficiency as well as buying assets incur significant expenses that are often far beyond companies' normal capabilities (in most cases profits are not sufficient for the necessary investments). Over-expanded bureaucracy also increases business demand for financing since interminable administrative procedures make daily operations more costly. Obviously it matters for all types of firms, regardless of their size, yet this issue is particularly challenging for the SMEs because they simply do not have as high incomes as big enterprises do. It is estimated that only 8 per cent of lending in the

¹⁰ S. Hertog, *Benchmarking SME*p.28.

MENA region goes to small end medium enterprises. In the case of the GCC countries it is only 2 per cent. This is substantially lower than in the middle and high-income countries, where lending average is 18 per 22 per cent respectively¹¹. According to the *Doing Business Report 2014*, in terms of business financing MENA region performs the worst in the world (even Sub-Saharan Africa does better). Saudi Arabia ranked 55th, the United Arab Emirates and Oman 86th while Bahrain, Kuwait and Qatar were jointly on the 130th place (the United States and Germany ranked 3rd and 28th respectively)¹².

Cornerstone of Development

The GCC's incumbents seem to be aware that a fully sustainable economy cannot be based solely on state enterprises that operate mainly thanks to incomes coming from the energy industry. Efforts aiming at diversification and private sector development date back to the wake of the so-called oil shocks that occurred in the 70's of the 20th century. The purpose of the latest strategies is to enhance the competitiveness of the national economy on the global arena. All of them stress the need to boost productivity and competitiveness, and include promotion of a business environment conducive to growth. Targeted areas also include integrating economies with the global knowledge economy, encouraging

¹¹ Q. Saleem, *Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance*, International Finance Corporation, World Bank Group, http://www.ifc.org/wps/wcm/connect/1e6a19804fc58e529831fe0098cb14b9/IFC+Report_Final.pdf?MOD=AJPERES, accessed: 15.03.2014, p.2.

¹² The World Bank, *Doing Business 2014. Understanding Regulations for Small and Medium-Size Enterprises*, 2013, p.10.

entrepreneurship, attracting foreign investments, fostering innovation, and ensuring access to finance for the SMEs. Other themes focus on recognition of the need to improve education and health outcomes, and the desirability of improving the efficiency of the public sector¹³.

Unfortunately, as of yet none of these actions have yielded any tangible results. It is especially noticeable while analysing the so-called distance to frontier, a measure introduced by *Doing Business 2012*. It is an index that assesses how much the regulatory environment for local entrepreneurs improves in absolute terms over time¹⁴. As chart 2 shows, in terms of protecting investors, enforcing contracts, getting credit and resolving insolvency the Middle East countries perform much worse than the OECD high income and Europe and Central Asian ones do.

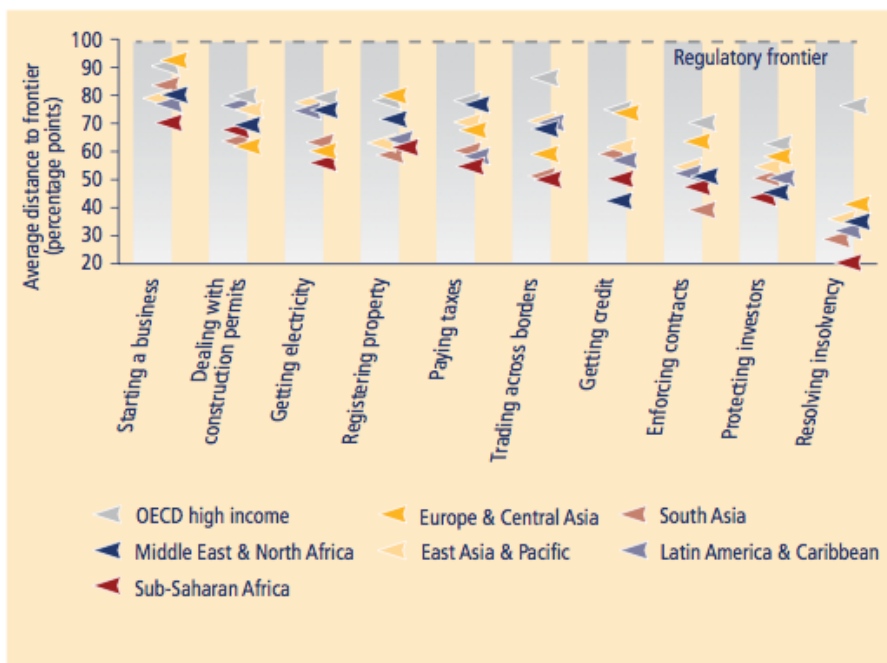
Furthermore, most of the diversification has been focused on projects conducted by the SOEs, which thanks to sovereign backing are able to engage in longer-term strategies of research and product development (for private entities they are often too risky and do not generate sufficient profits). The massive investment in airports, planes and flight service facilities by Etihad (Abu Dhabi), Emirates

¹³ Middle East and Central Asia Department, International Monetary Fund, *Gulf Cooperation Council Countries. Enhancing Economic Outcomes in an Uncertain Global Economy*, 2011, p.2.

¹⁴ It shows the distance of each economy to the “frontier,” which represents the best performance by any economy observed on each of the *Doing Business* indicators since 2003 or the year in which data for the indicator were first collected.

(Dubai) and Qatar Airways (Qatar) ¹⁵, the SABIC involvement in materials research and national human resources' development are a perfect examples ¹⁶.

Chart 2 – Distance to the frontier by region in 2013



Source: The World Bank, *Doing Business 2014. Understanding Regulations for Small and Medium-Size Enterprises*, 2013, p.4.

It is a common knowledge that the more affluent we are the lazier we become. It is especially evident as far as the GCC states are concerned. Atif

¹⁵ M. Hvidt, *Economic diversification in GCC countries: Past record and future trends*, The London School of Economics and Political Science, January 2013, Number 27, http://eprints.lse.ac.uk/55252/1/Hvidt_2013.pdf, accessed 30.01.2014 *op. cit.*, p.36.

¹⁶ S.Hertog, p. 30.

Kubursi put it very clearly, if oil supplies were everlasting, and the demand for oil strong and continuous, an economic diversification would be pointless. (...) However, in the real world, oil resources are finite and experience shows that both the price of and the demand for oil have fluctuated considerably. Moreover, oil revenues quickly crowd out any other economic activity¹⁷. Unless, the Gulf incumbents take this simple truth to heart, once oil peters out, there will be no money to maintain these glittering palaces and modern skyscrapers. And the Gulf may once again be nothing more than just a vast desert belonging to the Bedouin.

¹⁷ M. Hvidt, *op.cit.*, p.1.

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