

## **Muhammad Al-Jasser: “Assessment” project of small and medium size enterprises**

Opening speech by His Excellency Dr Muhammad Al-Jasser, Governor of the Saudi Arabian Monetary Agency (SAMA), at the inauguration ceremony of the “Assessment” project of small and medium size enterprises, Saudi Company for Credit Information (SIMAH), Riyadh, 8 October 2011.

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### ***Your Excellencies and Dear audience,***

I am pleased to participate with you in celebrating the launching of the “Assessment” Project of Small and Medium Enterprises. First, I would like to express my thanks and appreciation to the colleagues at the Saudi Company for Credit Information (SIMAH) for the development of this important project, which I hope will be provided with all necessary means of support by all entities concerned for its success.

### ***Dear brothers and sisters,***

The national economy consists of a large and integral variety of public and private institutions that use available human and material resources to produce continuous flows of goods and services to meet the domestic community’s needs and a part of the external demand. Of course, domestic enterprises differ in size based on various criteria, the most important of which are: the number of workers, the amount of capital, sales and others. One of the misconceptions is that large enterprises are the main impetus of economic activity. This belief has arisen from the good news repeatedly published about those institutions in various mass media. However, the actual reality emphasizes that small and medium size enterprises play an important role in the economic activity in both the developed and developing countries, through their absorptive capacity in employing the workforce of the different levels of training and education. A study by the Riyadh Economic Forum on “the Saudi Business Sector and Meeting the Economic Challenges” showed that the average number of workers in the Saudi private sector stood at 8.4 workers per one single institution, and, consequently, 90 percent of the institutions in the Kingdom is considered within the scope of small and medium size enterprises.

Small and medium size enterprises are considered the best efficient and effective tool for accelerating economic and social development, especially in remote areas with the least opportunities for development. They also provide a fertile field for training workers and developing their skills. To this end, governments have paid great attention to such enterprises and established the basic regulatory framework needed for their growth and development, particularly after having proved their ability to reduce pressure on the government sector in providing job opportunities and training. Governments also helped big enterprises in the marketing process and in providing raw materials and primary commodities at the different production phases. It is noted that most regional and international aid donating agencies and organizations have a growing tendency to provide financial resources and technical assistance aimed at assisting such small and medium size enterprises to depend upon themselves and play their anticipated role in the economy. We, in Saudi Arabia, have the same tendency. The Kingdom has attached great importance to this sector and encouraged all authorities concerned to support such enterprises. Several government initiatives have been taken to support and finance small and medium size enterprises, as clearly evidenced by the contributions made by government development funds. However, in spite of substantial government support, the private sector, in particular finance companies should seize such opportunities to achieve the goals of the financial sector and the Saudi economy in general.

### ***Dear Brothers and Sisters,***

Some may wonder what are small and medium size enterprises, and how can we distinguish between them; and is there an international definition for them. Indeed, there is a substantial difference at the international level in their definition. If we rely on capital as a standard, for example, we will find that a facility with a capital of 10 million euros, is considered a small-size enterprise in the European Union, while it is considered a medium-size enterprise and perhaps large-size enterprise in some developing countries. The terms “small” and “medium” are comparative words and have relative concepts that vary from one sector to another and from one country to another. However, the general practice in each country or region is to rely on a set of criteria intended to define medium and small size enterprises. Among the most important criteria are: the amount of labor, capital, annual sales, and the overall financial position at the end of a period. In the European Union, a small-size enterprise has about 50 workers, and the volume of its activity is around 10 million euros. Medium-size enterprises are defined as those which employ about 250 workers and their annual commercial activity is around 50 million euros. In Saudi Arabia, the Saudi Industrial Development Fund adopts the annual sales standard to identify small and medium size enterprises for the purpose of funding by “Kafalah” program. They are defined as enterprises with annual sales not exceeding RIs 30 million. The World Bank has conducted a questionnaire and distributed it to commercial banks to establish a definition for small and medium size enterprises. The result has shown differences between banks in their definitions, but it can be concluded from that survey that small-size enterprises are those whose annual sales range from RIs 100 thousand to RIs 5 million, and employ 2 to 49 workers. The medium-size enterprises are those with a turnover of RIs 5 million to RIs 50 million per annum, and employ from 50 to 200 workers.

### ***Ladies and gentlemen,***

SMEs have various advantages, such as their easy establishment due to low capital required for their establishment and operation, their easy establishment procedures, and low establishment and administrative expenditures due to their simple organizational structures. They are also characterized by management independence by their owners, who seek to achieve the best possible success. Moreover, they are characterized by low administrative and marketing costs, low employees’ salaries, easiness of procedures within their structure, high effective communications and quick access to information required for work, and the use of non-sophisticated production and operation means. They are also able to adapt to changes, especially in keeping up with consumers’ desires and preferences or change in the structure of labor force or policies of production, marketing and finance, enabling them to overcome economic changes and cycles. SMEs are also characterized by the freedom to enter and exit the market, thanks to their fixed and total assets and liabilities. Finally, they are flexible in geographic spread.

Regardless of these advantages, growth and development of SME sector faces a number of challenges that might be greatly similar, not only at the level of a single country, but at the global one as well. The most important of these challenges are the high cost of capital due to high interest rates compared to large enterprises, difficulties in obtaining adequate finance due to lack of guarantees and their modest credit record, inability to compete and influence market forces and utilize economies of scale, inability of applying and facilitating government procedures to expand their activities, humble financial expenditure on development research, non-separation between ownership and management (80 percent of SMEs are run by their owners). These advantages and disadvantages, however, represent an opportunity for the financial sector to further focus on financial support through financing these enterprises, commensurate with risk level that must be taken into consideration when financing SMEs, and to set appropriate finance prices commensurate with risk levels.

### ***Ladies and Gentlemen,***

Business Enterprises have witnessed significant growth in recent years. The number of enterprises subscribing to the Social Insurance System went up from about 121.5 thousand in 1426H to approximately 218.4 thousand in 1430H, recording an annual average growth of 16 percent. Individual proprietorship firms represented 93.1 percent of the total of annual average growth, limited liability Enterprises 4.7 percent and holding Enterprises 0.6 percent. Economic activity of these enterprises was focused in three areas: commercial activity 34.3 percent, construction and building 32.3 percent and manufacturing industries 14.6 percent. Small Enterprises with less than 5 employees accounted for the largest share of 55.5 percent of the total number of enterprises at the end of 1430H, while the rest, enterprises with more than 60 employees represented 3.8 percent. These data show that most of the enterprises in the Kingdom are small, in terms of the number of workers. SMEs' contribution to the Kingdom's GDP is very low, accounting for 33 percent, while SMEs constituted 64.3 percent of Japan's GDP, 43.3 percent of Spain's GDP, 56 percent of France's GDP, 44 percent of Austria's GDP, 43 percent of Canada's GDP and 33 percent of Australia's GDP. SMEs' contribution to the U.S.A's GDP is more than 50 percent. The insignificant contribution of SMEs to the Kingdom's GDP may be due to the Oil and Governmental sector which represent the major impetus of economic activity.

### ***Dear Brothers and Sisters,***

SMEs are facing clear challenges in gaining the necessary funding for meeting their expansion needs due to various reasons including poor management, and lack of adequate guarantees and, subsequently, the difficulty of obtaining the necessary funding. In order to overcome this problem in the Kingdom, the Ministry of Finance, in collaboration with Saudi banks, established a guarantee program (Kafalah) for financing SMEs. The program, with a capital of RIs 200 million, is managed by Saudi Industrial Development Fund to cover a proportion of the risk of the financing entity in case of the failure of the guaranteed activity in repaying the finance or part thereof. The program also aims at encouraging banks to finance SMEs that have the constituents for success, but at the same time, they cannot present the necessary guarantees or accounting records to prove their eligibility for funding. The program has recorded good performance since its inception in 2006 until 1-Oct-2010, as the number of guarantees approved by the Ministry of Finance during that period reached 1,668 with a total value of RIs 644 million, while loans granted by banks under the umbrella of the program amounted to RIs 1.6 billion, benefiting about 1,113 SMEs. This is in addition to financing loans granted by Saudi Credit and Saving Bank to young people and small businesses, as well as the financial support of the Centennial Fund and the program of "Bab Rizq Jameel" of Abdul Latif Jameel which provides material support to the youth's projects and training courses.

### ***Dear Brothers and Sisters,***

Today, SIMAH project for assessment of SMEs emerges as an important plan in order to encourage banks to finance these enterprises in a scientific and systematic way that takes into consideration the prevention of risks related to its financing, and helps banks to diversify their portfolios, which adds a new area to the main finance areas in the Kingdom. For example, the corporate finance granted by banks exceeded RIs 800 billion at the end of the 2<sup>nd</sup> quarter of 2011, the individuals' finance was RIs 217.5 billion and the public sector's finance amounted to RIs 250.5 billion at the same period. Today, through this project, we endeavor to make the SMEs' finance a tributary of finance in the banking sector to achieve the development objectives that the Kingdom seeks to realize for its economy. It is needless to stress the importance of the diversification of the banking sector's loans to all segments of the economy and the business sector, which can decrease lending risks, enhance the efficiency of funding in the economy in general and increase banks' efficiency in determining the quality of these enterprises' assets, giving it the opportunity of obtaining finance that will contribute to the development of the private sector.

I would like to emphasize that the status of the MSEs in the Kingdom still needs a lot of care and insuring a suitable environment so that they can play their required role in the economy, especially in the field of job creation and Saudization. This project may be the real start for combining efforts to help this important sector to overcome one of the most important obstacles facing its development, namely, obtaining the required finance to fulfill its financial needs.

***Thank you all for listening, and I wish you success.***