

## **Muhammad Al-Jasser: Small and medium enterprises**

Opening speech by His Excellency Dr Muhammad Al-Jasser, Governor of the Saudi Arabian Monetary Agency (SAMA), at the symposium on “Small and Medium Enterprises”, organized by the Institute of Banking in cooperation with the International Financing Corporation, Riyadh, 2 November 2010.

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### **Excellencies and honored audience,**

It gives me great pleasure to welcome you all in the headquarters of the Institute of Banking. I'm delighted to receive an invitation to deliver the opening speech for the symposium on “Small and Medium Enterprises” before this distinguished elite of participants and audience. I would like to express my thanks and appreciation to the colleagues at the Institute of Banking and International Finance Corporation (IFC) for organizing this symposium. I will try in this speech to shed light on some ideas related to the importance of the role of these enterprises in the national economy, challenges facing their growth, and provision of appropriate funding for them.

### **Dear audience,**

The national economy consists of an integrated wide range of public and private enterprises which utilize available material and human factors of production for providing continuous flows of goods and services to meet the needs of the domestic society and part of external demand. As a matter of fact, the sizes of local firms vary according to the size of labour, capital, sales...etc. It is mistakenly believed that large-scale enterprises are the main impetus for economic activity. Such belief has stemmed from the attention paid to these entities by different mass media. However, the true state of affairs emphasizes that small and medium enterprises (SMEs) play an important role in the economic activity in both advanced and developing countries through their massive absorption capacity to employ labour force, including those with modest and average training and scientific qualifications, apart from their role in the daily movement of goods, services and commercial activity. For instance, small and medium enterprises in the Euro area account for 99.8 percent of total business enterprises, 60 percent of value added, and 70 percent of total employment. Such percentages are not confined to the Euro area only, but many other countries in the world may have similar percentages as well. Small and medium enterprises are considered the most efficient and capable instrument to accelerate the pace of economic and social development, especially in remote areas with less opportunity to benefit from development. Apart from being the nucleus of large-scale enterprises, 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. Based on this perspective, governments have long since paid great attention to such enterprises and enacted laws to provide the infrastructure that would contribute to their growth and development, particularly after having proved their capacity to reduce pressure on the public sector as regards the provision of job opportunities. Moreover, small and medium enterprises serve as a wide arena for developing workers' technical and management skills. They also assist large enterprises in the marketing process and providing crude materials and primary commodities throughout the phases of production.

Most regional and international donor institutions and organizations have a growing tendency to provide financial resources and technical assistance to these small and medium enterprises to be self-dependent and play their necessary role in the economy.

### **Dear audience,**

Some may wonder what small and medium enterprises are, how we can differentiate between them and do they have an international definition. In fact, there is much difference in

their definition at the international level, and it is difficult to reach a uniform definition. If we depend on the capital criterion, for example, we will find that an enterprise with a capital of 10 million Euros is considered a small-sized enterprise in the European Union while it is regarded as a medium or probably large enterprise in some developing countries. Moreover, “small” and “medium” are two comparative words and have relative concepts that vary from one sector to another and from one country to another. However, the general practice in every country or region is to depend on a number of criteria, including manpower numbers, capital, volume of annual sales and total financial position at the end of the period. In the European Union region, small enterprises are defined as those having 50 workers and an activity volume of 10 million Euros, while medium ones are those with 250 workers and an annual activity volume of 50 million Euros. In the kingdom of Saudi Arabia, the Saudi Industrial Development Fund adopts the criterion of the annual sales for defining small and medium enterprises whose annual sales do not exceed RIs 20 million for financing purposes according to “Kafallah” program. The World Bank has distributed a questionnaire to commercial banks to determine a definition for small and medium enterprises. The result of the questionnaire has showed that there is difference in banks’ definitions. However, it may be concluded that small enterprises are those with annual sales ranging from RIs 100 thousand to RIs 5 million and workers from 2 to 49. Medium enterprises are those with annual sales from RIs 5 million to 50 million and workers from 50 to 200.

**Dear audience,**

SMEs are characterized by many features including, simplicity of their establishment due to the low value of the capital needed for their foundation and operation, simplicity of their establishment procedures, and low cost of their establishment and administration because of the simplicity of their administrative structure. Moreover, SMEs are featured by the independent management by their owners who seek as much success as possible. Their other features are: low administrative and marketing cost, and labor wages, simple routine procedures, highly efficient communications and readily available information needed for work therein, the usage of uncomplicated production and operation methods, the ability to cope with new changes with regard to meeting consumers’ preferences and tastes, the ability to change the composition of labor force, production, marketing or finance policies to face quick changes without any hesitation, helping them to overcome economic cycles and changes. In addition, SMEs are also characterized by the freedom to enter and exit the market because of the modest ratio of their liabilities to fixed or full assets, and the easiness to convert small enterprises into liquidity in a short time without incurring a significant loss. Furthermore, the exit of a SME will have no significant impact on the market. Finally, SMEs are flexible to move and spread geographically. In spite of these features, the growth of SMEs is facing a variety of challenges which may be similar to a great extent not only at the level of one country only, but also at the global level. The most prominent challenges are the high cost of capital as a result of high interest rates compared to large enterprises (LEs), the difficulty of obtaining proper finance due to shortage of guarantees and modest credit record, inability to compete and affect the market’s powers and making advantage of economies of scale as is the case with LEs, weak capacity to face and facilitate governmental procedures to expand their work, and low spending on development research works.

**Dear audience,**

Business enterprises in the Kingdom of Saudi Arabia have witnessed notable growth over the last years. The enterprises subscribing to the Social Insurance system have increased from 121.5 thousand in 1426AH to 218.4 thousand in 1430AH, with an average annual growth of 16 percent. Individual enterprises represent 93.1 percent, limited partnership enterprises 4.7 percent, and joint enterprises 0.6 percent of the total number. These enterprises’ economic activity is concentrated in three areas, namely, commerce with 34.3 percent, construction and building with 32.3 percent, and manufacturing industries with 14.6 percent. Small enterprises employing less than five persons have accounted for the bulk share, representing 45.5 percent of total enterprises at the end of 1430AH, enterprises with

5–59 employees constitute 42 percent, while the remaining 3.8 percent has been accounted for by enterprises with more than 60 employees. These data show that most enterprises in Saudi Arabia are small ones, based on the number of employees. The SME's contribution to total GDP is low. The share of private sector gross product, which SMEs are part of, is 33 percent, while the share of SMEs in GDP is 57 percent in Japan, 64.3 percent in Spain, 56 percent in France, 44 percent in Austria, 43 percent in Canada, 33 percent in Australia and more than 50 percent in the United States. The SME's modest contribution to GDP in Saudi Arabia could be ascribed to the immensity of the oil and public sectors, being the main catalyst for economic activity.

SMEs coverage in the national income accounts might be low.

**Dear audience,**

Small and medium enterprises are facing clear challenges to obtain the necessary funding to meet their expansion needs because of several reasons; one of which is the lack of guarantees for granting credit. To overcome this problem in the Kingdom, the Ministry of Finance, in cooperation with Saudi banks, has established “Kafalah Program” for financing small and medium enterprises. It is a program administered by the Saudi Industrial Development Fund with a capital of RIs 200 million to cover a proportion of the risk of the funding entity in case the guaranteed enterprise fails to repay the finance or part thereof, and to encourage banks to finance viable small and medium enterprises, which cannot provide the necessary guarantees or accounting records that prove their eligibility for funding. The program has been performing well since its inception in 2006 up to the end of 2010. The number of guarantees approved during the period amounted to 1,668 with a total value of RIs 644 million against loans to the tune of RIs1.6 billion granted by banks under the umbrella of the program, which benefited about 1,113 small and medium enterprises. This is in addition to loans provided by the Saudi Credit and Savings Bank, for financing young people and small enterprises, as well as the Centennial Fund, and Abdul Latif Jameel's “Finance Program” that provides material support for youth's projects and training courses.

**Dear audience,**

In conclusion, I wish to emphasize that the status of small and medium enterprises in the Kingdom still needs a lot of care and an appropriate environment to perform their required roles in the economy, especially in the field of Saudization of jobs. This important symposium may, hopefully, discuss this topic from its different aspects and provide the necessary recommendations to assist competent authorities in making appropriate decisions for this important sector.

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