MANAGING SMALL AND MEDIUM ENTERPRISES IN OMAN AND FINANCING PROBLEMS

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ABSTRACT

Small and medium enterprises play a very important role in a country like Oman in terms of their potential contribute to employment and growth. However, SMEs in Oman are in their nascent stage and need to be nurtured to contribute in a significant manner to the employment and growth of the country. The basic objective of this paper is to look financing problems faced by small and medium enterprises, as this is seen to be the critical obstacle to growth of SMEs in countries like Oman. Small enterprises are defined as those with 1 to 9 employees and medium enterprises are those with 10 to 99 employees.

A framework was developed to examine the financing issues surrounding small and medium enterprises. The framework looks at the interlinkages between SME financing constraints, sources of SME financing, working capital financing problems and service sector SME financial constraints. Analysis leads us to conclude that more than 62% of small and medium enterprises in the MENA region find financing a problem. Majority of the small enterprises reported that a large part of their assets are financed by owners funds (internal financing), while less than 25% of their funding requirements are met by short term bank borrowings, and long term borrowings. Supplier's credit (payables) is a very important source of funding for small enterprises in Oman. The results clearly force us to conclude that small enterprises are not getting enough funding from banks and financial institutions. Internal equity financing and supplier's credit are extremely important sources of financing for service sector firms in Oman.

The author concludes that obstacles which need to be looked at by the policy makers for development of SMEs in middle east countries like Oman are lowering interest rates, ensuring that banks and financial institutions give long term loans, reducing the need for collateral requirements and lastly making banks more accessible especially to small borrowers. There appears to be a need for better and easier communication between banks and small enterprises.

However we conclude with a very troubling question which emerged in process of data analysis - "Does Oman really need small enterprises ?".

Keywords: SME, Financing, Oman, MENA (Middle East and Narth Africa).

INTRODUCTION

The recent World Bank Review on Small Business Activities establishes the commitment of the World Bank Group to the development of the small and medium enterprise (SME) sector as a core element in its strategy to foster economic growth, employment and poverty alleviation (Buckland et.al, 1995). Small and medium enterprises are necessary engines for achieving national development goals such as economic growth, poverty alleviation, democratization and economic participation (Audretsch et.al,1998).The contribution and significance of small and medium – sized enterprises (SMEs) as an important engine of growth has increasingly gained importance in both developed and developing countries. These enterprises are often regarded as the "backbone" of the economy, serving as major sources of technological development, new jobs and a seedbed for entrepreneurship (ACOST, 1990).

Amongst the most important factors responsible for the relative lacklustre performance of SME's in developing world is the acute shortage of external financing. In fact SME face financing problems associated with banks, private equity, venture capital and lack access to public equity, and this makes initiation and sustenance of small and medium enterprises a difficult proposition that relies only on internal sources of finance.

In Oman, the issue of lack of SME financing has caught the attention of the policy makers ever since the November 2006 conference on SMEs organised by the Central Bank of Oman and the IFC (International Financial Corporation which is a part of the World Bank Group). Several leading local and international banks operating in Oman have established separate small and medium enterprises financing departments in the last two years to overcome the financing constraints and obstacles faced by small and medium enterprises.

It can be clearly seen that investigation of the critical problems of SME financing in Oman is an important topic and would therefore require a thorough and judicious exposition of relevant areas of research. This paper would essentially focus on the financial problems of SME enterprises in Oman, with particular emphasis on the financing gap in terms of sources of financing, and on financial constraints and role of working capital financing.

1. Review of Literature

Importance of Small and Medium Enterprises

Although small and medium enterprises are the lifeblood of most economies, the importance of the SME sector varies greatly across countries (Liedholm et.al, 1998). While in countries like Azerbaijan, Belarus and Ukraine less than 5% of the formal workforce is employed in small and medium enterprises, this share is more than 80% in Chile, Greece and Thailand (SME 250). Similarly, the ratio of the informal economy relative to gross domestic product varies from 9% in Switzerland to 71% in Thailand (Keasey, 1993).

Keasey (1993) argues that small and medium enterprises are particularly important in supporting economic growth and employment generation in developing countries, because they have certain advantages, important among which are:

- Tend to use more labour intensive production processes than large enterprises, leading to more equitable distribution of income with in the country;
- Provide livelihood opportunities through simple, value-adding, processing activities in agriculturally based economies;
- Nurture entrepreneurship; and
- Support the building up of systemic productive capacities through linkages between small and large enterprises.

Despite the growing importance of the small and medium enterprise sector as a new global paradigm essential for developing countries, SME's still remain in the nascent stages of economic development with acute problems of financing (Snodgrass et.al, 1996). Although they contribute significantly to generating employment, their productive contribution to the overall Gross Domestic Product (GDP) remains relatively marginal. As ummed in Gatewood et.al (1994), there is little doubt that, in aggregate terms small and medium enterprises have increased their share in employment and economic growth at a much faster rate than large firms, but the precise nature of their contribution has been a subject of much debate.

What also becomes fairly evident from the analysis of the contribution of small and medium enterprises to employment vis-à-vis the contribution to GDP (as revealed from the Table 1), the higher income countries have an employment contribution of nearly 60% and the SME contribution to GDP in high income countries is almost 50%, while in case of middle income and low income countries the gap between employment contribution of the small and medium enterprise sector and contribution to GDP is lesser.

Banerjee and Duflo (2004) looked at issue of obstacles to obtaining finance by firms of different sizes. They conclude, that in some Asian countries such as India, the

2006	Low Income Countries	Middle Income Countries	High Income Countries
	%	%	%
Contribution to Employment	32	56	64
Contribution to GDP	16	39	51

Table 1. Small & Medium Enterprises contribution to employment and GDP (Median Values) Source: World Bank Report, 2006

largest private companies do not face funding constraints, but this is not the case for small and medium sized enterprises. They say the small and medium sized firms mostly depend on retained earnings and on limited amounts of external finance, and this constrains the ability of SMEs to fund investment and to drive growth.

Beck and Demirguc-Kunt (2005) investigated the link between growth, poverty reductions and the SME segment in manufacturing, the determinants of firm size, financing patterns across firms of different sizes, the growth obstacles faced by firms of different sizes and the role of financial development in overcoming these growth constraints.

Their research has lead to the following conclusions:

- While a larger share of SMEs in manufacturing is correlated with faster economic growth, there is no evidence of causality from SMEs to economic growth or poverty reduction.
- Smaller firms are more constrained by financial and institutional underdevelopment, while the development of financial and legal institutions helps level the playing field between small and large firms.

Beck and Demirguc-Kunt (2005) looked at the differences between firms of different sizes and the obstacles faced by them. They divided the obstacles into three types: financing obstacles, legal obstacles and corruption. They concluded that in all the three types of obstacles the small and medium enterprises faced more constraints compared to large firms.

Beck, Demirguc-Kunt, Laeven, and Maksimovic (2004) using World Bank data from a sample of 10,000 firms drawn from 80 countries comment that small and medium firms rate financing as a bigger obstacle compared to large firms. Specifically they say their estimation indicates a 38.5% probability for small (medium) firms that they rate financing as major obstacle, while it translates into a 28.5% probability for large firms. Their study also analysed the nature of the obstacles. The survey asked specific questions asking respondents to state which of the following were major financing obstacles: (a) collateral requirements of banks and financial institutions, (b) bank paperwork and bureaucracy,(c) high interest rates, (d) need for special connections with banks and financial institutions, (e) banks' lack of money to lend, (f) access to foreign banks, (g) access to non-bank equity, (h) access to export finance, (i) access to financing for leasing equipment, (j) inadequate credit and financial information on customers,(k) access to long-term loans, and (l) corruption of bank officials.

They conclude that high interest rates followed by lack of access to long term loans are the major financing obstacles for small and medium firms in the 80 countries covered by the survey. They also conclude that the most important characteristic explaining variations in financing obstacles experienced by firms in different countries seems to be the overall institutional development in that country, implying that better developed banks and financial institutions reduce the financing obstacles faced by small and medium firms.

Beck, Demirguc-Kunt, Laeven, and Maksimovic (2004) paper also gives us some indication of how to define a small and medium enterprise. In the 10,000 firm survey covering 80 countries done by World Bank, the following definitions were adopted : Small Firms 5 to 50 employees, Medium Firms 50 to 500 employees, and Large Firms 500 plus employees.

2. Framework

This section looks at the conceptual framework on which the present study is based. One purpose of the study is to look at the relationship between financing constraints faced by an SME and its need for working capital financing.

First we look at the meaning of the word financial constraint. Firms which are growing year on year due to increasing sales may experience financing constraints if they are unable to secure the funds required to finance the growth in sales. One would expect that growing sales imply higher investment in production capacity, higher levels of inventory, more accounts receivables and a general increase in the assets of the business to support the growth in sales. Fixed asset investment, inventory and receivables all imply a need for more funds. The first source of finance is naturally internally generated funds from plough back of profits generated from higher sales. If firms are able to access external finance at reasonable cost, especially equity finance, then they would not face the problem of lack of funding. However if external financing is difficult, costly or the firms managers are reluctant to raise new equity finance, then the firm is likely to face financing constraints.

One of the important issues to tackle in the process of encouraging and developing SMEs operating in the services sector in the Oman is to ensure adequate availability of funds for establishment and growth of service oriented businesses. Financing is important for both new service ventures as well as established service organizations.

Entrepreneurial activity in small and medium sized service enterprises is especially hindered due to lack of financing. Unlike other businesses service oriented business organizations typically suffer from financing difficulties. Lenders hesitancy in financing such service oriented businesses needs to be overcome by use of innovative procedures and fresh thinking.

Firms operating in the service sector would typically have lower debt ratios (lower debt to total capital or lower debt to equity ratio) given the fact that their ability to borrow is lower, because of lack of physical inventory. A major component of bank credit for service firms is for financing fixed assets such as buildings, furniture, fixtures etc.

However their requirements for financing is high because of the nature of their operating cycle. For a pure service firm major items of expenditure in the process of producing the services are wages and salaries. The service produced is intangible and therefore cannot be stored and has no shelf life. One would expect that wages and salaries are paid in the Gulf region on a monthly basis (and not weekly unlike some other countries). Cash outflow due payment of wages takes place on a monthly basis. For a manufacturing firm raw material costs are the normally the major items of expenditure in producing the goods. Supplier finance is normally available for manufacturing firms, and further banks are willing to provide finance for raw material and finished goods inventory. For a pure service business cash inflows depend on the nature of the service being sold and produced. Typical service firms (such as those involved in tourism, hospitality, logistics, service contracts, construction services, training, software, IT services) receive cash only when receivables are paid for which can be 60 to 90 days after the date of billing. (in some cases the collection period is even longer extending to 120 to 180 days). Manufacturing companies like service companies also have average accounts receivable period of 60 to 90 days, but have the advantage of being able to offset debtors against creditors. Financing constraints related to the operating cycle are therefore theoretically, more likely in pure service oriented businesses.

Bianchi & Hise (1994) using data drawn from a survey conducted by AT&T Capital Corp and the American Institute of Certified Public Accountants say that start up service companies identified inadequate funding as their biggest hurdle. They blamed lenders. According to the survey results, twenty eight percent of service startups said that lenders are too conservative, sixteen percent reported being unable to find investors and twelve percent said that lack of collateral is the reason for inadequate funding.

Many studies which have done both the macro level data and micro (company) level analysis show that there appears to be some constraints in financing service businesses. Lenders hesitancy in financing service oriented businesses needs to be overcome by use of innovative procedures. Feinberg (1988) commenting on developments in service lending in other countries says that financial institutions are establishing 'new units (departments) for service companies that cannot meet traditional collateral credit. Credit risk, cash flow analysis and other intangible assets are replacing collateral as the basis for loans. Equity kickers such as warrants and options are allowing lenders to participate in borrower's profit.'

In the context of the need for innovative procedures, one would like to mention a recent World Bank study titled: "Export Financing for SMEs: The role of factoring" talks about the need to introduce factoring to solve the financing problems of SMEs. (World Bank, 2006).

3. The Final Framework

The following framework was used in this paper to design and to conduct the data analysis:

3.1 Framework

SME face financing constraints. If they face financing constraints, they would exhibit positive sales growth, high debt equity ratios, low cash to asset ratios. Further qualitative information – through answering questions would also lead to the same conclusion. Such SME will also face working capital financing constraints. Using this conceptual framework, if SMEs face working capital constraints, we expect they will exhibit higher levels of inventory, higher levels of accounts receivable, and lower levels of cash. SMEs also face problems in obtaining long term bank financing. Our framework also suggests that service sector SMEs face higher levels of financing obstacles compared to SMEs in the industrial sector. The framework finally indicates that small enterprises face more financial constraints as compared to medium sized enterprises.

The above framework also implies the following at the data collection stages:

- It should differentiate firms between service sector and industrial sector.
- It should ask questions about the level of financial constraints experienced by the firm.
- It should ask qualitative questions on the reasons why SMEs are facing financing constraints and financing obstacles.
- It should try to get quantitative – financial information related to sales, assets, cash, current assets, inventory, receivables and payables.
- It should seek information on debt to equity ratio, short term bank borrowings, long term bank borrowings.
- It should collect information on all sources of financing.

4. Review of Trends in Small and Medium Enterprises in Oman using Published Data

Secondary data is available from published sources such as the Ministry of National Economy in Oman, the Ministry of Commerce in Oman, the Oman Chamber of Commerce and Industry (OCCI), and the Omani Centre for Export Promotion and Development (OCIPED). However a major problem with secondary data which the author experienced was that most of the published data is old (most of the data relates to the period 2003 to 2005 or before). Although the ministries and other organisations claim that they have done surveys and collected data in the period 2004 to 2007, the information is not publicly available either from their websites or from the ministries themselves. For example the Ministry of National Economy website says that a survey of industries was conducted in 2004, but the survey report is not available for public usage. A "Glance At Industry In Oman" published by the Ministry of Commerce and Industry in 2003 is the only recent source of data on small and medium industries in Oman. Other publications such as the "Statistical Year Book" published by the Ministry of National Economy carries data on number of commercial establishments in Oman divided according to size of initial capital investment, but does not classify them into small, medium and large enterprises. Further the data published by the Ministry of National Economy, Oman clubs trading establishments with manufacturing and service enterprises, while the present paper concentrates only on SMEs in the manufacturing and service sector.

The "Yearly Industrial Statistical Book 2008" published by Ministry of Commerce and Industry reports data related to the industrial sector in Oman. Previous editions of the "Yearly Industrial Statistical Book" were published in the period 2004 to 2007. Data published in this publication is of limited use for the present study because of three reasons: One, unlike the earlier publication "Glance at Industry in Oman" which was a census based, the "Yearly Industrial Statistical Book" is based on a sample survey of industrial establishments in Oman. Researchers who consult the "Glance to Industry in Oman" for data on small and medium sector enterprises for the years prior to 2003, and to the ""Yearly Industrial Statistical Book" for SME data for the period after 2003 come to the strange conclusion that the number of industrial enterprises in Oman have shrunk from 862 in 2001 to 483 in 2007. However it is important to remember that the earlier publication is census based and the later publication is sample based. It is also important to remember that the Ministry of Commerce and Industry has discontinued publishing "Glance at Industry in Oman" and has now switched over to publishing the "Yearly Industrial Statistical Book".

The second reason why "Yearly Industrial Statistical Book " is of limited used is that the "Yearly Industrial Statistical Book" covers only medium and large enterprises - that is those firms which have more than 10 employees. It does not look at small enterprises, that is those which employee less than 10 employees. From the point of view of the present paper this is a serious limitation because, going by the "Glance at Industry in Oman " figures of the 2003 publication, nearly 46 percent of the enterprises in Oman are small, while 44 percent are medium sized and 10 percent are large enterprises. This implies that the more recent publication of the Ministry of Commerce and Industry, Oman ("Yearly Industrial Statistical Book") does not cover nearly half the firms which are important for this paper.

The third reason why "Yearly Industrial Statistical Book" is of limited use to this paper is, page 3 of the publication itself states "to obtain comprehensive results of the manufacturing industry sector and its contribution to GDP, one must consult the annual statistics book issued by the Ministry of National Economy." (Ministry of Commerce & Industry, 2008). However, said earlier the Ministry of National Economy publication "Statistical Year Book" of Oman, shows data which is clubbed across trading, industrial and service establishments and does not report the data according to number of employees or according to sales - both of which (employees and sales) form the basis for differentiating a small enterprise from a medium enterprise, and a medium enterprise from a large one.

The major source of secondary data for this paper is the "Glance at Industry in Oman, 2003" published by the Ministry of Commerce and Industry, Oman. Previous editions of this publication for earlier years were also used to draw the necessary data.

5. Trends in SMEs in Oman

Tables 2, 3 & 4 give information about the number of small, medium and large enterprises, gross value added by the small, medium and large enterprises both in value terms and in terms of percentage share, and the average number of employees in different types of industrial activities in Oman. In addition to the tables the appendix attached at the end of the paper gives another table with details of total number of employees in each sector.

Some of the important trends and facts which emerge from this data are as follows:

- Small enterprises account for 46% of firms, while medium enterprises account for 44% of the firms in 2001. Large enterprises are only 10% of the total number of firms operating in 2001.
- In terms of numbers there are 862 firms out which 394 are small, 382 are medium sized and 86 are large enterprises.
- Food products, readymade garments, metals and metal products and non-metallic products are the types of activities in which a majority of the firms are operating.
- The gross value added figures are very revealing. Although small enterprises account for 46 % of the number of firms, they account for only 2% of the gross value added. On the other hand large enterprises which stand at 10% in terms of number of firms contribute 83% of the gross value added.
- Data on gross value added per employee shows that gross value added per employee is much higher in the large enterprises as compared to small enterprises.
- The data on small and medium enterprises which is available only for the pre 2003 period forces us to conclude that SMEs in Oman have failed in many ways. Their employment capacity seems to be lower than large enterprises. The 700 odd SMEs together employed

roughly 15000 people, the 86 large enterprises gave employment to 19000 people. Further the ability of SMEs to add to the gross value added is much lower than large enterprises.

- If SMEs are to contribute to Omani economy – two things are required. There is need for a much larger number of SMEs to be established for SMEs to provide substantial employment opportunities within the country. Further, there is need for high gross value addition, for SMEs to contribute to the growth and development of Oman's economy.
- However the data analysed so far is only upto 2001, and there may have been a substantial change from then to now.
- The next section looks at trends in medium enterprises in Oman using published data which is available up to 2007. Data on small enterprises is not available for recent years and therefore the next section only looks at the trends in medium versus large enterprises.

6. Structure of Medium Enterprises in Oman and Contribution to Growth and Employment in Oman

For the sake of giving a complete view of the trends in Oman, in the Table 2 figures related to medium and large industries in the country are reported. As mentioned earlier the Ministry of Commerce and Industry in Oman has stopped publishing the "Glance at Industry in Oman " publication which used carry information on small enterprises. Since 2004, the Ministry of Commerce and Industry is publishing annually a new report called "Yearly Industrial Statistical Book". The table reported below therefore shows only data relating to medium enterprises and not data relating to small enterprises due to limitations imposed by the change in the nature of publications released by the Ministry of Commerce and Industry in Oman.

The tables given along with report data related to medium and large enterprises in Oman for the year 2007 based on the "Yearly Industrial Statistical Book, 2008" published by the Ministry of Commerce and Industry in Oman. Using the data reported the author have calculated some additional ratios which are reported in the tables. Before drawing any conclusions it is important to remember that the data is based on a sample survey and it is not census based.

There is a strong argument in favour of small and medium enterprises due to their ability to generate higher levels of employment etc. (Keasey (1993) for example argues that small and medium enterprises are particularly important in supporting economic growth and employment generation in developing countries). Looking at the data related to Oman for the year 2007 we can draw the following conclusions:

- Sales / Revenues per employee are higher for large enterprises compared to medium enterprises.
- Gross Value Added per employee is higher for large enterprises compared to medium enterprises.
- Fixed capital per employee is much smaller (2581 Omani Rials) for medium enterprises compared to large enterprises (31931 Omani Rials).
- Gross Value Added per one rial of fixed capital investment is much higher in medium enterprises compared to large enterprises.
- Gross Value Added per rial of fixed capital investment is highest in the 10 to 19 employees sized firms and the 30 to 49 employees sized firms.

The data seems to be leading us to the conclusion that with the same level of savings and investment and much larger number (percentage) of the population can find employment if the money is invested in creating small and medium enterprises compared to large enterprises. For example the data indicates that one

Size (in terms of number of employees)	Number of Establish-ments	Shipments and Revenues In 000s Omani Rials	Finished Goods Man-ufactured In 000s Omani Rials	Gross Value Added In 000s Omani Rials	Fixed Capital Formation In 000s Omani Rials	No of Emplo-yees
10 to 19	110	35202	35668	11927	614	1588
20 to 29	63	48448	53012	13326	1528	1531
30 to 49	95	111907	113327	54268	2188	3703
50 to 99	86	152404	182335	74616	28733	5988
Medium Enterprises Total	354	347961	384342	154137	33063	12810
100 to 199	61	345891	338997	112370	96821	8728
200 plus	54	2198775	3335243	1136468	969190	24657
Large Enterprises Total	115	2544666	3674240	1248838	1066011	33385
Grand Total	469	2892627	4058582	1402975	1099074	46195

Table 2. Medium Enterprises In Oman

Size (in terms of number of employees)	Ratio of Revenues to Capital	Ratio of Revenues to Finished Goods	Gross Value Added per establishment In 000s Omani Rials	Revenues per Establishment In 000s Omani Rials
10 to 19	57.3	1.0	108.4	320.0
20 to 29	31.7	0.9	211.5	769.0
30 to 49	51.1	1.0	571.2	1178.0
50 to 99	5.3	0.8	867.6	1772.1
Medium Enterprises Total	10.5	0.9	435.4	982.9
100 to 199	3.6	1.0	1842.1	5670.3
200 plus	2.3	0.7	21045.7	40718.1
Large Enterprises Total	2.4	0.7	10859.5	22127.5
Grand Total	2.6	0.7	2991.4	6167.6

Table 3. Medium Enterprises in Oman

million rials of investment in SMEs will give employment to 387 people, while the same one million rials of investment in large enterprises will give employment to 31 people (based on 2007 sample data). So if the goal of governmental policy is to generate more and more employment there is not doubt that the government should encourage establishment of more and more small and medium enterprises.

However, if the goal of governmental policy is to increase gross value added per employee which means higher GDP per capita (Gross Domestic Product per person), then the investment should be directed towards large enterprises.

In contrast, the above data also indicates that if the government would like to achieve higher economic growth (that is growth in gross domestic product) with a given level of investment, then it is better of encouraging medium enterprises (especially those which employee

Size (in terms of number of employees)	Number of Employees	Revenues/ Sales per employee	Gross Value Added per employee	Fixed Capital per employee	Gross Value Added per unit of Fixed Capital
10 to 19	1588	22168	7511	387	19.4
20 to 29	1531	31645	8704	998	8.7
30 to 49	3703	30221	14655	591	24.8
50 to 99	5988	25452	12461	4798	2.6
Medium Enterprises Total	12810	27163	12033	2581	4.7
100 to 199	8728	39630	12875	11093	1.2
200 plus	24657	89174	46091	39307	1.2
Large Enterprises Total	33385	76222	37407	31931	1.2
Grand Total	46195	62618	30371	23792	1.3

Table 4. Medium Enterprises

less than 50 staff) rather than large enterprises.

The conclusions given by the Oman data is sightly different from the conclusions arrived at by other authors such as Keasey (1993). While the Oman data does lead us to the conclusion that medium enterprises are important in supporting economic growth and employment, the data also says that a higher GDP per capita and higher sales revenues per capita (which can imply higher income levels per person) can be achieved primarily by supporting larger enterprises rather than small and medium enterprises.

7. Definition of SME

It may be mentioned at the outset that there is no universally accepted definition for the paradigm of SMEs (Snodgrass et.al., 1996). Definition of the word small and medium enterprise varies from country to country. Also the definition adopted by the World Bank is not the same as the definition adopted by other institutions.

Beck, Demirguc-Kunt, Laeven, and Maksimovic (2004) quoting a study done by World Bank covering 10,000 firms and 80 countries say that a firm with 5 to 50 employees is defined as being a small enterprise, a firm with 50 to 500 employees is defined as a medium enterprise, and firms with more than 500 employees are coined as being large firms.

Bank Muscat, the leading bank in the Sultanate of Oman has a completely different definition of the word small and medium enterprises. Bank Muscat two years ago started a separate small and medium financing department. They have also obtained a 100 million dollar credit line from IFC (International Finance Corporation which is a part of the World Bank Group) for financing their small and medium sector lending. Bank Muscat has adopted the following definition as shown in Table 5.

The Ministry of Commerce and Industry, Sultanate of Oman has a different definition. As per the ministry's

Small Firms	Sales Turnover of less than 100,000 Omani Rials (approximately 260,000 US Dollars)
Medium Firms	Sales Turnvover of 100,000 to 500,000 Omani Rials (approximately 260,000 to 1,300,000 US Dollars)
Large Firms	Sales Turnover of more than 500,000 Omani Rials (approximately 1,300,000 US Dollars)

Table 5. Definitions

publication “Glance at Industry in Oman”, which was brought out by their Department of Industrial Statistics the definition of small, medium and large is as shown in Table 6.

Further the Ministry of Commerce and Industry has taken only those enterprises which belong to either industrial or service sectors as being part of the group which can be called as SMEs. Those firms which are operating in the sphere of banking, finance, brokerage and insurance are not included in the SME group.

The Ministry of National Economy in Oman has a different way of classifying enterprises. In their publication “Statistical Year Book 2008” they have divided enterprises according to the capital invested by the owners in the firm. Although they don't use the word small, medium and large, their classification can be easily adopted to fit the words small and medium. One problem with the Ministry of National Economy, Oman's style of reporting the data is that they club all types of economic activities, that is, shops, trading establishments, finance companies, money exchanges, brokerage firms etc are clubbed with industrial and service firms, while the present study is looking only at SMEs in the industrial and service sectors.

In this study the author has adopted the definition given by the Ministry of Commerce and Industry, Sultanate of Oman in their “Glance at Industry in Oman “ publication.

There are many reasons for adopting the Ministry of Commerce and Industry definition.

One, it is a definition given by a government department and therefore has the official stamp of approval. It is suitable for the circumstances in the Sultanate of Oman. Oman is a small country with a developing industrial and services sector. There were hardly any industrial / service enterprises in the country thirty years ago. Two, if one were to use the definition adopted by the World Bank study, 80 percent of the industrial and service enterprises in the Sultanate of Oman would come under the

Small Firms	1 to 9 employees
Medium Firms	10 to 99 employees
Large Firms	100 plus employees

Table 6. Definitions

definition of the word small and medium enterprises as per the Omani Share Holding Co's Guide 2008, published by the local stock market authority in Oman (Muscat Securities Market, 2008). Data published by the Muscat Securities Market indicates that out of the 51 industrial companies only ten percent have more than 500 employees, and out of the 43 service sector companies only fifteen percent have more than 500 employees. For the purpose of this study the author have excluded banks, financial firms and insurance firms.

The third reason for adopting the Ministry of Commerce and Industry definition and not the Bank Muscat definition is that the Bank Muscat definition is based on sales turnover.

Lastly it is important to mention that the Ministry of Commerce and Industry continues to use the original definitions of the word small enterprise (1 to 9 employees) and medium enterprise(10 – 99 employees) even in its latest publications such as the “Yearly Industrial Statistical Book, 2008”

8. Sample Survey Results: Data Analysis

This section presents the results of the sample survey in a summary form. The information was collected from Muscat Securities Market data base. The data base used reports firmwise data for the year 2007, 2006 and 2005. In the frequency tables reported below data for each firm relates to a firm year. Data relating to a particular firm relating to a particular year is treated as a firm year. The tables, results and the analysis for each item of data collated is presented below. Some, additional frequency tables are also reported at the end of the paper.

Tables 7 and 8 reported show the frequency distribution of the sampled firms according to their annual sales. Majority of the medium enterprises are in the above 750,000 rials per year categories. The table apart from showing the distribution of small and medium enterprises in Oman, also brings out the problem of defining an SME. For example if we take the Bank Muscat definition and classify these firms, nearly 50% of the medium enterprises would be classified as large, because their sales are above 1 million rials. This appears to be a typical

Table showing frequency distribution of firm years according to level of sales	Number of SME (10-99 employees)
Less Than 100,000 OMR	
100,000 0MR to 200,000 OMR	
200,000 OMR to 500,000 OMR	9
500,000 OMR to 750,000 OMR	9
750,000 OMR to 1000,000 OMR	10
More than 1000,000 OMR	28
TOTAL	56

Table 7. Sales (in Omani Rials)

Table showing percentage distribution of firm years according to level of sales	SME (10-99 employees)
Less Than 100,000 OMR	0.00%
100,000 0MR to 200,000 OMR	0.00%
200,000 OMR to 500,000 OMR	7.14%
500,000 OMR to 750,000 OMR	12.50%
750,000 OMR to 1000,000 OMR	30.36%
More than 1000,000 OMR	50%
TOTAL	100.00%

Table 8. Sales (in Omani Rials)

problem while looking at firms in Oman. Even a cursory look at the data of firms listed in the Muscat Securities Market, the local stock market, shows that many companies which have less than 100 employees actually report sales much higher than the 1 million rial which is used sometimes to classify an enterprise as being large and not medium.

Tables 9 and 10 show the distribution of the small and medium firms in the sample according to asset size.

Table showing frequency distribution of firm years according to level of sales	Number of SME (10-99 employees)
Less Than 100,000 OMR	
100,000 0MR to 200,000 OMR	
200,000 OMR to 500,000 OMR	2
500,000 OMR to 1000,000 OMR	7
1000,000 OMR to 2000,000 OMR	11
More than 2000,000 OMR	36
TOTAL	56

Table 9. Small and Medium Firms (sample in asset size)

Table showing percentage distribution of firm years according to level of sales	SME (10-99 employees)
Less Than 100,000 OMR	0.00%
100,000 0MR to 200,000 OMR	0.00%
200,000 OMR to 500,000 OMR	3.57%
500,000 OMR to 1000,000 OMR	12.50%
1000,000 OMR to 2000,000 OMR	19.64%
More than 2000,000 OMR	64.29%
TOTAL	100.00%

Table 10.Small and Medium Firms (sample in percentage)

Majority of the SME reported assets of more than one million rials. Although not strictly valid comparing the sales figures with the asset figures leads us to conclude that for a typical small sized firm in our sample one rial of assets are required for one rial of sales, while for medium enterprises two rial of assets are required for every one rial of sales. The tables related to sales and assets read together imply that a typical SME employee (whether working in small or a medium enterprise) contributes about 20,000 rials per year to sales, but in a small enterprise the investment (assets) required is half the investment required to achieve the same level of sales in medium enterprise. Clearly, the sample data does indicate that if the economy has a shortage of investment capital it should encourage small enterprises given capital constraints, but the moot question is: Is there a shortage of investment capital in Oman. Oman, is an oil – rich economy with large oil surpluses with the government. It would be difficult to conclude that there is a shortage of investment capital in Oman. If this line of argument is true then we may be forced to conclude that the policy makers in Oman may be better of encouraging medium enterprise rather than small enterprises.

The bigger problem in the SME paradigm from Oman's point of view is the difficulty in ensuring flow of financing to the small and medium enterprises (especially small enterprises) rather than lack of investment capital as a constraint in financing small and medium enterprises.

The five tables given – Tables 11 to 15 show ratios related to the liquidity position and working capital financing requirements of small and medium enterprises in the sample.

Current ratio and quick ratio are standard ratios used to

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less Than .5	0	1
.5 to 1	7	10
1 to 1.5	12	35
1.5 to 2	21	50
2 to 3	7	14
More than 3	9	12
TOTAL	56	122

Table 11. Current Ratio

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less Than .5	0	1
.5 to 1	19	48
1 to 1.5	22	45
1.5 to 2	12	24
2 to 3	2	3
More than 3	1	1
TOTAL	56	122

Table 12. Quick Ratio

look at the liquidity position of business enterprises. A majority of the small enterprises reported current ratios in the range of 1 to 2, and quick ratios in the range of .5 to 1. Both ratios indicate that from a liquidity point of view small firms are adequately cushioned. Medium enterprises also reported similar results but on the higher side, leading us to conclude that medium enterprises in Oman are in a more comfortable situation from a liquidity point of view.

Since the objective of this paper is to look at the data from the point of view of financing constraints and financing obstacles, the question to be asked is, 'does the data on current ratio and quick ratio give us any leads?'. A close look at the data reported in Tables 11 and 12, indicates that many small enterprises may be suffering from financing constraints problems as compared to medium enterprises, given that 27 out of 66 small enterprises are reporting a current ratio of less than 1.5, while only 19 of the 56 medium firms are reporting a current ratio of less than 1.5.

9. Working Capital and Financing Constraints

Tables 13 to 14 read together indicate the working capital constraints if any experienced by small and medium sector firms in the sample. Majority of the small firms in the sample reported inventory periods ranging from 100 to more than 200 days and accounts receivables period ranging from 60 to 200 days, while a majority of the medium enterprises reported similar results, except that medium enterprises are reporting longer accounts receivables periods compared to small firms. Further, accounts receivable period is on an average longer than the accounts payable period for both small and medium enterprise.

In the section where the framework for looking at the financing problems of SMEs was discussed, the authors said that, "The disaggregation of the working capital allows them to reason that increase in working capital requirements of a firm can lead to financing constraints if there is an increase in inventory investments and increase in accounts receivables".

Looking at the data, using the framework on working capital financing discussed earlier, does indicate that small and medium sector firms in Oman suffer from extremely long cash cycles which may be in the range of 200 days plus, which implies that a lot of working capital finance is required to run an SME in Oman, and the problem of constraints posed by the need for working capital finance may be more acute for medium enterprises.

This leads us to conclude, that the financing problems of SMEs in Oman can be mitigated by use of innovative banking and financial products which will help SMEs (and medium enterprises in particular) in tackling the funding needs of a working capital cycle.

10. Are SMEs Financially Constrained ?

Using the framework presented in Section 4 we look at the sampled data to check whether small and medium firms

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less Than 5 days	0	0
5 to 20 days	0	1
20 days to 30 days	2	5
30 to 60 days	5	9
60 to 100 days	9	21
100 to 150 days	13	27
150 to 200 days	18	39
More than 3	9	20
TOTAL	56	122

Table 13. Inventory Period (in days)

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less Than 5 days	1	3
5 to 20 days	2	5
20 days to 30 days	2	5
30 to 60 days	5	9
60 to 100 days	9	27
100 to 150 days	13	33
150 to 200 days	18	29
More than 3	6	11
TOTAL	56	122

Table 14. Accounts Receivables Period (in days)

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less Than 5 days	2	3
5 to 20 days	2	4
20 days to 30 days	4	9
30 to 60 days	9	17
60 to 100 days	8	29
100 to 150 days	8	22
150 to 200 days	15	23
More than 3	8	15
TOTAL	56	122

Table 15. Accounts Payable Period (in days)

in Oman are financially constrained? To quote from Section 4 "we can classify a firm as financially constrained if it has a positive real sales growth, a high debt ratio and a low cash to ratio".

Tables 16, 17and 18 report the debt ratio, cash ratio and sales growth of the sample 122 firms. These tables read together indicate that a typical small enterprise in Oman experienced a 30% plus year or year sales growth, exhibited a debt ratio of 35% and a cash ratio of 5%. Although sales growth is positive and cash ratio is low,

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
1 percent to 25 percent	13	40
26 percent to 50 percent	9	28
51 percent to 75 percent	9	21
76 percent to 100 percent	25	33
TOTAL	56	122

Table 16. Debt Ratio (Debt / Assets)

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less than 5%	18	55
5% to 10%	22	40
10% to 25%	12	18
25% to 50%	4	9
More than 50%	0	0
		0
TOTAL	56	122

Table 17. Cash Ratio (Cash to total Assets)

Table showing frequency distribution of firm years	SME (10-99 employees)	TOTAL
Less than 5%	8	13
5% to 10%	16	25
10% to 25%	19	35
25% to 50%	9	43
50% to 75%	4	5
75% to 100%	0	1
TOTAL	56	122

Table 18. Sales Growth

small firms in Oman have average debt ratios and therefore cannot be classified as being financially constrained. (Median adjusted debt ratio (using book values) is reported as 33% by Rajan & Zingales(1995) as quoted in Myers(2001).

Medium enterprises on the other hand experienced 25% sales growth (lower than small firms), had low cash ratios, but reported very high debt ratios in the range of 75% plus indicating that medium enterprises in Oman are financially constrained and could expand further but for lack of funding avenues.

Although the data does indicate that medium enterprises are financially constrained because they have already borrowed to the limit and cannot borrow any further, there is a problem in concluding that small enterprises in Oman are not financially constrained. While small firms are not financially constrained in the classic sense of the term, since they can borrow more given their low debt ratios, they may be facing obstacles in obtaining external financing such as bank loans, because of the very fact that they are small, less credit worthy (from a bankers point of view) and unable to provide enough security.

11. SMEs and Sources of Financing

Tables 19 to 22 report data on sources of financing for the sampled SMEs. The tables provide answers to the following questions: What percentage of assets are financed by the following sources of finance. Major sources of financing reported include short term bank borrowings, long term debt, supplier's credit and equity financing. Equity financing includes original capital plus retained earnings plus reserves if any. Internal funds generated by a firm through profit creation and ploughed back into the firm are reported as part of equity financing.

Important findings are:

- A large majority of the small enterprises reported that 51 to 100 % of their assets are financed by owners funds (internal financing).
- Majority of small enterprises source less than 25% of their funding requirements from short term bank borrowings, and long term borrowings.

• Supplier's credit (payables) is a very important source of funding for small enterprises in Oman, and could account for 50% to 75% of the funding required for financing the firm's assets.

• Comparatively medium enterprises are less dependent on equity (internal) finance, and manage to get funds from short term bank borrowings, supplier's credit and long term borrowings to fund their assets. These three external sources of financing together may account upto 75% of the fund required by a medium enterprise in Oman.

• Financing pattern of industrial firms seems to be somewhat similar to medium enterprises, with a majority of the funding coming from short term bank borrowings, supplier's credit and long term borrowings.

• Some industrial firms also reported a high dependence on internal equity financing, while some reported that their dependence on equity financing is nil.

• Their findings shows that 12 industrial firms reported that their dependence on equity financing is zero may be somewhat unbelievable. On examining the original financial information reported by them, it was noticed that these firms have been reporting losses and therefore the original capital has disappeared. One would expect that firms will close down unless there is a change in their fortunes and their existing assets are revalued.

• Internal equity financing and supplier's credit are extremely important sources of financing for service sector firms in Oman.

• Majority of the service firms reported that they source less than 25% of their funds from short term bank borrowings and long term borrowings.

	Zero percent	1% to 25%	26% to 50%	51% to 75%	75% to 100%
Short Term(Bank) Borrowings	18	60	12	3	0
Payables Supplier's Credit	0	78	21	0	6
Long Term Borrowings	12	45	30	6	6
Owners Funds/Equity (including Retained Earnings and Reserves)	12	12	24	24	30
Other Liabilities Non Current	24	81	0	0	0
Other Liabilities Current	18	45	0	0	0

Table 19. All Firms Summary Table : percentage of assets financed by the following sources of finance

	Zero percent	1% to 25%	26% to 50%	51% to 75%	75% to 100%
Short Term(Bank) Borrowings	18	42	6	3	0
Payables Supplier's Credit	0	48	18	0	6
Long Term Borrowings	12	30	21	6	6
Owners Funds/Equity (including Retained Earnings and Reserves)	12	6	24	12	18
Other Liabilities Non Current	24	48	0	0	0
Other Liabilities Current	18	30	0	0	0

Table 20. Industrial Sector Summary Table: percentage of assets financed by the following sources of finance

	Zero percent	1% to 25%	26% to 50%	51% to 75%	75% to 100%
Short Term(Bank) Borrowings	6	18	6	0	0
Payables Supplier's Credit	0	30	3	0	0
Long Term Borrowings	6	15	9	0	0
Owners Funds/Equity (including Retained Earnings and Reserves)	3	6	0	9	12
Other Liabilities Non Current	0	33	0	0	0
Other Liabilities Current	6	15	0	0	0

Table 21. Service Sector Summary Table. percentage of assets financed by the following sources of finance

	Zero percent	1% to 25%	26% to 50%	51% to 75%	75% to 100%
Short Term(Bank) Borrowings	4	34	11	4	2
Payables Supplier's Credit	0	37	15	4	0
Long Term Borrowings	6	24	17	6	2
Owners Funds/Equity (including Retained Earnings and Reserves)	6	19	9	9	13
Other Liabilities Non Current	15	37	0	0	0
Other Liabilities Current	11	26	0	0	0

Table 22. Medium Enterprises Summary Table: percentage of assets financed by the following sources of finance

12. Qualitative Data

Table 23 shows results of MENA (Middle East and North Africa) figures which were taken from the World Bank WBES study.

It shows % of firms rating obstacle / constraints as problematic (moderate obstacle or major obstacle).

13. Results Responses to Qualitative Questions

In this last section on data analysis, the results of qualitative questions posed in the World Bank WBES survey

	Middle East & North Africa Based on WBES #
How problematic is financing (obtaining enough funds) as an obstacle to doing business ?	62 %
Collateral requirements of banks and financial institutions	55 %
Paperwork	54 %
High interest rates	78 %
Need special connections with banks	39 %
Banks lack money to lend	37 %
Problems with bank officials	21 %
Lack of access to foreign banks	38 %
Lack of access to equity partners	39 %
Lack of access to export finance	38 %
Lack of access to lease finance	37 %
Inadequate credit information on customers	42 %
Lack of access to long term bank loans	58 %

Table 23. Results of MENA based on WBES

(World Bank, 2000) are reported. Important findings from the responses to the qualitative questions are as follows:

- 62% of small and medium enterprises say that financing is a problem.
- A large percentage of the small and medium enterprises reported many areas where they face major problems which include, lack of access to long term bank loans, high interest rates, collateral requirements, need for special connections with bank officials, and lack of access to export finance, lease finance and equity partners.

Based on the responses to the qualitative questions we conclude that obstacles which need to be looked at by the policy makers for development of SMEs in Oman are lowering interest rates, ensuring that banks give long term loans, reducing the need for collateral requirements and lastly making banks more accessible especially to small borrowers. There appears to be a need for better and easier communication between banks and small enterprises.

Conclusion

Small and medium enterprises play a very important role in a country like Oman in terms of their potential contribute to employment and growth. However, SMEs in Oman are in their nascent stage and need to be nurtured to contribute in a significant manner to the employment and growth of the country.

The basic objective of this paper is to look financing problems faced by small and medium enterprises, as this is seen to be the critical obstacle to growth of SMEs in countries like Oman.

The SME definition adopted is in line with the definition used by the Ministry of Commerce and Industry in Oman. Small enterprises are defined as those with 1 to 9 employees and medium enterprises are those with 10 to 99 employees.

The conclusions given by the Oman data are sightly different from the conclusions arrived at by other authors such as Keasey (1993). While the Oman data does lead us to the conclusion that medium enterprises are important in supporting economic growth and employment, the data also says that a higher GDP per capita and higher sales revenues per capita (which can imply higher income levels per person) can be achieved primarily by supporting larger enterprises rather than small and medium enterprises.

Important conclusions derived from the analysis are as follows:

- 62% of small and medium enterprises in the MENA region say that financing is a problem.
- SMEs reported many areas where they face major problems which include, lack of access to long term bank loans, high interest rates, collateral requirements, need for special connections with bank officials, and lack of access to export finance, lease finance and equity partners.
- Majority of the small enterprises reported that a large part of their assets are financed by owners funds (internal financing), while less than 25% of their funding requirements are met my short term bank borrowings, and long term borrowings. Supplier's credit (payables) is a very important source of funding for small enterprises in Oman. The results clearly force us to conclude that small enterprises are not getting enough funding from banks and financial institutions.
- Comparatively medium enterprises are less dependent on equity (internal) finance, and manage to get funds

from short term bank borrowings, supplier's credit and long term borrowings to fund their assets.

- Internal equity financing and supplier's credit are extremely important sources of financing for service sector firms in Oman.
- Majority of the service firms reported that they source less than 25% of their funds from short term bank borrowings and long term borrowings.

We conclude that obstacles which need to be looked at by the policy makers for development of SMEs in Oman are lowering interest rates, ensuring that banks and financial institutions give long term loans, reducing the need for collateral requirements and lastly making banks more accessible especially to small borrowers. There appears to be a need for better and easier communication between banks and small enterprises.

Also there is urgent need for innovative financial products and institutional reform (including procedural reform) to overcome obstacles to financing SMEs in Oman.

However we conclude with a very troubling question which emerged in process of data analysis. The question is - "Does Oman really need small enterprises ?".

The data on small and medium enterprises forces us to conclude that SMEs in Oman have failed in many ways. Their employment capacity seems to be lower than large enterprises. The 700 odd SMEs in the country together employed less number of people than the 86 large enterprises. Further the ability of SMEs to add to the gross value added is much lower than large enterprises. Sample data related to sales and assets read together implies that a typical SME employee (whether working in small or a medium enterprise) contributes about 20,000 rials per year to sales, but in a small enterprise the investment (assets) required is half the investment required to achieve the same level of sales in medium enterprise. Clearly, the sample data does indicate that if the economy has a shortage of investment capital it should encourage small enterprises given capital constraints, but the moot question is: Is there a shortage of investment capital in Oman. Oman, is an oil – rich economy with large oil surpluses with the government. It would be difficult to conclude that there is a shortage of investment capital in Oman. If this line of argument is true then we may be forced to conclude that the policy makers in Oman may be better of encouraging large and medium enterprises rather than small enterprises.

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