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Fostering Entrepreneurship and SMEs to Support Economic Diversification in Oman

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Fostering Entrepreneurship and SMEs to Support Economic Diversification in Oman

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ABSTRACT:
The transition to a vibrant economy under Oman Vision 2040 and the urgency to develop a more dynamic private sector that can absorb the entry of a young and educated labor force both stress the need to empower SMEs, which play a large role in supporting job creation and nonhydrocarbon activity in Oman. This note takes stock of the role of small and medium-sized enterprises (SMEs) in Oman, identifies past and current bottlenecks that hinder entrepreneurial dynamism, and documents recent reforms aimed at lowering the costs associated with doing business, facilitating access to finance, and enhancing the integration of SMEs into value chains. The analysis suggests that policies complementing existing initiatives, through a private sector driven credit guarantee scheme, by adapting insolvency frameworks tailored to SMEs, and supporting linkages between SMEs and multinational enterprises in Special Economic Zones (SEZs), could help maximize long-term gains to SMEs and the broader economy.

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SELECTED ISSUES PAPERS

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Oman

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A. Context

1. SMEs are expected to play a key role in supporting long-term growth and job creation in Oman.[1] Oman aims to diversify its economy away from hydrocarbon production towards a private sector and knowledge driven economy that is competitive internationally, as stated in its national strategic plan, Oman Vision 2040. Concurrently, the economy will need to create around 30 thousand new jobs annually between 2024 and 2032 to absorb the entry of a young and increasingly educated labor force, which cannot longer rely on public sector jobs amid efforts to entrench fiscal sustainability (IMF, 2024a). As such, SMEs, which represented around 98 percent of firms, contributed to about 33 percent of nonhydrocarbon GDP, and employed 76 percent of the private sector workforce in 2023, are poised to play a larger role in Oman's diversification.[2]

2. Oman has experienced a decline in firm entry throughout the last decade. The startup rate, measured by the share of newly registered limited liability companies, has been on a downward trend in Oman during 2006-2020, falling from 14.5 percent in 2006 to 6.5 percent in 2020. A similar trend can be observed among all newly registered establishments through 2021, including when grouped by size as identified by initial capitalization levels (Figure 1).

3. SME activity rebounded in the post-COVID 19 period. The SME share of the private sector workforce increased from 68 percent in 2020 to 76 percent in 2023, mainly reflecting the expansion of small firms. Similarly, the SME contribution to nonhydrocarbon GDP slightly increased following the pandemic to almost 33 percent (Table 1), but it remains well below that of other peers (for example, UAE's level at 64 percent in 2022).[3]

Figure 1. Startup Rates Across GCC Countries

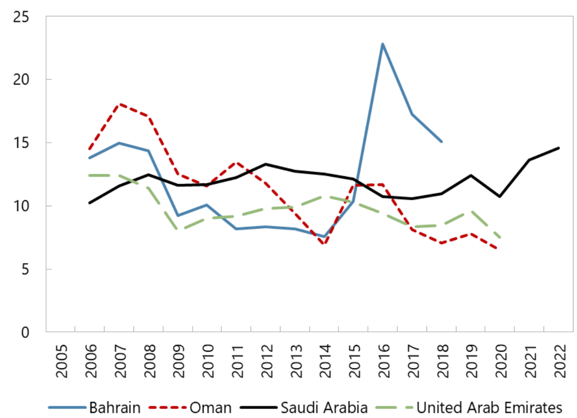
(Newly registered firms/establishments in percent of total firms/establishments)

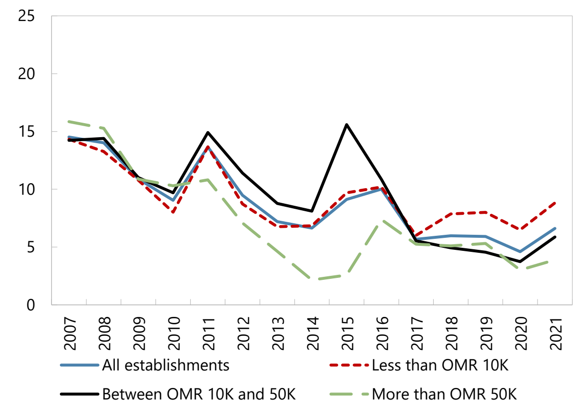
(a) Limited Liability Companies **(b) Establishments in Oman by Initial Capital**

[1] In Oman, SMEs (micro, small and medium enterprises) are defined as firms with less than 151 employees or OMR 5 million in revenues.

[2] Most of these firms operate in the wholesale and retail trade, construction, and manufacturing sectors.

[3] See [Small and Medium Enterprises | The Official Portal of the UAE Government.]





Sources: World Bank, Global Entrepreneurship Database, NCSI, and IMF staff calculations.

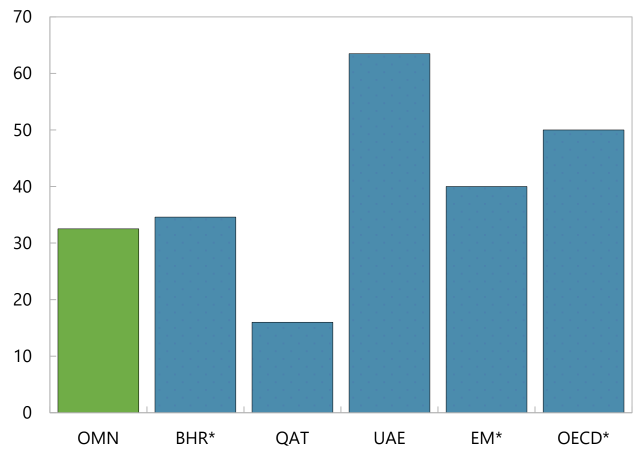
Table 1. SMEs Contribution in Oman

	2020	2023
SME (% nonhydrocarbon GDP)	31.3	32.5
SME Employment Share	68.4	75.7
o/w micro	35.1	35.9
o/w small	23.8	31.3
o/w medium	9.5	8.5
SME Rate	99.6	99.7
o/w micro	88.2	85.6
o/w small	10.4	13.3
o/w medium	1.0	0.8

Source: NCSI and IMF staff calculations.

Note: Employees and firms in public administration are excluded from calculations.

Figure 2. SMEs Contribution to GDP Across Countries
(Percent of nonhydrocarbon GDP, unless otherwise stated*)



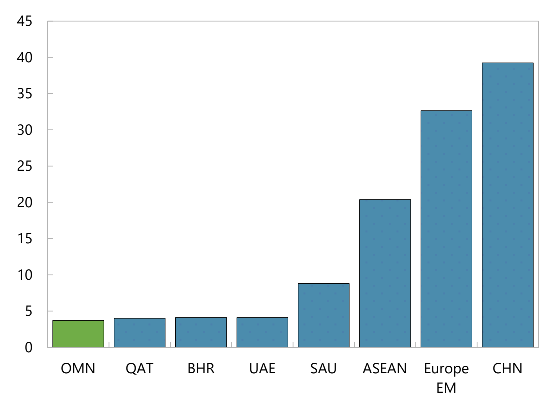
Source: NCSI; Ministry of Finance and National Economy (BHR); Qatar Chamber of Commerce; Ministry of Economy (UAE); World Bank; OECD and IMF staff calculations.
Note: *are in percent of total GDP.

B. Obstacles to SME Development

4. SME growth and entrepreneurship have been hindered by several obstacles in Oman. In particular:

- **Limited access to credit.** As in many other emerging markets and developing countries (EMDEs), entrepreneurs planning new business ventures and SMEs' expansion projects have faced constraints in access to finance through commercial banks, owing to higher risk (as non-performing loans are estimated at almost one third of total loans to the sector), imperfect information about business prospects, and lack of collateral. While the Central Bank of Oman (CBO) has long recommended a floor of 5 percent of commercial banks' loan portfolio to be allocated to SMEs, this has only reached 3.7 percent in 2022 (Figure 3), highlighting the need for additional initiatives that can help crowd in commercial banks.

Figure 3. Credit to SMEs
(Percent of total commercial bank loans)



Source: CBO; IMF Financial Access Survey; Qatar SME lending report; Saudi SME Bank; and IMF staff calculations.

- **Risk-taking is insufficiently encouraged.** On one side, insolvency legislation in Oman does not provide for a path towards financial rehabilitation to struggling entrepreneurs wishing to return to business activity and it was until recently, difficult for distressed business owners to restructure company debt while continuing their operations. On the other side, existing legal forms of incorporation used to impose a high capital threshold to register as a limited liability company, and thus disincentivized self-employed individuals and small business owners to separate their personal assets from their businesses. These bottlenecks highlight the importance of reducing administrative and legal costs to support SMEs and young entrepreneurs. As in other GCC countries, relatively high salaries and job security offered by the public sector have also acted as an additional deterrent to risk-taking and calls for encouraging a more entrepreneurial mindset among young Omanis.

C. Recent Policy Actions

5. **The Omani authorities started enacting key reforms in recent years to tackle several of the shortcomings previously identified.** A Bankruptcy Law was introduced in 2019 to allow distressed companies to continue operating under certain conditions. In the same year, a new Commercial Companies Law was also introduced (replacing the old 1974 Companies Law) to facilitate the incorporation of One-Person Limited Liability Companies and a Credit Bureau (Mala'a) was established to enhance credit decisions by alleviating asymmetric information constraints. The Invest Easy One-Stop Shop was launched in 2021 to facilitate doing business in the country. Home businesses and freelancers are also now able to benefit from a commercial registration number.

6. **The SME Development Authority (Riyada) has launched a wide-ranging array of initiatives to ease SMEs' access to finance, in partnership with Oman Development Bank (ODB).** Riyada's funding is provided for a variety of purposes, including: (i) working capital and fixed assets acquisition; (ii) supporting businesses in increasing their in-country value (ICV); and (iii) accompanying firms in business incubators. More than 400 projects have been financed since 2022, for a total of OMR 38 million. Riyada has also launched this year a grants system to support innovative and high-tech SMEs and provided support to 67 projects so far; and is currently working on enabling Family Offices to support SMEs as Angel Investors. ODB also offers loan facilities to support micro projects (up to OMR 20 thousand) and SMEs (up to OMR 250 thousand). Trade credit insurance for SMEs doing business domestically and abroad is also available through Credit Oman, a government-owned entity. In addition, the recently launched OIA's Future Fund Oman, an OMR 2 billion growth fund focused on investing in nonhydrocarbon private sector industries, targets 10 percent of its investments in SMEs—reaching OMR 60 million as of September 2024.

7. **Several private sector initiatives to expand access to finance continue to play a pivotal role and are expected to grow further in the future.** Bank Muscat, with IFC support, was a pioneer in Oman in providing collateral-free lending to SMEs through its "al Wathbah" program over a decade ago, alleviating one of the biggest hurdles facing entrepreneurs. The SME Development Fund, an entity owned by both public and private stakeholders and established in 2014, provides subsidized credit for asset acquisition or project financing (up to OMR 500 thousand). SMEs have also been able to access crowdfunding since 2021, with 9 platforms registered so far. Going forward, capital markets and private equity are expected to play a key role in the SME financing landscape, through the establishment of a parallel stock market for emerging businesses, including SMEs, and an investment company focused on providing financing to SMEs in industries targeted by Oman Vision 2040.

8. Better integration of SMEs into the business landscape is ongoing. SMEs are exempt from registration fees on Esnad—the electronic platform for government tenders—and benefit from a preference for government procurement contracts within a 10-percent price differential. The Public Authority for Special Economic Zones and Free Zones (OPAZ) has several programs in place to better integrate SMEs into value chains of Special Economic Zones (SEZs), targeting 10 percent of contract values to be allocated to SMEs. OPAZ has also dropped markedly registration and service fees for SMEs within SEZs.[4] In cooperation with OPAZ, Riyada has established SME incubators to take advantage of knowledge diffusion through FDI and has increased access to finance to SMEs operating in SEZs through the Tawasul Fund, in partnership with ODB.

D. Policy Priorities: Building on the Reform Momentum

9. Ongoing reforms are steps in the right direction, but more remains to be done. Encouraging risk-taking by reducing the costs associated with business failure and enhancing access to finance will foster entrepreneurship, while supporting linkages with leading foreign firms will help SME grow.

Encouraging Risk-Taking

10. Modernizing insolvency frameworks would help foster innovation and encourage entrepreneurship.

- **Tailoring insolvency procedures to SMEs.** The newly introduced restructuring procedure in Oman does not cover businesses in operation for less than two years and post-bankruptcy rehabilitation lacks debt forgiveness. Entrepreneurs would thus benefit from additional amendments to bankruptcy legislation, similar to those adopted in Bahrain, by (i) considering a streamlined and less costly procedure for SMEs, and (ii) offering a path of financial rehabilitation to business owners by allowing non-consensual debt relief (Box 1). Insolvency procedures for SMEs should also allow entrepreneurs to remain in control of the business, given their importance in business operation compared to larger firms (World Bank, 2022). These actions could help entrepreneurs venture into riskier activities that ultimately stimulate innovation and productivity growth, while preserving creditors' rights. Evidence suggests that reforms aimed at streamlining the reorganization process are associated with stronger firm recovery (Gine and Love, 2010).

- **Adopting an Early Warning Tool.** To complement insolvency legislation reforms, an Early Warning Tool aimed at identifying debtors' emerging difficulties to support early interventions to avoid insolvency could also be considered, drawing from the experience of Denmark and France (World Bank, 2022).

Enhancing Access to Finance by Mobilizing the Private Sector

11. Initiatives to support access to finance would gain from being more market driven. Oman has undertaken considerable efforts to support access to finance, but many remain concentrated in public financial

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[4] Registration fees for SMEs within SEZs dropped from OMR 1 thousand to between OMR 30 and 40, while OPAZ service fees were reduced by 50 percent (see Public Authority for Special Economic Zones and Free Zones).

institutions, which may possess neither the expertise in screening and monitoring businesses nor the same proximity to enterprises as private banks.

12. To strengthen incentives for commercial banks to expand credit to SMEs, a well-designed credit guarantee schemes (CGS) could be implemented to alleviate collateral constraints.[5] CGS present several attractive features. One key advantage is that they enable to push the risk frontier more effectively than commercial banks, because they allow governments to spread risks that insufficiently developed financial markets cannot bear, while leveraging the private lenders' superior ability to screen and monitor entrepreneurs (Anginer et al., 2014). Empirical evidence is consistent with the effectiveness of CGS in supporting SMEs' access to finance (Zecchini and Ventura, 2009).[6]

13. Credit guarantees can differ depending on public policy objectives as well as the firms and sectors targeted. Important considerations in the design of CGS include the coverage ratio and the CGS ownership structure:[7]

- **Guarantee coverage**. Partial guarantees (less than 100 percent) are important to mitigate moral hazard and incentivize adequate monitoring from commercial banks. However, partial guarantees may not help reach all business segments. In nascent industries and sectors considered as priority by Omani policymakers, a full coverage may need to be assessed. For instance, in Korea, the Technology Guarantee Fund was created to facilitate financing for new-technology firms, which may cover up to 100 percent of the loan, while also assisting with business prospects evaluation and technology appraisal (OECD, 2013). This reveals that while standard CGS can reach most SMEs, in some cases moral hazard and financial sustainability considerations are outweighed by the need to support innovative entrepreneurs. Similarly, in the US, the coverage ratio of credit guarantees under the "7a" loan program is higher for smaller loans, hinting at the need to reach the smallest firms that could face more acute financial constraints.[8]

- **Ownership structure**. Private sector involvement tends to be associated with better financial performance (Beck et al., 2010).[9] Full private ownership through mutual guarantee schemes (MGS) could also be considered. A notable example is the *Confidi* system in Italy, formed by over 200 local mutual guarantee schemes that vary in their sectoral and geographical coverage and are owned by local enterprises. They have an information advantage about business prospects and can induce peer pressure and are more involved in credit assessment than public CGS (OECD, 2013). The organization of MGS could be considered in industries where there is a sufficiently developed ecosystem of local enterprises that can assess small enterprise business prospects.

[5] Survey evidence of CGS across European countries (Chatzouz et al., 2017, ECBI, 2014) show that the primary failure they address is the lack of collateral for SMEs and young businesses (rather than information frictions), by providing mostly guarantees for investment or working capital loans.

[6] Firms in Italy which benefitted from CGS exhibited higher leverage and lower borrowing costs than otherwise similar firms. Survey findings from Western Europe indicate that banks also report that the main value-added of CGS is that they lower borrowing costs and enable to reach SMEs with riskier projects or lower collateral requirements (Chatzouz et al., 2017).

[7] See World Bank (2015).

[8] See Types of 7(a) loans | U.S. Small Business Administration, where the coverage ratio is 85 percent for loans under $500 thousand and 75 percent otherwise. In addition, collateral is not required for loans under $50 thousand.

[9] Similarly, Chatzouz et al. (2017) indicate that while most CGS in Western Europe are publicly owned, many do not operate for profit.

14. Mala'a's continued reforms to become a full-fledged credit bureau would maximize the gains of insolvency and financial access reforms. Information collected by the credit bureau should be fully utilized for the appraisal of creditworthiness of loan guarantees. Leveraging information on personal credit history would also complement personal insolvency legislation as it could help secure creditors' rights, while encouraging risk taking.

15. Scaling up FinTech could support small business lending. Ongoing efforts under the CBO's FinTech Accelerator Program to establish an ecosystem of Fintech startups—currently supporting two startups focused on microfinance and loan-based crowdfunding—should continue to enhance SMEs' financial inclusion. FinTech loans can have a catalytic effect on firms' future access to finance as they tend to be junior unsecured loans. Beaumont et al. (2024) show that in France, access to FinTech loans was used to acquire new assets that could then be pledged as collateral for bank credit. They reported a subsequent significant increase in bank credit. FinTech loans were also used to substitute for expensive short-term financing.

Helping SMEs and Entrepreneurs Grow

16. Efforts to strengthen the integration of SMEs into SEZs value chains should be accelerated. The diversity of industries across SEZs presents a unique opportunity for SME growth. Current pilot initiatives to facilitate the integration of SMEs in SEZs should be further expanded. Efforts should particularly focus on connecting large multinational enterprises operating in SEZs with SMEs, by identifying the needs of the former and helping the latter acquire the knowledge and skills to supply large foreign firms. Local SMEs in Oman would benefit from policies that enhance spillovers from multinational enterprises (MNEs) by strengthening linkages between them and by increasing local SME capacity (OECD, 2023). These policies could include:

- Support in technology acquisition, digitalization (IMF, 2024b), and R&D across SMEs, for instance, through grants and business incubators. Efforts to increase productivity among domestic SMEs could later be complemented by support in reaching export markets, including through financial assistance, marketing local companies abroad, and helping entrepreneurs connect with foreign enterprises and investors.[10]

- Increasing the skillset of labor in SMEs, and encouraging labor mobility of expatriates (IMF, 2024a). This could involve wage subsidies or time-bound cash grants for SMEs to hire skilled foreign workers or with specific skillsets and backgrounds, as well as incentives to encourage high-skilled expatriates working in Oman create SMEs within SEZs. For Omanis, collaboration between universities and SEZs could be enhanced, by collaborating with MNEs in SEZs to identify future workforce needs and adapt program courses to businesses requirements and by incentivizing internships of students in local SMEs and foreign MNEs to build human capital.[11]

[10] In Czechia, Czech Match helped SMEs connect with foreign partners through advisory services and a one-week acceleration program abroad, while the Czech Accelerator program supported domestic SMEs by providing space in foreign incubators. In the Slovak Republic, the Investment and Trade Development Agency designed an "Online B2B matchmaking" tool to help firms find customers abroad (OECD, 2024).

[11] In Portugal, the *Inov Contacto* program managed by AICEP (Trade and Investment Agency) supports high-skilled graduates in conducting a short-term internship in a local firm followed by a longer-term internship in a multinational company abroad, together with a training course on international management (OECD, 2022).

- Identifying collaboration opportunities between local SMEs and large MNEs and helping the former acquire the knowledge and skills to meet production requirements for foreign companies. The Invest Oman initiative could be leveraged to promote domestic SMEs, connect them with foreign MNEs, assess their needs and support upskilling of local firms to meet them, as implemented in other country cases, such as by the Investment Development Agency in Portugal (OECD, 2022).[12]

Box 1. Corporate Bankruptcy Reform in Oman

Oman's new Bankruptcy Law became effective in 2020 (Royal Decree 53/2019) and offers the possibility for distressed business owners to restructure their debt while continuing operations. The restructuring process is expected to occur with minimum court supervision, facilitated by the Ministry of Commerce's role as a mediator, and does not require a high threshold of creditors to agree. However, some caveats exist:

- The company needs to be in operation for at least two years, potentially discouraging new entrepreneurs to start riskier projects.

- Even if a majority of creditors agree to restructure the company debt, the agreement does not bind non-participating parties to the agreement.

The two other alternatives present in the law are (i) bankruptcy, and (ii) preventative composition. Bankruptcy in Oman, as in several other countries in the region, does not imply debt forgiveness. Preventative composition, unlike restructuring, happens under court supervision and requires a majority of creditors holding two thirds of claims to consent to a settlement, and is binding to all creditors. However, like bankruptcy, it does not lead to non-consensual debt discharge.

The law, in addition to the new, out-of-court restructuring procedure discussed above, no longer imposes civil disabilities to bankrupt owners of liquidated companies. However, creditors remain entitled to enforce their claims following the post-bankruptcy period (3 years), and the law does not feature a simpler procedure for small businesses that address characteristics specific to SMEs such as greater creditor disengagement and lower business sophistication. Simpler procedures would be particularly beneficial to SMEs given that they tend to be more vulnerable than larger businesses to economic downturns and less willing to attempt insolvency procedures due to high costs and documentation requirements, preventing a reallocation of resources following liquidation. Oman could draw from Bahrain's example:

In 2018, Bahrain became the first country in the region to allow individual entrepreneurs to be discharged of their debt following bankruptcy, under certain conditions. In addition, the country has enacted provisions that directly benefit small businesses below an asset threshold of BHD 10 thousand. Specifically, the bankruptcy procedure no longer requires a trustee or a creditor committee. It allows reorganization plans to be adopted by a simple majority and empowers the court to impose a plan that pursues the best use for the debtor's assets, while shortening timelines for dispute resolution. Financial support is also provided to small business debtors to cover their bankruptcy proceedings expenses.

[12] The "Suppliers Clubs" initiative of AICEP helped match foreign and domestic firms to collaborate on joint projects, and provided financial support to help local SMEs meet foreign firms' requirements.

Box 1. Corporate Bankruptcy Reform in Oman (concluded)

Oman would benefit from introducing a bankruptcy reform that provides a streamlined procedure for SMEs in line with international standards (United Nations, 2024), including with lower documentation requirements, supervision by insolvency specialists, simplified procedures for business liquidation and reorganization, simpler plan approval mechanisms, minimal use of courts and financial support to small businesses to start the bankruptcy procedure (World Bank, 2022).

Sources: Curtis, Mallet-Prevost, Colt & Mosle LLP; Kilborn, 2020; United Nations, 2024; World Bank, 2022.

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