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ABU DHABI CHAMBER

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## Small and Medium-sized Enterprises in Abu Dhabi

October 2019

In association with  IHS Markit™



# Dear reader



Of the many topics covered by the Abu Dhabi Chamber in this report series, perhaps none is as important and far-reaching for Abu Dhabi's economic development as the performance of the country's sector of small and medium-sized enterprises (SMEs).

So why are SMEs so important for Abu Dhabi? The Emirate strives to transform itself from an oil-dependent economy to a modern, knowledge-based market economy. The modern market economy, however, critically rests on SMEs. More than 99% of all companies in the typical market economy are SME.

Abu Dhabi's SME sector is about the same size—98%, if micro enterprises are counted in the SME basket. Although SMEs generate less economic activity in Abu Dhabi. The sector accounted for 29% of GDP, or 44%

of the nonoil economy (counting in micro enterprises again). As a comparison, the SMEs in the US economy account for close to 50%.

The government of Abu Dhabi has prioritized the development of the SME sector, thanks to the Ghadan 21 program and the related Hub 71 initiative. These will help mitigate lack of SME financing, an issue which frequently comes up in company surveys.

This report takes stock of the development of the SME sector to date and provides key data that help to assess the recent moves by the government to support SMEs in Abu Dhabi. Practical examples of how SMEs operate are given. The report also recommends steps to help further shape the Abu Dhabi Chamber's policy advice and workshop offerings.

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8:00 AM - 3:00 PM (Sun - Thu)

Printed in the United Arab Emirates

Cover images: Shutterstock/IHS Markit

## Small is beautiful

The SME sector has become a focus in Abu Dhabi in recent years. More and more, smaller and mid-sized companies are a central key for Abu Dhabi's transformation away from oil and the development of a vibrant private sector.

What exactly is a small and medium-sized enterprise (SME)? Definitions differ between countries and may change even within a country. Let us first clarify the definition of a SME.

The United Arab Emirates (UAE) government has issued a definition for SMEs with the two relevant criteria being annual turnover and the number of jobs.

In addition, SMEs are classified depending on the sector they are operating in—trading, manufacturing, and services. Different thresholds apply for a company to classify it as a SME. Manufacturing enterprises tend to be larger in terms of annual revenue and the number of jobs compared with the average trade or services enterprise (see chart 1).

Based on that definition, a small enterprise in trading has a turnover of less than AED50 million and employs between 6 to 50 people. A small enterprise in manufacturing has the same turnover threshold but a higher number of jobs—10 to 100—while a small services enterprise again has the lowest headcount—6 to 50 employees—and a lower turnover threshold of AED20 million.

The medium-size sector in manufacturing has up to 250 jobs and has a turnover of up to AED250 million. A medium-sized trading enterprise has the same threshold levels,

while in services a medium-sized enterprise employs between 51 to 200 people and generates turnover of up to AED200 million.

Micro enterprises, the smallest category, capture all companies that have fewer employees than small enterprises or where the company owner is his own single employee.

These classes matter because policymakers and regulators build their decisions and funding on those classes. Companies vying for SME support need to comply with one of those categories. These asset classes also represent how relevant SMEs are for the economy at large, especially when it comes to grabbing the headlines and the attention of a government body.

## Defining small and medium-sized enterprises

The desire to enhance the relevance of the SME sector was likely a motive for the decision to ditch the rather narrow definition of SMEs that the Abu Dhabi Statistical Centre used until a few years ago. The center has adopted a broader concept which, in a similar way, is used by other governments and organizations, including the Organisation for Economic Co-operation and Development (OECD) and the European Union. The numbers quoted in this report follow that broader concept.

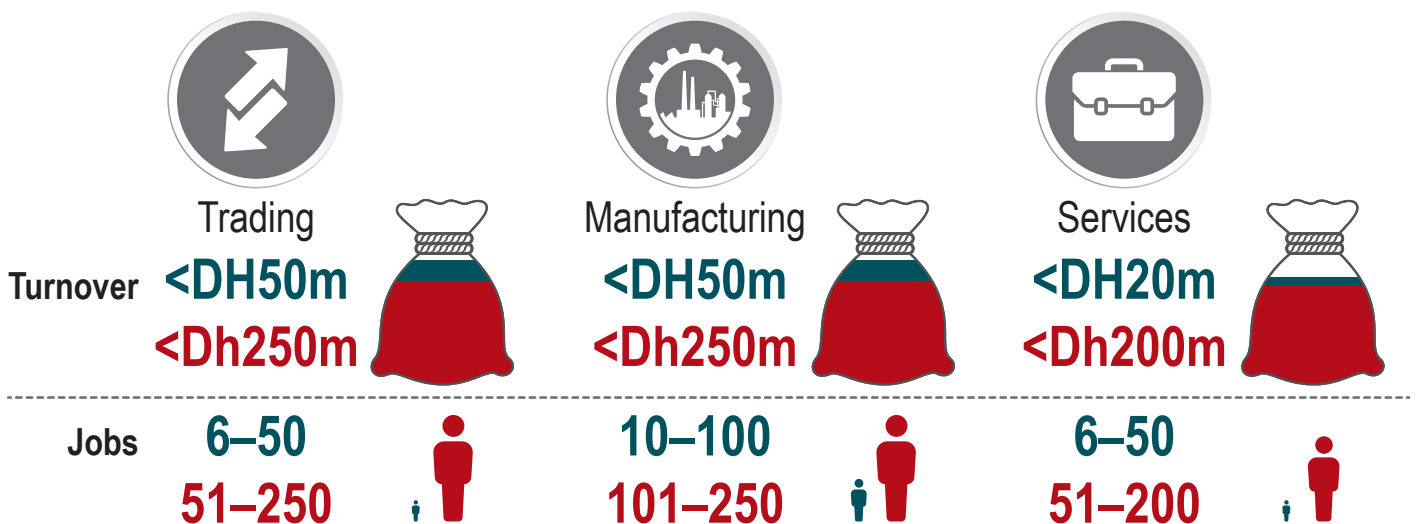
Abu Dhabi and the UAE have ambitious goals for the development of the SME sector. The UAE Competitiveness and Statistics Authority estimated the size of the SME sector at 53% of the UAE economy in 2019—



**6–250**  
jobs classify a SME  
in manufacturing  
and trading

Chart 1: Definition of a small and medium-sized enterprise (SME)

● Small ● Medium

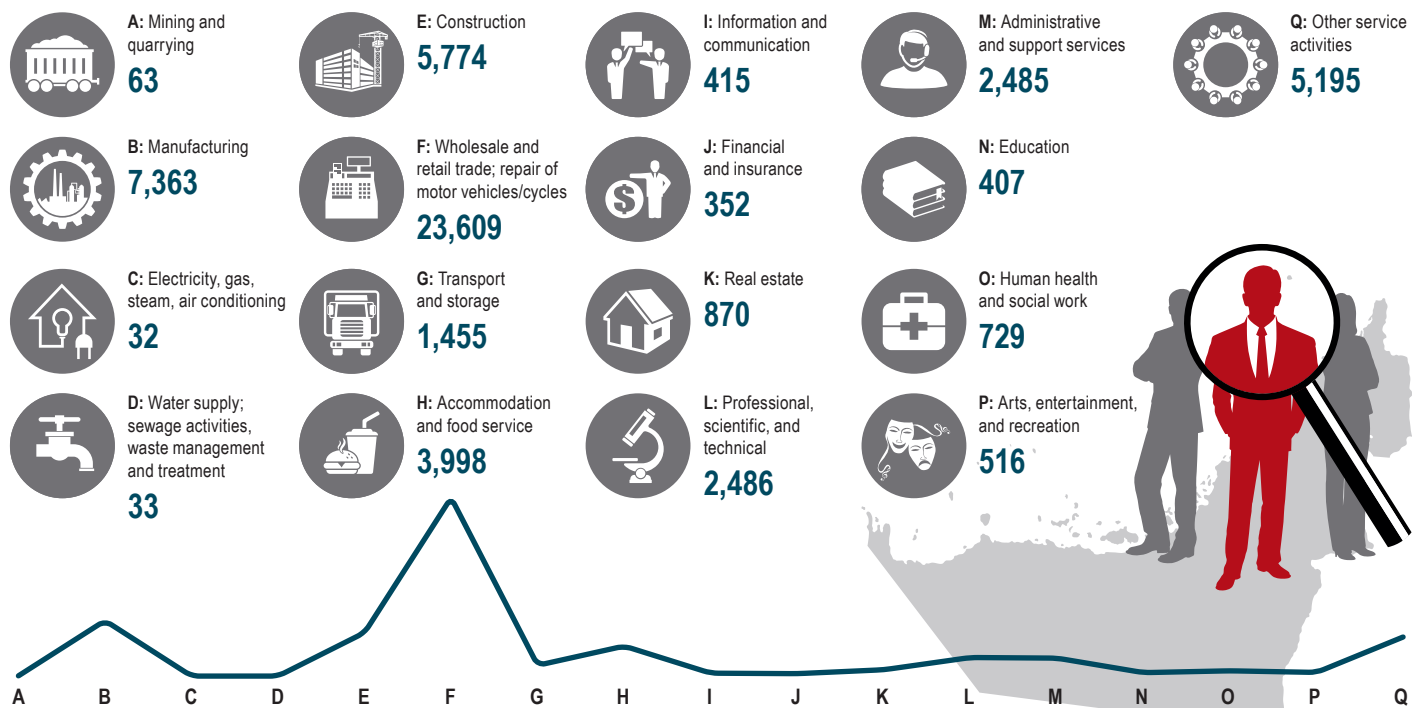




## Sectoral Report

Small and Medium-sized Enterprises in Abu Dhabi


**Chart 2: Activities of SME by sector in Abu Dhabi, 2017\***



\*Number of establishments.

Source: SCAD

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**29%**  
SME share of  
the Abu Dhabi  
economy (44%  
in the nonoil  
economy) in 2017

up from 49% in 2018. The federal government wants to lift that share to 60% in 2021 (see chart 2).

This target seems reasonable for the UAE. The 60% goal for the SME share in 2021 may be regarded as ambitious but achievable. To reach that goal, policies need to be geared toward enabling a vibrant business sector that is open to success as much as failure. Entrepreneurs need to be able to take risks and build on the lessons learned.

The contribution of the SME sector to the Abu Dhabi economy is more modest owing to the higher share of the oil sector in the economy. SMEs accounted for 29% of total gross value added in 2017 in Abu Dhabi. Stripping out the oil sector lifts that share to 44%.

It is safe to assume that this share grew further in 2018 and 2019. A backward comparison prior to 2017 is not possible since the SME definition changed with the publication of the 2017 numbers (see chart 3).

Employment in SMEs has been higher in the overall economy compared with the SME contribution in terms of GDP. Of all employees in the Abu Dhabi economy, 43% received their main salary from a company categorized as a SME in 2017, which compares with the 29% share for total gross value added. SMEs tend to dominate

in sectors such as retail, which have lower production (or turnover) per job and a lower productivity. This also explains why SMEs tend to have a higher share of employment relative to production.

### In which sectors were SMEs most successful in Abu Dhabi?

To determine success of SMEs by sector, several categories come to mind, including the number of employees, the contribution to production by sector, or the productivity by sector for SMEs.

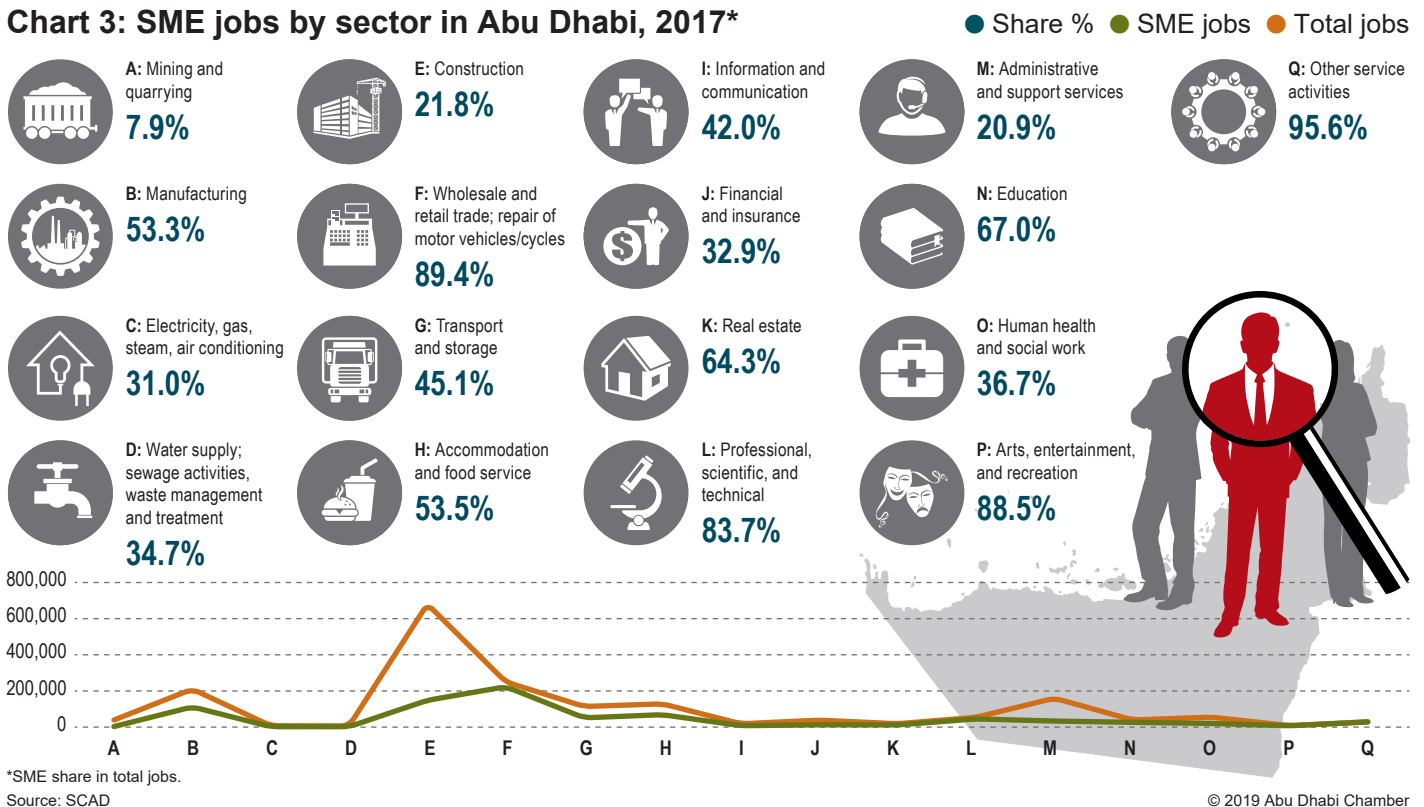
Retail trading is the sector where SMEs clearly dominate—this is the case everywhere in the world, and Abu Dhabi is no exception. More than one-quarter of all jobs offered by SMEs were found in that sector—223,000. This number is equivalent to nearly 90% of all jobs in retail trade (see chart 4).

Yet productivity was low. SMEs managed to reach just 40% of the labor productivity of large companies operating in the retail sector. Thanks to employment, SME retail nevertheless contributed almost 80% of output.

The second-most important sector from a job perspective is construction, which is the largest sector for the entire economy in terms of employment. Nearly 150,000 jobs



**Chart 3: SME jobs by sector in Abu Dhabi, 2017\***



are employed through SMEs. However, that is slightly more than one-fifth of total construction employment.

SMEs and large companies are roughly equal in terms of productivity for construction. The contribution to sector output between SMEs and large companies is thus at about the same level as the employment share suggests.

Two other service-oriented sectors are strong with SME participation. These are "Professional, Scientific and Technical services," law firms and consultancies fall in this category, and the large sector of real estate. Both had contribution rates from SMEs that neared 85% and 70%, respectively, and their productivity even exceeded those of large companies by around 15%.

Large companies clearly lead SMEs in the sector of hotels and restaurants, where the latter reached but three-quarters of the productivity of the former. Jobs are divided roughly in half between the two, as is the contribution to the sector's output.

The last sector and probably least successful for SMEs, at least in the small selection of sectors reviewed here, was manufacturing. Despite having the third-highest job count of all sectors for SMEs, they contributed less than one-fifth of the sectoral output, mostly because productivity

with SMEs reached but one-quarter of their larger rivals.

### Rivalry and cooperation

A vibrant SME sector is a good indicator for a healthy and fast-growing economy. SMEs can thrive, sometimes spectacularly, but far more often they are likely to prosper or fail and will vanish once their purpose is no longer relevant.

However, a vibrant sector ensures high founding rates. Between the time of founding and the demise, plenty of jobs can be generated by SMEs. Occasionally, one of the SMEs takes aim at the big prize and morphs from obscurity to a well-known brand, multiplying the job-creating potential.

It is important to understand the nature of SMEs, their business and the challenges the executives are confronted with in everyday business life. Often, businesses are not competing with larger-scale rivals, but are collaborating with them. In fact, there are many examples of how smaller scale companies can help larger-scale companies achieve important cost savings and revenues that otherwise would not be possible.

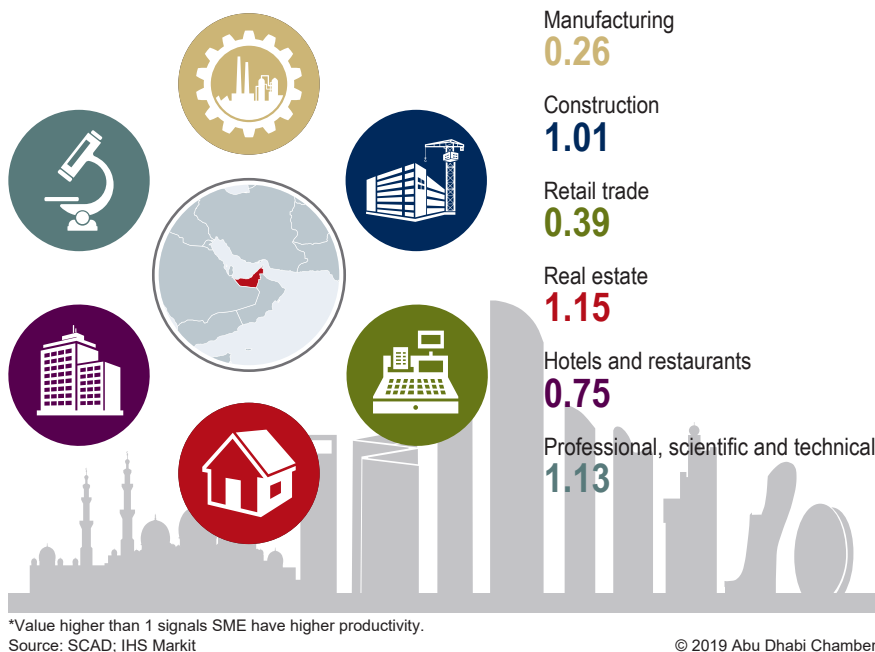
While there is a case for supporting smart new firms operating at the technology frontier, there are many others that dwell on established technologies and deliver more



**223,000**  
Jobs offered in  
retail trading by  
SMEs



**Chart 4: Productivity of SME relative to large companies\***



1/4

**SME productivity  
in manufacturing  
relative to large  
firms**

traditional services. It is important to provide fertile ground for the new technologies of tomorrow. However, the more traditional ones should be taken care of too, for they are required to enable a truly vibrant SME sector and a functioning, broad-based economy.

To illustrate that point, let us focus on how relations between companies are typically organized, especially in a business-to-business context:

- Vertically: through customer relationships in the supply chain
- Industry clustering: this concept stretches beyond vertically oriented supply chain relationships and includes the agglomeration of companies with similar businesses, processes, or products within a narrowly defined geographic area; in the new virtual business world, this narrowly defined geographic area can be replaced by a narrowly defined scope in virtual space

The vertical dimension of the supply chain is what most people associate with the concept of value-creation or value-adding. A basic commodity changes form as it climbs the value chain, being traded until it reaches the final customer.

### The benefits of clustering

Industry clustering, in contrast, is not exactly vertical. A geographical cluster forms wherever companies can exploit synergies through collaboration. One example is using the waste product of a production process as

an input for another different process.

The chemical and pharmaceutical sector provides a good example of the impact of clustering, especially for the transformation of the waste production process into the input of another process. Abu Dhabi already experiences such clusters where companies with a similar and a different sectoral background co-locate, e.g. the Ruwais chemical facility.

The benefits of co-location occur for several reasons, and they are important for SMEs.

First, clustering increases the productivity of firms by providing them access to shared business best practices; specialized labor and service providers; experienced management talent; and resources for training, product testing, marketing, and improving the local business environment.

Second, as cluster participants and their customers interact formally and informally, they share knowledge that drives the direction and pace of innovation for their respective firms.

Third, as people leave established companies to start new firms, clustering encourages entrepreneurship and increases the frequency of new business formation within the region.

Supporting the smaller companies not only helps them, but also has an impact on the entire sector through various backward and forward linkages between the companies. There is a highly positive “clustering” or “co-location” effect of SME support in such cases.

Abu Dhabi’s industrial policymakers know this, as is proven by the opening of industrial zones such as Khalifa Industrial Zone of Abu Dhabi (KIZAD) or centers like the Abu Dhabi Global Market (ADGM), which dwell on these benefits for companies located there. Sectors chosen by the industry strategy prosper by putting these positive effects to work.

Moreover, there are industry-specific advantages that companies in these sectors enjoy if they choose to co-locate. For the chemicals industry, the co-location of firms can provide numerous advantages including:

- Shared infrastructure, which reduces costs through economies of scale in waste treatment, incineration, and the provision of steam and other utilities
- Logistics integration, which reduces costs, efforts, and risks in the transport, handling, and storage of materials
- Materials integration in which by-products from one process become the raw materials for other processes, reducing chemical waste and decreasing the additional costs associated with externally

purchased raw materials

- Greater expertise and more efficient processes in areas such as R&D; process engineering; logistics; and environmental, health, and safety monitoring and performance

The chemicals industry acts as a customer for knowledge-based companies such as law, accounting, and IT firms and suppliers of hydrocarbon feedstocks, equipment, construction, and services. Energy-intensive and nonenergy-intensive businesses—small and large firms—collaborate and share mutual dependencies in the cluster.

Meanwhile, downstream manufacturing companies (such as plastics processors) benefit from their proximity to petrochemical manufacturers. A similar case can be made for other businesses and sectors—automotive, agriculture, metals and others.

Through competition and cooperation, clusters enhance firm productivity, encourage product and process innovation, improve wage rates, and enhance the market success of companies linked together in complementary activities.

### Get regulation right

Successful support strategies recognize the complex relationship of SMEs within these clusters. Regulations are not applied strictly to the letter of the law but are interpreted in a way that the SME can thrive while the meaning of the regulation is preserved. This applies to rules and regulations as diverse as competition law and safety standards. This is perhaps one of the most critical aspects of government regulation.

Bureaucracy needs help to achieve that. Training can help but will not be enough considering the huge number of different occupations that SMEs and the regulating bureaucracy work on.

Hiring an expert for certain businesses could be a solution. Or establishing a team that would counsel on contended decisions of the regulatory body—including an expert on the business that it regulates could help solve this lack of knowledge issue.

It is a highly important question since bureaucracies being unaware about the peculiarities of a certain business can create big obstacles, which could become insurmountable.

### Financing and support tools

Another key issue that frequently comes up in enterprise surveys is the lack of sufficient financing. This relates to all sorts of SME financing—financing of investment, factoring, not enough scope for overdraft, etc.

"Regulations are not applied strictly to the letter of the law but are interpreted in a way that the SME can thrive while the meaning of the regulation is preserved"..

Abu Dhabi provides a lot of funding and support if you know where to find it. In an interview held with a new two-year-old company in the region, Cycled Technology said that many people do try out the available support. The downside is that there is often a clear vision or determination missing a clear vision or determination to make it work.

The prime funding address for SMEs in Abu Dhabi remains the Khalifa Fund for Enterprise Development (KFED), which targets Emirati nationals. Moreover, the Dubai-backed Mohammad Bin Rashid Establishment for SME is also available, since Emirati nationals can apply to both entities.

SMEs that compete with firms from neighboring countries, especially Saudi Arabia, are still disadvantaged in some respect. Funding is cheaper and usually on better terms compared with the offering in Abu Dhabi. To create a level playing field, new financing facilities need to be set up.

The Abu Dhabi government has already taken steps to mitigate financing problems as part of the Ghadan 21 initiative. Under the Hub71 program, which is a part of the Ghadan 21 initiative, government funding equal to AED50 billion has become available. Other smaller programs have been put in place, as well.

Nudging the private sector into SME financing will also be helpful. The working capital credit guarantee program, equal to AED10 billion, which is also part of Ghadan 21, will help companies get access to private financing sources.

Financing facilities from the private sector have hardly been available to date. This has been attributed to the small size of the market in terms of microfinance, and institutional issues such as a lack of a bankruptcy law, registration of collateral, hidden fees and other cost obstacles for would-be borrowers, and other issues bogged down the development of private financing.

### Recommendations

Most of these issues have been discussed. There are steps in the right direction, but the private sector will likely kick off financing on a larger scale only once the market has reached a certain threshold level.

A government-induced stimulus is needed to kick off the market for small-scale enterprise financing. Size issues could be overcome, and



**Clustering  
occurs wherever  
companies can  
exploit synergies  
from close  
collaboration**



**AED10  
billion**  
In financing  
from the working  
capital credit  
guarantee program  
of Abu Dhabi's  
government

financing will become available on a more widespread basis as soon as the sector has crossed a certain threshold level. The new credit guarantee program by the government will be helpful in that regard.

Government procurement also plays a role for the development of SMEs. Reserving a certain share of government contracts for SMEs will get those companies more business. Once these projects are completed, new reference material will be available for new projects with government and private sector companies alike. Government procurement would become a tool to promote local SMEs and the local workforce.

Government incubation programs are a huge help. Government-funded education such as Masters or PhDs help students to be able to start a business without worrying about paying for school fees. For innovation companies there is a lot of funding available for innovation companies.

The areas with recommendations for improvement that could be improved include: 1) Reduction of cost to register companies, for example i.e. the cost of visa fees. 2) Simplifying the government paperwork can greatly help out new SMEs. SMEs can benefit from an easier process to register their companies.

3) It also helps if the government can set out clear policy to support companies. One specific suggestion that resulted from an interview is that if the government makes recycling compulsory, then an SME in the recycling business will see their business easily take off. 3) Consolidating government initiatives initiatives will also help SMEs to better know where to find the best support. 4) Help to set up the right networking events between corporates and SMEs to make it easier for SMEs to improve communication and establish the right networking contacts.. This will help SMEs better communicate and make the right networking contacts.

Many of the recommendations found with the earlier report on Entrepreneurs in Abu Dhabi also apply to this report. The training workshops offered by the Abu Dhabi Chamber are important tools to help not just entrepreneurs, but executives of many smaller companies to improve efficiency and comply with new business standards. Moreover, with the new financing tools becoming available, new training seminars could be developed to educate which funds are the best to apply for and how the application process works. ■



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