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The Structural Constraints of Entrepreneurship in Bahrain

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INTRODUCTION

In 1932, Bahrain became the first country to discover oil in the Arab Gulf region. It was also the first to start running out of it. The country's modest oil reserves pushed it to diversify its economy early on compared to its neighbors, giving Bahrain a head start as it experimented with expanding various non-oil sectors. Since the 2008 launch of Bahrain Vision 2030, the country has sought to implement a comprehensive economic development strategy built on three guiding principles: "sustainability, competitiveness, and fairness."¹ A series of Government Action Plans, policies, and programs have attempted to echo these principles.

Bahrain's Crown Prince Salman bin Hamad Al Khalifa stressed in 2017 that the Government Action Plan for 2015–2018 had three priorities: to transform the role of the public sector from a primary employer to a regulator of the market, to support entrepreneurship and innovation, and to invest in human capital, particularly the capacity, productivity, and competitiveness of Bahraini citizens.²

In the decade since the launch of Vision 2030, Bahrain has invested in a set of institutional frameworks that aim to support a robust entrepreneurship ecosystem. Small and medium enterprises (SMEs) today contribute 30% of the Bahraini gross domestic product (GDP),³ and the number of start-ups has increased by 46% in the last three years.⁴ But a deeper look

at the Bahraini economy reveals a number of structural factors that limit the growth of the private sector and create certain roadblocks for the country's planned transition to a post-oil economy.

These factors include achieving fiscal sustainability in the context of low oil prices since 2014 and increased government debt-fueled spending. Despite Bahrain's efforts to diversify its economy, oil revenues still constitute 70–80% of total government revenues.⁵ Second, the country's dependence on regional funds—mainly from Saudi Arabia and the United Arab Emirates (UAE)—to support various infrastructure and development projects exposes the economy to vulnerabilities, especially as the entire region faces stagnating economic growth. Third, supporting an entrepreneurship and innovation ecosystem will require greater investments in education to prepare citizens for the knowledge economy.

This paper aims to provide an assessment of the current entrepreneurship ecosystem in Bahrain, and it argues that a number of procedural reforms can be pursued to further improve it. However, these procedural reforms will only provide limited returns in the current economic framework and in the context of regional economic pressures.



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BACKGROUND: BAHRAIN'S ECONOMY

Bahrain has a total population of 1.5 million people, 52% of whom are Bahrainis while

the remaining 48% are expatriates.⁶ The gross domestic product per capita in 2017 was \$51,800 (Table 1), placing the country fifth among the six Gulf Cooperation Council (GCC) countries. While Bahrain's GDP per capita has been steady in the last few years, it is difficult to assess changes in wealth distribution since data on income inequality remain scarce. It is worth noting that none of the six GCC countries are included in the GINI Index, which aims to measure inequality.⁷

TABLE 1 — GDP PER CAPITA ON A PURCHASING POWER PARITY BASIS (2017)

Country	Estimated GDP per capita PPP in 2017
Qatar	\$124,900
Kuwait	\$69,700
United Arab Emirates	\$68,200
Saudi Arabia	\$55,300
Bahrain	\$51,800
Oman	\$45,500

SOURCE CIA Factbook⁸

Bahrain's economy today is in a weak fiscal position and remains vulnerable to internal and external shocks.

Like most countries in the region, Bahrain has a youthful population: 35% of all residents are under the age of 25.⁹ As each new year brings more job seekers to the labor market, the bloated public sector struggles to generate new jobs to absorb them. As a result, there is increased pressure on the private sector to serve as the primary engine for job creation.

In addition to demographic pressures, Bahrain has fewer natural reserves to buffer current austerity measures designed to reduce government spending; such measures include lower fuel and food subsidies and the introduction of a value added tax (VAT). Despite the March 2018 announcement of a newly discovered reserve estimated to contain 80 billion barrels of shale oil, it is not known how much oil can be recovered or if it will be commercially viable once extraction costs are determined. Further, commercial production could take four to five years and

require significant investments.¹⁰ While the reserves may offer a much-needed boost to the economy, Bahrain should continue its strategy of investing in non-oil sectors as part of the effort to diversify and expand the country's economic base.

Bahrain's economy today is in a weak fiscal position and remains vulnerable to internal and external shocks. The country's financial sector suffered a huge blow during the 2008 global financial crisis, while the country's 2011 political crisis¹¹ negatively affected economic growth and efforts to attract foreign investments.¹² One can even make an economic case for the need to pursue reconciliation efforts between the government and various political groups to create an environment more conducive to sustainable social, political, and economic development.

Low oil prices since 2014 have reduced government revenue and hindered regional growth. Bahrain's economy is also affected by direct ties to its neighbors. First, Bahrain has been relying on direct regional support, including a GCC infrastructure fund set up in 2011 for Bahrain and Oman.¹³ In addition, Saudi Arabia plans on building a new road and rail causeway to expand the flow of goods and people between the two countries,¹⁴ while the UAE is funding an airport expansion project and various investments in Bahrain's housing, health care, water, and transportation sectors.¹⁵

Second, Bahrain is a weak link in the GCC states' currency peg to the dollar due to its depleted foreign exchange reserves and limited sovereign wealth fund compared to its neighbors. In addition to seeking assistance from its neighbors to sustain the currency peg,¹⁶ the Bahraini parliament has approved raising the public debt ceiling to \$34.5 billion, which equals the country's GDP of about \$32 billion.¹⁷ Public debt was about 33.6% of GDP in 2012 but rose to 74.2% of GDP in 2016.¹⁸

Finally, the tourism sector, which constitutes about 5% of GDP, relies heavily on citizens and residents of other GCC countries, especially Saudi Arabia.¹⁹ Any changes in the flow of people in the region affect Bahrain; recent measures in Saudi Arabia allowing the construction of movie

theaters and the development of a local entertainment and cultural infrastructure will have an impact on Bahrain's tourism sector.

ENTREPRENEURSHIP AS A KEY PILLAR TO DIVERSIFYING THE ECONOMY

Launched by Crown Prince Salman bin Hamad, who heads the Economic Development Board (EDB), Vision 2030 outlines a strategic direction toward a post-oil economy. The vision stresses investments to grow non-oil sectors such as banking and financial services; real estate; tourism; logistics; and information and communication technologies (ICT). See Table 2 for a closer look at each sector's contribution to the economy.

Institutional Frameworks to Support Entrepreneurship and SME growth

Bahrain has been able to establish a number of institutional frameworks to create an ecosystem conducive for start-ups and for the growth of small- and medium-sized enterprises (SMEs). Currently SMEs contribute 30% to Bahrain's GDP, and the government is hoping to increase that share in the coming years. The breakdown of micro, small, medium, and large enterprises in Table 3 shows that micro and small enterprises comprise almost 90% of the total.

A number of governmental, semi-governmental, private, and international institutions aim to support start-ups and SMEs in Bahrain; see Appendix 1 (<http://bit.ly/2LgAEKP>) for an overview of the country's entrepreneurship ecosystem. These entities and initiatives often work collaboratively to connect government agencies, investors, entrepreneurs, students, and all relevant stakeholders to facilitate SMEs in all stages of growth. Even if one is an aspiring entrepreneur with an idea but no business plan or capital to operationalize it, there are ways to attain business training and capital through the Bahrain Development Bank and its Rowad incubator program. Opportunities to scale-up businesses are also available through a variety of government and private sector funding schemes.

TABLE 2 — CONTRIBUTION OF VARIOUS ECONOMIC SECTORS TO BAHRAIN'S GDP (2015)

Sector	Contribution Percentage
Oil and natural gas	13.35%
Processing industries	17.34%
Transport and telecommunications	7.52%
Commerce	4.61%
Real estate and business services	5.70%
Financial projects	17.18%
Government services	14%
Agriculture and fishing	0.32%
Water and electricity	1.41%
Building and construction	7.39%
Hotels and restaurants	2.44%
Social and personal services	6.04%

SOURCE *The Information and eGovernment Authority of Bahrain*²⁰

TABLE 3 — ESTIMATED NUMBER OF MICRO, SMALL, MEDIUM, AND LARGE ENTERPRISES IN BAHRAIN (JANUARY 2018)

	Micro	Small	Medium	Large	Total
Number of Enterprises	85,000	5,485	950	176	91,611

SOURCE *AlSharq AlAwsat* at <https://aawsat.com/english/home/article/1152416/bahrain-plan-develop-more-6300-smes>

Since its launch in 2006, Tamkeen—a semi-governmental agency tasked with facilitating the growth of the private sector as a driver for economic development—has provided training to over 140,000 individuals and businesses; in a country with a population of 1.5 million, this is a significant number.²¹

The entrepreneurship ecosystem today includes specialized incubators such as the Bahrain Fashion Incubator and the Bahrain Women Incubator Center (Riyadat). Angel investors such as Tenmou and Anginvest Ventures offer various funding schemes,

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and there are a few co-working spaces such as Space 340 and Corporate Hub 9 (Ch9), which offer space, training, and various advisory services.

Some of the Bahraini start-up success stories include OneGCC, a digital platform that aims to connect GCC nationals to jobs in the region in line with employment nationalization strategies;²² Skiplino, a mobile app that provides an innovative and efficient way for businesses to manage queues to reduce waiting times and improve customer service;²³ and the mobile application Fish.me, which helps to directly connect local fisherman with their customers, eliminating the role of a middleman or market.²⁴

Over the years there has been an increase in new start-up ideas in technology and light manufacturing. For example, Rowad, an incubator program run by the Bahrain Development Bank, provides coaching, incubation, funding, and mentoring for start-ups and SMEs. In 2016, 11% of business ideas and projects that participated in the program were related to technology, while 33% were related to manufacturing.²⁵

“Business-friendly Bahrain”

Under the slogan of “Business-friendly Bahrain,” the government has simplified the process of opening a local or foreign-owned business, obtaining a commercial registration, and procuring work visas. Bahrain’s push to liberalize its economy resulted in the opening of many sectors for 100% foreign ownership. Companies doing business in Bahrain now encounter simplified processes; in this regard, Bahrain is ranked fifth in the Middle East and North Africa (MENA) region and 34th among 134 countries according to the 2017 Global Entrepreneurship Development Institute (GEDI) Index.

While the processes for opening a business, obtaining permits for electricity, and setting up facilities have all improved, there is still room for improvement in areas such as accessing credit and financing options. In regard to the former areas, Bahrain ranked 66th out of 190 countries, and 2nd in the MENA region,²⁶ according to the World Bank’s Ease of Doing Business index. However, when it came to obtaining

credit, Bahrain ranked 105th.²⁷ The GEDI also reported that a “10% enhancement of conditions for entrepreneurship [has] the potential to add \$6bn to the economy.”²⁸

A separate study by AlRabeei and Kasi (2014) also identified “lack of finance” and poor access to credit to scale-up businesses as key barriers to SME growth in addition to “scarcity of human resources” and “fierce competition.”²⁹ This study, which collected data from a survey of 200 owners and managers of Bahraini SMEs, shows that although Bahrain’s entrepreneurship ecosystem has flourished over the past decade, few scholarly studies have systematically assessed its effectiveness. A further study by AlRabeei and Scott (2014) cites another challenge: the lack of effective marketing strategies for some organizations that support SMEs.³⁰

Despite flourishing institutional frameworks and programs that support start-ups and SMEs, entrepreneurs and the general public are not necessarily aware of them.

Information and Technology and FinTech

Over the past decade, Bahrain has sought to become a hub for niche sectors such as Islamic banking and finance, which remain vital sectors to the economy.³¹ Today there is an increased interest to tap into the global digital economy, expand the country’s information and technology (ICT) infrastructure, and invest in cloud technologies and cybersecurity. The launch of the Bahrain FinTech Bay in March 2018³² represents the country’s aim to invest in financial technologies (or “Fintech”), and steps have been taken to improve regulatory frameworks to accommodate such an effort. For example, the Central Bank of Bahrain launched a fintech unit to facilitate the development of regulations for digital financial services and to oversee a “regulatory sandbox,”³³ which is “a framework set up by a regulator that allows fintech startups and other innovators to conduct live experiments in a controlled environment under a regulator’s supervision.”³⁴

In addition, Bahrain's achievement in convincing Amazon Web Services (AWS) to open a regional office in the country demonstrates the political will to attract foreign investments and become a hub for cloud technology and services. The AWS office opened in January 2017³⁵ and will be followed by the launch of an AWS Region planned for 2019 that provides further cloud and data services.³⁶ AWS has also launched various educational and training programs in Bahrain, the UAE, and Saudi Arabia in collaboration with universities and various business incubators and accelerators.³⁷ In Bahrain, AWS has launched cloud-related training with the University of Bahrain as well as with Bahrain Polytechnic; more than 3,000 Bahrainis have signed up for the program.³⁸

While such programs facilitate knowledge-sharing and skills training, they are not necessarily sufficient to provide enough high-skilled workers. AWS estimates that there will be a need for "10,000 data solution architects in the next five years"³⁹ in the Middle east. To produce such tech-savvy workers, Bahrain will need to consider more significant investments in science, engineering, and technology training and education.

CONCLUSION: WHAT DOES SUCCESS IN THE ENTREPRENEURIAL DOMAIN LOOK LIKE IN BAHRAIN?

Bahrain's private sector is creating new jobs, but not necessarily for citizens. According to one estimate, SMEs employ a total of 421,257 workers in Bahrain but only 52,918 are Bahraini nationals; the rest are citizens of other countries.⁴⁰ As the country is moving to attract foreign direct investment and talent for various sectors, it is important to keep in mind that the goal of nationalizing the labor force—or "Bahrainization"—can create tension with the goal of becoming a global financial and technological hub. One step that Bahrain can consider is to invest in a college or university that specializes in technology and innovation and targets the local youth population. As Bahrain further liberalizes its economy, it can consider

ways to train Bahrainis to become more competitive by meeting global standards of productivity and creativity.

One can argue that in many ways, Bahrain has adopted a series of promising policies to diversify its economy, and it has succeeded in building an ecosystem of institutional frameworks to support start-ups and SMEs. Additional procedural reforms can further enhance this ecosystem, such as improving regulatory frameworks for venture capital, crowdfunding, bankruptcy and insolvency laws, and general processes to enforce contracts and resolve commercial disputes. Another key area for improvement is better access to credit for seed funding and for SMEs seeking to expand their businesses.

Bahrain is not the only country in the region pursuing entrepreneurship and innovation as a key pillar to economic diversification. Neighboring countries like Saudi Arabia and the UAE are also investing in fintech hubs and start-up funds, and attracting international venture capital investment. The key challenge for Bahrain will be to build on its comparative advantage and capitalize on niche sectors, whether in tourism or financial services, to distinguish itself from other GCC countries that have the advantage of a more stable fiscal position and more natural resources.

Finally, while there is still potential to expand the entrepreneurship ecosystem in Bahrain, its current economic structure faces tremendous fiscal pressure, remains dependent on regional support, and is navigating the legacies of various internal and external shocks. It is important to note that economic diversification and reform are not purely technical processes; rather, they depend on fundamental political and socioeconomic transformations. Moving forward, Bahrain will need to pursue both procedural and structural reforms to advance its strategy to move toward a post-oil economy.

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APPENDIX

Please see <http://bit.ly/2LgAEKP> for Appendix 1.

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