

Kuwait SMEs: Size, Obstacles and Suggested Remedies

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Abstract: *This paper examines the current status of small and medium enterprises (SMEs) in the economy of Kuwait. It begins by discussing the theoretical relationship between SMEs and economic development in its various stages. It points to the difficulty of placing Kuwait in this set-up. It then examines the existing role of SMEs in the Kuwait economy and concludes that it is not delivering. The paper then discusses what are the causes behind that meagre contributions. The paper finally proposes some policy option to invigorate SMEs.*

Keywords: *Small and medium enterprises, Role in economic development. The new paradigm Causes and, Suggested solutions.*

1. SMEs IN KUWAIT: RELATIVE SIZE, OBSTACLES AND REMEDIES

The objectives of sustained economic growth and equitable distribution of income are universally shared by policy makers everywhere. For developing countries, they are even more urgent and hence the search for workable recipes. A few approaches have been suggested. Many argue that the previous approaches of the second half of the Twentieth Century have failed. As Woodworth (2000) listed them, these were: first the 1960's capital intensive modernization approach to jump-start the economy failed. So did the 1970's green revolution as it depended on availability of tractors, fertilizers, seeds etc. Similarly, the 1980's World Bank basic needs approach failed being too expensive. Woodworth suggests micro enterprise, micro entrepreneurship and microfinance. He is not alone in this. Amini (2004) credits small business (by comparison to the traditional large scale, capital intensive approach) as not only generating jobs and incomes, providing opportunities for almost everyone but also as resulting in a more equitable distribution of income. Chowdhury (2007) similarly argues that there is growing evidence of a causal relationship between employment, economic growth and poverty reduction.

As far as developed economies are concerned, the argument is moot, but for less developed economies, SME is presented as a vital element in development and hence economic policy should be supportive of SMEs. Thus, a search for isolating constraints on SMEs has been waged in order to alleviate them. Adeoti (2005) calls for integrating SMEs promotional measures into the framework of environmentally sustainable development. Many country studies also sought to identify constraints before SMEs in order to focus policy on alleviating them. Alasadi and AbdelRahim did that for Syria (2008), Chowdhury (2007) for Bangladesh, Arinaitive for Mexico (2006), Arendaski et al for Poland (1994), Frost for Eastern Europe (1996), Ivy on Slovakia (1999), Al-Sheikh for Jordan (1998) and Mambula for Nigeria (2002). Carree and Thurick would even argue that the shifts in the world economy since the 1970s: global competition, increase in uncertainty, growth in market fragmentation and changes in technology, all point to the movement away from large scale firms and towards small firms.

Given the above dominant thinking, it was only natural that Kuwait policy-makers formulate and implement measures to promote SMEs. Nonetheless, it is felt that results fall far short of the objectives sought. Nonetheless, that did not lead to abandoning them but rather doing more and intensifying the efforts. However, of late the relationship between entrepreneurship and economic development has been revealed to be much more complicated than previously thought. Thus, it is better to discuss this emergent thinking before assessing the extent of SMEs in Kuwait and what is expected of the sector contribution to growth.

2. EMERGING PARADIGM

One of the few early attempts to examine the alleged positive relationship between entrepreneurial activity and economic growth was that by van Stel et al (2005). Their study revealed an impact, but

not a simple linear one, between TEA (total entrepreneurial activity) and GDP growth. They found that TEA has a negative effect for the relatively poor countries while it has a positive effect for the relatively rich countries. In another article, two of the above authors along with two others (Wennekers et al, 2005), argued that there is a natural rate of nascent entrepreneurship that varies with the level of economic development. Regressing GEM, (global entrepreneurship monitor, a relatively new indicator developed by a consortium with the same name,) on per capita income or alternatively on an index of innovative capacity, they uncovered a U-shaped relationship: as nations develop economically, the prevalence of nascent entrepreneurship and of new business start-ups is likely to decline until a revival occurs at the high end of the economic development. Their study covered 34 countries and used data from GEM which measures the rate of nascent entrepreneurship as the number of people actively involved in attempting to start a new business, expressed as a percentage of the adult population. This GEM was conceived in 1997 by M. Hay and Bill Bygrave of London Business School and Babson College (Sternberg and Wennekers, 2005) and since then has grown into a consortium of 64 national teams.

This GEM indicator has again been refined into GEI (Global Entrepreneurship Index) that combines GEM measures of entrepreneurial attitudes, activity and aspiration with other economic indicators that concentrate more on the institutional characteristics. Recognizing that it is not just quantitative measures of entrepreneurship but qualitative measures of institutional differences are also required to estimate the impact of entrepreneurship on the economic development of countries (Bosma et al, 2008). GEM is now a research consortia. The consortium's 10th annual report introduced this GEI concept along with classifying countries into three categories: factor-driven, efficiency-driven and innovative-driven countries. Factor-driven countries are those at low levels of economic development with a large agricultural sector providing subsistence for the majority in the countryside. Then extractive industry expands and triggers growth and results in an oversupply of labor as more people quit subsistence agriculture. Efficiency-driven is the next stage where the industrial sector expands and institutions emerge to support further industrialization. Policies then tend to favor large scale and large national business units. In the third stage, emphasis moves towards service, increasing sophistication of the industrial sector, R&D and knowledge generating institutions gain momentum to serve an increasingly affluent population.

The authors see different roles and relationship for entrepreneurial activity and economic development in each stage. In a factor-driven economy, the resulting oversupply of labor feeds subsistence entrepreneurship as surplus labor seeks to create self-employment opportunities. Hence the number of entrepreneurs and TEA will tend increase. In the second stage, with modern manufacturing starting to absorb surplus labor, the necessity driven entrepreneurship declines and gives way to an emerging small scale manufacturing sector. The third stage opens the way for the development of opportunity seeking entrepreneurial activity that is not afraid to challenge established incumbents in the economy. Often small ones enjoy an advantage over larger ones and act as agents of "creative destruction".

Bosma et al study (2009) found an S-shaped relationship between their GEI and economic development. When factor driven economies progress beyond a certain threshold, the GEI tends to increase. The shape of the S-curve according to them broadly matches the three phases of economic development. Not only this but they have also found the GEI to be positively related to three other facets of the "development diamond": economic freedom, competitiveness and the ease of doing business (Bosma et al, 2009.) The GEI was also found to correlate highly with GDP.

3. NASCENT ENTREPRENEURSHIP AND KUWAIT

The question now is what are the implications of all this to Kuwait? What is the extent of entrepreneurship in Kuwait? In what category does the country fall and what policy implications are there? Unfortunately Kuwait was not included in the two studies referred to above. So we have to infer from the limited available information we have.

To begin with, Kuwait is an oil rich city-state where oil exports made up 37% of its GDP. Services make up 52% of the economy, 16% for industry and less than 1% for agriculture. The government sector dominates the economy comprising 2/3 of it and employed 230,000 out of 1.7 million in 2006. The private sector contributes 36% of the economy. Kuwaiti GDP is substantial and hence the private sector, though relatively small is still substantial (KD. 8.3 billion in 2006 i.e., some 30 billion US dollars.) The number of private establishment in 2005 was estimated at 50,000 mostly sole proprietorships according to the Statistical Abstracts (Annual Abstracts). Looking at sheer numbers

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and with a native population of 890,000 in that year, that would mean that one in 20 Kuwaitis owns a business establishment or 5 per 100 people. Including multiple and expatriate ownerships makes the percentage even less. That percentage is almost half the world average of 11% (the number of persons engaged in entrepreneurial activity per 100 people (Scarborough, 2014)).

We tried to get for Kuwait an estimate of the TEA measure employed by Wennekers et al (2005) ,% of owner/managers of business to the total labor force, and see where that would place Kuwait in their U-shaped scheme. In that scheme, the nascent rate declines with per capita income from 10%, bottoms up at 4% @ around 20,000 US\$ per capita and then rises with income till about 10%. These were 2001 figures. The high per capita of Kuwait should put its nascent rate in the rising section, 4% and above. Our approximation of the rate (% of employers and self employed people out of total labor force (16,303 out of 761,620 in 1995) according to the Annual Abstracts) gives the rate of 2%, far below what Kuwait's level of income suggests.

There is also the question of what category is the Kuwaiti economy in the GEM scheme and what that implies for the size and role of the entrepreneurship in development. Being substantially oil dependent, one is tempted to place Kuwait in the factor-driven category. But for the purposes of the GEM scheme, a factor-driven economy is one with a large agricultural sector where mining displaces and creates an oversupply of labor and hence subsistence entrepreneurs. This does not hold in the case of Kuwait. Kuwait has no agricultural (subsistence) sector to speak of and it has, if anything, a labor shortage rather than surplus. Kuwait though has many of the characteristics of efficiency-driven stage: a developed manufacturing sector, developed financial institutions and available capital supply (in fact, one recent studies put Kuwait as leading in this last category.) Kuwait also has a number of the characteristics of the third stage, a well developed service sector, an affluent and well educated consumer class.

What this means is that the TEA (total entrepreneurship activity) should be substantial, i.e., between 5 and 10% and rising, but it does not seem to be so.

Rather than looking at the TEA or the GEM alone, one should also consider the GEI (the Global Entrepreneurship Index) as this deals with more than mere numbers and looks at qualitative and institutional factors. This requires an involved study that is not possible for the authors at present. However, one may look at those factors that has been found to be highly correlated with the GEI (Bosma et al, 2009) above: the extent of economic freedom (.79), the ease of doing business (.79), Global Competitiveness Index (.82), GDP (0.79) and with the corruption perception index (.89) in 2008; the brackets indicate the respective correlation magnitude.

The high per capita income of Kuwait (about 40,000 US PPP in 2008) should mean that it should have a high value of GEI and hence substantial contribution to GDP. The other indicators however are on the low to medium side. Kuwait ranking in these categories were

		Ranking	Score %
1	Economic Freedom Index (Heritage)	74 out of 178 countries	63
2	Ease of doing business Index (World bank)	86 out of 190 countries	
3	Global Competitive Index	39 out of 134 countries	45
4	Perception of Corruption Index (Transparency)	69 out of 175 countries	43
5	Innovative capacity (Global Innovative Index)	62 out of 142 countries	31

Now what does all this mean?

Kuwait is behind and even though some may be tempted to say it is not far behind and is in the upper quarter or upper third in some categories, one should remember that the score spread between Kuwait position and the leading country is much larger relatively speaking than the spread between Kuwait and those behind it in almost all four categories.

We conclude this section by stating that despite its high per capita, affluence, a well developed infrastructure, the dominance of services in its economy, the educated and sophisticated consumer class, entrepreneurship is not playing the role it should. In the next two sections, we discuss some of the reasons for that and then offer some of suggested remedies.

4. REASONS FOR SMB'S LIMITED CONTRIBUTION

Kuwait is a rich country with a consumer society and should thus provide ample opportunities for entrepreneurs with innovations to introduce and niches to capture. Not only this, but article 16 of

Kuwait's Constitution elevated private property, capital and enterprise to the status of basic foundations of the social entity of the state and the nation's wealth. So why did private proprietorships not prosper and the contribution of SMB's remained limited?!

We believe the reasons lie in the followings:

- The government monopolizes or virtually monopolizes many sectors. In oil, the government naturally dominates and until recently, even gas stations were government-owned. Air-travel, public-transport, entertainment parks, and even movie theatres, etc... are largely in the hands of the public sector.
- The trouble with the government in this regard is that it does those things on a grand scale and thus pre-empts the private sector. And since the government by nature is not very cost-conscious and can sustain deficits, the private sector is further deterred. Thus there is little room left in the market for a competitor. So the private sector stays away from areas that are normally the realm of the private sector.
- Another problem is that once started and operated by the government, a project becomes wedded to the public sector. It acquires a life of its own. There will be no incentive to hand it to the private sector. No considerations of efficiency or policy will hand it back. On the contrary, there will be vested interests who oppose giving it to the private sector. Unions, politicians and public opinion leaders would oppose the move. Fear of unemployment, reduced incomes and lower profits for suppliers, scare a government sensitive to public opinion.
- As a matter of fact that is a major consideration why privatization in Kuwait which is moving at a snail's pace, if at all.
- The democratic system of Kuwait slows down the national decision making process and has actually blocked many huge government development projects. By comparison with other GCC countries, Kuwait has the slowest GDP growth rate, is the least attractive to FDI and the country is exporting the most capital. Hence, not only has Kuwait failed to attract enough foreign business, but domestic capital is fleeing too. This is partly because of the limited market and the limited absorptive capacity. But if there was rapid economic growth, those trends would have been mitigated. One reason growth is relatively slow is the inability of the government to pass many of its major projects in the Kuwaiti Parliament. That is because there is no political consensus. As we have seen changes of government are all too frequent for any democracy, let alone when compared with other GCC countries where government change is rare and where governments embark on huge projects, stimulating their economies and creating opportunities for entrepreneurs to grow and prosper. In Kuwait by contrast, opportunities are thus made slimmer.
- **Kuwait business environment.** The Business Monitor International gives Kuwait a low composite score in the business environment ranking in the Middle East and North Africa region. Actually it states: "Kuwait overall business environment can be considered unattractive in a regional context, in spite of a low level of perceived economic risk and the country's abundant oil and gas resources". (BMI: **Kuwait Oil Gas Report Q2 2006.**)
- The World Bank Index of the **Ease of Doing Business** for 2013 ranks Kuwait as number 86 worldwide. That means Kuwait environment leaves a lot to be desired. Another observer of the scene wrote "Despite its vast wealth, Kuwait is unable to break free from the shackles of bureaucracy and a lack of political consensus" **MEED**, 17-23 November 2006.
- **Monopolies.** It is not only the government Goliath that pre-empts small entrepreneurs; there are a few private Goliaths too. Franchising in many countries is an area that is mostly inhabited by small entrepreneurs. According to many observers, it is now widely accepted that franchising plays an important role in furthering the development of small and medium sized enterprises (Preble, 1995; Sanghavi, 1998; Scarborough, 2014). Not so in Kuwait. Such an outlet is not an option for many as it is monopolized by a few big franchisees with multiple franchises that cover Kuwait and beyond exclusively for one franchisee. Just imagine popular names like McDonald, Burger King, Starbucks, The Body Shop, Toyota, The Donut House etc... many with tens of outlets in Kuwait. Some own not only all the multiple outlets of a specific brand name in Kuwait, but those of more than one name and sometimes even outside Kuwait too. This monopoly naturally limits opportunities for most other would-be successful entrepreneurs. It may be argued that that small

market size justifies the exclusivity in a few cases. Maybe you cannot have many separate Toyota dealers, but you certainly can have more than one Toyota dealer and many McDonald franchisees. What makes things worse is the government unwittingly supporting this trend. Gas stations are plenty in Kuwait or anywhere for that matter. Yet, in its privatization of gas stations the government undertook a few years back, it allocated them to only two newly created companies when it could have insisted that they should have been awarded to many sole proprietors and not more than one each. Again blocked opportunities for many would-be entrepreneurs.

- **The Welfare-state.** In Kuwait and many GCC countries the welfare-state has reached unheard-of proportions, e.g. wife and children allowances, medical treatment abroad, study abroad, etc... This other than the standard free education, free health-care, free housing, subsidized basic foods, etc...

Now with a benefactor taking care of one from the cradle to the grave, naturally the incentive of many to fend for oneself is dampened.

One other aspect of the welfare state is guaranteed employment. The right to work is enshrined in the Kuwaiti Constitution and the government is obliged to make jobs available for the citizenry (Article 41). The government feels that it is its duty to hire people in government jobs. Once hired, Kuwaitis get to enjoy the many benefits of an attractive employer. The pay is handsome and exceeds the private sector's, the benefits plenty, the hours short and holidays long. Permanent employment is offered and no lay-off are ever entertained. Lay-offs possibility or threat thereof, is one reason we understand why many in other countries opt to start their own businesses.

Again, this dampens the motivation to go into business for oneself.

5. POLICY RECOMMENDATIONS

To begin with let us state at the outset that it is not that the government is not aware of the problem or that it is not doing anything about it. In its economic plan of 2005-2006, the Plan points to the meager contribution of the private sector and has a section on "Stimulating the Private Sector". They list five reasons as the ones behind the private sector's small share in the GDP; from over-dependence on oil and on government expenditure, to the strong cooperative movement in Kuwait as hindering the growth of the sector. In fact the government commissioned the World Bank to suggest ways to stimulate the private sector. A number of mechanisms have also been outlined in the Development Plan including privatization, improving the business environment, streamlining procedures, new laws etc... Mechanism No. 5 specifically addresses the stimulation of SMB's which is hoped to occur through more incentive laws that will hopefully result in more KSPD's (Kuwait Small Projects Development Company). This is the Kuwaiti equivalent of the US Small Business Administration (SBA). KSPD Co. was started in the late 1990's and entrusted with a substantial fund to finance SMB's both as a lender and equity holder. It is operational but of course it is only one and can do but so much. There is a few other SMB's financiers. There is the Industrial Bank of Kuwait SMB's fund and a couple of other private companies. Nonetheless, capital is not the bottleneck in Kuwait. Kuwait is a rich country and no one with the right ideas will be constrained by the lack of capital. A recent study about the availability of capital for new projects listed Kuwait among the top in this dimension ranking as #34 Worldwide and the second best Arab country as far as availability of finance, www.milkeninstitute.org. Kuwait also has one of the highest saving rates in the world according to a recent HSBC study. (AlQabas, 7/10/2009). Lately, The Small Project Authority with a billion KD chest fund specifically to encourage small businesses has been launched. This is a welcome step but is not sufficient as capital shortage was never the critical factor.

Kuwaitis and other observers always ponder the question; why can't Kuwait move as fast as Dubai, Abu Dhabi or Qatar? Times were when Kuwait was the 'bride' of the Gulf or rather, the 'pride' of the Gulf and the others far behind. That was just two or three decades ago. But today there are a few things these others can do but Kuwait cannot. First the systems of government are different. In Kuwait, unlike the other principalities, decision-making at the national level is complicated with a variety of interests and a "lack of political consensus" as one observer put in. The Emir of Kuwait cannot decree all those ambitious economic project e.g. Northern Oil fields, BOT's, Dow-Equate \$7 billion petrochemicals complex, silk-city in Bubyah etc..., some of many pending projects. Otherwise, Kuwait would have been a hub of economic activity offering unlimited opportunities for SMB's to prosper. Nor can the Emirate open the country for expatriates and grant them freedom of operations like other principalities do. The parliament and the public opinion delay and constrain the

process. Nor would we wish for Kuwait to give up its democratic way of life. Democracy is slow anyway! So we have to look for the cure elsewhere. We thus name some areas where we think improvements are possible. A few of them has been suggested by some before but we hope to add a few fresh ones too. There are:

- Accelerate the privatization process. Here again we do not call for a “shock treatment” privatization style irrespective of the consequences. But still there are areas that can be left to the private sector. There are for one thing, many companies that need to be still mostly in the hands of the government, e.g., The National Cinema Company, The Touristic Enterprises Co.
- Make “Doing Business in Kuwait” easier. We have already noted the World Bank rating that ranks Kuwait as # 86 globally. Sure, there must be a lot that can be done to expedite the process by reducing the number of procedures,, the time and the cost they take, etc... Just like one MP suggested a few years ago, (the late Ahmed Al Rabie): Why should one prepare and submit a formal feasibility study just so he can start a business. After all it is the applicant’s money and if they want to depend on their intuition instead of a formal study, so be it!
- We cannot call or abolish the welfare state nor laying people off the government rolls. But the employment for life umbilical cord must be severed. Here we would like to suggest a system of sabbatical or temporary leave of absence. Kuwait government employees should be given the option to take two or three years off to pursue their own business projects giving them declining salary and benefits in the meantime. Anytime before or at the end of the period, they can rejoin their jobs if things did not work. At present, 83% of the Kuwaitis national work-force is in the government sector (*Al Watan Daily*, 2/8/2009). Others put the figure as 95%. Citizens are lured by the job security and the generous pay and thus many would not venture to work for hire in the private sector or for themselves. But if they feel their job is secure, some may take the plunge. They do not have to spend their sabbatical as self-employed and can work for hire too.
- We feel a proposal like this has a lot to recommend it and its costs are minimal. Probably many of the government employees are already underemployed anyway. The sabbatical may even be thought of as a training course like those the Civil Service Commission sponsors. This way, government employees can venture into business and still rest assured that their job is secure. That should have a positive impact.
- Weaken the foreign franchise monopoly tendencies. These monopolies are granted by multinational corporations over which Kuwait government has no control. The government cannot decree them out of existence. That goes to the heart of the system. But there must be something that can be done. Franchising is one reason for the spread of SMB’s abroad and multiple franchises are the exception rather than the rule in advanced countries. But here multiple and Kuwait-wide, exclusive franchising is the rule without exceptions. Now if companies like Microsoft can be made to give-up some of its practices to make room for others in the US and EU, as efficient and good-intentioned as it is, sure something could be done to make some domestic monopolists here unload some of their franchises. There is no meaning for one person or firm to own all 40 Mac Donald’s or all 60 Starbucks in Kuwait. A profit tax could be levied for instance, on anyone who owns more than ten franchises.

Or barring that, in future, any foreign franchisor wishing to enter Kuwaiti market can be required not to give exclusive franchise rights for the whole country for one entity. A maximum could be set on the number of multiple franchises one can operate, that maximum varying according to the nature of the industry. In future, the government can also allocate new gas station franchises one station only to each franchisee.

Let us finalize this section with one optimistic note. Kuwaitis have a reputation as an enterprising people, merchants by nature. Up until now that spirit has been partially held in check by the overstretched government role, the monopolies and the environment. The desire to transact and the entrepreneurial spirit are still alive though. This can be attested to from the huge number of applicants for licenses to start a business issued. According to the Ministry of Commerce and Industry an average of 4500 licenses were issued for a starting a single proprietorship and about another 4200 to start a limited company and still more for other legal forms in each of the years 2006, 2007. We thus had an 8700 plus approved applications reflecting intentions to start a business. We understand that in the US some 850,000 Americans (Scarborough, 2014) were trying to start a business around the same

time; that is about a hundred times that in Kuwait. Knowing that the populations proportions are also 100:1 (300 million to 3 million), that means the entrepreneurial spirit in Kuwait is not any less than that of the Americans. So all that is needed is to give it a hand.

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