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**COLLEGE OF BUSINESS ADMINISTRATION
DEPARTMENT OF BUSINESS AND MANAGEMENT**

**SMALL MANUFACTURING BUSINESSES IN BAHRAIN
(A STUDY OF FINANCING PATTERNS)**

BY

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(A study of Financing Patterns)



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Chapter 1

Introduction to Small Businesses and Research Methodology

1.1. Introduction:

The Small enterprise sector has always been an important part of economic development in any country irrespective of its ideology, culture, religion and whether it is a developed or developing country. Additionally, it can probably be safely said that now, for political and social reasons, the small enterprise sector has never been more important. In many countries all over the world, small enterprise development is receiving increase attention from government and non-government institutions, including employers' organisations.

It has been proven that the national economy in any country, constitutes, in its totality, of many groups of small, medium, and large firms. The size by itself, does not give the firm more weight in the hierarchical ladder of importance. After all, the economical achievements will come as a result of group effort to be put together to fulfil a common objective (Kuwait Chamber of Commerce, 1985). Therefore, when small and medium firms flourish and revive, their effect will reflect positively on both, the

national economy and on social commitments as a whole. Conversely, when those firms experience a down turn or a slump, the effects will reflect negatively on the economical and social developments.

In fact, it will not be an exaggeration, if we say that small firms were and still are the seedbed for the economic and social development. They are mostly regarded as a fertile transition to many large firms which will have stronger and deeper roots than many other firms started large.

The economic significance of the small enterprise sector is highlighted by the following (Philip A. Nick, 1980):

- 1- large number of enterprises involving between 60 and 90 percent of all enterprises.
- 2- its role in servicing large-scale and state-owned enterprises as well as catering for its own markets.
- 3- by providing linkages between economically and geographically diverse sectors in the economy.
- 3- increasing personal savings and investment; propensity for special subcontracting, and
- 4- the relatively low capital cost in creating employment opportunities.

The social reasons for promoting the small enterprise sector include the need to improve the quality of life as reflected by increasing opportunities for gainful employment; and the need to absorb the under and unemployed which cannot be accommodated by government or large scale enterprises. Additional benefits accrue from the possibilities for enhancing job satisfaction and providing opportunities to move to a more industrialised life-style.

At the same time, problems exist in assisting growth and development of a sector which is fragmented, disorganised, without a legislative voice-piece and is difficult to contact collectively or individually. Moreover, assistance to the sector requires to co-ordinate inputs involving managerial training, finance, technological considerations and development packages. Such coordination can emanate from many sources, including employers' organisations.

All of these problems are serious and impede the developments of small firms. Because of the wide scope involved in examining all of those problems, it will be difficult to cover all of them in one single project. Additionally, any project that aims to cover all of those issues will probably lack an in-depth analysis of each problem. Therefore, it was decided to take only one problem area, specifically "Finance" and study its impacts on the growth and development of small firms in Bahrain.

1.1.1. Purpose of the Project:

Financial issues are important to any organization, be it big, medium or small. However, well established firms may face less difficulties with regard to sources of fund. Normally such firms are being viewed by creditors, such as banks etc., with some sort of confidence. Of course, there may be small firms that are well established and therefore, will benefit from this perception as well.

On the other hand, many small firms are still viewed with caution. This is because of the higher default risk amongst such companies. Therefore, a research that studies how small firms grow or decline is quite important to the community. There are so many reasons which hinder or assist small firms, amongst which is the financing patterns. The purpose of this project is to study these patterns and see how small firms in Bahrain are financed.

Any firm will require an initial capital to start the business. It will also require a working capital to be able to operate and finally will require more to grow. The way in which small firms go about the above mentioned stages will be examined in this project.

1.1.2. Scope of The Project:

In Bahrain there are many enterprises that can be classified as small. Those may be found in the services and manufacturing sectors. Furthermore, in each of those two broad categories, we find many industries such as follows:

- Services:
- Building and maintenance.
 - Repair of T.V. and Radio sets.
 - Plumbing..
 - Electrical Installation etc.
- Manufacturing:
- Chemical.
 - Food.
 - Fabricated Metal Products.
 - Non Metallic Mineral Product, etc.

Because of the impracticality of covering all industries, and the fact that services and manufacturing are subject to different environmental issues which will undoubtedly influence the result, the research had to be limited to one or the other (services or manufacturing). The availability of information on the small business enterprises was the main determinant factor to choose the area to be researched.

The Ministry of Development and Industry had recently published a booklet on all manufacturing firms in Bahrain. The

booklet enlists all manufacturing firms by industry and their addresses. It also gives other valuable information, such as the number of employees in each company, the capital, the date of establishment and the type of ownership, i.e. a sole proprietorship, partnership with foreign or local people etc. Such information was not found readily available for the service sector. Therefore, it was decided to research the small manufacturing firms. However, there are so many industries in the manufacturing sector. For this reason the most populated industries were chosen for this research.

Four industries were found suitable for the purpose of this research, namely:

- Chemical
- Fabricated Metal Product.
- Food.
- Non Metallic Mineral Product.

Not all firms in those industries were considered. Only those that met the definition criteria were chosen. In addition to those criteria, it was decided to choose firms that have been established before 1985. The reason for this was to ensure that those firms have been reasonably long enough in the business and thus could give more trust worthy results, i.e. normally such firms would have undergone a variety of environmental conditions that would shake the business up, thus would give more reliable results.

In Summary: the scope of the research was limited to the following:

- 1- Manufacturing small firms in chemical, fabricated metal product, food and non metallic mineral product.
- 2- Firms in the above industries with establishment date of not before 1985, capital of not more than BD 200,000 and employees not exceeding 15 people.
- 3- The research mainly focuses on the financing issues, but makes some references to general information about the company and the owners. Such information was felt to be necessary in understanding the behaviour of the entrepreneur in managing their enterprises.

1.1.3. Constraints:

Researches, invariably encounter various problems throughout the stages of the research process. Some of these problems may be serious that would sometimes lead to abandoning the research or delay its execution. Others may be minor and could be overcome with certain tactics.

This research, is not any different from others, also went through some problems which delayed its execution. Those problems (constraints) are summarised below:

- 1- Some of the owners were not cooperative in answering the questionnaire.
- 2- Incorrect listing of addresses and telephone numbers of some of the firms, resulted in being unable to include those firms in the survey.
- 3- The low level of education of some of the owners caused difficulty in understanding the questions, hence some results may not be very accurate.
- 4 The time devoted for the collection of data did not suit some organisations, which caused further delay.
- 5- Customers intervention caused delays and distraction to those answering the questionnaire.
- 6- The unavailability of some owners resulted in excluding those firms from the survey.

1.2. Methodology:

This project consists of two parts, the theory and the empirical studies. The methodology adopted to gather information for the theory part was a manual search for relevant secondary data. Text books, journals, magazines, newspapers, publications and reports from various administrations that focused on small businesses were reviewed.

Data collection for the empirical part of the research centred upon personal interviewing entrepreneurs through a written questionnaire. This method was chosen for various reasons, amongst which are:

- 1- high degree of personal interaction between the investigator and the respondent
- 2- facial expressions and body languages are detected and could influence the results. Such items can not be noticed with mail or telephone interviews.
- 3- results are obtained on the spot, i.e. very quick and prompt. Whereas mail interviews can take weeks before the results are received and could get lost, i.e. never reaches and there is the possibility that the interviewee ignores it and therefore, never gets done.
- 4- Some of the questions are highly technical (specialised) and therefore may not be understood easily by an ordinary lay man.

Although personal interviewing has the 'aforementioned advantages, there are some difficulties with such a method. Two types of errors can arise from personal interviewing and as such we have to be aware of them (Davis D. et al, 1985). They are:

- 1- Non response errors and
- 2- Response errors

The first one could arise from the fact that the interviewee refuses to answer our questions, because of busy schedules, confidentiality etc. While there are numerous methods of reducing non response errors, it is rarely the case that we can completely eliminate them (Mayer C.S., 1974).

The second type of errors are present when a discrepancy exists between reported data and the true value of the variable of interest. While we can never fully estimate these types of errors, we do have some knowledge as to their sources which can help us plan for their minimisation. The response errors inherent in personal interviewing appear to fall into four categories (Davis D. et al, 1985):

- 1- Interview Variability: The difference in the interview situation and the characteristics of the interviewer, i.e. sex, age etc.
- 2- Question Structure and Sequence: The format and the order of the question may bias the results.

3- Methods of Administration: Some of the recent researches suggest that personal interviews may stimulate answers which appear to be more socially acceptable (Wiseman, 1972). Others suggest that response interviews may actually be inversely related to the degree of structure in the questioning process during the interview. However, the evidence is very inconclusive at this time (Sudman S., et al, 1974).

4- Respondent Error: Respondents may give inaccurate answers, either intentionally or unintentionally, and hence will distort the results.

However, those types of errors and problems with personal interviewing may be tolerated, especially when weighing them against the time constraints, the understanding of the questions, reception of the responses etc. For those reasons it was decided to opt for personal interviewing.

1.2.1. Presentation and Analysis of Data:

A data base program was made for sorting out the data. That program was written in D-Base language which enabled sorting out the answers to all questions in the questionnaire. The program was designed to compute various comparison checks between questions, i.e. comparing question 1 with question 3, etc. Once the sorting out data made available, it was rearranged in a tabular form for final presentation.

The analysis of the data was then carried out using a contingency chi-square test. The chi-square test investigates whether a dependence relationship exists between two variables or whether the variables are statistically independent (Keller, et al, 1990).

Since the data in this project have been arranged to verify whether industries are different from each other as far as the financial and major characteristics are concerned, i.e. whether there is dependency between the variables or not, the chi-square test have been found to be useful to carry out this verification.

Chapter 2

SMALL BUSINESSES

Their Role in The Economy and Problems Encountered

2.1 An Overview of The State of Small Enterprises

During the 1960's and early 1970's, most developmental efforts were directed towards large-scale enterprises. However, it was eventually realised that concentration of efforts in this direction could only go so far. Moreover, the alarming decline in the small enterprise sector was recognised to be the outcome of financial and related factors and not simply the result of economies of scale and the myth of technology (Nick P., 1980).

Much has been written about the dynamic role that small enterprises can play in the development process. Amongst their many positive attributes is their ability to pioneer new approaches where if mistakes occur, they do not drag down the economy in the same way as do failures in large scale enterprises. To slow down change is to slow down growth and the ability to effect change in the small enterprise sector is a major contribution to national growth and development.

2.2. Definition of Small Business:

The definition of small business in any economic sector, production, or service has always been a point of debate. It differs from one country to another depending on its economic capabilities and circumstances. Therefore, a precise definition does not exist, despite its importance amongst researchers and academics.

A firm that can be considered small in Japan, could very well be considered a giant one in any of the third world countries. However, some criteria have been agreed upon which differentiate a small business firm from a big one (Bahrain Chamber of Commerce, 1989).

A small business may be defined on the basis of quantitative criteria, i.e. the number of employees; the size of investment; and annual sales. Another commonly acknowledged criterion defines small business according to the degree of delegation of authority and responsibility. Other criteria suggest that small business is unable to adopt modern technology (Perrigo, A.E.B., 1972, 1973) or to raise needed capital through a stock exchange (Symposium Report, 1975).

For the purpose of this project, small firms will be defined as those whose capital does not exceed BD 200,000 and does not employ more than 15 employees.

All of these criteria, to some extent reflect the characteristics of a small firm, but disagreement on each criterion is unavoidable (Kao R.W.Y., 1987). For example is a bolt manufacturing subsidiary of an auto company a small business? Similarly, questions may be raised about the inclusion or exclusion of professionals, farmers and other self employed individuals. Should a law firm or a doctor's office be encompassed under the definition of small business?

The Federal Business Development Bank of Canada use a working definition to guide its lending practices among other things. It defines a small business as any firm employing less than seventy people and with annual sales of less than \$ 2 million (Kao R.W.Y., 1987). The congress of the United States defined small business (in the small business Act of 1953) as follows (Barnes W.B., 1954):

Small business is one that is independently owned and operated and is not dominant in its field of operation.

The Committee for Economic Development stated that a small business has at least two of the following four features (Committee for Economic Development Report, 1974):

1- Management is independent, since the manager usually owns the firm.

2- Capital is supplied and ownership is held by an individual or a few individuals.

3- The area of operations is primarily local, although the market isn't necessarily local.

4- The firm is small in comparison with the largest competitors in its industry.

Obviously some of these definitions may not be applicable in this part of the world (Arabian Gulf).

According to a research which was commissioned by the United Chamber of Commerce of the GCC in January 1989, the following criteria were used to define small businesses (Chamber of Commerce, 1989):

2.2.1. Number of Employees:

A number of countries agree that this criterion is the best for defining small business. It is the most widely used one, although the number of employees in a small firm can differ from one country to another. For instance, Kuwait defines small business as one whose employees range from 1 to 9, and a medium business for firms whose employees range from 10 to 50. In Saudi Arabia, a firm can be defined as small if its employees are less than 50. In Iraq, a small business is defined by Iraqi Statistical Bureau as one whose employees are less than 10. Other Gulf states, including Bahrain, do not have a figure for defining small business.

In a worldwide context, the U.S.A. considers a firm that has employees of less than 250 as being a small business. And in India the criteria for small business is a firm with less than 100 employees. In Japan, firms are considered to be small if their employees are less than 300. In Germany, the firms with less than 9 are considered to be small. In Sweden, companies with less than 200 employees are considered to be small (Neck P.H., 1980). A report from the United Nations about small productivity firms in Egypt and Turkey stated that those countries consider firms that employ less than 10 workers as being small.

2.2.2. Invested Capital:

This is another debatable criterion which some countries use it as a measure to define small business. Others use it in conjunction with the number of employees to define the category of the business.

In Kuwait, small business firms were defined for those whose capital do not exceed Kuwaiti Dinar (KD) 200,000. Iraq stated a capital of up to Iraqi Dinar (ID) 6,000 for small business firms. In Korea, firms with an invested capital of not more than U.S. \$ 200,000 are considered to be small firms, Pakistan uses U.S. \$ 50,000 and India uses U.S. \$ 100,000 to define small business.

Clearly one can conclude that no universally accepted definition of small business firms exists. However, generally it can be said that a small business firm is one that has a limited number of employees, a limited capital and adopt unsophisticated technology. It can also be reasonably inferred that firms of such small employment size are independently owned and operated ventures servicing strictly local markets.

It can also be safely assumed that there is no lower limit to the size of a small enterprise, which can be taken to include the formal and informal sector. A problem, does arise, however, when attempting to establish an acceptable upper limit for the definition.

2.3. The Role of Small Business:

Small businesses perform a number of important functions in the society beyond their major roles in providing goods and services. Some of these functions are (Kao R.W.Y, 1987):

2.3.1. Economical Role:

Although the giant corporations and mass production firms play an important role in the economy in terms of productivity and capital investment, it is the small business firms that constitute the backbone of the nations' economy.

A lot of researches that have been conducted in many European countries proved the importance of small businesses in the general development of the economy. Small businesses have created a lot of opportunities to people and contributed towards reducing unemployment that is considered to be a major problem in any country. In addition, small businesses do not require a huge amount of capital and could normally be started by a single person. Therefore, no additional external financing will be required from the country to establish the small firm. As a result the government could concentrate on the development of other economical issues.

The fact that small businesses are established by the community themselves, will emphasise the inter-relationship amongst them and make them more dedicated to the various economical development programs. Depending upon the entrepreneurial enthusiasm and skills, total investment injected into the system may reach the level which will assist in the economic prosperity of the country. This will also expand the number of small business units throughout the whole geographical areas which will work towards partial contractual agreements with the giant firms to absorb the products and services of these small firms. This in turn will increase the efficiency of the whole economic infra structure and increase dependency between all types of organizations with each other.

The existence of small businesses is also important in rural areas where the infra structure is very poor and such firms can adapt to such poor conditions. Their existence will assist in reducing unemployment in those areas and will also prevent labour migration from villages to the cities.

2.3.2. Innovation:

Even though small business firms have limited financial resources for research and development, a substantial number of successful innovations are in fact made by small firms. They represent a major spawning ground for the new ideas that lead to industrial progress. The very nature of large corporations makes

it difficult for them to devote the resources, especially the managerial talent, necessary to develop and exploit truly revolutionary new ideas (Brigham E.F., 1982).

2.3.3. Seedbed for New Ventures:

Small business provides the entrepreneur with a means of entry into the business world, e.g. many entrepreneurs in the electronic field started their own companies to provide simple computer services to smaller firms on a contract basis. Many of these service bureaus have now become sizeable operations.

In recent years, newspapers and periodicals have published articles concerning businesses that began in the basement of a house or in a small garage or at a street corner (Kao R.W.Y. 1987). Some of these business people have become multi-millionaires owning multinational companies. For example, Compaq Computer Company was incorporated in 1982 with only three employees. Its first year was devoted to product development and in 1982 sales were zero. In 1983, however, Compaq began marketing its personal computer, and its sales hit \$11 Million, a record first volume for any new firm. By 1986 Compaq was included in Fortune's 500 largest U.S. industrial firms (Weston & Brigham: 1987).

Obviously this particular company may have been more successful than most new businesses, but it illustrates the point that small business is the door from which entrepreneurs can enter to the business world.

2.3.4 Competition:

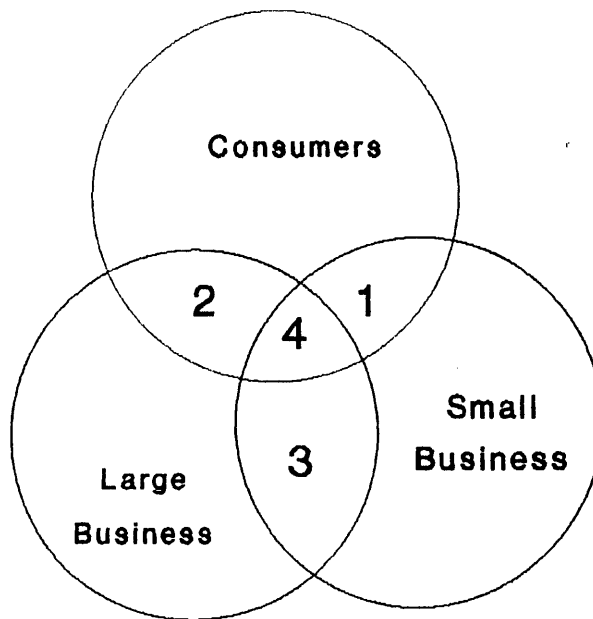
Through small business sector, customers can escape from being monopolized by large firms. Small firms can provide differentiation in products and services, thus offering consumers alternative choices. Such phenomenon acts as a check on monopoly and increases the economic efficiency of the market system. For example if all restaurants in Bahrain were controlled by Hardies, then the people in Bahrain would have only a choice of grilled chicken or hamburgers. Independently operated small restaurants, however, offer consumers a choice of different menus and a variety of foods.

2.3.5. A Complement to Large Companies:

Small companies are able to function as suppliers and marketers for large corporations. Sometimes it is uneconomical for large firms to produce small parts or deal with minor jobs. Therefore, these large firms often subcontract such items to small firms. Similarly, large firms do not normally sell their products directly to consumers. Smaller firms act as distributors for those giant firms. Fig. 1 illustrates the interdependency between the large and smaller companies.

Figure 2.1

Interdependency Between Small And Large Companies



- (1 & 2) Consumers demand for goods & services is supplied by small business 1 and large companies 2. Consumers also work as employees for business**
- (3) Small Business work as a supplier, distributor, whole saler for large companies**
- (4) Consumers, small businesses and large companies demand from and supply to each other goods and services.**

2.4. Composition of Small Business Firms:

The following tables show a percentage distribution of business firms by kind of business and employment size:

Table 2.1

Percentage Patterns of Small Business Firms in U.S.A.:

Industry	up to 5 employees	up to 10 employees	up to 20 employees	up to 50 employees
Ext. Indust.	52.4	67.1	80.5	91.5
Manufacturing	37	52.5	67.5	82.6
Whole Sale	50.3	71.5	86.9	96.4
Retail Trade	64.9	81.5	91.1	97.2
Contract Cons.	64.5	81.7	91.8	97.6
Comm. Services	76.4	87.1	93.6	97.5
All Industries	66.7	81.2	90.3	96.3

(Source: Country Business Patterns, 1984, Part 1:
U.S. Summary, Social Security Administrations).

Table 2.2

Percentage Patterns of Business Firms in Bahrain:

Industry	up to 5	5-9	10-- 19	20-- 49	50-- 99	100- 249	250- 449	> 500	Tot- al
All Activities	2858	928	474	368	97	83	29	17	4854
Agriculture	27	16	7	2	1	-	-	-	53
Mining & Plastic	1	-	-	-	2	2	-	-	5
Petrochemical	1	1	1	2	2	-	-	1	9
Metal Products	-	-	3	3	-	1	-	2	9
Ship Building	29	15	10	6	2	2	2	1	67
Other Industries	488	240	57	19	10	6	-	-	820
Power & Gas	2	-	-	1	-	1	-	-	4
Contractors	75	109	134	134	31	38	15	9	545
Rest. & Hotels	141	86	26	13	10	5	4	-	285
Whole Sale Trade	1563	261	87	71	15	12	3	-	2012
Transportation	17	11	23	14	4	3	2	3	77
Communications	1	1	-	-	-	2	-	1	5

(Source: Yearly survey of firms and manpower - 1985
Ministry of labour and social affairs, Bahrain.)

It is clear from the data in the above tables, that small businesses predominate in all the private sectors of the economy. The relative importance of the small firms, however, differ considerably from one type of business to another, so also the long run trends in the industries vary (Baumback C.M., 1988).

2.5. Characteristics of Small Business:

Small business firms in the Arabian Gulf are characterized by many features that distinguish them from big firms. These characteristics can be summarized as follows (Aldin S., et al, 1987):

2.5.1. Easy to Establish:

These firms operate to satisfy the local total and partial needs in all economical sectors. Because of the fact that these firms require relatively small capital, they are easier to be established than big firms. Therefore, individuals are attracted to invest in such a productive field which will ultimately increase the total utility of the country.

2.5.2. Independent Management:

Most of small firms are centrally managed by the owner(s) of the firm. This will lead to a personal concern of achieving as much success as possible.

2.5.3. Self Training Organizations:

These types of establishments are considered to be auto training centres for their owners and employees. The way they run the business, of continuous operation and being responsible for technical and financial matters that require knowledge and gathering of vast amount of information, will qualify them for handling big investment operations in the future. This in turn will lead to more investment opportunities which will create more jobs to the community.

2.5.4. Adaptation to modern Environmental Changes:

Small firms respond quickly to environmental growth and developmental changes, especially with regard to consumers with rapid changing taste. In contrast, big firms are slow to adapt, due to difficulties in changing their production plans. For instance top management of IBM and du Ponts are typically so involved in their complex business plans, corporate strategies and hierarchical structures that they have little time to spend on developing the potential in convenience stores, fast foods operations, personal computers etc. Therefore, small business entrepreneurs turn out to be more flexible and efficient (Brigham E.F., 1982).

2.5.5. Employment Opportunities:

Due to the nature of these firms, which uses simple technology, normally provide employment opportunities for a large number of people. In addition, they allow a direct contact between the owner(s) and the employees, create a friendly relationship between them and increase the awareness of the owners on what the employees are doing.

2.5.6. Quality Product:

Small firms normally rely on very limited and specialised fields of production. This specialisation may lead to a better quality than that of big firms. Working in small firms would require competent individuals capable of designing products that meet the needs and wants of their consumers.

Table 2.3 overleaf compares small businesses with large companies with respect to some major characteristics.

Table 2.3

Characteristics of Small vs Large Firms:

Characteristics	Small Firms	Large Firms
1- Market Share	Small/insignificant	Substantial/Significant
2- Management	Managed personally by the owner, rather than by an appointed director	Managed by an appointed director
3- Strategy Characteristics	a- Concentration on a certain market niche, with a restricted of products/services b- Rapid adaptation to changing market conditions. c- Flexible production cycles, offering greater variability to a stable market	a- Selection and employment of one or more strategies depending on long-term objectives, environmental variables and existent competition b- Slower adaptation to changing business conditions c- Less flexible production cycles, limited variability on products/services in "risky" markets as well,
4- Capital	Rather Limited	Substantial
5- Major objectives	Survival	Return on investment, or growth or both
6- Organizational Structure	a- Emphasis on informality and critical importance of the organizational head b- Lack of departmental sub-organization c- Short channels of communications frequent personal contact	a- High degree of formalisation in terms of job description, and procedures. b- Widespread departmental and sub-departmental organization c- Longer channels of communications

source: Arthur Meidan, Handbook of Business Policy, Management Decision Volume 24, Number 4, 1986).

2.6. Problems The Small Firms Encounter:

Private sector enterprises in the Gulf area receive various subsidies and facilities, e.g. the industrial sector is facilitated with the necessary services in addition to donations. At the same time there are no restrictions on imports and exports for trade industry. The service sector gets full support and encouragement from the government through loans and other financial supports. Despite all these assistance granted to small businesses, it is not yet up to the desired level and has been far below the expectation of the government (Mohammed Khamis, 1985).

Most governments have supported various programs and created a number of institutions to encourage the growth of the small enterprise sector. The S. Corporation Tax Status of the internal Revenue Code in the U.S.A. allows small corporations to enjoy certain benefits to enable and encourage them to grow. This code defines tax laws and gives certain considerations to small business to encourage the flow of equity capital (Weston and Brigham: 1987).

In Bahrain the Ministry of Development and Industry has started a program of different phases that assists and develops the small and medium manufacturing companies. This program

commenced in 1990 and two phases have already been completed (Akhbar AL-Khaleej, 1991). The third phase of the program is being implemented and is expected to finish end of 1991. This program has already yielded some positive results in the sense that Bahrainization in the concerned factories has risen from some 13% to 43% which in turn will contribute to raising quality and reducing costs. A Government official announced in Alayam newspaper No 916 dated 8th September 1991, that the aim of the program is to promote small businesses in Bahrain through some consultancy advice in order that such small businesses could become exporters and compete with other international firms worldwide. The official added that small and medium firms in Bahrain represent the backbone of manufacturing industry and therefore, the program will extend to all manufacturing small and medium firms as per a planned schedule. (Alayam Newspaper No. 916).

However, there is still some doubt as to how best to promote and assist the small enterprise sector. Every government needs a strong unit or division within its framework capable of providing central guidance and control of diverse programs regarding small enterprise development which are either being implemented or planned. Governments may be involved in major economic restructuring programs, and the lack of having a specialised unit dealing with the development of small businesses and their programs will lead to less attention being devoted to them.

Consequently a lot of problems have impeded the effectiveness of those enterprises (Qabil M.S., 1990). This section attempts to explore the major issues that impeded the effective role of the small firms.

2.6.1. Marketing Problems:

One of the major problems that small and medium firms faces is the problem associated with marketing issues. The severity of this problem varies according to the type of business of those firms. However, in general, the problems lie in the limited local market and the homogeneous product.

These problems result from the fact that small firms generally try to follow a policy of producing large quantities and keeping bulk stocks of their product in an attempt to compete with large firms and foreign products. In addition, small firms do not use scientific approaches in marketing their products. Instead they depend on personal skills to study the market needs without referring to properly trained marketing experts which will reduce their expenses.

Other marketing related problems may be the lack of sufficient information about the market and the inability of those small firms to benefit from the available information. Those problems manifest as a result of the lack of proper marketing plans and market researches. Therefore, it is

necessary to coordinate with other small firms in an attempt to overcome these problems and reduce the amount of competition on the commodities produced by the concerned firms. It is also necessary to adopt a strategy of sharing some activity channels that will help in the growth and development of those markets. The cooperation and coordination amongst the firms of similar products will eventually enhance their bargaining power over the suppliers to get better prices for the raw materials and the necessary items for their products.

2.6.2. Financial Problems:

Another major problem that small firms face is financing problem. Although this project will examine, in depth the small business financing, the author will briefly highlight the nature of the problem in this section.

The problem seem to be in the capital composition of the enterprise. The high debt to equity ratio would result in paying high interest on bank loans which ultimately would disrupt the investment opportunities and lead to mismanagement. Most small businesses are privately owned by one person, a small family or a limited number of people or families. Generally their financial resources are limited which is reflected in their limited capital. Consequently, such capital may only suffice the initial start-up in the

first phase of any project. It certainly will require additional capital to undertake the subsequent phases which include operations, renovations and growth. Additionally, those firms suffer from unobtainable receivables (bad debts) which will make them unable to meet their debt obligations and be vulnerable to bankruptcy.

Conceptually, there is no difference between the financial problems of large and small companies. However, in view of the size of operation, the financial management of a small firm has several distinct characteristics (Kao R.W.Y., 1987).

Due to the fact that small firms have limited financial resources, they can not employ financial specialists. Therefore, the owner manager will take the responsibility of the financial management of the enterprise. Consequently, the owner, has to have some financial knowledge to be able to analyse the financial data and use them to make decisions. The entrepreneur should also be able to explain the financial situation of the company to the investors and creditors, at least, in the early stages.

2.6.3. Managerial Problems:

Most small and medium firms are managed by the owner of the firm. In most cases such managers lack the experience and knowledge in many areas of the activities of their establishment (Dr. Salah A. Al-Baqi, ' 1987). Such organizations are also ill-structured and do not have proper organization charts which define the nature of each job in the organization. Due to these unorganized practices, a lot of problems can be encountered, especially those related to production, i.e. provision of raw material in time, quality assurance and control. In addition to operating the plants in the most economically way to yield maximum profit.

Such organizations require special talents and long experience to successfully manage all activities such as production, marketing, financing, etc. Therefore, training policies must exist to improve the skills of those who will run such organizations.

2.6.4. Lack of Information and Statistical Data:

Most decisions in small businesses are made on the basis of the owners' own perception to the problem. They do not rely on information or official statistical data which may be available for:

- a) economic development plans, and
- b) local and external market indicators.

The reason for such practices may be attributed to the ignorance of the importance of information and statistical data. In addition, for many small firms, there are no proper filing systems to store such information.

2.6.5. Availability of Raw Material:

One of the things that separates small firms from the big ones is the former's reliance on the local market for raw material. However, we see that, in many cases, small firms tend to use imported raw material in an attempt to produce substitute products. This will create a lot of difficulties to those firms with regard to getting the material. The problems may be associated with high prices (because of small quantities being required) or the unavailability of import organizations who can order the material for those firms. Even if such organizations are available, the cost for their services may be too high.

2.6.6. Other Problems:

There are more problems other than those mentioned above. Those include:

- a) Poor planning and lack of research and development which will lead to poor production.
- b) No consideration is given to the safety and security aspects.
- c) Qualified workers are taken by large firms, leaving the small ones with inadequately qualified people. In addition to having unutilized resources which resulted from the prevailing poor economical conditions that followed the boom period.
- d) Unplanned expansions in operation and overstocking in a haphazard manner.
- e) Fast growth in the firm's activities without proper planning and with no concern to the future economical conditions.
- f) No proper policies and procedures are followed for the selections and development of employees.

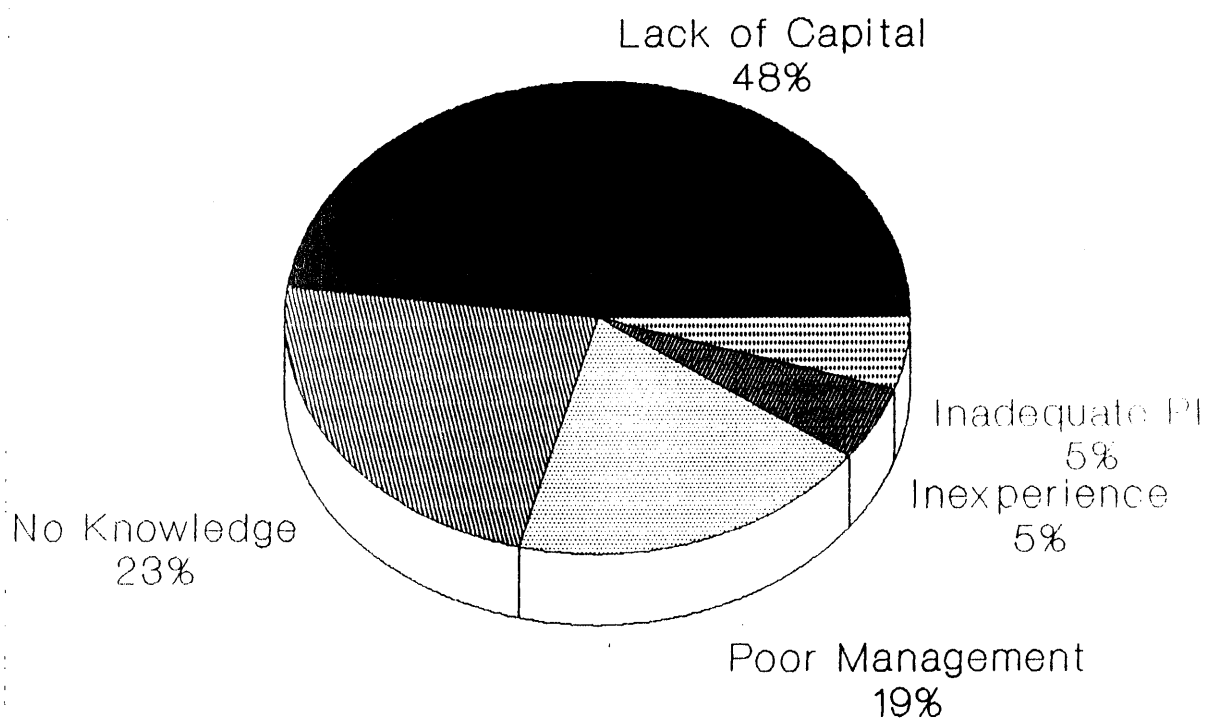
Some studies conducted in U.S.A., more or less, confirm those problems. According to a survey of 703 businesses commissioned by Minolta Corporation, it was found that the main reasons for failure of new firms are (Megginson Scott Megginson, 1991):

- 1- Lack of capital.
- 2- No business knowledge.
- 3- Poor Management.
- 4- Inadequate Planning.
- 5- Inexperience.
- 6- Burdensome government regulation and paperwork.

The following pie chart illustrate the percentage failures of small businesses due to the aforementioned reasons:

Figure 2.2

Reasons & Percentages of Small Business Failures



Chapter 3

FINANCING SMALL BUSINESSES

3.1 Funds Requirements of Small Businesses:

Raising money to go into business is often a great barrier to many entrepreneurs. It requires a special skill to convince lenders and investors who will be involved in such a business. Because of the high bankruptcy rate of new small business, lenders and many of the financial institutions are unwilling to lend or invest in these new ventures. This inaccessibility to start-up capital leaves the new business on a weak financial foundation, vulnerable to the causes of business failure.

In searching for funds to expand and operate a small business, the entrepreneur has to identify the types of capital needed. There are three types of capital required by businesses: Fixed capital; working capital; and growth capital (Scarborough, et al, 1988).

3.1.1. Fixed Capital:

It is needed to purchase the fixed assets such as building, machinery and other types of equipment that is needed for the production.

3.1.2. Net Working Capital:

This is the difference between the current assets and current liabilities and is needed to offset the uneven flow of

cash into and out of the business. It is normally used to buy inventory, pay bills, finance credit sales, pay salaries and take care of unexpected emergencies, etc.

3.1.3. Growth Capital:

It is needed to expand the business, i.e. if there is high demand on the company's product which it can not meet without cash infusion. This additional cash will be used to expand the plant size, sales and production work force.

Entrepreneurs must meet all three types of capital requirements, and although they are interdependent, each has certain sources, characteristics, and effects on the business and long term growth (Scarborough, et al, 1988). Once the owner identifies the type of capital needed to get the business going he or she must begin to shop around for the funds.

3.1.4. Growth and Net Working Capital Needs:

Entrepreneurship often underestimate the required net working capital to start up a business (Weston and Brigham: 1987). Less experienced founders of new businesses invariably have a naive point of view of the business. They expect to come up with a product that will immediately be accepted by the market and for which it will pay a substantial price. This high price, in turn, is expected to lead to high profit margin, which in turn will finance all of the firm's other needs.

Rapid growth consumes cash rather than generate it. Rapid growth does generate profits, but profits do not pay the bills - Cash does. Any firm that wishes to sustain a high growth rate, must invest in each of the working capital items (mentioned earlier) before any cash is received. If the firm is growing at a fast rate, then it is experiencing a constant need for new funds. These funds must come from new external equity or from new debt; retained earnings will not be adequate (Weston & Brigham: 1987).

3.2. Sources of Funds for Small Business:

Small business owners have a number of sources they can tap for funds. The sources from which they obtain funds will depend to a large extent on the manner in which they intend to use the funds. It is also important where on the industry life cycle the firm is, i.e. is it:

- 1- on the experimentation stage, or
- 2- on the exploitation stage, or
- 3- on the maturity stage, or
- 4- on the decline stage.

This is because small firms face fundamentally different situations, and have vastly different problems and opportunities in each stage of the life cycle. Industries of small firms can also be classified into two main categories (Eugene Brigham: 1988) viz:

- 1- Traditional small firms, and
- 2- Small firms with growth potential.

Each of these categories can go to a different source for financing needs (Refer to figure 3 for financing patterns). The aim, of course, is to secure financing at the lowest possible cost. In ensuring that providers of fund will perceive the request as being relatively less risky, the entrepreneur will have to provide one of several things as follows (Howard Stevenson, et al: 1989):

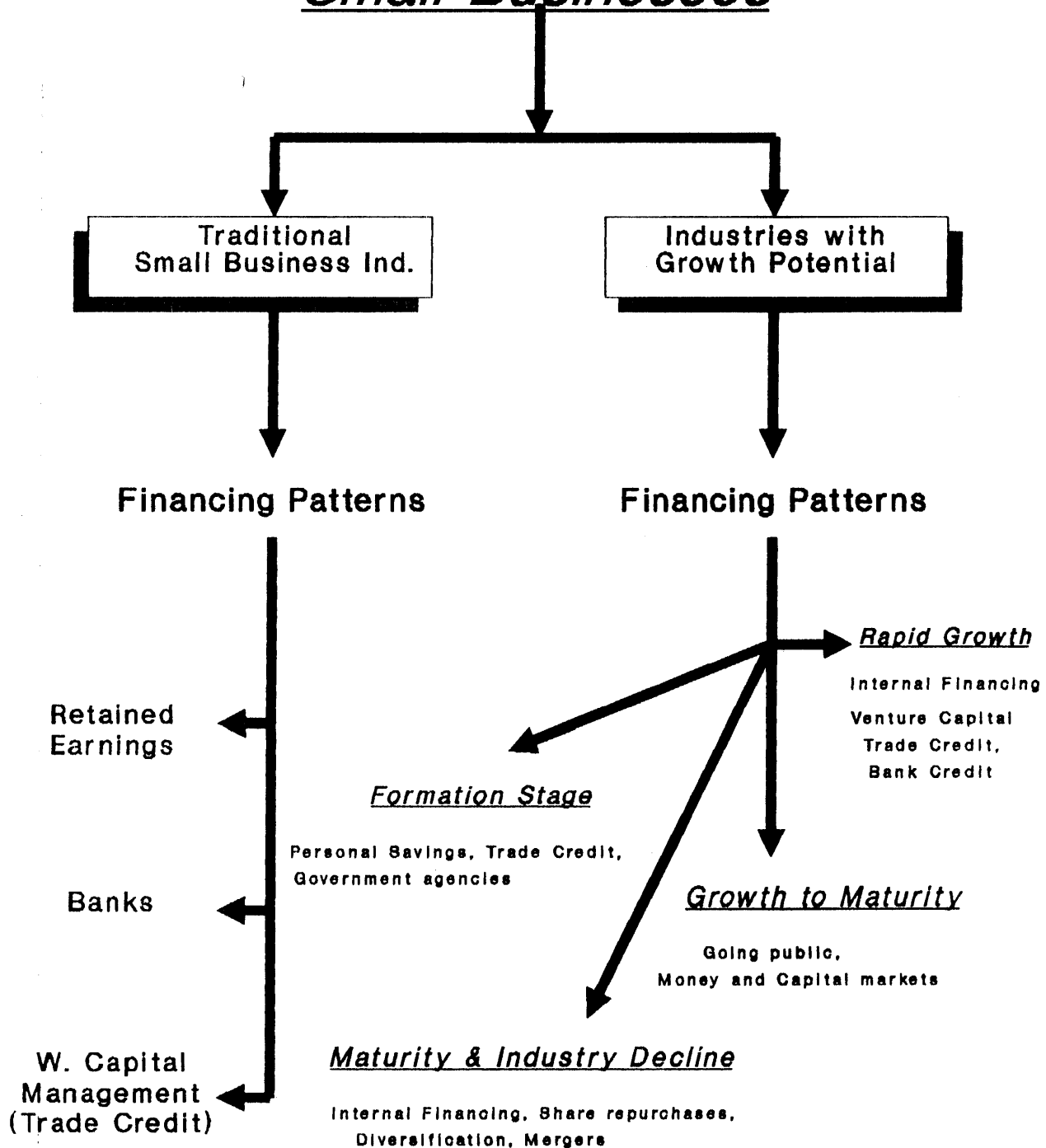
- 1- Pledge personal or corporate assets against a loan.
- 2- Promise to repay the loan over a short period of time when the investors can judge the health of the business, rather than over the long term when its financial strength is less certain.
- 3- Give investors some mean of control over the business through either loan covenants or participation in management (i.e. a seat on the board).

In addition to the above, creditors will be more concerned about the healthiness of the firm wishing to get a loan. Creditors will do a careful financial analysis through which the status of the firm can be determined. Such analysis is extremely important, in order to find out whether the company in question will be able to repay its debt or not. The creditors will be particularly concerned about indicators of liquidity and about continuing prospects for profitability. Those businesses who

Figure 3.1

Financing Patterns of Small Business

Small Businesses



appear to be able to pay off the loan on a timely basis and that they will remain in business, will be considered for loan grants (Weston and Brigham: 1987).

However, bankers (or any other creditors may encounter certain problems with small firms customers that will hinder them from being able to determine the creditworthiness of a small firm (Weston and Brigham: 1987):

- 1- Small firms may not have audited financial statements. Furthermore, the statements may have been produced on an irregular basis, i.e. in some months but not in others. Therefore, the financial data is not reliable.
- 2- The extra risk that could result from the dependence on the leadership of a single key individual. The unexpected death of that person could cause the company to fail.
- 3- The lack of diversity of the product line or customer base, which makes the firm susceptible to a sudden loss of revenue.

The funds may be obtained from one or a combination of the following sources, and dependent on whether the firm is a growth oriented one or a traditional firm (Baumback C. 1988):

The available sources of funds that can be obtained from the market fall into two categories, namely: Equity financing and Debt financing.

3.2.1. Equity Financing:

It represents the owner(s) personal investment in the business. Such financing is sometimes referred to as "risk capital" because the owner(s) is vulnerable to loose the fund if the business fails.

3.2.1.1. Common Sources of Equity Capital:

i- Personal Savings:

The most common source of equity funds used to start up a small business is the owner's personal savings (Scarborough & Zimmer: 1988). As a general rule, the entrepreneur is expected to provide at least half of the start-up funds in the form of equity capital. This is because if he or she is not willing to risk their money, other potential investors are not likely to risk their money too.

Furthermore, if the owner's contribution is less than half of the initial capital, then excessive borrowing will be necessary. Such borrowing may have a high repayment schedule which will put intense pressure on cash flows.

ii- Personal Borrowing from Friends and Relatives:

A common way of financing a business, would be through contributions from relatives who have faith in the abilities of a member in the family. In addition, this member is known to all members of the family and therefore, he or she will be a better candidate than an outsider. Such family investment is known as love money (Raymond Kao: 1984).

Although it is a way of financing a business, especially at the start up stage, it is considered as a poor practice. Such financing may lead to conflict amongst the associates who provided the loan. They may impose certain recommendations which may not be in harmony with the wishes and objectives of the proprietor. However, if a business is to succeed and the most desirable results are to be obtained, the social relationship should not be mixed with business transactions. The transactions should not be treated as a favour.

iii- Partners and Shareholders:

Funds can be obtained by engaging a partner. Money is easier to borrow in a partnership, because partners share debts. Alternatively, a corporation may be formed through many investors (shareholders) and funds will be more readily available. An organization that is classified as a corporation will be more attractive to investors for the following reasons:

- a) Legal limited liability, i.e. in case of bankruptcy, stockholders losses will be limited to an amount equivalent to their share.
- b) The organization has a continuous existence and each investor is free to dispose of his/her stock at any time.

iv- Financial Assistance Programs:

In some countries such as U.S.A., there are small business administrations that are established to make financial assistance programs. For instance, in U.S.A. the small business act of 1953 spells out the type of assistance that small business can get through small business administrations. It says

"To make loans to enable small business concerns to finance plant constructions, conversion, or expansion, including the acquisition of land, equipment, facilities, machinery supplies or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment or materials to ensure a well balanced national economy (Baumback C.M. P.388, 1988)."

However, the Small Business Administration is not allowed to make such loan facilities unless private financing is not available on reasonable terms. Small business administration classifies the loan programs as follows:

- a) Business loans
- b) Disaster loans
- c) Developmental loans
- e) Other loan programs i.e. energy loans for firms engaged in manufacturing, selling, installing, servicing or developing energy etc.
- f) Guaranteed lines of credit - credit as opposed to loans, especially for building contractors.

v- Small Business Investment Companies:

Another way that small firms can obtain their financing needs, is through investment companies. Normally loans and equity capital that are not met by other lending institutions, can be obtained from those investment companies. Such firms have been developed in Canada when a small firm development Act and SODEQ (Societe de Development Enterprise Quebecoises) were introduced (Ramond Kao, 1984). Both of these are designed to encourage the private sector to provide venture capital funds for smaller firms.

in accordance to the Small Business Development Corporations Act, private investors or corporations can form a small business development corporation. This corporation will receive a 30% rebate from the government on their investment and is required to invest 70% of its capital in small businesses.

Similarly the U.S. government has introduced a similar act for Small Businesses Investment Companies in 1958 (Clifford Baumbach, 1988). The purpose of that act was to meet the needs of small businesses for long term debt and equity capital which the government felt were not adequately met by other lending institutions.

vi- Venture Capital Companies:

Small firms do not ordinarily have access to the public markets for four reasons (Fred Weston & Eugene Brigham: 1987):

- a) An issue must be large enough to capture the attention of participants in the market, otherwise it will be ignored.
- b) The issue has to have good secondary market where investors are able to sell their stocks with minimum effect on stock prices in general. Small issues have limited market and are not actively traded.
- c) Good information records. Such factor may not exist for small firms, especially those that are seeking funds for the first time. Therefore, it is difficult for investors to determine a fair value for the stock.

d) It is important for any investor to evaluate the risk involved in the investment made. High return are usually accompanied by high risk. And an investment in a small firm, especially a new one, is likely to be riskier than most.

Therefore, risk analysis is vital to investors in small business. In evaluating potential opportunities, the providers of funds will typically use some form of a risk/return model. However, the general public is not equipped to make such evaluations.

For those aforementioned reasons, the debt and equity market is not a suitable source to supply risk capital that supports the development of new small business. Consequently, an industry of venture capital firms have been developed to supply both capital and managerial experts to growth business (venture Capital Journal, October 1982). Therefore, another way an entrepreneur can obtain equity, is through venture capital companies. However, these companies do not normally invest in business which are at the infancy stage. Such companies look for promising ventures that are developed and have good operating history and good future prospects. Therefore, their policy is to enter, in these investments, as shareholders as opposed to just granting loans.

Over the past 20 years there has been a greater emphasis on the need for venture capital. In times of high and uncertain increases in interest rates, many heavily borrowed companies have been forced into liquidation. The effect of a rise on capital costs differs with the growth stage of the borrowing company. Companies at a take-off stage have been forced to revise their plans and those at the start up phase have been largely knocked off course. Despite the fact that those companies are familiar with financial projections and cash flow forecasts, they may lack certain precision measurements which would cause their calculations to be upset by unforeseen circumstances (Mohammed Khamis, 1985). Revised calculations are a temporary arrangement to get improved loan facilities.

The real problem is the weak capital base and the solution is strengthening that base. Despite the enthusiasm of some entrepreneurs for holding all the equity, results indicate that for any project with significant long term growth, up to 70% of the equity required needs to come from other sources. In many cases family businesses subscribe or relatives assist, however, it is prudent for some families to avoid the risk or equity capital responsibility for risk ventures. It is known that:

Risk = Reward.

These 2 'Rs are linked and as we magnify the potential reward we also magnify the risk. Venture capital investors made significant rewards in supporting high tech. ventures which are characterised as high risk companies (Dr. Mohammed Safwat, 1990).

Therefore, venture capital could be described as Adventure capital, disregarding safe returns on gifts and blue chip. Venture capital pursues opportunities of above average rewards and incomparable risks. Another consideration of venture capital for growth enables a company to accelerate and perform without the burden of high interest rates.

Although venture capital business appear to be attractive, there is usually high risk associated with it. A company could have good growth potential and appear to be very successful which will draw the attention of a venture company. However, such successful company could introduce a product that does not take off the ground and consequently drain all the firm's resources. In such a case, the venture firm will loose all of its investment. For in stance, the Osborne Computer Corporation which developed the first portable personal computer and it grew from scratch to sales of nearly \$100 million in just two years. A venture Company called Seven Rosen Partners invested \$300,000 in the firm in the summer of 1982, but in the summer of 1983, Osborne filed for bankruptcy and Seven Rosen lost all of its investment (Weston and Brigham: 1987).

Venture companies contribute more than just money to growing small firms. If a substantial investment is made, venture capital investors would assign a member on the board of directors, and assist the company in locating management or scientific talent. In such cases, the venture company would assume the role of an advisor to the small firm.

In Bahrain, there is a strong evidence that the cost of capital is a major inhibitor of growth. At the same time there are significant pension and trust funds which must need to be invested in a portfolio which combines safety with a small degree of risk. To the degree that these funds are exposed to risk in portfolios outside Bahrain, they could be directed to a Bahrain venture capital fund.

Currently, there are no venture capital firms established in Bahrain. However, the nearest to this scheme is the Islamic Banks. Those banks can enter as partners (Musharaka) by contributing funds as a credit to a going concern company. The profits are divided between the bank and its client according to the relative shares. These type of partnership, normally include an agreement whereby the bank promises to sell to the client partner its share at a future date.

Another type of Musharaka, is the so called declining partnership share. Under this agreement, the bank will enter as a partner/promoter of a certain new project with one or more partners/promoters. The bank, however, agrees to sell and the partners promise to retake the equity of the bank either all at once or in instalments (BMA Publication, 1987).

vii- Internal Sources

Small firms should always carefully analyse their own resources before seeking outside financing. Quite often, it is found that there are idle materials in the inventory which can be utilized as a source of fund by selling them. Identified surplus material must be disposed of as quickly and as economically as possible to ensure efficient operation. It is also important to exercise tight control on credit sales. Small firms that are in need for funds should not extend the credit sales, as it will tie up too much capital in slow or doubtful accounts.

Idle assets in the form of fixtures, equipment which do not affect the operation of the firm, could be sold to provide some sort of funds for the business. Extra space may be rented to secure extra income, and so on.

In summary, the traditional small firms have the following areas from which they can be financed (Eugene Brigham: 1987):

- 1- The proprietor must rely on internal financing (retained earnings) to a greater extent than would the management of a large firm.
- 2- The proprietor must be a jack-of-all-trades and master of all if the business is to survive in the long run.
- 3- Working capital management is critical to the small entrepreneur, for if a breakdown occurs here, the firm will not remain solvent, and will go out of business.

3.2.2. Debt Capital:

It involves the funds that the small business owner has borrowed and must repay with interest. Borrowed capital has the advantage of allowing the owner to maintain complete ownership of the business. However, it must be repaid with interest at some point in the future. Since, small businesses are considered to be riskier than large businesses, they must pay higher interest rates. (The higher the risk, the greater the return demanded.)

3.2.2.1. Potential Sources of Debt Capital:

A) Commercial Banks and Other Lending Institutions:

Commercial banks are a primary source of funds for small business. In fact some banks have established small business loan departments for the purpose of financing small businesses. Generally, small business loan applications are evaluated by banks on the following criteria (Baumbach C. 1988):

- The nature of the business as evidenced by past records and the bankers appraisal of profit prospects for a new venture.
- The managerial ability of the applicant and his risk averseness
- the type of collateral that ensures repayment of the loan, in case the expected profits do not materialize.

There are various types of loans made to small business from commercial banks. Amongst those are (Scarborough and Zimmer: 1988):

a) Short Term Loans:

Such loans are usually needed to replenish the working capital account to finance the purchase of more inventory, or to finance credit sales to customers. There are various types of short term loans that include:

i) Traditional Bank Loans:

Such loans are usually repaid within 6 months and small businesses are not required to pledge any specific collateral to support the loan (Scott McMurray, 1986).

ii) Lines of Credit:

This is an agreement between the bank and the small business owner that allows the latter to borrow a predetermined amount (usually limited to 40 to 50% of the firm's present capital) at any time during the year. Such type of loan is usually secured by a collateral.

iii) Asset-Based Financing:

This type of financing allows the small business owner to borrow money by pledging its assets as collateral (Susan Schoch: 1984).

iv) Discounting Accounts Receivable:

Under this arrangement the small business pledges its accounts receivable as a collateral. Even though the bank screens all receivables and accepts only qualified receivables, it makes an allowance for the risk involved with uncollectible ones.

v) Inventory Financing:

Under this arrangement the business firm pledges its inventory such as raw materials, work in progress and finished goods as collateral. However, due to the fact inventory is not a highly liquid asset, the bank lends money against a portion of the inventory's worth, usually 50% of its value (Tim Smart: 1985).

b) Intermediate and Long Term Loan:

Such loans are normally required to increase fixed and growth capital. There are three types of intermediate and long term loans (Scarborough and Zimmer: 1988).

i) Unsecured Term Loan:

Such loans are only granted to those who have good business operating performance and experience indicating a high probability of repayment. However, specific terms are required by the bank that may place restrictions and limitations on the firm's financial decisions.

ii) Instalment Loans:

Such loans are given to small firms to facilitate the purchase of equipment, real estate and other fixed assets. The bank usually lends the small business from 60 to 80% of the equipment's value in return for a security interest in the equipment.

iii) Discounted Instalment Contracts:

Banks extend loans to small firms when the owner pledges instalment contracts as collateral. This process operates in a similar manner as discounting accounts receivables.

B) Trade Credit:

Small business firms invariably experience difficulty in securing loans and as a result may not be in a good financial

position to pay cash for expensive materials. This phenomenon is also known to most suppliers who therefore, provide for trade credit to stimulate the sale of their equipment and material. Equipment can normally be purchased by making a down payment of 20 to 30 % and the remainder is paid over a period of one to two years. Trade credit from suppliers for the purchase of materials is the most common and most widely used type of financing in the small enterprise. It often provides a major part of the small business' working capital needs. However, this method, can sometimes get relatively costly, especially if discounts are available but not taken. The effective interest rate on such credit can be extremely high.

C) Miscellaneous Outside Sources:

Other sources of credit to the small business owners include special arrangements by sales financing companies who specialize in buying dealers' instalment account paper at a discount.

D) Commercial Finance Companies:

When a small firm is denied a loan from a commercial bank, the owner of that firm can approach a commercial finance company who is usually willing to tolerate more risk in its loan portfolios. Such companies require some form of collateral to secure repayment of loan.

Their most common methods of providing credit to small businesses are accounts receivables financing and inventory loans. They operate in exactly the same way as commercial banks do.

Chapter 4

SOME CHARACTERISTICS OF SMALL MANUFACTURING BUSINESSES IN BAHRAIN

4.1 Background:

After 1973, the Gulf region in general has witnessed a noticeable increase in the role of the public sectors which automatically was also reflected in the private sectors. Individuals and/or partners started to form establishments in all types of industries, such as manufacturing, agriculture, trade and services to fulfil their personal objectives as well as to improve the standard of living. Additionally, such establishments would have assisted in stimulating the national economy in the region. Such a move has been supported by the governments of the Gulf countries through the encouragement of free economy. Private sectors were given as much assistance as possible in order to overcome any problems that they may encounter.

The existence of large firms is, of course, very important for a several reasons, such as:

- Diversification of risk
- Benefiting from the economies of scale to penetrate the foreign markets, especially with the current policy that supports production for export purposes.
- Establishment of capital intensive - projects and so on.

However, we must not deny the important role that small and medium firms are playing in the Gulf area. These firms are considered to be one of the strongest pillars for the national economies. These small and medium firms fulfil the requirements for social and economic development through product improvements and creation of a wide variety of jobs.

4.2. Research Definition of Small Firms:

Small firms, in this research, have been defined as follows:

A company whose capital does not exceed BD 200,000 (BD 1 = \$ 2.6) with an employee size of up to 15 people.

Of course it is difficult to draw a line that distinguishes small from medium and from big firms as was discussed in chapter 1, but the determination of such a definition was based on a research conducted on small businesses for this region. The research did not clearly define small business in Bahrain but lists various official definitions for the Gulf areas. Those definitions were considered to formulate a definition for small firms in Bahrain. Therefore, this definition should not be taken as an official or formal one, but the non existence of a government definition for small firms and the need of establishing a reference point had led to this choice.

4.3. Monetary and Financing Aspects of Small Firms in Bahrain:

In Bahrain, there are no special financial institutions that give financial assistance to small and medium businesses, nor are there any legislative laws that dictate the banking sector to provide policies for granting financial concessions to small businesses (Chamber of Commerce, 1985). Therefore, small businesses, like big ones, rely on self financing from the owner of the firm and bank loans. Bank loans are made in accordance with the trading conditions of the country.

A study was conducted by the Chamber of Commerce in 1985, which focused on the role of employer organizations in assisting the small business firms. In this study, it was concluded that, up to the time of this study, there was no governmental policies which obligates bankers to devote some of their funds to the development of small businesses. This policy should not be considered as contradictory with the overall government policy which allows for aiding small firms at times of adverse conditions. From this point of view, it can be said that small firms compete on equal footing with big ones and receive the same facilities from the government.

4.4. Characteristics of the Small Manufacturing Firms:

4.4.1 Size of the Firm in the Sample:

The size of the firms included in the sample was determined by two factors, the number of employees and the amount of capital. The figures at the initial stage and at the time of the survey for these two factors were compared to determine the intensity of the firms within each industry. Such comparison is shown in the following tables:

Table 4.1 (a)
Size of The Firm at The Initial Stage

Size of Enterprise	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
No. of Firm	9	14	13	12	48
Total Cap. BD	312,200	686,100	1,021,500	767,500	2,787,300
Total Labour	35	94	62	88	279
Av. Cap. 2/1	34700	49000	78600	64000	58000
Av Labour 3/1	3.88	6.71	4.77	7.33	5.81
Capital/Labor	8943	7302	16478	8731	9982

(BD 1 = \$ 2.65)

Table 4-1 (b)
Size of the Firm as of Today:

Size of Enterprise	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Total Firm	9	14	13	12	48
Total Cap. BD	513,700	818,200	1,097,800	982,900	3,412,600
Total Labour	68	165	142	132	507
Av. Cap. 2/1	57100	58400	84400	81900	71100
Av Labour 3/1	7.56	11.78	10.92	11	10.56
Av Cap/Av lab	7553	4958	7729	7445	6733

(BD 1 = \$ 2.65)

From tables 4-1 (a & b), it appears that the food industry is the most capital intensive one, which may be attributed to the fact that the food manufacturing companies keep a variety of ingredients from which they make the different types of product. Therefore, their current assets are high compared to other industries. This conclusion will be verified later, when we analyse the data of the ratios for current assets to fixed assets.

The second most capital intensive industry is the chemical, which was expected due to the nature of its product. Chemical industries need more capital than labour who should be skilled in their job. A question may be asked as to why, in this particular case, chemical was not found to be the most capital intensive? This research included some companies that

manufacture traditional medicines (made out of plants) and therefore, they do not require large amount of fixed assets (machinery etc.). All that is required is a boiling pot and some filtering stages for the processing. Because of these, the results might have been affected. As expected, the other two types of industries, i.e. Fabricated metal and Non Metallic Mineral, were more labour intensive. Again, Fabricated metal and non metallic mineral industries are characterised by requiring more labour than capital.

Table 4-1 (b), exhibits the size of companies as of today. The results indicate that all industries were more labour intensive today than when they were initially started. Most of the firms have increased their number of employees (manpower) without an appreciable increase in the capital. This indicates that at the initial stage, actual capacity was larger than the utilized capacity, the latter being determined by market demand.

4.4.2. Educational Level of Owners:

The educational level of the owners of the manufacturing firms in the four industries was examined in an attempt to see whether any significant impact is being experienced as a result of the education. The result is given in table 4-2 below.

Table 4-2
Education of Owners

Level of Education	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Secondary or Less	6	13	7	9	35
College or More	3	1	6	3	13
Total	9	14	13	12	48

Table 4-2 indicates that almost three quarter (73%) of the owners of small businesses are educated to a secondary school level. Whether this level of education has an impact on the success or failure of the business, we shall see when we examine the relationship between growth and education of owners.

Furthermore, those owners seem to be taking all decisions concerning the operation of the organisation. Some of those decisions are strategic ones, especially those that concern the financing issues of the firm. The importance and the impact of those decisions will again be examined when we analyse the growth of the firms in each industry. The analysis will enable us to see whether small businesses are growing or not and whether growth is being influenced by the level of education of the owners.

The result given in the Table 4-2 above was statistically tested to see whether industries differ in the educational level of the owners or not. The following hypothesis was constructed.

H_0 : Owners in each Industry do not differ in the educational level

H_1 : Owners in each Industry differ in the educational level.

$\alpha = 0.05$, d.f. = 3, accept H_0 if $X^2 \leq X_{\alpha}^2$, d.f.

Chi-square = 5.417 $\leq$ 7.815 α , 3, therefore, accept H_0 ¹.

¹See appendix for calculation.

Note: Since some of the cells figures are ≤ 5 , the results should be interpreted with caution.

4.4.3. Organizational Structure:

Small firms are known to be lacking formal organizational structures. This phenomenon is examined in the following table (4-3):

Table 4-3
Organizational Structure

Organization Structure	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Exists	3	4	4	2	13
Doesn't exist	6	10	9	10	35
Total	9	14	13	12	48

From the above Table it appears that the majority of the small firms (73%) do not have a formal organization structure. This of course is expected due to the fact that small firms which met the criteria as defined in this project did not have employees more than 15. In addition to the fact that those firms seem to be owned by a single owner (sole proprietorship). Therefore, the owner himself runs and take all decisions that affect the operation of the firm. Therefore, to him/her a proper organisation structure is not important. On the other hand, the low level of education, as noticed earlier, may also explain the reasons as to why the owners do not give much weight to an organisation structure.

The results given in Table 4-3 were statistically analysed to see whether industries differ in their opinion about the need for an organisation structure or not. The following hypothesis was constructed and tested.

H_0 : Industries do not differ in their organisation structure.

H_1 : Industries do differ in their organization structure.

$\alpha = 0.05$, d.f. = 3,

Accept H_0 if $x^2 \leq x_{\alpha, d.f.}^2$

Chi-square = $0.942 \leq 7.815_{\alpha, 3}$

Therefore, accept H_0 .

²See appendix for the calculation

Since some of the cells figures are < 5, the results should be interpreted with caution.

4.4.4. Market Coverage:

Small firms in Bahrain concentrate on the local market. However, whether all industries follow this policy or not, this can be seen in the following table:

Table 4-4

Markets Served by Small Businesses in Bahrain

Market Coverage	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Local Only	6	13	8	12	39
Local & Reg'l	3	1	5	-	9
Total	9	14	13	12	48

Due to the size of the small manufacturing firms, the local market dominates their operation. This is because the plants of such firms are not big enough to produce a capacity more than that required by the domestic market. However, there are some firms that extend the market coverage to cover some of the neighbouring countries in the Gulf States. In particular, firms in the food industry seem to have a good market share abroad in comparison to other industries. The chemical firms also try to penetrate the regional market, and that is mainly through firms that manufacture traditional medicine (plants medicine). Firms in the non metallic mineral and fabricated metal industries seem to concentrate on the local market only. These results are clearly indicated by Table 4-4.

4.4.5. Problems in the marketing area:

Amongst many of the problems in the marketing area, both locally and internationally is the competition. Table 4-5 below examines this problem area as seen by the four industries:

Table 4-5
Type of Competition Faced by Small Business

Competition	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Local Only	8	13	13	12	46
Local & Reg'l	5	11	13	8	37

This table shows that the different industries covered in the research face competition from both the local and regional markets. That's why the totals shown do not coincide with the research population. Therefore, this table can be analysed as follows:

Forty six companies out of the 48 (total population) or 96% of the small firms covered by this research face severe local competition. In addition to this, 37 of those companies (or 77%) also face foreign competition. Therefore, it is obvious from the above results, that industries are not different from each other, as far as competition is concerned, even though some industries, such as non metallic mineral and chemical, suffer less than others by the regional market.

4.4.6- Who Makes the Decisions:

Small firms are characterised by a certain degree of centralization, i.e. one man (the owner) takes all decisions. This characteristic has been tested for small firms in Bahrain and the following table lists the results:

Table 4-6

Degree of Centralization in Decision Making

Decisions are Made by	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Owners Only	6	10	8	10	34
Participative	3	4	5	2	14
Total	9	14	13	12	48

The above table indicate that owners of the majority of firms (71%) in all industries take operational and strategic decisions and only 29% of the owners believe in participative management. This could be a natural phenomenon, especially with small firms where, owners have few employees that do not have high responsibilities. Those employees are only hired to carry out the job as being dictated to them. Furthermore, such organizations are producing a single product with the exception of food industry, therefore, it is not necessary to appoint many qualified personnel to run the enterprise. Only a few experts are required to organize the work and ensure the production is made to the required specifications and standards. They do not

normally interfere or get involved with the financial or any other managerial issues confronting the organization.

However, the other 29% of small firms' owners who get their managers involved in the decision making process, do so either because they manufacture more than one product or their businesses extend to a regional market. Normally such firms would operate with a proper organization structure that is designed to suit the volume of the business. The food industry, in particular, would fall under this category, although not all firms in this industry have many variety of products and foreign business.

The results were statistically tested to see whether industries differ in the policy of decision making or not. The following hypothesis was constructed:

H_0 : Industries do not differ in their policy of decision making.

H_1 : Industries do differ with regard to their decision making

$\alpha = 0.05$, d.f. = 3

Accept H_0 if $X^2 \leq X^2_{\alpha}$, d.f.

chi-square = 1.529³.

From the distribution table of X^2 , chi-square = 7.815

Therefore, accept H_0 .

³See appendix for calculation.

4.4.7- Strategic decisions:

The issue of how strategic decisions are made by small firms in Bahrain was examined in all four industries. Table 4-7 below tabulates the results:

Table 4-7

Bases of Strategic Decisions

Bases of Strategic Decision	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	48
Market Indicators	2	1	1	1	5
Experience	8	13	13	11	45
Market Research	2	2	6	4	14

This table lists the responses of the firms to the tools used to make strategic decisions. Some firms use more than one tool, i.e. in some cases a company may use market research and their experience of the market to make a strategic decision. Hence the total responses shown in the total column are greater than the number of the companies interviewed.

From the responses in Table 4-7, it appears that the majority of the companies (71%) across all industries rely on their experience to make strategic decisions. The remaining 29% use market research. This phenomenon can be attributed to the fact that the owners of small firms in Bahrain are not highly educated (mostly up to secondary school level). This fact has been verified by the results obtained from table 4-2.

The responses obtained for market indicators were very low (10%), and nothing obtained for intuition, and thus it was ignored.

4.5. Summary and Conclusion:

It is difficult to find a universal definition for small firms. However, in this research, small firms have been defined as those that do not employ more than 15 employees and with a capital of not more than BD 200,000 (where BD 1 = \$ 2.65). The characteristics of such firms have been studied, the results of which are presented in a tabular form which highlights an easy comparison between the firms in each industry. A summary of these characteristics is as follows:

- 1- The firms in the food industry turned out to be the most capital intensive ones, as compared with the firms in the chemical, fabricated metal and the non metallic mineral industries.
- 2- Three quarters of the owners of small firms in Bahrain seem to be only educated up to a secondary school level. However, this level of education did not influence the growth of these firms.
- 3- The majority of small firms do not have a formal organization structure which could be explained by the fact that they were operating as sole proprietorship.

- 4- Small manufacturing firms in Bahrain mainly concentrate on the local market. However, few firms in the food and chemical industries have some operations in the other Gulf States.
- 5- Most of small manufacturing firms across all industries in Bahrain face severe local and foreign competition. This phenomenon indicates that they are indifferent as far as the issue of marketing problems is concerned.
- 6- A great number of small manufacturing firms in Bahrain seem to be running with a large degree of centralization, especially with regard to decision making. This is again attributed to the fact that the firms are owned by a single owner.
- 7- Almost three quarters of the small manufacturing firms rely on their experience to base their strategic decisions. Such firms are found to be owned by low level educated people. The rest of the firms use market research and experience as tools to make strategic decisions.

Chapter 5

Financing for the Small Manufacturing Businesses in Bahrain

This is the second chapter which presents additional findings of the study. The specific areas of focus include the analysis of financial goals, evaluation of enterprise, initial financing, financing ongoing operations as well as financing growth of the small manufacturing firms in Bahrian.

5.1. Financial Goals

The following tables (a, b, c and d) rank the industries' responses in a 1 to 4 scale, where 1 denotes the most favourable and 4 denotes the least favourable goal of the firm. The total number of firms in each industry is indicated against the desired goal and in accordance to the priority of ranking.

Table 5-1 (i)
Financial Goals of Small Businesses

a)

Food Industry		High ----- Low			
Description	Ranking	1	2	3	4
Max. of market value		6	5	1	1
Survival		2	-	6	1
Growth		6	7	-	4

b)

Chemical Industry		High ----- Low			
Description	Ranking	1	2	3	4
Max. of market value		4	5	-	-
Survival		-	1	3	2
Growth		5	4	-	-

c)

Non Medalllic Mineral Prod.		High ----- Low			
Description	Ranking	1	2	3	4
Max. of market value		2	6	1	3
Survival		4	4	3	5
Growth		6	2	4	-

d)

Fabricated Metal Product		High ----- Low			
Description	Ranking	1	2	3	4
Max. of market value		4	6	2	1
Survival		3	5	6	7
Growth		7	4	1	1

Table 5-1 (i) explains the views of entrepreneurs of small manufacturing firms with regard to the goals of their firms. It is quite obvious that all firms in each of the four different industries view the maximizing of market value⁴ and growth to be the most important goals. However, the non metallic mineral

⁴Maximization of market value should be interpreted as the maximum value that entrepreneurs would get should the firm is

and fabricated metal industries are a bit more concerned about survival than the other two industries.

The reason for this is that the products of these two industries are mostly used for construction purposes, i.e. in houses that are under construction etc. It was claimed that this particular area (construction) has been the most affected by the poor economic conditions prevailing in the region. Almost all respondents in those two industries were complaining about the recession. In some instances, it was pointed out that, during the seventies (70's), there was a boom in the demand which led to make customers wait for as long as 6 months before they receive their orders. Whereas, at the present time, i.e. during the recession, the demand is so poor which made the customers dictate the date of delivery for their orders, and invariably, the order gets completed on the same day it was raised. In other instances, it was indicated that some firms do not get any business unless they search for it by knocking on the doors of the clients.

Therefore, those firms view the survival as being their short term goal, at least, during the prevailing poor economical conditions. However, they still give more weight to the maximising of market value and growth.

Rearranging the results of the above tables, so that all industries are viewed together, and taking the highest rank (number 1) to be the most important, we find the following:

Table 5-1 (ii)

Goals of Small Businesses (Summary)

Goal of the Company	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Maximization of market value	4	4	6	2	16
Growth	5	7	5	6	23
Survival	-	3	2	4	9
Total	9	14	13	12	48

Table 5-1 (ii) above confirms the finding presented in Table 5-1 (i). It can be clearly seen that the majority of companies (48%) in all industries view the growth goal to be the most important one. The second highest important goal indicated to be the maximizing of market value, as 33% of the enterprises have this view. The remaining 19% thought that survival goal is the important one for them especially at the present time when the recession is severely influencing their business.

Therefore, we can conclude that small manufacturing firms, generally operate with a frame of mind oriented towards growth and/or maximizing of market value. This indicates that, even though the business may undergo a cyclical pattern of operation throughout its life, the intention of growth still dominates.

To verify the results obtained above for the financial goals, entrepreneurs were asked to evaluate their firms. The results are given in the following tables.

5.2. Evaluation of Enterprises:

In an attempt to find out how entrepreneurs perceive the value of their enterprises, if it is to be sold now, i.e. at net asset value, greater than or less than net asset value. The responses are listed down in Table 5-2 (a). The reasons for these responses are listed in Tables 5-2 (b & c).

Table 5-2 (a)
Evaluation of Market Value by Owners

Price of the Firm	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
At Net Asset	1	3	4	3	11
> Net Asset	8	7	8	6	29
< Net Asset	-	4	1	3	8
Total	9	14	13	12	48

From table 5-2 (a) above, we can see that 60% of the total firms in the four industries think that they can sell their firms at a price greater than net asset values. Approximately 23 % of the respondents thought that they can only sell their firms at net asset values (asset - liabilities). And only 17 % of the respondents feel that their companies are worth less than the net asset values. These responses reflect the total industries in question. However, if we take each industry on its own, we find that:

- 1- Eighty nine percent of the firms in the chemical industry can be sold at a price greater than net asset values and only 11 % of them, are at net asset values.
- 2- Fifty percent of the firms in the fabricated metal industry are worth more than the net asset value, 21% can be sold at net asset value and 29% of those firms are worth less than net asset value.
- 3- Sixty two percent of the firms in the food industry are worth more than the net asset value, 31% can be sold at net asset and 7% are worth less than net asset value.

4- Fifty percent of the firms in the non metallic mineral industry are worth more than the net asset value, 25% can be sold at net asset and the remaining 25% can be sold at a value less than net asset.

Again, all of the above results show that the general opinion amongst all firms in all industries, is centred upon owning a worthy organization. This view is further examined when the owners were asked about the reasons for their belief, i.e. is it because the market value (M.V)⁵ greater than book value (B.V.) or is because the present value (P.V) of cash flow (C.F) greater than BV. The results are given in the Table 5-2 (b) below.

Table 5-2 (b)
Reasons for price greater than net asset value:

Reason	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
M.V. > B.V.	1	2	-	2	5
PV of CF > BV	7	5	9	5	26
Total	8	7	9	7	31

It is obvious from this table that those firms who felt that their companies are worth more than net asset values, feel so, because the present value of future cash flows is greater

⁵M.V. means, current asset resale value of individual asset.

than the book value. This also means that such companies believe that they have a goodwill value. This is seen in all industries without discrimination. The Table shows that 84% of the responses are in favour of present value of cash flows greater than book value. These findings support the declared financial objectives of maximization of market value reported earlier.

The remaining 16% feel that the reason is due to the market value⁶ of the net assets is greater than the book value. Such firms may have special type of assets that are not easily bought, either because it is out of production but still required for a particular manufacturing process, or the land on which the factory is built has appreciated in value. Therefore, anybody who wishes to buy such firms will be forced to pay higher price than the factory is actually worth.

Table 5-2 (c)

Reasons for price less than net asset value:

Reason	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
M.V. < B.V.	-	6	1	2	9
PV of CF < BV	-	-	-	1	1
Total	-	6	1	3	10

⁶By market value, we mean current resale value of individual asset.

There are only 9 enterprises out of 48, that were surveyed, i.e. 19% feel the market value is less than the book value. Most of those companies (67%) are from the fabricated metal industry. This indicates that those firms do not place much weight on their future cash flows. Such a phenomenon could be attributed to :

- 1- The fear from the prevailing poor economic conditions has led the owners of such firms to have a pessimistic view.
- 2- Because of the recession and severe competition, the market value was expected to be less than that of the book value.

5.3. Initial Financing:

Now we would like to analyse how small manufacturing firms in Bahrain are financed at the initial stage. There are a number of means through which owners can take, in order to assist them with the starting up of the business. These means are analysed and discussed below.

5.3.1. Ownership Structure

Entrepreneurs may opt to seek partnership structure in establishing a business. The partnership could be with some members of the family or any other person who is willing to participate in the capital of this new business. Table 5-3 below analyses the ownership structure of the firms within the four industries.

Table 5-3
Ownership Structure

Enterprises Structure	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Single Owner	7	9	8	10	34
Family/part.	2	5	5	2	14
Total Firms	9	14	13	12	48

Table 5-3 indicates that the majority of small firms (71%) prefer to have a sole proprietorship structure, i.e. owned by one person. The remaining 29% in the four industries covered in this study, represent the family owned and partnership structure. Although this is the general opinion which can be hypothesised and verified, there are certain advantages and disadvantages in running a sole proprietorship organisation. We can construct a hypothesis to find out whether the opinion of the firms in those industries differ with regard to remaining as the sole owners or going partnership:

H_0 : Industries do not differ in their opinion about the remaining as single owner or becoming partnership.

H_1 : Industries do differ in their opinion.

$\alpha = 0.05$, d.f. = 3, accept H_0 if $X^2 \leq X^2_{\alpha, \text{d.f.}}$

Chi-square = $1.952^7 \leq 7.815_{\alpha, 3}$

therefore, accept H_0 .

⁷See appendix for calculation.

Since some of the cells figures are < 5, the results should be interpreted with caution.

Of course there are certain advantages and disadvantages of a single owner structure. Below is a list of some of those:

Advantages:

- 1- Strategic decisions are not influenced by many views of the family or other partners, and invariably are taken faster.
- 2- The profit is not shared by many other members.
- 3- conflicts over top management positions are avoided.

Disadvantages:

- 1- More risk, i.e. if the business collapses, then all losses will be born by one man.
- 2- In case of shortages in financial resources, growth may suffer, especially if the owner is not willing to seek bank borrowing for any religious reasons.
- 3- The consequences of any decisions will be the sole responsibility of one person (the owner).
- 4- More mental and physical stress, especially if the owner can not leave the work site and go on vacation.

These are not the only advantages or disadvantages but these also highlight the main idea when considering the establishment of a business.

5.3.2. Percentages of Initial Capital

The initial capital could include equity and debt capital. The combination of these two types of capitals for small manufacturing firms has been analysed in Table 5-4 below. The equity capital of all firms have been added up and similarly the debt capital. The results were divided by the number of firms to find the average of the industry as shown in Table 5-4.

Table 5-4
Capital Structure

Type of Capital	Industry			
	Chemical	Fab. Met.	Food	Non Met.
Equity Capital	88	79	68	73
Debt Capital	12	21	32	27
Total	100	100	100	100

The above table shows the average ratios of equity and debt capital for the four industries. From the table, it can be seen that the chemical industry is the least user of debt capital. This is because of the fact that many firms in that industry do not use any borrowing and rely on 100% equity capital. The other industries also do not seem to be having high debt capital ratio.

This could be as a result of tight lending policies from the financial institutions' point of view, especially for the startup of the businesses. To verify this phenomenon, the commercial banks, in Bahrain, were asked about their policy for

granting loans to small businesses. All banks responded that the policy is to give for financing working capital needs and growth, none responded for the startup, i.e. commercial banks in Bahrain view the startup businesses as being risky, hence they avoid getting involved with them at the initial stage. However when the business is established and gained some reputation, then the banks start to consider loan grants for such businesses. This indicates the degree of difficulty small firms are facing in securing loans at the initial stages. Of course, there are other criteria that banks use in granting loans, such as reputation, good financial records and availability of strong collateral.

New businesses can not be judged on their financial records or reputation, simply because they are new and those things do not exist. The only thing they can aim for is the strong collateral. That is why, we found that the utilization of debt capital is quite low. However, there are some firms whose owners have other businesses and thus, he or she is already known to the bank. Such people will not face much difficulty in getting a loan.

On the other hand, there is another factor that has to be taken into consideration with regard to debt capital, and that is the interest charges. There is a great number of entrepreneurs who refuse to get engaged with any loan that asks for interest payment, for religious purposes. This could be another element to the low debt capital ratio that is indicated by the above table.

5.3.3. Sources of Debt capital

The lack of venture capital companies and other financial institutions in Bahrain, resulted in making the commercial banks to be the major sources of debt capital for small firms. Table 5-5 below lists the sources of debt capital that small firms use to fund their businesses.

Table 5-5
Sources of Debt Capital

Sources	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Comm. Banks	4	10	12	9	35
Other Sources	-	1	1	-	2
Total	4	11	13	9	37

Table 5-5 indicates that 77% of the firms (37 out of 48) use external sources of debt. However 35 out of those 37 companies, or 95% use commercial banks as the source of their debt capital. None of the firms included in the survey indicated the use Islamic banks or other financial institutions as a source of debt capital. One firm in each of the fabricated metal and food industries seem to have used other sources such as sister companies for their debt capital. From this, we can conclude that the commercial banks are the only mean to obtain loan from, for the financing needs. Bahrain does not seem to have any financial institutions that are exclusively set up to give financial aid to small businesses. Meanwhile, the Ministry of Development and

Industry announced that a development bank will be established for this purpose very soon (Akhbar Al-Khaleej No. 4971, 1991). It is hoped, once that bank is established, it will encourage the small businesses by granting loans at a subsidised interest rates. This will certainly help to flourish the economy of the country and to create competition amongst the existing financial institutions (banks etc.) which ultimately will bring the interest rates on business loans down.

5.3.4. What Determined the Size of the Firm at the Initial Stage:

There are so many factors that could limit the size of the firm at the initial stage. Table 5-6 lists these factors and how entrepreneurs view them as major determinants during their initial investments.

Table 5-6
Major determinants of Initial Investment

Determinant Factors	Industry				Total
	Chemical	Fab. Metal	Food	Non Met. Mineral	
That was Proportional to Loan	-	-	2	1	3
That much was needed for Business	2	3	2	4	11
Not to put all eggs in one basket	1	1	3	1	6
I had only that much to invest	7	11	9	9	36

Entrepreneurs of small firms in the four industries covered by this investigation were asked about the determining factors of the size of their firms at the initial stage. The Table above lists their answers and it indicates that 75% (36/48) of them attributed the determinant factor to the amount of capital they had at that time. Nearly a quarter of the owners (23%) also indicated that the business required that much only, and very few said that they did not want to put all the eggs in one basket or that much was proportionate to the loan they were going to get.

Therefore, it is obvious from this Table that the main determining factor was the limitation of capital. Of course, one could ask as to why they did not borrow an amount proportional to their capital to start up with a bigger size firm. It is quite possible for entrepreneurs to approach banks or other financial institutions to raise some fund for the purpose of starting up the business. However, at the initial stage, people try to take a conservative approach about starting a new business. There are so many reasons that dictates this behaviour. Here are some of these reasons:

- The market may not big enough to absorb all the products.
- The brand name is not yet established and therefore, customers would be hesitant to purchase this new product.
- There could be some retaliation from already established firms that might kill the infant enterprise.

- Banks and other financial institutions will not be very enthusiastic about granting a loan for the purpose of start up.
- If some banks are willing, then they would charge very high interest to cover the risk of this new business.

All of these and possibly many others would certainly play a major role in preventing new entrants to the market from starting big. Although, some of these may be minimised by conducting market research and feasibility studies prior to establishing the business, they cannot be completely eliminated.

5.3.5. Why did you Limit Your Equity Investment to the Ratios Given:

The factors indicated in table 5-6 could limit the total size of the investment of a small firm. Table 5-7, on the other hand, shows the factors that limit the equity investment at the initial stage.

Table 5-7
Major Determinants of Initial Equity Investment

Determinant Factors	Industry				Total
	Chemical	Fab. Metal	Food	Non Met. Mineral	
Limitation of market	5	11	12	12	40
Limitation of Owned Capital	7	12	7	9	35

The answers shown in the above Table indicates the reasons for limiting the equity investment to the ratios given. It can be clearly observed that the reasons were "the limitation of the market" and "the limitation of owned capital". The first reason is self explanatory and the other indicates that owners had limited owned capital.

5.3.6. Type of Premises:

Manufacturing firms need some space where a factory and a storage area could be founded. The space needed by small firms is, of course, smaller than that needed by big firms, nevertheless, it has to exist. Such a space can either be rented (leased) or bought, if the entrepreneur can afford to do so. Table 5-8 below tabulates the number of firms which fully own or partly own the premises.

Table 5-8
Ownership of Premises

Type of Premises	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Fully Owned	3	5	6	7	21
Partly Owned	6	9	7	5	27
Total	9	14	13	12	48

Table 5-8 indicates the type of premises that small manufacturing companies have, i.e. whether they prefer to have

an owned place or a rented one. From the responses obtained, it was found out that some organizations fully own the place, whereas some others either fully rent it or lease the land from the government and then build their own factory. Of course leasing the land is a kind of assistance granted by the government to small businesses. Such a facility certainly reduces some of the financing burden on the entrepreneur who has a limited capital. Land is quite expensive in Bahrain, and therefore, paying a nominal fee per year for the land (through a leasing agreement) would probably prove to be better than buying it, especially when the money needed has to be borrowed from the banks at market rates of interest.

The above data was statistically analysed to test whether industries differ in their ownership of the premises. For such an analysis, a hypothesis was constructed and a CHI-Square test was applied to test the result. The hypothesis was:

H_0 Industries do not differ with regard to their ownership.

H_1 Industries do differ in their ownership.

$\alpha = 0.05$, d.f. = 3

Accept hypothesis if chi-square (χ^2) $\leq \chi^2_{\alpha}$, d.f.

Chi-square = 1.832⁸.

From the distribution of χ^2 tables, chi-square = 7.185

Therefore, hypothesis H_0 is accepted, i.e. Industries do not differ in their ownership of premises.

⁸See appendix for calculation.

5.4. Financing Ongoing Operation:

Ongoing operation can be financed through trade credits, i.e. credit purchases. However, it is also expected that the same firm will also sell on credit terms. Therefore, the owner of the firm has to ensure that the average collection period is shorter than the average paying period so that the firm does not run into liquidity problems. The following two tables (Table 5-9 and 5-10) show how the small manufacturing firms in Bahrain are handling the credit sales and purchases issues respectively.

5.4.1. Sales:

Table 5-9
Cash vs Credit sales

Sales	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
M. Cash	4	3	4	8	19
M. Cr	2	6	4	1	13
50/50	3	5	5	3	16
Total	9	14	13	12	48

One important method of financing working capital needs would be through trade credits. Therefore, it is important to know how sales and purchases are handled. The business will only grow if sufficient sales are made, i.e. it should exceed the expenses or else the business will not be profitable and would be prone to failure. Because sales generate income to the business, which is needed in time to pay bills, salaries and make investments etc. This forces the entrepreneur to concentrate more

on cash sales. Of course, in any business, there will be some sales on credit to attract customers. Nevertheless, it is essential to specify the collection period to be as short as possible. This period should be compared with the average pay out period which should be a bit longer in time. In cases, where the average collection period is longer than the average pay out period, the entrepreneur will face difficulty in settling the accounts. He or she may use bank borrowing, and incur additional expenses resulting from interest charges.

In table 5-9, the trend of sales, either in cash or credit, was examined in all companies in the four different industries. A hypothesis was constructed, as shown below, to test whether companies in the different industries differ in their sales or not.

H_0 : industries do not differ in their sales policies (mostly cash, mostly credit or 50/50).

H_1 : Industries differ.

$\alpha = 0.05$, d.f.=6.

Accept χ^2 if it is $\leq \chi^2_{\alpha}$, d.f.

Chi-square = ⁹

From the distribution table of χ^2 , chi square = 12.592.

Therefore, accept H_0 .

⁹See appendix B for calculation.

Since the value of some of the cells is < 5 , the results should be interpreted with some caution.

The distribution of the results indicate that there is a fair percentage of sales on credit (27%) and a fair percentage 50/50 (33%). Therefore, this result will be compared, at a later stage, with the bad debts to see if they are excessive.

5.4.2. Purchases:

Table 5-10
Cash vs Credit Purchases

Purchase	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
M. Cash	5	4	2	6	17
M. Cr	2	6	3	2	13
50/50	2	4	8	4	18
Total	9	14	13	12	48

The results in the above Table indicates quite a mixture of purchase types, i.e. cash, credit and cash & credit (50/50). The companies that buy mostly on cash represent approximately 35% of the total firms. Those that buy mostly on credit represent 27% and those that buy on 50/50 basis represent 38%. This means that there is a great number of small firms who do not utilize the facility of trade credit as a means of short term financing for the working capital needs.

From the results, it can be depicted that firms in the chemical industry are the ones that mostly use cash purchases. Because a large number of firms in this industry are producing

traditional medicine, the raw material that is used for their product is coming from plants, seeds etc. These types of materials are normally purchased from farmers who hardly practice/believe in trade credit.

On the other hand we see approximately 43% of firms in the fabricated metal industry purchase mostly on credit and 29% of them are purchasing on 50/50 basis. The previous Table 5-9 (sales) also indicated that the majority amongst all firms that sell mostly on credit or 50/50 are coming from the fabricated metal industry. Therefore, these two findings complement each other, because firms that sell on credit would naturally purchase on credit, so that they can function.

Sixty two percent of firms in the food industry purchase on 50/50 basis. This again ties up with the sales policy of those firms that have the majority of them are selling on 50/50 basis.

In the non metallic mineral industry we see half of the firms (50%) purchase mostly on cash. Similarly their sales are also mostly in cash. Of course this particular industry was badly affected by the recession and to avoid excessive bad debts, those firms chose to adopt this policy. Such a response came out very strongly during the survey.

To test whether industries differed in their purchase policy or not, the following hypothesis was constructed.

H_0 : Industries do not differ in their purchase policy

H_1 : Industries differ in their purchase policy.

$\alpha = 0.05$, d.f. = 6

Accept H_0 if $X^2 \leq X^2_{\alpha}$, d.f.

Chi square = 8.248 (see appendix for the calculation)

From the distribution of X^2 12.592

Therefore accept H_0 ¹⁰.

¹⁰See appendix B for calculation.

Since the value of some cells is less than 5, the results should be interpreted with some caution.

5.4.3. Annual bad debts:

Whenever sales credit exist, some bad debts are bound to occur. Table 5-11 below compares the average bad debts between the four manufacturing industries.

Table 5-11

Bad Debts

Bad Debts	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
≤ 1%	3	7	10	11	31
≥ 5%	1	6	-	1	8
Total	4	13	10	12	39

Table 5-11 shows that 39 firms (81%) out of the 48 surveyed are experiencing bad debts. The remaining 9 firms were not involved in credit sales and thus do not experience any bad debt. Bad debts are inevitable in any credit sales. Looking at the Table above we find that the bad debts of 80% of the companies lies in the region of up to 5%, whereas the remaining 20% of the companies experience more than 5% of their total sales. The bad debts which are in excess of 5% is mostly experienced by firms in the fabricated metal industry. This means that firms in this particular industry sell more on credit terms, and this is in line with the findings of

Table 5-9 of this section. That Table indicated that 79% of the sales of the firms in the fabricated metal industry is either mostly on credit or on 50/50 (11 firms out of 14) basis.

Indications were there to attribute the excessive bad debts in the fabricated metal industry to the recession which affected it most. Therefore, credit sales had to be encouraged to differentiate their product and get an edge over their rivals. As a result, no stringent securities were enforced that will ensure debt recovery.

5.4.4. Liquidity, Working Capital in Percentage:

In an attempt to find out the percentage distribution of current to fixed assets and current liability to owners equity, the firms were asked to complete a simple balance sheet question, the answer to which is given in Table 5-12 below.

Table 5-12 (a)
Percentage Distribution of Assets and Liabilities

Asset (Averages)	Industry			
	Chemical	Fab. Met.	Food	Non Met.
Curr. Asset	27.56	57.57	60.77	44.25
Fixed Assets	72.44	42.43	39.23	55.75
Total	100	100	100	100

Table 5-12 (b)

Liability (Averages)	Industry			
	Chemical	Fab. Met.	Food	Non Met.
Curr. Liab.	11.67	30.07	35.85	19.58
Owners Equity	88.33	69.93	64.15	80.42
Total	100	100	100	100

The figures shown in the above Tables 5-12 (a & b) were calculated using the answers of the simple balance sheet question D4 (refer to the questionnaire in appendix A). The percentages of current assets to fixed assets and current liabilities to owners equity were added up for all firms in each industry. The results were then divided by the number of firms in each industry to find out the averages of the industry.

Having obtained those results, it will be possible to calculate the current ratio (current assets / current liabilities) which will enable us to assess the liquidity of each industry. Furthermore the results will be used to calculate the working capital needed per industry.

Current Ratio (Current Assets / Current liabilities =

- 1- Chemical Industry: $27.56 / 11.67 = 2.36$
- 2- Fabricated Metal Industry: $57.57 / 30.07 = 1.9$
- 3- Food Industry: $60.77 / 35.85 = 1.7$
- 4- Non Metallic Mineral Industry: $44.25 / 19.58 = 2.26$

As a rule of thumb, the current ratio should be better than two (2). If the result is less than 2 then normally this would indicate that there is a liquidity problem. Creditors are normally concerned about this ratio, and get very cautious when processing any loan application if the ratio is less than 2. Companies with a current ratio of less than 2 will probably start to pay their bills more slowly, resulting in a build up of bank loans. If the current liabilities rise faster than the current assets then the current ratio will fall and this could spell trouble. Since the current ratio provides the best single indicator of the extent to which the claims of short-term creditors are covered by assets that are expected to be converted quickly to cash, it is the most commonly used measure of short term solvency (Weston & Brigham, 1987).

From the above results we can see that the quick ratio for fabricated metal industry is on the margin, i.e. just below 2 and for the food industry it is 1.7, whereas for the chemical and non metallic mineral industries it is over 2. Therefore, the food industry seems to be the most vulnerable area to liquidity problems and is most likely to face the most stringent terms and conditions for loans.

From Tables 5-12 a & b we can calculate the net working capital as follows:

Net Working Capital = Current assets - Current liabilities

1- Chemical Industry:	27.56 - 11.67 = 15.89%
2- Fabricated Metal Industry:	57.57 - 30.07 = 27.5%
3- Food Industry:	60.77 - 35.87 = 24.9%
4- Non Metallic Mineral Industry	44.25 - 19.58 = 24.67%

Working capital is very important, especially for small firms. Although such firms can minimize their investments in fixed assets by renting or leasing plant, land, building and equipment, they cannot avoid investments in cash, receivables and inventories. Further more, small firms have relatively limited access to the long-term capital markets and they must rely heavily on trade credit and short-term bank loans, both of which affect working capital by increasing current liabilities (Weston & Brigham, 1987). The working capital items are represented by raw material inventory, work-in-progress inventory, finished goods inventory and accounts receivables and when a firm produces a product, it must make investments in all of those items before any cash is received.

The results of the survey for the working capital indicate that the small Chemical firms have the least working capital ratio compared to the other three industries, i.e more capital assets and hence it is more capital intensive which confirms an earlier results. This may suggest that this particular industry is adopting a tighter policy with regard to the working capital, i.e. the holding of cash, receivables and inventories are minimized. The Tables 5-12 (a & b) also confirm this finding

when we see the chemical industry keeps merely 27% of current assets, while the rest of the industries keep more than 50% of the total assets as current assets.

As have been stated earlier, chemical firms in this survey, include some factories that manufacture traditional medicine, and the nature of such product does not require much of raw material. Therefore, it is expected that such firms will hold less current assets than other firms in the food or fabricated metal industries.

5.4.5. Current Liabilities:

The current liabilities may be divided into two categories, namely: payable (resulting from trade credit) and bank borrowing. The following Table 5-13 has been constructed to see what percentage of bank borrowing is represented in the current liabilities for each firm in each industry.

Table 5-13
Distribution of Current Liabilities

Industry		Chemical								Average
Company	1	2	3	4	5	6	7	8	9	Divided by 5
Payables %	25	20	100	--	30	--	--	--	--	35
Borrowing %	75	80	--	--	70	--	--	--	100	65

Industry		Fabricated Metal														AV.
Company	1	2	3	4	5	6	7	8	9	10	11	12	13	14	/13	
Payables %	50	10	---	30	--	20	30	20	---	100	100	100	20	20	38	
Borrowing %	50	90	100	70	--	80	70	80	100	---	---	---	80	80	62	

Industry		Food													AV.
Company	1	2	3	4	5	6	7	8	9	10	11	12	13	/13	
Payables %	20	40	---	25	20	30	20	30	100	20	---	35	25	28	
Borrowing %	80	60	100	75	80	70	80	70	---	80	100	65	75	72	

Industry		Non Metallic Mineral												Average
Company	1	2	3	4	5	6	7	8	9	10	11	12	/9	
Payables %	--	--	---	10	20	30	40	20	20	---	20	20	20	
Borrowing %	--	--	---	90	80	70	60	80	80	100	80	80	80	

The Tables above indicate the percentages of bank borrowing and payable of each firm in each industry. From these tables, the industry average was calculated, the result of which is shown in the last column of each Table. This industry average was then multiplied by the current liability figures given in the previous table to calculate the percentage of bank borrowing and payable (the two items that constitute the current liability) of the industry as shown below.

Table 5-14
Distribution of Liabilities

Liability (Averages)	Industry			
	Chemical	Fab. Met.	Food	Non Met.
Bank Borrowing	7.6	21.6	22.2	15.7
Payables	4.0	8.4	13.6	3.9
Owners Equity	88.4	70.00	64.2	80.4

The results shown in the Table 5-14 above, clearly indicate that almost all small firms in all industries do not rely heavily on bank borrowing or trade credit to finance their growth or ongoing operation. This is particularly evident in the chemical industry where 44% of the firms rely on internally generated funds to finance their enterprises, i.e. do not use bank loans, nor do they purchase on credit. This phenomenon could result from so many things that lead the owners/entrepreneurs not to take this policy. Amongst the reasons could be:

- the difficulty of getting loan for one reason or another (this will be verified later).
- religious reasons. The Islamic religion bans the loans which dictates interest charges that has to be paid at the maturity. Therefore, religious entrepreneurs refuse to seek loans from banks for that reason and this was indicated by some respondents.

Whilst interest rate charges are burdens on all business firms, they sometimes cannot escape from incurring it. Short-term credits, sometimes, are essential to finance a particular project that could lead to the success of a company. Boycotting loans by small businesses will undoubtedly drive away some of the opportunities that materialize which cannot be captured in time. Those opportunities may be taken up by big firms and thus could endanger the status of that particular firm which refused to take it.

On the other hand, the trade credit is another spontaneous source of financing in the sense that it arises from ordinary business transactions. It is also very important, especially for weaker firms that cannot qualify for bank financing. Therefore, any business man should try to capitalize on this opportunity or else he might be jeopardising his enterprise.

5.4.6. Difficulty of getting loan:

Small businesses usually face some difficulties in securing a loan from a bank. The difficulties could be due to high interest rates, slower processing of the loan and security being pledged. The following Tables (5-15, 5-16 and 5-17) list the responses of entrepreneurs regarding those issues in comparison to large firms.

Table 5-15
Interest Charges Compared to Large firms

Interest Cost	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Higher	3	9	7	7	26
Lower	-	-	-	-	-
Same	1	1	5	1	8
Total	4	10	12	8	34

Table 5-16
How Easy/Difficult is it to Secure a Loan

	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Easy	1	4	7	3	14
Difficult	3	6	5	6	20
Total	4	10	12	9	34

Table 5-17
Type of Security to be Pledged

Security to be Pledged	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Receivables/Inv	3	7	10	7	37
Land	2	8	8	7	25
Others	1	5	8	6	20

Table 5-15 lists the responses of entrepreneurs regarding the cost of borrowing from the bank. The results indicate that 76% of the respondents believe that they are being charged higher interest rates than large firms. However, 42% of firms in the food industry believe that they are not being treated differently from large firms and thus the interest charges are same. This indicates that firms in the food industry might be more stable or less risky than others. It was discussed earlier in this chapter that the fabricated metal and non metallic mineral industries suffered more from the prevailing poor economic conditions. This could be one of the reasons that led banks to be a bit more cautious in dealing with small firms in those industries which resulted in charging higher rates. The high default risk in any industry is normally compensated for by higher interest rates, which is called risk premium.

Table 5-16 shows whether loans application from small firms are processed easily or with some difficulty. The results indicate that 41% of the firms (total) get loans quite easily, whereas 59% get it with difficulty. The result also suggest that 67% of the firms in the food industry have their loans applications processed easily, whereas more than 60% of firms in the other industries, feel that their loan applications are processed with some difficulty. This confirms the findings previously reported, which highlighted a significant number of firms in the food industry to be charged a similar interest rate as large firms.

The result from Table 5-16 has also been statistically been tested to see whether industries are being treated differently in the processing of loans applications or not. The following hypothesis was constructed:

H_0 industries do not differ in the treatment of processing loan applications.

H_1 industries differ

Accept hypothesis if chi-square $(\chi^2) \leq \chi^2_{\alpha}$, d.f.

$\alpha = 0.05$, d.f. = 3

chi-square = 2.061¹¹.

From the distribution table of χ^2 , the theoretical value of chi square is = 7.815

Therefore, accept the hypothesis.

Table 5-17 concerns the security to be pledged to get the loan. It appears that small firms are required to pledge enough security in order to be qualified for a loan. Amongst the securities, they have to give deeds for lands and/or buildings, receivables & inventories and "Others". Pledging receivables is especially sensible for the small firm that has customers with better credit histories than the firm itself, as this allows the firm to take advantage of the strength of its customer base. However, the firm must ultimately bear the risk of nonpayment on

¹¹See Appendix for calculation.

Since the value of some of the cells is less than 5, the results should be interpreted with some caution.

the part of its customers, and it gets only part of the funds due from its customers.

Under "others" small firms may have to pledge fixed deposits, third person guarantee or any other type of security. Again the results reported in Table 5-17 has been statistically tested to find out whether industries differ in the type of security being pledged or not. The following hypothesis was constructed.

H_0 industries do not differ in the type of security to be pledged.

H_i industries differ

Accept hypothesis if chi-square (χ^2) $\leq \chi^2_{\alpha}$, d.f.

$\alpha = 0.05$, d.f. = 6

chi-square = 1.046¹².

From the distribution table of χ^2 , the theoretical value of chi square is = 12.592

Therefore, accept the hypothesis.

From those three Tables we can conclude that small firms do face difficulties in securing loans from banks. The first being the high interest rates, the second is the difficulty in processing the loan application and finally the security

¹²See appendix for calculation.

Since some the value of some of the cells is less than 5, the result should be interpreted with some caution.

required to be pledged. For such reasons, small firms may not be very keen on relying heavily on bank loans to finance their growth and/or ongoing operations.

These findings also support other studies that have been conducted on the issue of small firms financing. In particular, a study entitled "a Report of the Small Business Financing Review" which was released by the Canadian Government, had the following conclusions (Raymond Kao, 1984):

Security requirements of banks and other lending institutions were perceived as excessive.

There was no evidence that banks treat small business loans differently from larger loans. Small businesses had to ask for a premium because of higher transaction costs per dollar of loans granted by banks.

Stricter collateral requirements required by the bank on loans to small businesses were justified in terms of the dependence of the firm on the health and capability of the owner.

5.4.7. Financial ratio analysis:

Financial ratio analysis is crucial to any business, as it can give some guidance to the owner of how the business is behaving. Table 5-18 below illustrates the number of firms in each industry that carries out financial analysis.

Table 5-18
Do Small Businesses Make Financial Ratio Analysis

Analysis	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
is done	4	11	12	9	36
Not done	5	3	1	3	12
Total	9	14	13	12	48

Table 5-18 indicates that 75% (36/48) of the small firms do financial analysis. However, it appears that the food industry takes the lead in this exercise, because almost all companies (with the exception of one) carry out financial ratio analysis. Going back to the major characteristics of small firms, which has been discussed earlier in Chapter 4, we find that amongst the four industries being studied, the food industry appeared to be the one that has more firms whose owners are educated to a college level. This could, to a certain extent, explain why the same industry recognises the importance of financial analysis more than the others.

As has been discussed in the previous chapters, financial ratio analysis is particularly important to small firms. Such analysis highlights problem areas in the firm. In addition, the analysis will provide valuable information to creditors who might be concerned about the financial position of a firm before considering any loan grants. Therefore, it is in the owner's interest to make sure that the firm's financial data are credible, even if it is a little more expensive to do so.

Furthermore, if the banker is uncomfortable with the data, then the firm's management should also be uncomfortable. Because many managerial decisions will depend on the numbers in the firm's accounting statements, these numbers should be as accurate as possible (Weston & Brigham: 1987).

5.5. Financing Growth

This section is devoted to an analysis of financing growth. Certainly "Growth" is a very important 'phase' of the life cycle of any firm, and it would obviously be interesting to see how small businesses manage and raise finance for the crucial phase. (Growth could be in the market share and/or assets.)

5.5.1. Average Growth:

Tables 51-19 (a through c) below will examine the growth of the firms in all four industries and see whether there is a relationship between education and growth.

5.5.1. (a) Average Growth and its relationship with the level of education of the owners:

Table 5-19 (a)
Chemical Industry

Educational	Percentage Growth									Average
	Companies									
Secondary or Less	1	2	3	4	5	6	7	8	9	8.7
			12.5	0	6.1	8.3	11.5	4.4		
College or More	12.5	12.7							10	

Table 5-19 (b)
Fabricated Metal

Educational	Percentage Growth														A v e r a g e
	Companies														
Secondary or Less	1	2	3	4	5	6	7	8	9	10	11	12	13	14	
	-8.3	0	5	17.8	10	8		7.1	-1.4	-2.3	16	-1.9	10.8	12	
College or More							11								6.0

Table 5-19 (c)
Food

Educational	Percentage Growth													A v e r a g e
	Companies													
Secondary or Less	1	2	3	4	5	6	7	8	9	10	11	12	13	
		4.4		1.1		4.8	4.1		4.2		17.5			
College or More	3.6		6.4		1.6			4.6		4.2		15.8	2	5.7

Table 5-19 (d)
Non Metallic Mineral

Educational	Percentage Growth												Ave- rage
	Companies												
Secondary or Less	1	2	3	4	5	6	7	8	9	10	11	12	
	1.1		8	8	10				6.4	1	1.3	8	
College or More		4				4	7.1	5.8					

The above four Tables indicate the percentage growth of small companies (since their establishment until now) for the four industries covered in this research. The average growth for the Fabricated Metal, Food and Non Metallic Mineral industries are more or less the same. And it is only marginally higher for the chemical industry. However, if we analyse the growth of those firms within their respective industries, we find the following:

Chemical Industry:

All firms, except for one, in this industry are having a reasonable positive growth, i.e no decline. If we compare this with the education level of the owners in this industry, we find that two thirds (67%) of those firms have owners with an education level of secondary and below giving an average growth of 7.1%. On the other hand the remaining one third (33%) of the firms have owners that are educated to a college level and having an average growth level of 11.7%. However, this difference in the average growth levels is not necessarily attributed to the high education of the owners. Both averages are not symmetrical, i.e. one was calculated for 6 companies whilst the other was only calculated for 3, hence the difference.

Fabricated Metal Industry:

Firms in this industry are characterised by being owned for people that are educated up to secondary school level. Almost all companies, except for one, that were covered in this survey were of that nature. Here, we find that there are firms with negative growth and others with reasonable positive growth. The two extremes of companies are being run by owners of similar educational level and therefore, it would be unfair to blame education in this particular instance.

It was mentioned earlier that this industry has been hit very harshly by the recession which could be the cause for such negative results. Furthermore, this negative growth is taken as an average for the whole period of operation for those firms. Therefore, there must have been instances of positive growth, or else, the firms would have closed down by now.

Food Industry:

This industry is more or less evenly distributed between the two types of owners, i.e. there are six firms which are run by a secondary educated people and 7 firms run by college educated owners. The average growth level of the two classes of firms is 6% and 5.5% respectively, for college owners. The two results are so close to each other that they can be regarded as same.

This indicates that the higher educational level in this industry did not cause any significant advantage as far as growth is concerned.

Non Metallic Mineral Industry:

In this particular industry, again there are more companies that are owned by secondary educated people than by college educated ones. The growth rate in the first category of enterprises, is found to be varying. Some made quite reasonable growth and in others the growth was very low. In Contrast with the enterprises owned by college educated people, we find the growth rate is moderate.

Therefore, the results are not very conclusive, i.e. one can not put all of the blame on the educational level for what seems to be poor performing companies. The educational level might be a minor factor, and there are others more. We noted from earlier analysis that this industry was another one that got severely affected by the recession. In addition, competition is also quite severe.

From the respondents point of view, they do realize the decline in their growth rate, but they attribute it to the poor economical conditions prevailing in the country. However, they also feel that the market is improving and anticipate good growth in the coming years.

5.5.1 (b) Educational level of owners in firms which have grown by 4.5% or more since the day of establishment.

In Table 5-19 above we saw how firms have performed in each industry, i.e. which firm had a positive growth and which one declined. The following Table 5-20 analyses the number of firms that had a growth rate in excess of 4.5% and whether education had any impact on their growth or not.

Table 5-20
Number of Companies with > 4.5% Growth in Each Industry

Level of Education	Industry				Total
	Chemical	Fab. Met.	Food	Non Met.	
Secondary or Less	4	8	5	5	22
College or More	3	1	2	2	8
Total	7	9	7	7	30

the above table lists the companies that had growth in excess of 4.5% since their establishment in relationship with the education of their owners. The table clearly indicates that 73% of the enterprises with $\geq 4.5\%$ growth are run by secondary school educated people. The remaining 27% are run by college educated people.

The results may be deceiving, because it shows that the number of companies whose owners are college educated, and meet the growth rate indicated above, are less than those which are

managed by secondary school educated owners. The reason for such a result was simply because the total number of companies included in this survey with college educated owners, turned out to be less. This phenomenon can be seen earlier in the chapter, in table 1.2 of the "Major characteristics". That table indicated the owners with college education represented only 27% of the total small firms covered by this research.

Therefore, we can conclude from these results that the level of education did not impact the performance of small firms.

5.5.2. Financing Growth:

Growth can be financed through many sources amongst which are retained earnings, additional investment and borrowing from banks. Table 5-21 examines how the small manufacturing firms utilize these sources.

Table 5-21
Sources of Growth Capital

	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Retained earnings	9	14	13	12	48
Additional investment	4	1	-	-	5
Borrowing from banks	3	10	12	9	34

Table 5-21 above indicates that all small firms which have been covered in this survey, use retained earnings to finance their growth. In addition to that, 71% of the firms use bank borrowing for the same purpose and only 10% of the firms use all three means to finance the growth. The retained earning, of course, is a major source of long-term financing for the small business. It can be regarded as the baby that is taken care of until it grows, so that when it is fully grown, it will start to pay off. Therefore, it is natural to see all firms use the retained earning as a source of fund.

The additional investment as a source of fund, was not emphasised much. Only 4 firms from the chemical industry which constitute approximately 44% of the total firms in that industry, and 1 firm from the fabricated metal industry use it to finance their growth. Firms in the chemical industry appear to be the least that use bank loans. This could be the reason for the apparent high percentage of the firms in this particular industry that try to use additional investment as a source of fund for growth.

Therefore, we can conclude that there is a strong indication that all firms rely on their internal funds to finance their growth (this again will be verified when we analyse the turnover ratios later on). Of course debt financing has its implications on the business. Weston & Brigham points out three important ones as follows (Weston & Brigham, 1987):

- By raising funds through debt, the owners can maintain control the firm with a limited investment.
- Creditors look to the equity, or owner-supplied funds, to provide a margin of safety.
- If the firm earns more on investments financed with borrowed funds than it pays interest, then the return on the owners' capital is magnified or "leveraged".

5.5.3. Why so Much Reliance on Internal Funds:

If firms have enough earnings, they can plow it back into the business to reduce the burden of high interest rates that will be incurred from bank borrowing. However, there may be other reasons for relying on internal funds. Table 5-22 below tabulates the number of firms that rely on internally generated funds to finance their growth and an analysis for such phenomenon follows:

Table 5-22
Reasons for Relying on Internal Funds

Reasons	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Enough Earnings	1	2	-	2	5
Not willing to pay interest	4	4	1	2	11
Total	5	6	1	4	16

Table 5-22 indicates that there were a total of 16 companies from all industries (33%) that do not use bank borrowing. The reasons given by the respondents for this policy were as mentioned in the table, i.e. either enough earnings or not willing to pay interest charges, may be for some religious reasons. However, out of the 16 companies, 11 of them (69%) refuse to make bank borrowing mainly due to interest charges. Further analysis to this phenomenon reveals that the majority of those companies are from the fabricated metal and chemical industries.

During the gatherings of the data, it was found that a great number of the owners in the chemical industry are villagers and had limited education. Culturally, those people tend to be highly conservative and more observant to the religion laws. Therefore, it is understandable to see those people banning bank borrowing.

Fabricated Metal industry, which is the 2nd in the list that do not use bank borrowing, could also have the same reasons as stated above for the chemical, i.e. religious. On the other hand, it could be attributed to the recession. And as indicated earlier that, debt could increase the problems for firms in an industry that is experiencing recession. Therefore, such firms preferred to stay out of any problems that may be encountered as a result of debt. Of course, if their earning is also not enough to plow back in the business, they may shrink and the possibility of going out of business is high.

5.5.4. Turnover Ratios During the Growth Process:

Another method for financing growth would be the increase of the turnover ratios, such as receivables and inventory. Those firms who rely on internally generated funds would be particularly benefited from such method. In Table 5-23 below, the performance of such ratios for the small firms is examined.

Table 5-23
Turnover Ratios

Turnover Ratios		Industry				Total
		Chemical	Fab. Met	Food	Non Met.	
Receivable	Inc.	7	8	13	7	35
	Dec.	-	4	-	2	6
	Rem.	-	2	-	3	5
Inventory	Inc.	7	9	11	10	37
	Dec.	-	4	-	1	5
	Rem.	2	1	2	1	6
Payable	Inc.	5	7	10	6	28
	Dec.	-	3	-	1	4
	Rem.	1	2	2	2	7

The majority of firms (76%), that sell on credit, had their receivables turnover increased. This indicates that the average collection period got shorter. Consequently, the money can be used to finance other investments and projects, especially during growth opportunities. Such a source of financing will make the firms to reduce their dependency on debt capital which is quite costly. This finding supports the previous one obtained from

table 5-21 that indicated the firms' reliance on retained earnings as a source of growth capital.

The second observation is the increased inventory turnover ratio. Of course inventory turnover ratio helps us to analyse the firm's utilization to its inventory. An increase in the inventory turnover, suggest that the company's holding to stocks of inventory is not excessive. From the table above we find that the majority of the firms (77%) in all industries had their inventory turnover increased. This suggest that those firms are operating very efficiently. However, we see that 29% of the firms in the Fabricated Metal industry had a decrease in the inventory turnover. This could be attributed to the recession that affected this particular industry more than the others. This also supports other findings of this research which signalled a problem area in this particular industry.

Table 5-23 also indicates that 76% of the firms which purchase on credit had their payable turnover increased. This phenomenon, could reduce the advantages which are gained from increased receivables turnover ratio, i.e. increased payable turnover means that the average payout period has reduced. Thus for firms that are heavily relying on internally generated funds to finance growth, will not gain full benefit of increased receivables turnover. However, as long as the average collection period is shorter than the payout period, then the firm will have enough liquidity to pay its bills and hopefully keep some for additional investments.

Another important observation is that both inventory and receivable turnovers, which are both asset items on the balance sheet, have increased. On the other hand, the accounts payable is a single liability item on the balance sheet side. Therefore, it is hoped that the benefits of the two items will outweigh the disadvantages of the increased payable turnover, resulting in a net advantage of utilizing internal funds as a source for growth capital.

5.5.5. What are the major causes for any significant decline?

Businesses can decline as a result of so many factors. The major factors are given in Table 5-24 below.

Table 5-24
Major Causes for Decline

Causes of decline	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
N/A of raw material	1	-	-	-	1
Price increase of raw material	-	3	1	-	4
High Competition	1	8	1	7	17
Outdated plant/mach.	1	-	-	1	2
Availability of better substitute	1	-	-		1
Non payment of bills	-	2	-	-	2
Uneconomic prod size	2	1	-	1	4

Table 5-24 lists the major causes of decline amongst firms in each of the four industries. Although these tabulated results indicate that there have been some firms that declined, in actual fact those firms did not experience a permanent decline. This fact was stated by the owners of those firms during the interviews. They claimed that the recession affected the business tremendously, but it is picking up gradually. This phenomenon will be further examined by the next table which will indicate whether future growth is expected or not and why.

As can be seen, the major cause is the high competition which is mostly concentrated in the Fabricated Metal and the Non Metallic Mineral industries. Other causes were only experienced by minority of firms and thus can be disregarded.

5.5.6. Evaluation of future growth potential

In an attempt to find out how small firms view their growth potential in the future, each firm was asked to evaluate its product position with respect to others. An analysis was then done based on the responses given which are listed in Table 5-25 below:

Table 5-25
Future Growth Potential

	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Further growth is expected	8	11	12	9	40
Further growth is not expected	1	3	1	3	8
Total	9	14	13	12	48

If answer is (a)	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
Demand is growing	4	7	9	6	26
Competitive advantage	4	4	3	3	14
Total	8	11	12	9	40

If answer is (b)	Industry				Total
	Chemical	Fab. Met	Food	Non Met.	
No demand for product	1	3	1	3	8

These tables indicate that 83% of all firms expect future growth and only 17% responded that future growth is not expected. The highest of those firms who responded future growth is not expected came from the fabricated metal and non metallic mineral industries. Those firms thought the reason is due to the lack of demand for their product. It was mentioned that this could only be a temporary thing because of the recession and

severe competition, resulting from the highly populated industries. However, once the market conditions improve, they expect that there will be a growth potential.

On the other hand, those who responded that future growth is expected, also face competition and their industries are populated, but they believe that they have an edge. Some attributed that response to the fact that the demand for their product is growing and others stated that they have a competitive advantage.

These results support the previous statements of the owners who indicated that their decline was only a temporary one.

The data given in the 2nd table of this section has been statistically tested to see whether industries have different perception to growth or not. Therefore, the following hypothesis is constructed:

H_0 : Industries do not differ in growth perception

H_1 : Industries differ

$\alpha = 0.05$, d.f. = 3

Accept H_0 if chi-square (χ^2) $\leq \chi^2_{\alpha}$, d.f.

Chi-square = 1.339¹³.

¹³See appendix for calculation.

Since some of the values of the cells is less than 5, the results should be interpreted with caution.

5 . 6 . Summary :

This chapter examined and analysed the financing issues/patterns of small manufacturing firms in Bahrain during the three stages of operation, namely: Startup, ongoing and growth. The emphasis on the financing needs during each stage was based on how firms view their financial goals which was indicated to be (by the majority of firms) the growth and maximization of market value.

The financing patterns during the initial stage, i.e. startup of the business seem to have concentrated on by establishing sole proprietorship enterprises with a great percentage of the capital being an "equity capital". There were many reasons behind this policy, amongst which are, the size of the firms themselves and secondly the difficulty of securing loans, during this stage, from the available financial institutions in Bahrain.

The second stage of the financing patterns was to do with financing ongoing operation. The financing during this stage could be through bank borrowing, trade credits, i.e. purchase on credit terms, and increase in turnover ratios. Bank borrowing is costly and thus was not greatly welcomed by the small firms. Additionally, many were trying to avoid bank borrowing for some religious reasons. Alternatively, trade credits was used as a means of financing ongoing operation. However, firms are, not

only expected to purchase on credits, but to sell on credits as well. Therefore, some bad debts are expected as a result of credit sales.

The third stage is growth and the associated financing patterns. The research concluded that growth was not influenced by the educational level of the owners, i.e. growth was not just experienced by firms that had the university educated owners, but was also experienced by those who were owned by fairly low educated owners. This achieved growth seem to have been mostly financed through retained earnings and some firms use bank borrowing as well. Few firms only were found to use additional investment in addition to retained earnings for growth financing. Such firms do not use bank borrowing for the same reasons stated earlier, i.e. religious reasons. The firms that were involved in the study, were found to have their turnover ratios increased which verifies the fact that reliance on internally generated funds for financing ongoing and growth operation is emphasised.

Chapter 6

SUMMARY AND CONCLUSION

This study covered small manufacturing firms operating in four different manufacturing industries in Bahrain. They are:

Chemical, Fabricated metal, food and Non mineral metallic industries.

These industries were surveyed through a set of structured questionnaire which was designed to investigate how the firms in such industries are financed throughout the various operational stages. In addition, the characteristics of such firms within these industries were also studied and tested for any significant differences amongst each other groups.

The major finding areas are summarised as follows:

6.1 Major Characteristics:

There are a number of characteristics found to be identical for the firms covered by the research irrespective of the industry that they belong to. On the other hand, there are others that may be unique to some firms within an industry. Some of these results may be obvious and logical, whereas others may be unique.

1. The intensity of the firms has changed from the date of establishment. The firms were more capital intensive at the initial stage which gradually became more labour intensive in recent years. This is mainly due to increase in labour that resulted from the need for more production. It was also noticed that the food industry is more capital intensive than the other industries. This is a surprising result, however, such a phenomenon could be attributed to the high level of inventory of the ingredients that is required to be kept by the food industry for the different products and the sophisticated plants needed for processing.

2. The majority of the firms in those four industries were found to be owned by people with an education of up to a secondary school level. This could be a result of the nature and the size of the business, especially at the start up stage which does not require people with very high education. Additionally, during the 70's and earlier, the number of college educated people was very low in Bahrain. At that time, the need for highly educated people was very limited and only a few could afford to send their children for higher education. Now, of course, the situation has changed, but those who go for higher education, they seek employment with already established organizations after graduation. On the other hand, those who cannot afford to complete their university studies, have less opportunities to get employed. Thus they are forced to seek alternatives in order to be able to live. These alternatives include setting up a new small business.

3. Most organizations within the industries studied seem to be operating without a formal structure. This is mainly due to the limited number of employees in those firms and the type of ownership structure (mostly sole proprietorship). Therefore, the owners run the organization themselves and take all decisions.

4. The majority of the firms seem to be serving the local market with few firms, mostly from the Food and Chemical industry, which extend their coverage to the neighbouring Gulf Countries. Again, this seems to be a function of the size, in addition to the production capacity capabilities which are not big enough to fulfil more than the domestic requirements.

5. All industries covered in this research face severe local and foreign competition. Therefore, they are not different as far as competition is concerned.

6. The role of decision making is found to be handled mostly by the owners themselves, especially in firms that do not have a formal organization structure. This is, of course, a natural phenomenon for firms of small size. In addition, most firms rely on experience for strategic decisions. This could be attributed to the fact that the majority of the owners were not highly educated and thus have little knowledge about research and other tools which can aid decision making.

6.2. Major Findings on the Financial Issues

1. Almost all companies in these industries believe that the maximization of market value and growth to be their most important goal. Only a few firms indicated that their most important goal, at the present time is survival. These firms were mostly from the Fabricated metal and non metallic industries, which apparently were being the most affected ones by the poor prevailing economic conditions.

2. The majority of the owners believe that the market value of their firms is greater than book value because of the higher present value of future cash flows than market value. This means that these firms are having a high goodwill value. On the other hand, those that think their firms are worth less than net asset value, claim the reason to be the poor economic conditions prevailing in the region accompanied by high competition.

3. The ownership structure of most of the firms was found to be a sole proprietorship, i.e. single owner. The size and the amount of capital needed to establish this type of firms do not necessitate a partnership or company form of ownership.

4. The capital structure of the firms studied seems to consist of more equity capital than debt capital. There are many reasons which led to this policy, amongst which are:

- a) the difficulty of obtaining loan, especially at the start up stage.
- b) the religious belief which bans loan that calls for interest charges at maturity.
- c) The amount of capital needed is not so big, thus the majority of it can be provided by the owner himself.

5. Commercial banks seem to be the dominant source of debt capital. This is, of course, because there are no other financial institutions or venture capital firms that provide such facility in the country until recently. (A bank for industrial development has recently been established.)

6. The determining factor that limited the size of the initial investment of the majority of those firms was found to be the limitation of owners' capital. The difficulty of securing loans at the start up stage forced the owners to start the business with whatever they saved for that purpose. Another important determinant was the limitation of the market and the lack of knowledge about the market.

7. The industries were found to be indifferent regarding their policy for ownership of premises, i.e. some fully own the place, whilst others, leased the land from the government and built their factory on it. The choice of leasing or owning fully rests on the fact that the owner can not afford to buy the land especially at the initial stage of establishing the business.

8. The majority of these firms seem to sell mostly on cash, but credit sales also exist. The credit sale policy is necessary to attract customers especially in a highly competitive environment. The higher proportion of cash sales to the credit sales may have been resulted from the fear of bad debts, especially during the recession time.

9. The results for purchases seem to take an approximate even distribution shape, i.e. the differences between credit, mostly cash and 50/50 (cash & credit) were minor. Therefore, it can be concluded that the firms have no preference of one over the other.

10. Bad debts seem to be experienced by a lot of firms in all industries. However, it is mostly in the region of less than 1%. Bad debts are inevitable whenever credit sales exist. The chemical industry seems to be having the lowest number of firms that experience bad debts, mainly due to the fact that the majority of the firms in this industry do not sell on credit terms.

11. Amongst the four industries, the Food industry seems to be having the least liquidity ratio (Current ratio). This can give rise to placing tougher terms and conditions for loans on this particular industry. On the other hand, the chemical industry seems to be having the least working capital ratio which indicates that this particular industry is adopting a tighter policy on the working capital needs.

12. The current liabilities which is composed of payable and bank borrowing is found to be quite low compared to owners equity. Furthermore, the percentage of bank borrowing is higher than the percentage of trade credit. This indicates that trade credit is not efficiently used as a source of financing working capital needs.

13. It was quite evident that the small firms in all of the four industries faced difficulties concerning loan grants from commercial banks (the only financial institution to give business loans). The difficulties were mainly due to high interest charges, time taken by the banks to process the loan and the security required to be pledged. For those reasons, small firms may not be very keen on relying heavily on bank loans to finance their growth and/or ongoing operations.

14. The majority of the firms across the four industries, realise the importance of ratio analysis, thus such analysis are performed. This of course, will help them to have good picture of their firms' performance which in turn will improve their image in the eyes of the lending institutions.

15. The average growth in all four industries was found to be reasonable rate of growth. However, there were few firms in the fabricated metal and non metallic mineral industries had experienced a negative growth. This negative growth was found to

be not associated with the educational level of the owners. The educational level did not seem to impact the growth potential of those firms. The recession might have been the main reason for the negative growth of those firms.

16. All small manufacturing firms in these four industries seem to use internally generated funds to finance growth. In addition, a great number of them (71%) use bank loans for the same purpose. Those who do not use bank borrowing are in fact having either enough earnings or not willing to pay interest charges which is banned by Islamic religion. The latter reason will certainly influence the growth opportunities for some of those firms that do not have enough retained earnings set aside for growth purposes.

17. The majority of the firms seem to have their receivables, inventory, and payable turnover ratios increase. The increase in receivable turnover will result in increase reliance on the internally generated funds for financing ongoing operations and growth. On the other hand, increase in payable turnover, will reduce the benefits gained from the increased receivables turnover. But as long as the average pay out period is kept longer than the average collection period, then certain benefits will still exist. The increase in inventory turnover results in efficient utilization of the stock.

18. The major causes of decline for some firms, particularly in the Fabricated metal and non metallic mineral industries, is found to be due to high competition and recession. From the results it was evident, that some industries faced tougher times than others. The recession affected some industries more than others, and in particular those two industries. However, those firms envisage that the business will soon recover from the recession and expect good future growth potential for their firms, resulting from the high demand for their product.

6 . 3 . Recommendations :

Generally, we can say that the small manufacturing businesses in Bahrain, at least in the four industries studied, are doing well, but certain considerations have to be put forward to make them more effective. These consideration can be summarised as follows:

- 1- The establishment of an organization that will carry out planning and market researches, locally, regionally and internationally. Such information will then have to be on passed to the relevant enterprises for onward consideration. Such an exercise will no doubt have a positive effect on small firms that only rely on experience for their strategic decision making.

- 2- To encourage small firms to have a variety of products, it is suggested that the government and other big establishments, should purchase the products of these firms on priority basis.
- 3- The government should provide enough protection to the local products by imposing legislative laws on foreign products. i.e increase import tax or put stringent specifications.
- 4- Establishment of a financial institution that will take the role of financing small and medium firms, at subsidised interest rate charges. The high interest charges can inhibit business expansion, and they are bound to remain at high levels as long as there are no other financial institutions other than banks that will give loans to small businesses, i.e. those banks are monopolizing the market. The rates might even be higher at times of high inflation which will even make situations worse. It was noticed that those firms do not seek venture capital that will provide a good source of funds to finance growth, because up to the present time, there are no venture capital companies in Bahrain which provide this type of facility. However, the government is now going forward with the establishment of a development bank which hopefully will fulfil this role and open new horizons for small businesses in Bahrain.

Of course these are not the only considerations that will help small businesses, but certainly they are amongst the most important ones. Therefore, if these are fulfilled, small businesses in Bahrain will be more effective.

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QUESTIONNAIRE

If more than one owner, please indicate the level of education of each partner.

5. Do you have a proper organization structure? Yes - No
 -If yes, Can you please provide a copy of the organization chart.
6. In case of more than one owner, who and how the decision regarding finance, production, procurement, sales personnel and marketing etc., are made? Please describe.
7. In case of one owner, who and how the decision regarding finance, production, sales personnel and marketing etc., are made? Please describe.
8. Market Coverage:
- a- Local b- Regional
 c- Foreign d- Any other
9. Problems in the area of marketing:

Nature of problems:

Details

- | | |
|----------------------------|---------------------------|
| 1. Competition (local) | Severe-moderate-low-none |
| 2. " (foreign) | " " " " |
| 3. Scale of production | |
| 4. Transport | |
| 5. Payment | |
| 6. Red tapism | |
| 7. Quality | |
| 8. Any other (specify) | |

10. Strategic decisions are based on:

-Market research
 -Experience
 -Intuition
 -Market indicators
 -Others (specify).

B) Goals and valuation

1. The goals(s) of your firm order of importance
 - a) Maximization of market value
 - b) Survival
 - c) Growth
 - d) To secure a regular family income
 - e) Independence
 - f) Others (please specify)
2. At what price do you think you can sell your company?
 - a) At net asset value (assets-liabilities)
 - b) At a price greater than net asset value
 - c) " " less " " " "
3. If your answer is 'b', why?
 - a) Current market value of real assets is greater than their book value
 - b) PV of future cash flows is higher than book value of assets
 - c) Other reasons (please specify)
4. If your answer is 'c'
 - a) Current market value of real assets is less than their book value
 - b) PV of future cash flows is less than book value of assets
 - c) Other reasons

C) INITIAL FINANCING

1. Ownership structure

	<u>At the beginning</u>	<u>Today</u>
a) Single owner		
b) Partnership		
c) Family owned corporation		
d) Publicly "	"	
2. Any venture capital investment

	Yes	No
a) At the beginning		
b) Today		
3. Total assets

a) At the beginning	BD.....
b) Today	BD.....
4. Total equity capital

a) At the beginning	BD.....
b) Today	BD.....

5. Sources of debt capital At the beginning Today
- a) Commercial banks
 - b) Islamic banks
 - c) Friends and/or relatives
 - d) Other sources
6. Why did you decide to invest only this much (own capital) as initial investment in the present enterprise?
- a) I had decided to invest limited amount because I was apprehensive of success
 - b) I had only that much to invest
 - c) That much was proportionate to the loan/aid I was going to receive
 - d) Not to put all the eggs in one basket
 - e) Any other (please specify)
7. What are the reasons for limiting you to the initial size of the enterprise? (may check more than one reason):

Rank

- a) Limitation of owned capital
- b) Limitation of raising loan
- c) Limitation of market
- d) Lack of raw materials
- e) Lack of strong facility
- f) Lack of skilled workers
- g) Unwilling to take more risk
- h) Wanted to try first
- i) Lack of technical know-how
- j) Any other (please specify)

(D) FINANCING WORKING CAPITAL NEEDS:

1. Your major sales are on:

- Cash
- Credit (state number of days allowable)
- Both (state approximate percentages).

2. Your purchase are always on:

- Cash
- Credit (number of days to settle the account)
- Both (state approximate %).

3. Your annual bad debts are approximated to:

- < 1% of total sales
- < 5% " " "
- < 10% " " "
- Others (specify)

4. Please fill out following table in % terms as of today

<u>%</u>	<u>%</u>
Current assets	Current liabilities
Fixed "	Long term debt
	Equity capital
100	100

5. What % of your current liabilities is bank borrowing?

6. What is the annual interest cost relative to those paid by larger companies in your line of business?

- a) Higher
- b) Lower
- c) Same

7. If you use bank loans, how easy/difficult is it to secure a loan?

- Very easy
- Easy
- Quite difficult
- Very difficult

8. If you borrow from friends/relatives, do they interfere with the operational decisions?

Yes - No

If yes,

How frequent:

- Very frequent
- Frequent
- Quite frequent
- Occasional

9. What kinds of security are you required to pledge when you ask for bank credit:

- a) Receivables
- b) Inventory
- c) Fixed deposits
- d) Land
- e) Other (specify)
- f) None

10. Financial ratio analysis of the business is done:

- Monthly
- Three monthly
- Six monthly
- Yearly
- Never
- Others (specify).

11. The liquidity of the enterprize can be classified as:

- High
- Reasonably high
- Medium
- Reasonably low
- Low

(E) FINANCING GROWTH:

1. How did you finance your growth since your establishment?

Rank

- a) Retained earnings
- b) Additional investment from your personal funds
- c) Admission of new partners
- d) " " venture capital investment
- e) Borrowing from banks

2. How did your turnover figures change during your growth years?

Increased Decreased Remained

- a) Receivables turnover
- b) Inventory "
- c) Payables "

3. In case of significant decline, please check the appropriate reason:

Rank

- a) Lack of finance
- b) Non availability of raw material
- c) Rise in price of raw material
- d) Labour problem
- e) High competition
- f) Outdated plant/machineray
- g) Availability of better substitute in the market
- h) Mismanagemnet
- i) Non-payment of bills from parties
- j) Uneconomic production size
- k) Any other (please specify)

4. If you rely soley on internally generated funds, please specify briefly the reasons for this philosoply e.g. difficult to obtain bank loans, enough earning to finance projects, etc.

5- How do you evaluate future growth potential?

- a) Further growth is expected. ☐
- b) Further growth is not expected ☐

If the answer is "a", why:

- a) demand is growing ☐
- b) competitive advantage ☐
- c) others (specify) ☐

if the answer is "b"

- a) No demand for this product/service ☐
- b) difficult to raise loan ☐
- c) Availability of better product ☐
- d) costly raw material ☐
- e) Severe competition ☐
- f) others (specify) ☐

APPENDIX B

----- CROSSTAB / CHI-SQUARE TESTS -----
 Education of Owners

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	6	13	7	9	35
2	3	1	6	3	13
TOTAL	9	14	13	12	48

CHI-SQUARE = 5.417, D.F. = 3, PROB. = .1437

----- CROSSTAB / CHI-SQUARE TESTS -----
 Education of Owners

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	6.56	10.21	9.48	8.75	35.00
2	2.44	3.79	3.52	3.25	13.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 5.417, D.F. = 3, PROB. = .1437

----- CROSSTAB / CHI-SQUARE TESTS -----
Organizational Structure

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	3	4	4	2	13
2	6	10	9	10	35
TOTAL	9	14	13	12	48

CHI-SQUARE = .942, D.F.= 3, PROB. = .8152

----- CROSSTAB / CHI-SQUARE TESTS -----
Organizational Structure

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	2.44	3.79	3.52	3.25	13.00
2	6.56	10.21	9.48	8.75	35.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = .942, D.F.= 3, PROB. = .8152

----- CROSSTAB / CHI-SQUARE TESTS -----
 Degree of Centralization in Decision Making

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	6	10	8	10	34
2	3	4	5	2	14
TOTAL	9	14	13	12	48

CHI-SQUARE = 1.529, D.F.= 3, PROB. = .6755

----- CROSSTAB / CHI-SQUARE TESTS -----
 Degree of Centralization in Decision Making

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	6.38	9.92	9.21	8.50	34.00
2	2.63	4.08	3.79	3.50	14.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 1.529, D.F.= 3, PROB. = .6755

----- CROSSTAB / CHI-SQUARE TESTS -----
Ownership Structure

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	7	9	8	10	34
2	2	5	5	2	14
TOTAL	9	14	13	12	48

CHI-SQUARE = 1.952, D.F.= 3, PROB. = .5825

----- CROSSTAB / CHI-SQUARE TESTS -----
Ownership Structure

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	6.38	9.92	9.21	8.50	34.00
2	2.63	4.08	3.79	3.50	14.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 1.952, D.F.= 3, PROB. = .5825

----- CROSSTAB / CHI-SQUARE TESTS -----
 Ownership of Premesis

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	3	5	6	7	21
2	6	9	7	5	27
TOTAL	9	14	13	12	48

CHI-SQUARE = 1.832, D.F.= 3, PROB. = .6081

----- CROSSTAB / CHI-SQUARE TESTS -----
 Ownership of Premesis

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	3.94	6.13	5.69	5.25	21.00
2	5.06	7.88	7.31	6.75	27.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 1.832, D.F.= 3, PROB. = .6081

----- CROSSTAB / CHI-SQUARE TESTS -----

Cash vs Credit Sales

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	4	3	4	8	19
2	2	6	4	1	13
3	3	5	5	3	16
TOTAL	9	14	13	12	48

CHI-SQUARE = 7.062, D.F. = 6, PROB. = .3151

----- CROSSTAB / CHI-SQUARE TESTS -----

Cash vs Credit Sales

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	3.56	5.54	5.15	4.75	19.00
2	2.44	3.79	3.52	3.25	13.00
3	3.00	4.67	4.33	4.00	16.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 7.062, D.F. = 6, PROB. = .3151

----- CROSSTAB / CHI-SQUARE TESTS -----

Cash vs Credit Purchases

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	5	4	2	6	17
2	2	6	3	2	13
3	2	4	8	4	18
TOTAL	9	14	13	12	48

CHI-SQUARE = 8.248, D.F. = 6, PROB. = .2205

----- CROSSTAB / CHI-SQUARE TESTS -----

Cash vs Credit Purchases

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	3.19	4.96	4.60	4.25	17.00
2	2.44	3.79	3.52	3.25	13.00
3	3.38	5.25	4.88	4.50	18.00
TOTAL	9.00	14.00	13.00	12.00	48.00

CHI-SQUARE = 8.248, D.F. = 6, PROB. = .2205

----- CROSSTAB / CHI-SQUARE TESTS -----

How Easy/Difficult is it to Secure Loan

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	1	4	7	3	15
2	3	6	5	6	20
TOTAL	4	10	12	9	35

CHI-SQUARE = 2.061, D.F. = 3, PROB. = .5598

----- CROSSTAB / CHI-SQUARE TESTS -----

How Easy/Difficult is it to Secure Loan

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	1.71	4.29	5.14	3.86	15.00
2	2.29	5.71	6.86	5.14	20.00
TOTAL	4.00	10.00	12.00	9.00	35.00

HI-SQUARE = 2.061, D.F. = 3, PROB. = .5598

----- CROSSTAB / CHI-SQUARE TESTS -----
 Type of Security to be Pledged

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	3	7	10	7	27
2	2	8	8	7	25
3	1	5	8	6	20
TOTAL	6	20	26	20	72

CHI-SQUARE = 1.046, D.F. = 6, PROB. = .9838

----- CROSSTAB / CHI-SQUARE TESTS -----
 Type of Security to be Pledged

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	2.25	7.50	9.75	7.50	27.00
2	2.08	6.94	9.03	6.94	25.00
3	1.67	5.56	7.22	5.56	20.00
TOTAL	6.00	20.00	26.00	20.00	72.00

CHI-SQUARE = 1.046, D.F. = 6, PROB. = .9838

----- CROSSTAB / CHI-SQUARE TESTS -----

Future Growth Potential (2nd Table)

OBSERVED FREQUENCIES

	1	2	3	4	TOTAL
1	4	7	9	6	26
2	4	4	3	3	14
TOTAL	8	11	12	9	40

CHI-SQUARE = 1.339, D.F.= 3, PROB. = .7200

----- CROSSTAB / CHI-SQUARE TESTS -----

Future Growth Potential (2nd Table)

EXPECTED FREQUENCIES

	1	2	3	4	TOTAL
1	5.20	7.15	7.80	5.85	26.00
2	2.80	3.85	4.20	3.15	14.00
TOTAL	8.00	11.00	12.00	9.00	40.00

CHI-SQUARE = 1.339, D.F.= 3, PROB. = .7200