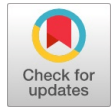


Understanding the Dynamics of Financial Constraints and Business Viability among Bahrain’s SME Sector



Alya Alhaddad

Abstract: With a strategic role in realizing national ambition and strategy, Small and Medium Enterprises (SMEs) have been referred to as the backbone of Bahrain’s economy due to their drive forward in corporate innovation and investment, making them pivotal to the Kingdom’s 2030 Vision. However, SMEs face persistent financial constraints that hinder their ability to thrive in an increasingly competitive market. This study examines the dynamics influencing the financial viability of Bahrain’s SME sector by addressing the potential challenges that obstruct access to essential funding sources and evaluating innovative solutions for overcoming these barriers beyond traditional financing methods. The research employs a mixed-method approach, incorporating qualitative and quantitative data to assess the extent of financial obstacles within Bahrain’s SME ecosystem. It analyzes various financing channels, including local bank funding, public initiatives, and alternative sources such as asset-based financing and crowdfunding. Findings reveal that while Bahrain’s banking sector plays a role in SME financing, stringent lending requirements and high collateral demands often prevent smaller enterprises from accessing these resources. Additionally, the study explores government policies and alternative financial instruments, offering recommendations to diversify and enhance access to financing through measures like credit rating improvements, innovative regulatory frameworks, and educational programs to increase financial literacy among SME owners. The findings of this research underscore the critical need for tailored financial solutions to support SMEs, positioning them as competitive drivers within Bahrain’s economy. By addressing these financial constraints, Bahrain can stimulate SME growth, ensuring the sector’s sustainability and resilience. This study aims to guide policy development that fosters a more inclusive financial ecosystem, empowering SMEs to contribute effectively to Bahrain’s economic transformation and long-term prosperity.

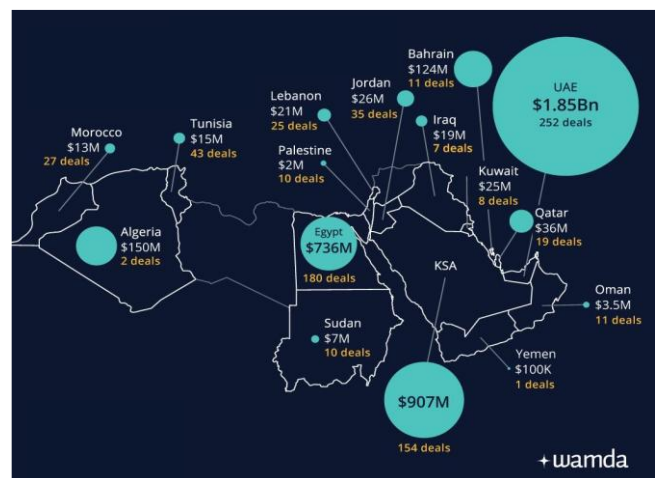
Keywords: SMEs (Small and Medium Enterprises), Financial Constraints, Business Viability, Bahrain, Capital Markets, SME Funding.

I. INTRODUCTION

With the momentum of revolutionizing the world’s financial landscape, entrepreneurship has spawned innovations in the service industry, stimulating economic growth among emerging economies.

The significance of Small and Medium Enterprises (SMEs) stems from being a source of creativity through the productivity of functional and competitive resources that has transformed the view of financing services within the country [1] [2].

Against the backdrop of the acceleration of petroleum prices, emerging oil-producing economies have increased the prosperity of innovation and economic development through entrepreneurial investments. This led to the distinguished position of nations, such as the Gulf Cooperation Council (GCC), in regard to individual development and income. Nonetheless, Bahrain’s strides to transition towards a digital economy through the diversification scheme is a glaring consequence of the regression of income compared to the growth of other Asian nations and the current decline of the oil industry. Transformation of the financial service sector through extensive innovation led to the strong impact of SMEs in improving investment efficiency and achieving sustainable development in the region.



[Fig.1: Investments in the MENA Region By Country in 2022 (Wamda, 2023)] [1]

According to Bahrain’s Economic Development (EDB), the aggregate scale of SMEs’ paradigm in the diversification and consequential impact on economic growth cannot be underestimated. Previous studies indicated that equitable and dynamic SMEs are regarded as a cushion for unstable economic conditions to maintain a sustainable position among emerging economies [3]. Further, entrepreneurship has proven to be one of the sustained drivers of employment creation as well as a source of competitiveness in regional markets. [4] underline that knowledge and innovation are defined as determinants of SME transactions and a



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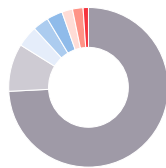
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prodigious potential for sustainable and economic development to strengthen the pillars of the economy. [5] supported ideas, arguing that innovation is a crucial driver of sustainable economic growth to secure economic prosperity. The author stated that the disruption of innovative SMEs plays a pivotal role in the economic diversification and employment opportunities for oil-producing economies, particularly the GCC nations.

A. Research Background

Since SMEs represent 93.3% of the registered establishments in Bahrain's economy, the country has launched the Bahrain Development Bank (BDB) as a targeted financial institution in an effort to diversify the national vision. With over 6,000 enterprises generating up to 70% of the country's workforce, the government's core interest in SMEs ranges from capability development to providing access to finance and sustainability.



Insurance Ancillary Providers	138	(74%)	Payment Service Providers	6	(3%)
Currency Exchange Services	18	(10%)	Fund Administrators	4	(2%)
Financing Companies	8	(4%)	Trust Service Providers	4	(2%)
Card Processing Service Providers	6	(3%)	Micro-finance Institutions	2	(1%)

[Fig.2: Financial & Insurance Services Sector, by Enterprise Type (Adapted From CBB, 2023)]

Although the SME sector contributes to almost 30% of the Gross Domestic Product (GDP), the Bahrain 2030 Economic Vision predicts the growth of SMEs will strengthen the non-oil GDP growth by 70% by 2030 [6]. 58% of Bahrain SMEs are operating in the retail and wholesale sector, followed by 28% in the finance service sector and 14% in the industry sector. With the development of SMEs in the country, it constitutes 64% of the private sector employment opportunities. The growth of SMEs in Bahrain's economy has been at the crest for economic diversification and resilience, with 14% of the Compound Annual Growth Rate (CAGR), positioning the country as a premier destination for start-ups. According to the Ministry of Industry and Commerce (MOIC) Commercial Registration, SMEs focus on services, accounting for 48%, followed by 42% trading and 10% manufacturing [7].

Aligning the guiding principles of Bahrain's Economic Vision 2030 with the development of SME sector performance and productivity drives the economy forward. The crux of the government is to implement policies that empower the position of SMEs and promote the country's entrepreneurial and innovation ecosystems [Appendix I](#). As the country's premier SME bank, the BDB, along with the government, are bridging the current technological gap by developing vocational training options to improve the capacity of SMEs' innovation outcomes.

Entrepreneurial investment faces restrictions and operational roadblocks, including disproportionately high tax burdens, credit and trade barriers, and constraints on funds and cash flows [8]. Therefore, financial backing from appropriate sources eradicates complications by creating

sovereign growth and wealth funds for SMEs as a commercial incentive to foster economic growth [9]. Despite the initiatives of Bahrain's government in establishing funding sources, SMEs are confronted with obstacles to access to financing as the Middle East and North Africa (MENA) region needs to be equipped for sustainable services. Moreover, as [10] argue, the trend of financial barriers along with regulatory complexities inhibits the SMEs development in the economy. The authors mentioned that the aim of actual SME policies is ambiguous from an economic viewpoint.

B. Research Scope

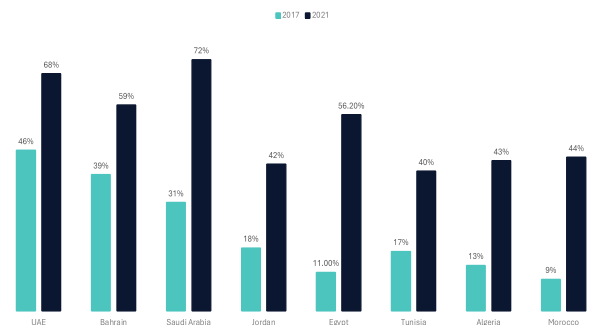
Against the backdrop, the research paper examines the extent of the relationship between local banks and digital financing inclusion in Bahrain regarding SMEs' constraints in accessing financial credit. Based on the change of capital stock requirements, it identifies the internal and external determinates to evaluate the potential sources of start-up financing and funding implications. The scope of the research is based on qualitative and quantitative data to develop the dimensions of SMEs in Bahrain. Limited to the objectives, the study places particular emphasis on the approach in how SMEs prevail over foreign liabilities and improve legitimacy with possible recommendations.

C. Research Objectives

The study paper is an initial study assessing the relationship between the economy, banks, and the government in the bulk of the credit to SMEs. By elucidating multiple streams of SMEs, the study contributes to an analysis of the domestic economic performance of SMEs in Bahrain based on credit reporting, secured lending, and insolvency regulation indicators. The paper builds on the moderating effects of the target market on SMEs and their scope of internationalism.

II. LITERATURE REVIEW

With the notion of global transformation of the finance landscape, previous studies have identified the drivers [Appendix II](#) of the low financial inclusion rate for the MENA region to be recorded at only 20% [11]. Despite the country's exuding financial efforts for sustainable development and efficiency, Bahrain's financial inclusion rate scored the third highest among the MENA nations at 59%, followed by the United Arab Emirates (UAE) at 68% and Saudi Arabia at 72%.



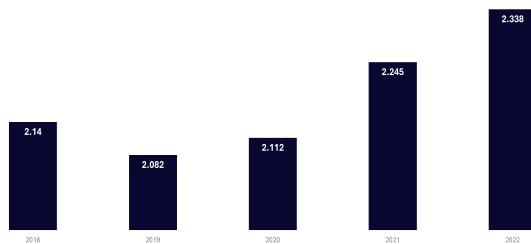
[Fig.3: Financial Inclusion rates in Arab Countries, 2017-2021 (Adapted from the World Bank, 2022)]



FinTech is considered one of the critical drivers built as a financial service based on the disruptive nature of ground-breaking Information and Communication Technologies (ICT) that impact traditional systems and business models by innovatively expanding mobile platforms [2].

Since Bahrain is regarded as the leading regional FinTech hub, transforming the financial sector reforms consumer expectations, ecosystems, and regulations into a new paradigm [1]. The emergence of such firms among SMEs improves investment efficiency algorithm-based digital solutions [9].

Bahrain EDB has stated that over the last decade, Bahrain has firmly established itself in the region as a hub for FinTechs, financial institutions, asset wealth management for insurance, and Islamic finance firms. With over 500 domestic and international corporations contributing to innovation, regulation, and investment, Bahrain's financial service industry plays a crucial role in the country's sustainable economic growth. It contributes 18.6% to the real GDP in 2022, making it the second-largest non-oil sector, with a total Gross Value Added (GVA) of \$6.1 trillion (BHD2.3 billion) [12]. The sector, which includes consumer finance, banking, insurance, and a broad spectrum of investment funding, has seen significant growth in recent years, with a 4.9% Year-on-Year (YoY) growth, ranking first among the MENA region in terms of finance and trade freedom in the 2023 Economic Freedom Index [11].



[Fig.4: Financial Corporation Sector, GVA (BHD, Billion) (Adapted from Tamkeen, 2023)] [12]

Bahrain's financial industry is comprised of over 365 financial institutions, establishing the country as an international financial center with a high concentration of licensed institutions and proactive skills and knowledge supervised by the Central Bank of Bahrain (CBB). The forward-thinking regulatory body, along with the agile ecosystem, led to the financial service sector contribution of \$1.1 billion (BHD414.6 million) to Foreign Direct Investments (FDI), equal to 13% [13].

According to the EDB annual report in 2022, Bahrain has long been a regional pioneer for FinTech, owing to its history as an ancillary financial service hub. The sector employs 3% of the private sector has seen more than 60% of financial services employment accounts coming from Bahraini nationals. Bahrain's high productivity in the finance sector, after the mining and quarrying sector, has led to the creation of high-value jobs [14], further solidifying its role as a regional pioneer for FinTech.

With the concertation of the transition to the digital economy, Bahrain's competitive operating costs and entrepreneurial talent pool enable FinTech to attract international players into the market compared with

neighboring countries. Bahrain FinTech's innovative initiatives with Trust Law, Open Banking, and e-KYC (Electronic Know Your Consumer) in 2019 led to the rise of the financial service industry contribution to \$99.87 million at 12% FDI, creating new 575 jobs and over 20 companies [12]. The industry has witnessed notable technological growth as it was ranked first in the Top Islamic Finance Destination in the MENA region as well as in the Cryptocurrency Asset-Platform in the Gulf. Further, the country's financial service sector was placed second in MENA in terms of economics, freedom, and regulations. S&P awarded Bahrain second place in the Most Advanced FinTech Ecosystems in MENA.

Bahrain is among the fastest-growing financial centers in the world and remains a magnet for investors by offering a dynamic and supportive environment for entrepreneurs and a multicultural and positively high-skilled talent pool that helps start-ups attract funding. Tamkeen's collaboration with Export Bahrain empowers SMEs to have power in the market by expanding their reach to international markets and contributing to the country's economic development. As reported in 2022, the export value of \$1750 million across 60 markets around the world indicates the extension of Bahraini local entrepreneurial talent as future competitors among global businesses and the success of the diversification objective in the national development strategy.

III. METHODOLOGY

Although Bahrain has made significant strides in the entrepreneurial market, emerging as a global employment hub leads to persisting complexities that must be addressed for sustainable economic growth. It includes competition from other regional hubs, the need for continuous infrastructure development, and uncertainty in the global economy. Nonetheless, Bahrain's adoption of proactive measures positions sustained economic growth and influence in the global start-up and entrepreneurship landscape.

A. Government Policies

Since Bahrain is committed to fostering innovation and entrepreneurship, the government seeks to support local start-ups through the SME Program resolution amendments set by the cabinet (depending upon the employment levels and annual turnover). Establishing the SME Development Board (SDB) strengthens the capacity and competitiveness of Bahrain's enterprises in the domestic and global landscape. Under the Cabinet resolution, the allocation of at least 20% from the value of government procurements and tenders and the 10% auction advantage of public utilities are aimed at improving SME financing within government departments and tenders.

Nonetheless, the availability of finance is the most controversial issue in analyzing SME funding obstacles. Some authors maintain that insufficient finance is not considered a fundamental obstacle to SME growth [15]. Others emphasize that the interaction between financial and institutional systems creates barriers to new firms' growth.

In Bahrain, numerous international and national organizations have allocated funds to support the



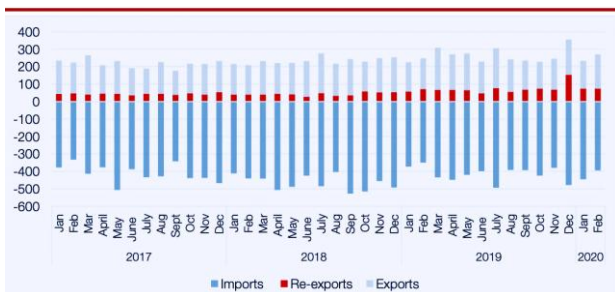
development of SMEs; however, in many cases, the funds have yet to be entirely borrowed by the emerging private sector [14]. Banks and financial institutions had to learn about evaluating loan applications from SMEs with little track records. The inability to deal with the financial needs of start-ups may explain the pattern to some extent. However, the entrepreneur’s behavior of asking for funds plays an essential role in denying credit requests. As proposed by the European Commission, providing appropriate financial feedback for SME credit applications encourages competition in the financial sector, leading to innovative services for enterprises.

Furthermore, Bahrain’s introduction of an established regulatory framework, including bankruptcy law along with credit reports under Article 68 of the CBB Law, led to the launch of the credit scoring system report. Bahrain Credit Reference Bureau, a public joint stock company, acts as a central data warehouse between financial and non-financial institutions by aggregating and analyzing comprehensive credit information for corporates and individuals. Despite the access to the open finance system, the absence of a credit scoring system for SMEs influences the growth and establishment of new firms in Bahrain [15].

By reiterating the support for the SME sector in growing the national economy, Bahrain’s government issued Legislative Decree No. 23 of 2020 on securing the interest with movable propriety regardless of their form and denomination [16]. It expands the scope of previous legislation and laws by enabling companies operating in various sectors to secure bank and commercial loans through “tangible or intangible” movable properties [17].

B. Impact of Post-Pandemic Policy Responses

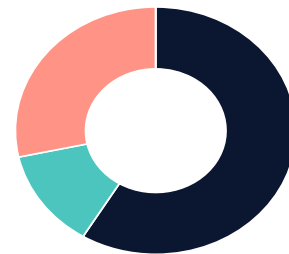
The spread of COVID-19 across the globe contributed to a distorting effect on small and medium firms in the country. Numerous challenges stem from the pandemic, subjecting a number of firms to suspend operations due to the higher vulnerability and fragility in response to the restrictions on international levels. The MENA region felt the ramifications of the virus as the proportion of firms in the market reported a drop in revenue by 11% in the early stages of the pandemic. Bahrain’s aggregate trade revenue fell by 10.9% (BHD5 billion), leading to a trade deficit with a static aggregate value of national exports [16].



[Fig.5: Non-oil Trade in Bahrain (BHD, Million) (EDB, 2018)]

In the wake of COVID-19, studies have shown that the implications for SMEs are more pronounced in the economy as private capital markets obstruct the access of such enterprises. This is due to the lack of scale and knowledge to move toward alternative finance sources and the difficulty of financial institutions in monitoring regulatory compliance [17].

Since SMEs play a critical role in Bahrain’s economic growth, credit extension remained idle between June and December 2020, while start-up loans accounted for 1.9% of the total loans. The Non-Performing Loans (NPLs) recorded a slight decrease from 12.6% to 11% in the same periods, while the provisioning levels reported a decrease of 35.1% in June to 43.1% in December due to the lack of financial support.



● Conventional Retail	58.6%
● Conventional Wholesale	12.9%
● Islamic Retail	28.4%
● Islamic Wholesale	0%

[Fig.6: SME Lending by Banking Segment in Q4 of 2020 (Adapted from CBB, 2021)]

Indicator	Q2 2020	Q4 2020	Change
SME Loans (% of total loans)	1.9	1.9	0.0
SME NPLs (% of total SME loans)	12.6	11.0	-1.6
SME Provisioning (% of total SME NPLs)	35.1	43.1	8.0

[Fig.7: SME Lending in Bahrain (Adapted from CBB, 2021)]

In part of its efforts in supporting SMEs during the economic recovery following COVID-19, the Bahrain Chamber of Commerce and Industry (BCCI) played a prominent role in shaping the economy by reporting the financial challenges leading to the implementation of the fiscal stimulus [18]. Bahrain’s government promptly activated a \$11.38 billion economic stimulus measure to mitigate the consequences of the outbreak on SMEs. Equivalent to 29.6% of the annual GDP, the economic package focuses on the bank’s low lending levels to soften the repercussions of the economic crises on SMEs. Extending support during the economic downturn helps the enterprises pivot rather than fail while increasing future employment opportunities.

In March 2020, Tamkeen announced the launch of the Business Continuity Support Program in support of small and micro firms to maintain the national sustainable economic development efforts [19]. The initiative aims to provide adversely affected enterprises with the liquidity to help sustain operations and employment. Tamkeen started at \$148.56 million (BHD56 million) of financial grants within the private sector enterprises to meet the current market challenges through creativity, innovation, and sustainability [20].

Similarly, the National Bank of Bahrain (NBB) introduced a ‘Tamweel Al Watani’ scheme in 2021. Limited to SMEs operated and owned by Bahraini nationals, the incentive aims to improve the cash flow positions across the country through the revival and development of the local market with low-interest loans. Following the directives of funding



solutions, NBB partnered with BDB to expand the trade finance solutions for SMEs that further stimulate Bahrain’s national ecosystem. The program bridges the gap between buyers and suppliers by optimizing the working capital through a range of financing and risk mitigation solutions.

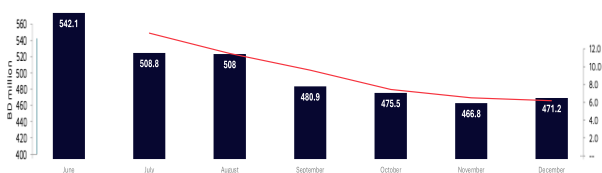
With the unprecedented move reiterating the national efforts, Bahrain’s top leaders and government are stepping in the right direction, providing financing coupled with capability development for SMEs. Therefore, government-supported developments, finance institutions, and banks must maintain and revise the Credit Guarantee Schemes (CGS) extended to SMEs to obtain trade finance and capital adequacy in the market for sustainable development.

C. SME’s Public Funding

Direct government investments through funds or co-investment funds are considered an effective means of addressing supply-side gaps in capital availability on the scale of SME markets. Despite the limited funding options, the BDB launched a digital banking platform, “Tijara,” targeted at SMEs applying for loans in 2021. The initiative is intended to drive digital transformation in simplified banking solutions and support economic growth in the SME sector.

i. Bank Funding

According to the CBB, the total number of banks operating in the state reached 86, including 13 national and 17 foreign banks with 56 wholesale banks. Since the banking system is a source of funding for the SME sector, the institutions have an essential responsibility to provide a variety of different products with credit facilities depending on the business purpose, collateral, term, amount, and other characteristics. Such products range from working capital and investment loans to receivables, asset-backed and real estate loans, and overdraft facilities [19]. Statistics released by the CBB records credit extension from banks to SMEs has grown by 4.1% during the first quarter of 2022 compared to the fourth quarter of the same year, as the data were BHD542.1 million and BHD471.2, respectively. This reveals that the country strives to create an ecosystem conducive to the growth of SMEs. The loans represent 9.4% of the total cumulative balance of credit facilities provided to private sector commercial and economic enterprises, reported as BHD5.5 billion in 2022 [12].

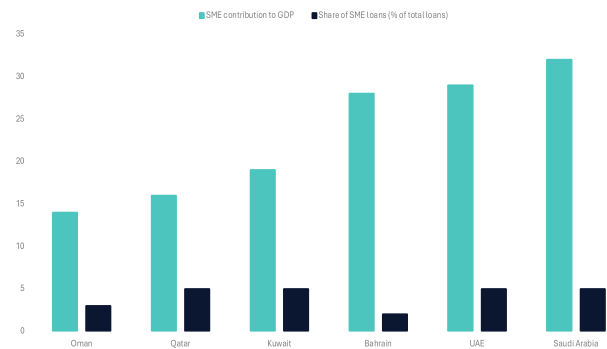


[Fig.8: SME Loans, 2020 (Q3-Q4) (Adapted from CBB, 2021)]

Despite the government’s motivation to develop SMEs, Bahrain has showcased a relatively inadequate track record of credit extension for such firms to meet regional and global norms in recent years [19]. According to a study conducted by [20], the structural constraints of entrepreneurship revealed that 11% of SMEs utilized the banking systems funding, with only half of the companies accepting credit

extensions. Based on the survey of over 500 SMEs and more than 15 banks, the research findings provided insights as three-quarters of SMEs utilize the financial services of more than two banks, which creates a barrier to the country’s economic development.

Furthermore, it is revealed that the lending requirements by commercial banks are quite strict, including minimum collateral assets worth BHD250,000 with audited financial statements as well as high interest rates on business loans. Tailored finance solutions are insignificant, ranging from credit letters to secured and unsecured loans and overdrafts [21]. Approximately 50 to 70% of financing applications for SME funding are rejected by conventional banks in Bahrain. SME bank funding is negligible, with about 3% of system-wide bank loans within the country allocated towards small to medium corporations [22]. Despite the economic stimulus package leading to a 29.6% SME contribution to the annual GDP, the imbalance between the cost and complication of servicing SMEs compared to the bank’s potential return reveals that the SME sector is not at the top of the financial institution’s agenda.



[Fig.9: Share of SME Loans, 2019 (Adapted from Deloitte, 2021)]

For the initial capital and investment expenditure, recent studies underlined the role banks played in the intricacies and hurdles of SME finance in Bahrain in terms of funding[21]. Further, the country’s underdeveloped leasing and factoring of credit products limits entrepreneurs’ support in obtaining credit. Further, the unwillingness of banks might be due to the limited assets and the lack of collateral and record of operations, which makes it challenging to fund such enterprises, given how expensive and inflexible they may be [21]. An early study by [6] mentioned that the limited tendency of banks in financing SMEs is narrowed down to the inadequate financial discipline of such firms along with the improper planning of feasibility study. According to [23], conventional banks’ small contribution is strictly derived from state banks’ unwillingness to lend money to SMEs and the start-up’s hesitation to apply for loans. In this area, SMEs’ insufficient information on funding sources plays a role in refusing credit extension or bank funding.

ii. Non-Bank Funding

Several multifarious micro-leaders service the SME segment financial support, such as Tamkeen, which offers financial support (up to BHD10,000) through various



programs for start-ups and entrepreneurs. Hope Fund and Bambucron are crowdfunding platforms that bridge the gap between entrepreneurs and investors. Crowdfunding is a financing option for raising capital by connecting entrepreneurs with a pool of potential investors on an electric platform. It increases market access and career mentorship to entrepreneurs from industry experts by offering an opportunity for start-ups to secure required funding [24]. Building on the discussion, two crowdfunding forms prevail: reward-based and equity-based [22]. Bahrain started as the first GCC nation to construct crowdfunding governmental regulations in pursuit of a knowledge economy, with the CBB launching the regulatory and legal framework for loan and investment-based crowdfunding platforms [13].

Global efforts of loan-based crowdfunding are expected to be worth \$300 billion, while equity-based is estimated to exceed \$100 billion by 2025. Forms of crowdfunding were exposed to stricter principles governing the conduct of platform operations in the first quarter of 2022, with the introduction of a new regime controlling the licensing and regulations. The revised version of the consolidated Crowdfunding Platform Operators (CPO) module replaces the existing financing-based crowdfunding regulations stipulated in the framework.

CBB recognizes the rules of Issuing a Crowdfunding License as a form of raising funds in the country or abroad. For the purpose of the module, equity crowdfunding excludes financial instruments such as Simple Agreements for Future Equity (SAFE) or similar products [23]. Reward-based or donation-based crowdfunding platforms are excluded from the scope of the regulation. Unlike traditional funding sources, crowdfunding has gained traction from start-ups in providing private benefits ranging from rapid access to capital with minimal collateral requirements imposed on SMEs [13].

Beban platform is one of Bahrain's first licensed financing-based investment platforms that offers funding opportunities to assist SMEs in the region. It builds partnerships to facilitate and solve the implications for investors in Bahrain and the Middle East. Through accumulated experience in investment, finance, and digital solutions, Beban helps established SME businesses solve their cashflow hurdles through experts with extensive experience.

Beban crowdfunding connects entrepreneurs with investors by bridging the funding gap and providing a secure platform to empower investing in equity-based opportunities. SMEs seek funds through the platform starting from \$100,000 for a share value of up to 3 years. SMEs lose invoices payable within 90 days and receive finance within 24 hours at 5%. Invoice Trading enables investors to invest in equity and debt opportunities by supporting SMEs' cash flow and increasing revenue for scalable to-business growth.

Launched in 2011, Bahrain established an Angels Investment Company called Tenmou, which facilitates funding opportunities for innovative Bahrain-based entrepreneurs. Business Angels are successful entrepreneurs who provide investments despite the high risk involved in

SMEs in exchange for equity. Furthermore, Venture Capital (VC) and Private Equity (PE) are gaining momentum in the country as alternative funding sources for SMEs. However, the source can be challenging due to the off-shore location and the encompassing privilege requirements.

Bahrain faces a myriad of implications in terms of vulnerabilities in the licensing process, legal and regulatory restrictions, and challenges in structuring investment systems. According to [25], the limited market demand for alternative financial instruments is found to be due to the lack of SME financial knowledge on innovative funding sources along with their inadequate approach to building a strategic vision and resources to attract other means of finances apart from debt. In 2021, KPMG took the initiative to support the expansion of SMEs in the country by raising capital via an Initial Public Offering (IPO).

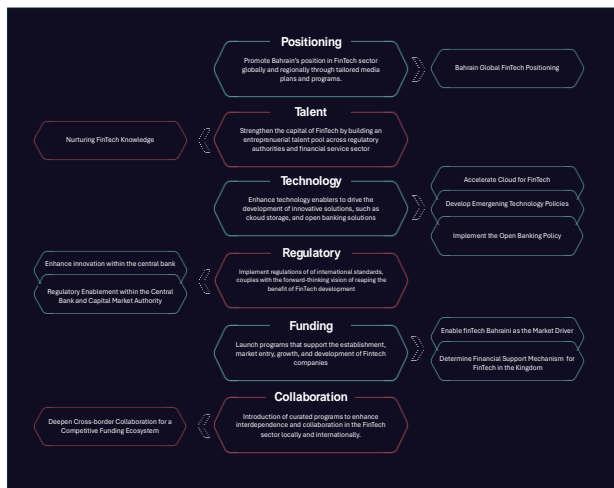
Additionally, the development of FinTech in Bahrain's ecosystem is considered an additional source of financing for SMEs that are acquiring business capital. Through the FinTech platform, start-ups and entrepreneurs are able to cater to their needs with a comprehensive suite of financial services. For instance, the Tijara platform is a digital business initiative that provides banking services to start-ups in the Kingdom. It is targeted at offering efficient and accessible lending products for SMEs' growth and development. BDB has partnered with FinTech to foster a supportive, prosperous future for Bahrain's financial sector, built on innovation and financial inclusivity.

Arab Financial Service (AFS) became the first acquirer of Spotii, a Dubai-based technological provider, to enable the Buy Now Pay Later (BNPL) solutions in Bahrain. It provides a transparent alternative to traditional higher-value payments through four cost-free installment plans. BNPL empowers businesses to cut through legacy systems by driving higher sales from every transaction while enhancing the customer experience with more control over spending behavior. MyMoneySouq compares SME bank loans by facilitating their entry into international markets. Additionally, the Bahrain Investment Market (BIM) contributes significantly to the liquidity and vibrancy of Bahrain's capital market. It is considered a dedicated platform that facilitates and enhances the access of growing companies, including start-ups, to attract investment and expand their operations.

IV. RECOMMENDATION

Based on the overview of the existing financing sources available for small and medium-sized enterprises, the path to improving the financial ecosystem structure would induce real change in sustainable economic development. Therefore, the research focuses on possible measures to improve SMEs' access to finance by comparing various practices adopted by multiple countries worldwide that would avert any opposing outcomes for the country's entrepreneurial future.





[Fig.10: Measures to Support Bahrain's Financial Service Market Development (Adapted from FinTech, 2021)]

A. Enhancing the Access to Existing Financing Instruments

i. Bank Referral Scheme

Since SMEs primarily depend on the traditional banking system, launching a financial platform with policy initiatives would assist in the regional growth of the service industry. The bank referral scheme is a designated platform intended to induce competition in the lending market; under the scheme, the incumbent bank must share information about SMEs seeking external funding through a finance platform. The initiative was implemented in the United Kingdom (UK) in 2016 to connect start-ups with alternative funding sources after failure to secure bank loans [26]. It is intended to foster an environment of funding that encourages experimentation and adaptability.

Facilitating the SME landscape through the proposition of technological finance platforms would assist the search for external finance sources [27]. The visibility of alternative lenders on the start-up application would improve the scheme's credibility and facilitate knowledge migration business flow by deepening global ecosystem ties. Applying such a scheme in the country through the SMEs Database created by MOIC would fuel the growth of promising start-ups in the country, contributing to the dynamism of Bahrain's entrepreneurial market. However, the main obstacle to achieving platform banking is the legacy systems that cannot support technology-based collaboration. Nonetheless, this is expected to be adjusted in the upcoming years, albeit at a slower pace in the country.

ii. Credit Rating

With the exacerbation of information asymmetry between SMEs and external investors, financial constraints prevent start-ups and entrepreneurs from accessing the credit market due to a lack of relevant information. Meanwhile, the inefficiency of resource allocation hinders investor's evaluation of the potential risks and benefits of SMEs, leading to adverse selection that aggravates the financial difficulties for SMEs [15]. Risk assessment and credit classification infrastructure play a significant role in the transparency of indicating the creditworthiness of start-ups and overcoming the deficiencies within the financial service sector.

Therefore, the integration of assessment infrastructure within the SME Database would leverage the predictive analysis of the degree of risk associated with the financing of particular firms and formulate comprehensive reports for potential investors. For instance, Thailand's National Credit Bureau launched the FICO SME scores for financial and non-financial institutions to assess the creditworthiness of start-ups and entrepreneurs. The analytical service acts as an effective tool to predict the firm's profitability and facilitate the financial funding decisions of external investors.

Setting off a digital SME Rating helps reduce information asymmetry between the parties, enabling robust SME growth in the industry while drawing in investments and venture capitalists to Bahrain. By leveraging enterprise credit reporting services, the classification system would boost the country's competitive business advantage. Bahrain's SMEs Development Board implemented the initiative in 2017 with the notion of extending the data quality and the development of the SME sector. However, the classification certificate uses little information to generate the score [24].



● Extremely risky	570 or less
● Risky	580 – 669
● Adequate	670 – 739
● Safe	740 – 799
● Extremely safe	800+

[Fig.11: FICO Credit Score (FICO, 2023)]

With the significance of SMEs in Bahrain's economy, introducing a database of credit risk assessments drives efficiency in the fund provision of SMEs. It cuts down the borrowing costs of interest rates and enhances social trading through investment portfolios. The initiative has been implemented in Japan, where the Credit Risk Database (CRD) accumulates extensive information on SMEs to deliver statistical data and credit scoring services to facilitate the financing access of such firms in the market with the securitization of claims [28].

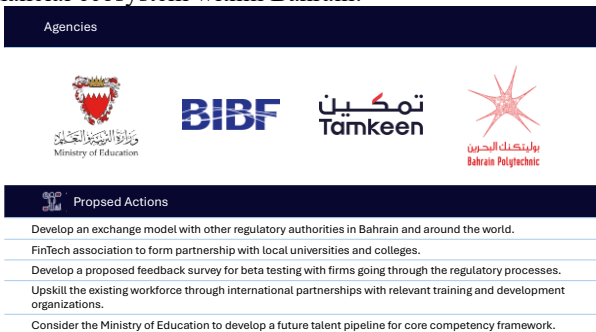
Under competitive financial service market conditions, the irregularity of the accounting system with the development of technology generates asymmetric information between suppliers and potential beneficiaries [25]. Accounting data normalization would reconstruct the financial statements in a standardized format as well as achieve high financial control over SME development in the country. The disclosure of data improves the financial performance of start-ups and entrepreneurs in the market. Further, the reflection of SMEs minimizes the information deficiencies between external funding sources and enterprises.

iii. Education and Financial Awareness

From a theoretical perspective, the role of supply and demand constitutes implications obstructing SMEs' financing. Studies have shown that evidence of demand failure relates to resource limitation and financial network complications that prevent start-ups from attracting finance and the investor's discouragement [29]. The chain of causes and consequences of hesitance to invest in SMEs may be attributed to the scarcity of transparent credit data and regulatory barriers. Therefore, the prevalence of risk aversion in the market creates a mismatch between the SME's perception and finance providers, which drives down the demand from entrepreneurs as well as discourages potential investors, leading to a lag in adjustment.

Although the entrepreneurship mindset in Bahrain is considerably present, the lack of ideas within the financial space hinders the productivity of relevant, innovative FinTech solutions. Building the drive for entrepreneurship through hackathons and accelerators promotes an innovative mindset of technological advancements. Adopting a similar measure to the European Investment Hub (EIH) in Bahrain would facilitate the SME's access to financial support and implement technological innovation. Acting as a single point of contact for regional multi-partners strengthens the start-ups and entrepreneurs' linkages to regional service providers [30]. Similarly, Banque de France, along with Banque Public d'Investissement (BpiFrance), has coordinated a network of regional correspondents that promote the equity of SMEs by offering financial advisory support.

With the integration of network programs to address the specific challenges of SMEs, the creation of targeted financial education programs through Tamkeen enhances talent retention and strengthens entrepreneur's skills and knowledge. Improving the understanding of the financial and economic landscape would reflect the importance of developing a long-term strategic plan for SME funding and understanding the financial risks associated with different instruments within the economy. Portugal's national strategy plan is targeted towards fostering the digital financial literacy of SMEs to understand the global economic context and improve the understanding of the financial transmission of credit. Alternatively, Tamkeen's partnership with ELITE Business Support to delegate the dynamic support of SMEs would facilitate access to capital markets and alternative funding sources. Through an international network of private SMEs, the initiative would enhance the productivity of the financial ecosystem within Bahrain.



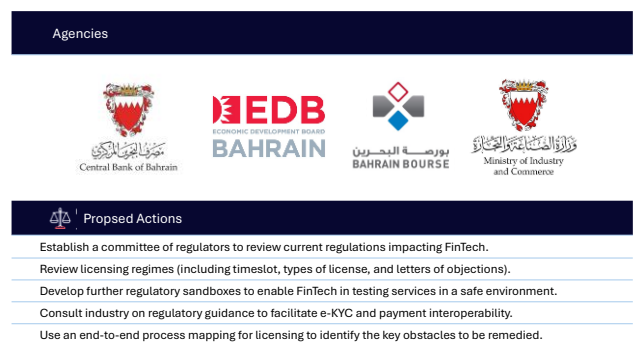
[Fig.12: Proposed Measures for the Development of SME Ecosystem – Education Pillar (Alhaddad, 2024)]

iv. Insolvency Regulation

The sustainable growth of SMEs within the economy is multidimensional and demands policy-makers to support and

retain the economic agents for the country's economic development. Studies have reported that insolvency practices ameliorate the rigid and intense compliance requirements of informal negotiation with financial creditors. Through access to effective insolvency systems, Bahrain's creation of a supportive regulatory framework would increase the value of assets to SMEs by revising certain business transactions.

Further, implementing the regulatory framework would influence the external investors' decisions in determining the risk evaluation of start-ups and entrepreneurs. Under the Italian Bankruptcy Law, the insolvency regime ensures the continuation of productivity levels and the preservation of micro-enterprise operations [31]. Addressing the insolvency procedures in Bahrain's targeted SME practices is crucial for transparency in the market as the transformation of the fragmented regulatory environment would facilitate funding, resulting in greater flexibility for entrepreneurs in the country.



[Fig.13: Proposed Measures for the Development of SME Ecosystem – Policy and Legislation Pillar (Alhaddad, 2024)]

B. Implementing Alternative Financing Instruments

With the technological advancements in the sphere of financial services, the increasing number of innovations creates an opportunity for the development of financing models for SMEs. Exploring financial instruments beyond traditional loans is critical for SMEs to thrive in the competitive business environment. Access to capital through alternative financing instruments is the key to maturing the industry and achieving long-term success in Bahrain.



[Fig.14: Proposed Measures for the Development of SME Ecosystem – Funding Pillar (Alhaddad, 2024)]

i. *Private Asset-Based Finance*

Diversification of financial instruments and sources of SMEs is an emerging trend in overcoming the risks associated with market access to capital and international commerce. Despite the repercussions of the financial crisis, the asset-based financing model has grown significantly over the past decade to reflect the support of entrepreneurs through diverse market conditions. The Organization for Economic Cooperation and Development (OECD) revealed that the global asset-based finance sector has gained momentum in emerging economies despite the inadequate banking infrastructure [25].

As the Bahrain economy begins to slow with the decline of oil prices, the banking system's liquidity is creeping into the level of caution, impacting the flow of deposits. Asset-based financing instructions would encourage the country to maintain credit rating and capital through ambitious investment infrastructure secured by property, accounts receivable, inventory, or equipment. Financial techniques such as factoring intended to optimize start-ups' cash flow have grown steadily in developing nations, particularly in the UK. To bridge the gap within the market, factoring is considered short-term commercial finance based on collecting creditworthy account receivables at a discount from a third party [32].

Nacional Financiera (NAFIN), a Mexican development bank, designed a network of reverse factoring practices to finance SMEs through a productive chain of programs. Implementing the form under NAFIN's technological platform identifies the market barriers for start-ups by transferring the credit risk of the loan to the supplier [33]. Further, the launch of the regulatory development framework for virtual asset trading platforms by Hong Kong's Securities and Futures Commission (SFC) would improve the environment in Bahrain by analyzing global practices for security on the FinTech platform [34].

Implementing reverse factoring creates instant liquidity by creating opportunities for SMEs to secure loans and generate cashflows, creating a competitive payment infrastructure [35]. Despite the lack of transparency in normalized credit data, asset-based financing instruments embed low risks to external investors while providing access to working capital through backed assets' liquidation value [36].

ii. *Capital Market Fund Raising*

By bridging the funding gap within the financial market, Bahrain's ecosystem reform with the SMEs Online Registration System aligns with SDB's five-year plan and the government's 2030 Vision to build a knowledge-driven economy supported by non-oil markets. Further, China's support for the growth of research and development (R&D) SMEs led to the establishment of unified national financing registration systems. People's Bank of China, the central bank, improved the country's business environment by providing loans for Micro-Small Medium Enterprises (MSME) based on credit information.

Formulating an adequate framework of appropriate regulation and legislation is conducive to developing and growing entrepreneurship and SMEs in the country. Implementing incentive measures and policies promotes and supports the firms in accessing the capital market and fosters

an ecosystem where innovation thrives while ensuring compliance in the market. BIM promotion of the SME sector has gained momentum amid government support. Therefore, the adoption of direct financing would aggregate the country's economic performance and develop this niche market in Bahrain. Although BIM provides financing means before the SME listing on the Bahrain Bourse (BHB), the coordination between BHB and SDB with local banks and BIM through online public listing applications would captivate external investors and inject capital into the market.

iii. *Micro-finance Institutions*

Credit provision is a critical element of the modern economy as it is an agent in the growth of enterprises within the country. Since SMEs play a prominent role in developing economies, Micro-Finance Institutions (MFIs) have become instrumental funding sources for entrepreneurs. The micro-credit loan provision of collateral security through group guarantees bridges the financing gap in the financial service market. Building an international network of investors provides valuable insights and opportunities for economic development. Women's Microfinance Initiative (WMI) is an East African organization set to provide credit financial services to rural businesswomen loans without collateral or interest to ameliorate their living standards.

Similarly, the BDB Women Business Finance Scheme "Riyadat" was implemented to support the growth and development of female entrepreneurs in Bahrain. The initiative intends to fuel the country's economic growth and create a transformational impact on the SME sector. However, the country must continuously evolve and motivate women entrepreneurs by implementing awareness programs on a mass scale across the country.

V. CONCLUSION

The spectrum of SMEs' financial sources nowadays differs with the technological advances and innovation within the ecosystem. Entrepreneurs' and start-ups' development stages in Bahrain have grown dramatically against a background of turbulence and uncertainty, with the main hurdle being the possibility of accessibility to financing conditions. SMEs' characterization of deep uncertainty, lower fixed investment opportunities, and static financing structure endangers the country's economic growth and employment.

The development of a sustainable FinTech ecosystem is a matter of time before the roadmap is built on Key Performance Indicators (KPIs), which are a phased approach to maintaining momentum. Stakeholders must take several immediate measures on the path toward an internationally recognized digital financing ecosystem. Although the sector plays a prominent role in the economic development of Bahrain's economy, the risks of negative cashflows and untried business models are due to technological development and the economic gap. Therefore, Bahrain has to evaluate the additional financing limitation by diversifying funding resources to innovative solutions to enable intense competition and drive sustainable economic development.



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I must verify the accuracy of the following information as the article's author.

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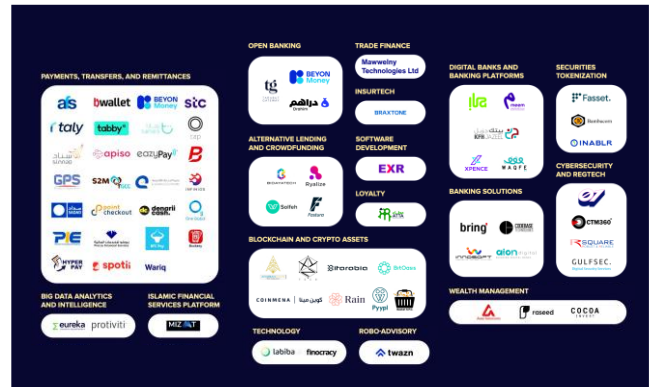
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contributes to the ecosystem’s innovation and growth. Although the number of FinTech start-ups is undetermined in Bahrain, the country served over 120 start-ups after opening the regulatory sandbox in 2021.



[Fig.17: FinTech Start-ups in Bahrain by Service (Arcapita, 2023)]

The gradual development of Bahrain in the FinTech space is driven by the supportive regulatory framework and the sector’s drive for innovations, which aligns with the Bahrain Vision 2030. Since the service industry is highly competitive, traditional institution-backed start-ups, such as Bwallet and Beyon Money (sponsored by Batelco, Bahrain’s telecommunication company), with FinTech start-ups, such as Benefit, increase the accessibility of technological and innovative applications.

Government

The discrepancy of view on FinTech differs in regulation, capital, and reporting requirements from governments due to the 2008 financial crisis. In support of the industry, the Bahraini government plays a crucial role in shaping the FinTech landscape. CBB regulatory sandbox maintains sustainable economic growth by supporting start-ups to test and develop innovative products in a controlled environment. Bahrain FinTech is a scalable initiative that aims to promote innovation labs, acceleration programs, curated activities, and educational opportunities by increasing public awareness. As facilitators for the industry’s development, Tamkeen and BDB contributed to developing the SME sectors by sponsoring optimal global practices and linking FinTech to SME for indirect funding opportunities, innovation, and entrepreneurship. Bahrain’s government’s supportive policies and investments in digital infrastructure are significant drivers of the FinTech ecosystem’s growth.

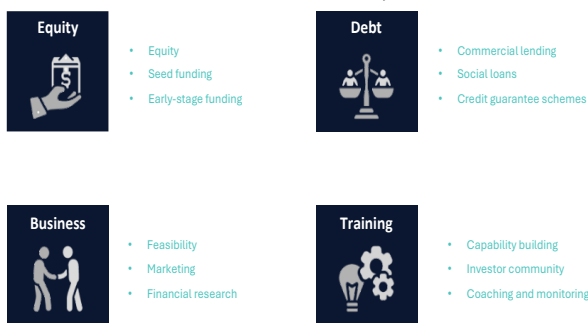
Technology Developers

Integral to Bahrain’s FinTech ecosystem, technology developers provide the necessary infrastructure and solutions to create a favorable environment and enable innovation. It includes blockchain data analytics and cloud computing developers to launch web-based applications at a fraction of the expense of in-house infrastructure. Entrepreneurs’ integration of Artificial Intelligence and big data is pivotal in advancing the technological capabilities of the FinTech sector within the country. While the capacity remained constrained, the demand for technology developers vastly outpaces the available supply, resulting in a surging gap within Bahrain’s ecosystem.

Appendices

Indicator	Micro	Small	Medium
Number of Employees	Up to 5	6 – 50	51 – 100
Annual Turnover (BHD)	1 – 50,000	50,001 – 1,000,000	1,000,000 – 3,000,000

[Fig.15: SME Definition in Bahrain (SME Development Board, 2023)]



[Fig.16: Core Activity of Bahrain Development Board (Adapted from Wamda, 2023)]

Appendix I: Bahrain’s Financial Ecosystem

Analysis of the complex network of interactions is instrumental in grasping the technological innovation and growth of the symbiotic FinTech industry. Based on the intersection between entrepreneurs, governments, and financial institutions, Bahrain’s FinTech system created a conducive environment to increase the innovation scale within the financial service sector.

FinTech Start-ups

Despite the upward trajectory for FinTech in combining innovative models with technology and automating existing services, it cascades a disruption across the service industry due to a significant shift of power unbundled by an increasing set of start-ups and entrepreneurs. The diversity of such firms, focusing on areas ranging from payment solutions and blockchain technology to digital banking, significantly

Financial Consumer

Since FinTech start-ups are targeted toward the end user to some extent, the primary source of revenue evolving preferences and behaviors influence Bahrain's ecosystem. According to the World Bank, the country's GDP per capita was \$30,152 in 2022, indicating a 12.26% increase from 2021, considering Bahrain a high-income economy. Based on the Bahrain Open Data Portal (BODP), the population in the country was recorded at 1.47 million in 2022, with over 20% between the ages of 15 and 30. Bahrain's literacy rate was reported at 97.46% in 2018. Since the country strives for a digital economy, it had over 2.1 million subscribers with a high 137% mobile penetration rate in 2023. It indicates the growing demand for digital financial services, with over 90% of Bahrainis active users of online banking, digital wallets, and investment platforms. Furthermore, statistics showed that social media penetration is recorded at 78% as financial consumers are open to tailored and efficient financial solutions.

Traditional Financial Institution

Bahrain's financial system's stability maintains sufficient governmental reserves and a low debt-to-GDP ratio, which depicts sustainable fiscal space for budget financing. Since Bahrain maintains an increasing credit rating for the banking sector, it failed to facilitate the SME credit supply requirements.

Although traditional financial institutions play a significant role in the market, the disruption of FinTech firms requires re-designing the business model to integrate digital solutions. Bahrain's banking system has transitioned into a more integrated and advanced financial ecosystem with a number of competition between banks offering FinTech and start-ups. For instance, Al Salam Bank's partnership with FlexxPay extends the bank's leading role, among others, by integrating digital solutions to enhance consumer retention and employee productivity. Outsourcing the Point of Sale (POS) leads traditional financial institutions to optimize and alleviate the financial pressure on employees and consumers. Furthermore, launching the Open Banking Policy in 2019 reinstates Bahrain's leadership in the Middle East as the first country to adopt the policy in its FinTech Hub.

Appendix II: Bahrain's Financial Inclusion

Bahrain's active promotion of financial inclusion efforts is set to enhance the accessibility and efficiency of financial services for daily transactions. Both the government and public sector have shown considerable effort and interest in improving the financial and social development of the country through the promotion of financial literacy and the launch of the national digitalization strategy. By introducing the concept of digital banks in Bahrain, the initiatives aim to enhance the consumer experience and break down the barriers to financial inclusion.



[Fig.18: Bahrain Financial Inclusion Rate (Adapted from Bahrain FinTech Bay, 2021)]

Despite the significant reduction in the number of banks, the expansion of physical access to financial services in

Bahrain showed a notable development, as evidenced by the steady increase in branches at 26% and ATMs at 6% between 2011 and 2017. Nonetheless, Bahrain has actively promoted the transition towards a digital cashless economy by encouraging the use of digital platforms and payment channels. This approach was reflected in the 74% increase in executing POS transactions through debit and credit cards, and an 87% increase in the payments made online.

Therefore, the country's government has supported the BDB and Tamkeen Labor Fund initiatives by providing financial services to mSME. Further, Bahrain encouraged FinTech ecosystem innovation through crowdfunding initiatives to bridge the gap of investment opportunities for product and solution developments for start-ups and entrepreneurs. In line with its move towards a cashless economy, Bahrain has been introducing the Wage Protection System (WPS), which formalizes the direct distribution of employees' wages into their bank accounts in the private sector. This regime is in alignment with neighboring GCC countries to ensure the timely payment of wages to employees and monitor employers who breach their obligations to employees. Under the WPS, this development ensures that each employee has access to the country's financial services. The availability of several financial literacy programs targeting diverse groups on economic education, investment, and entrepreneurship is a positive outlook for financial inclusion in Bahrain. Additionally, there are numerous training programs, such as those offered by INJAZ Bahrain, to support young individuals in learning more about informed financial planning, such as earning, spending, sharing, and saving money. However, the country shows a lack of private institutions and universities targeted toward financial literacy for SMEs on managing money through personal finance management courses.

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Alya Alhaddad, holds a B.Sc. in International Logistics Management and, is an International Trade master's student at Shanghai University. A high-performance individual with diligence to make an impact in the supply chain industry. Certified in International Logistics and Transport Management from the Chartered Institute of Logistics and Transportation (UK) with substantial theoretical knowledge to be maintained in operational practices. With experience in procurement and logistics, the author strives to extremely high standards and works hard to maintain that degree of competence to develop methodical decisions to achieve strategic objectives. By demonstrating a critical understanding of the range of techniques available to analyze international trade, the author is intrigued with the econometrics behind international supply chains and the implications they face in dealing with the complexity of globalization and the impact of advanced technologies on an international and national level.

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