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MR. KHALID AL RUMAIHI
Chief Executive,
Bahrain Economic
Development Board (EDB)

This is a very exciting time in the Gulf and in Bahrain in particular, and I am delighted to have the chance to launch this report into the potential for venture capital in the Kingdom.

As a result of long term demographics changes and a renewed focus on economic diversification in a lower oil price environment, the economies of the GCC are changing. As the economies change, the financial sector which funds them and supports their growth will need to evolve too. For the next wave of growth in the GCC — which is likely to be driven more by innovation than by increases in capital, land or people — sectors such as venture capital can have an important role to play.

When we look at Bahrain's role in these developments, we know that Islamic finance will be a central element. We are very proud of our role in pioneering and continuing to develop the Islamic finance industry — a heritage that continues today in the work of research institutions like Thomson Reuters.

However in the Kingdom, we are always looking not just at the past, but also at the future. Just as with the conventional financial sector, technology is changing the way the Islamic finance industry works and opening up new opportunities.

At the heart of that development will be new ventures and startups, which will only be allowed to thrive with a strong funding ecosystem supporting them. For the seventh consecutive year, Bahrain remains in the top 30 economies as ranked by the World Economic Forum's (WEF) Global Information Technology Report of 2016, demonstrating the success of the efforts made by the government in implementing their visions for ICT development in the country.

We believe that venture capital can have a big role to play in establishing that ecosystem for the next generation of Islamic finance startups — as this report makes clear, venture capital is a true Musharaka in spirit and should therefore be encouraged by Islamic financial institutions.

We hope you find the report insightful and interesting. And I hope to meet some of you in the future — either as part of the new wave of Islamic finance startups or the venture capitalists funding them.

One of a procession of fishing dhows passes the setting sun off the shores of the Bahrain capital of Manama October 25, 2002.
REUTERS/CHRIS HELGREN

Report overview

The Bahrain Islamic Venture Capital Report is aimed at serving as a catalyst for building a venture capital ecosystem in Bahrain and offers a guide into some of the regulatory and market infrastructure needed to support venture capital in Bahrain and the Gulf Cooperation Council (GCC) countries. In addition, the report covers:

- Experiences of other countries at different points in time, which act as a guide for this report's recommendations but are tailored to fit in Bahrain today;
- Recommendations following consultation with leading experts and market practitioners; and
- Shariah considerations related to venture capital.

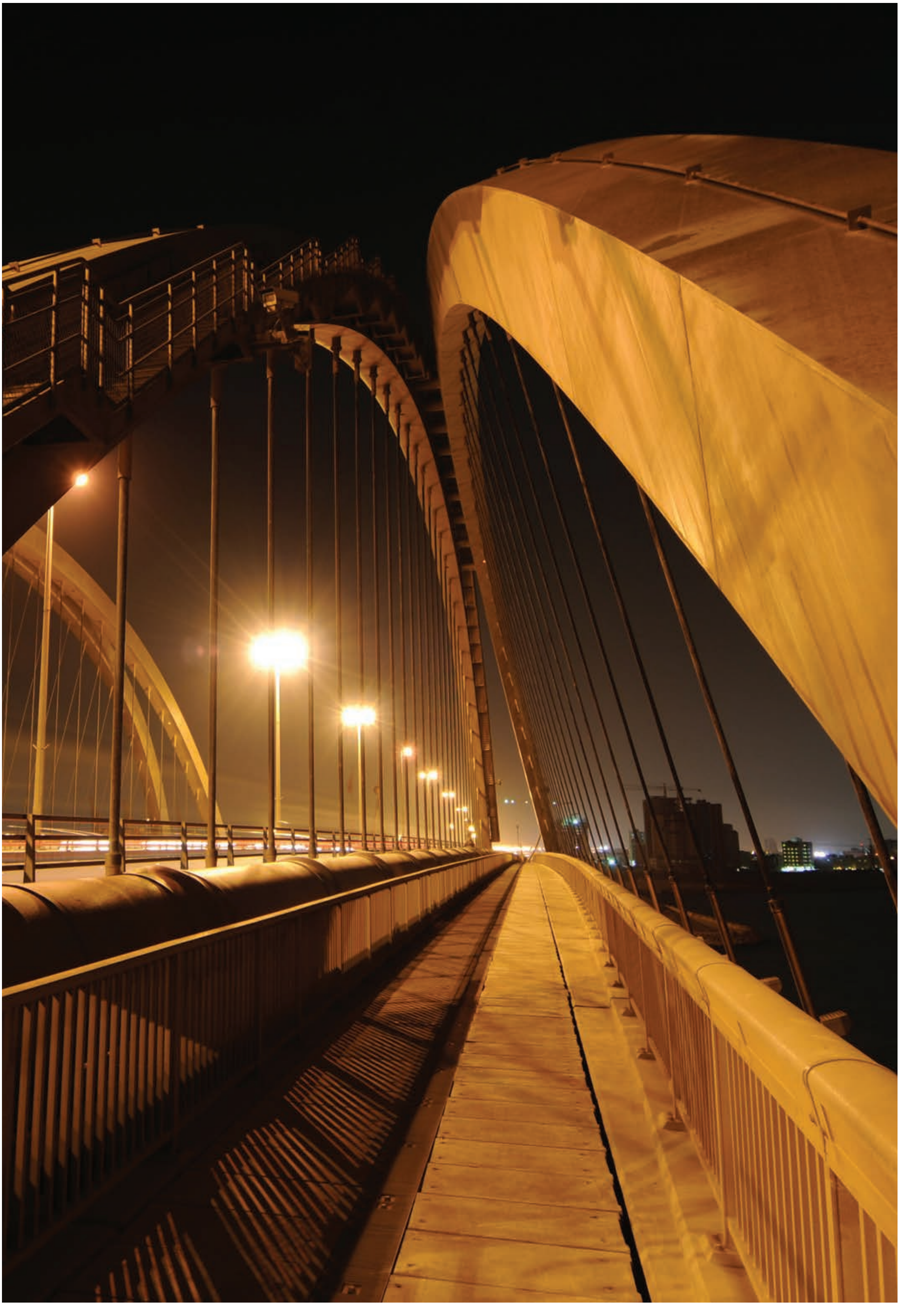
Purpose of the Report

This is not the first report to consider venture capital in emerging markets or even to consider some of the obstacles or reforms that could be made within the Middle East and North Africa (MENA) region to encourage greater development of venture capital.[1] However, it is unique because of its focus on Bahrain specifically, which has been a regional center for financial services, and the implications for the GCC and MENA region.

We hope that this report will serve as a catalyst for building a venture capital ecosystem in Bahrain and also provide a starting point for other regional markets. We also hope that this report will serve to guide venture capital into a more significant role in Islamic finance, and address some of the Shariah compliance issues related to this space.

1. See for example OECD. 2008 "Venture Capital Development in MENA countries: Taking advantage of the current opportunity" in *Making Reports Succeed: Moving Forward with the MENA Investment Policy Agenda*. Paris: OECD publishing. http://www.keepeek.com/Digital-Asset-Management/oecd/finance-and-investment/making-reforms-succeed_9789264052826-en#page48 (Accessed May 7, 2015)

City view of Bahrain's capital Manama is seen from Abraj Al Lulu September 2, 2010. REUTERS/HAMAD I MOHAMMED



This report is a combination of recommendations following consultation with leading experts and market practitioners, subsequent research along with interviews and case studies. The objective of this report is to contribute to the discussion on how to build a venture capital ecosystem in Bahrain and the wider GCC region. Additionally, we also hope that this report will serve to guide venture capital into a more significant role in the Islamic finance industry.

The following are some of the key takeaways from the report:

- Venture capital is an important industry that needs to be further developed in Bahrain and the GCC not only because of the financial returns but also due to the economic and social benefits it brings (e.g. job creation).
- An ecosystem is needed to create a vibrant venture capital industry, which includes favorable regulatory, accounting, legal and tax environment, availability of skilled resources, close link between the academia and the industry, availability of exit avenues through capital market and cultural acceptance of failure. It may take several years to build a healthy venture capital ecosystem with patience and consistency if no high level intervention is involved.
- There is a strong case for the government to kick start the venture capital industry by providing matching funds, setting up incubators, incentivizing and developing talent and other measures in line with other countries' experiences where the government led the development of such industry and the private sector followed.
- A change of mindset is required among capital owners of the region; the availability of institutional risk capital to entrepreneurs with talent, ideas and experience can be a game-changer for the region's economies and people.
- Bahrain and the GCC region should adapt some aspects of the global venture capital role model and customize it to suit the region's needs, e.g. focus more on SMEs rather than high technology sectors, encourage corporate venture capital, encourage sovereign wealth funds to increase their allocation for alternative asset class, have specific government intervention where needed, etc.
- Venture capital is true Musharaka in spirit and should therefore be encouraged by Islamic financial institutions; however, more research may be needed to ascertain the Shari'a legitimacy of certain tools and structures used by venture capital companies (e.g. preference shares, drag along and tag along rights, etc.).
- Retail Islamic banks may carefully think before participating in venture capital as the high risk nature of the business may not be in line with the unsophisticated retail money they are entrusted with.
- The GCC region is witnessing selective successes in the digital media and mobile applications space; such stories should be picked up by the media and celebrated in order to create role models for the youth of the region.
- Universities need to introduce courses on entrepreneurship and invest more on research and development with emphasis on applied research.
- Bahrain Investment Market, announced recently by the Bahrain Bourse, is a good platform to facilitate exit avenues for small to medium sized companies.

Overview of the Venture Capital industry and the report's methodology

The venture capital industry emerged out of Silicon Valley in the San Francisco Bay area in the middle of the 20th century and reached its apex in the late 1990s when it became a household idea due to the rising valuations of VC-backed companies that had gone public through initial public offerings (IPOs). As valuation increases went parabolic and then crashed, the luster was stripped somewhat from the sector for a brief period.

Investors may have seen a good portion of their fortunes lost (the NASDAQ lost close to 80% in the crash and it only regained the levels this year in April 2015) but the venture capital model has lived on and venture capital-backed companies like Apple, Amazon, Google and Facebook grew throughout the post-crash decade. In fact, since the financial crisis, the venture capital sector has become more front-and-center in the public imagination.

The point of this history (more of which is provided later) is that venture capital, like the companies it finances, grows and shrinks and evolves over time. The lesson from Silicon Valley in the 1990s or even in the last five years may not be replicable in exact form in other places or at other times. This does not mean that these experiences are not valuable; to the contrary, they can shed light on how to develop the pathway for venture capital in Bahrain and the GCC while adapting for local cultural, social and economic nuances.

The guidance from the case studies mentioned in this report has to be contextualized before preparing the recommendations. One of the ways we have accomplished this is to compare the research done by Thomson Reuters with the input provided by leading experts and market practitioners.

Concrete sculptures kept in front of the Bahrain National Museum entrance.
MANU M NAIR/SHUTTERSTOCK.COM

Venture Capital and Islamic Finance

As was mentioned in passing above, many people have identified similarities between the general structure of venture capital (equity investments in entrepreneurial ventures where profits are shared and the venture capitalist is at risk if the business fails)[2] and Islamic finance.

This identification of venture capital with Islamic finance centers around its perceived profit-and-loss sharing nature. The structure of most venture capital investments, however, is not always in full alignment with the profit-and-loss sharing nature that many proponents assume. Preference shares are used to protect the venture capitalist's interests and are often employed in ways that would not meet Shariah requirements.

Real world realities justify some of the cash flow and control protections built into these structures that do not necessarily violate Shariah principles even if the particular mechanisms used to create these protections do. As a result, it is important to recognize that venture capital is not the simple mudarabah or musharakah transaction that many assume it to be, nor is every modification away from these structures necessarily a betrayal of the risk-sharing nature of venture capital.

From the perspective of Bahrain and the GCC, venture capital can provide an important tool for promoting entrepreneurship, building employment opportunities and creating economic diversification away from hydrocarbons. It can also provide an avenue for Islamic finance to promote these goals, without relying entirely on debt-based products. We hope that this report will contribute to the growth and development of venture capital in Bahrain and the GCC, and support in creating an entrepreneurial ecosystem for the benefit of future generations.

2. See for example, Yusuf Jaffar. "Profit sharing in Islamic finance: Looking for inspiration in the venture capital industry," INCEIF blog, October 15, 2014 (http://www.inceif.org/research-bulletin/profit-sharing-islamic-finance-looking-inspiration-venture-capital-industry/) or Mikail, Said Adekunle. "Development of Islamic venture capital: Key considerations for investors," Thomson Reuters blog, August 20, 2014 (http://blog.thomsonreuters.com/index.php/development-of-islamic-venture-capital-key-considerations-for-investors/). Accessed May 6, 2015.

CASE STUDY

Historical development of venture capital in Silicon Valley

↑ **The accumulated star trails in the night sky above San Jose, California.**

The origins of Silicon Valley lie in the first half of the 20th century and have many roots within government programs, particularly those focused on defense. One of the well-known companies to emerge from Silicon Valley, Hewlett-Packard, began in a garage in 1938 when William Hewlett and David Packard built a precision audio oscillator starting with US$ 500 in cash and a used drill press valued at US$ 38. They formed their eponymous company the following year.[3]

The first West Coast venture capital firm, Draper, Gaither & Anderson, opened in Palo Alto in 1959 and Davis and Rock, formed in 1961, put venture capital into the popular understanding as it grew to be worth almost US$ 100 million by 1968. The 'silicon' part got its big start when Robert Noyce and Gordon Moore founded Intel in 1968, three years before the term "Silicon Valley" was coined.

The Silicon Valley venture capital sector grew with the growth of semiconductors that were eventually incorporated into personal computers in the 1980s. Its growth escalated rapidly and the technology boom entered the most rapid phase of its growth after the World Wide Web became available to the public in 1991. The growth of companies built around the World Wide Web accelerated through the late 1990s (including Google, which was founded in 1998).

The meltdown of the NASDAQ in 2000—the index was down nearly 80% from peak to trough—did not spell the end for the technology industry, but it did take the shine off of Silicon Valley temporarily. One of the biggest IPOs that signaled the return of venture capital successes was Google's IPO on August 19, 2004, when the IPO, priced at US$ 85 per share, opened at US$ 100 and has not looked back since.[4]

Like the rest of the economy, Silicon Valley was hit hard by the financial crisis, but has rebounded in the years since. The NASDAQ, where many one time VC-backed technology companies' shares trade, finally surpassed its high water mark from March 10, 2000 of 5,056 on April 23, 2015.[5] The companies leading Silicon Valley in 2015 are different from those of 2000, but the general venture capital model that provided them with funding has changed relatively little.

3. Carpien, Cindy, Bill Chappell and Emily Bogle "The Birth of Silicon Valley," *NPR*, http://www.npr.org/2012/03/26/149404846/the-birth-of-silicon-valley (Accessed May 6, 2015).
4. Russolillo, Steven. "Google's IPO, 10 Years Later: Just 10 Stocks Beat It," *Wall Street Journal Moneybeat blog*, August 19, 2014. http://blogs.wsj.com/moneybeat/2014/08/19/googles-ipo-10-years-later-just-10-stocks-beat-it/ (Accessed May 6, 2015).
5. Shell, Adam. "15 years after 2000 top, Nasdaq sets new record high," *USA Today*, April 23, 2015. http://americasmarkets.usatoday.com/2015/04/23/15-years-later-nasdaq-sets-new-record-high/ (Accessed May 6, 2015).

Singapore

↑ **A floating installation of 25,000 wishing spheres line Marina Bay as the city's financial district is seen in the background, ahead of the New Year's Day countdown celebrations, in Singapore December 31, 2014.** REUTERS/EDGAR SU

In Southeast Asia, Singapore has become a leader in venture capital, with domestic VC investments reaching US$ 450 million in 2013, up from US$ 28 million in 2010. The development of Singapore's VC industry has been highly government-led, with authorities providing up to 85% funding for startups (up to a ceiling of US$ 500,000), increased funding for R&D budgets at the National University of Singapore, and financing large-scale projects such as the biomedical R&D hub *Biopolis* to incentivize local biotechnology startups.

On the institutional side, the government has provided tax incentives for venture capital funds and their managers, allowed offshore fund structures, and eased visa laws for entrepreneurs and fund managers. It has built public awareness of entrepreneurship by recognizing entrepreneurs, helping them network with professionals from the Silicon Valley and made a point with its national "Phoenix Award" to highlight entrepreneurs who have overcome initial failures to succeed.

In addition to its domestic venture capital industry, the incentives, in many cases, are provided for venture capital funds targeting other ASEAN countries. Singapore is now the location of choice for managers who have raised more than half of the total VC funding from ASEAN-focused funds.

Brief History of Silicon Valley

1848

First year of the **California gold rush**, affirming California's image of a land of promise and prosperity. California became a U.S. state in 1850.

1891

Stanford University founded in Palo Alto by former California governor Leland Stanford.

1910

Lee de Forest, investor of the triode in 1908, arrives in the Bay Area. The triode would be a critical component for telephones, radio, television, radar and digital electronics.

1933

Air Base Sunnyvale commissioned to be a **Naval Air Station**. NASA later took over portions of the field for aeronautics research, attracting many private aerospace companies (e.g. Lockheed, once the area's largest employer).

1939

Two Stanford graduates start **Hewlett-Packard** out of a garage in Palo Alto. Their first product was an audio oscillator used to test electronic equipment. The garage where HP was started is considered to be the "Birthplace of Silicon Valley".

1951

Stanford Industrial Park, later renamed **Stanford Research Park**, created under the leadership of Stanford professor Frederick Terman, known as the "Father of Silicon Valley" (pictured). It was created as university-owned office space dedicated to high-tech companies. Early occupants included Varian Associates, GE, HP and Lockheed.

1955

William Shockley, one of three inventors of the transistor, and Arnold Beckman establish **Shockley Semiconductor** in Mountain View, California. The company was Silicon Valley's first silicon semiconductor research and manufacturing company.

1957

Eight young unhappy employees, known as the "Traitorous Eight", leave Shockley Semiconductor and launch **Fairchild Semiconductor**. Fairchild would be a pioneer in manufacturing silicon transistors and integrated circuits. Today, 92 public companies worth over US$ 2 trillion can be traced back to Fairchild, including Intel and AMD.

1968

Robert Noyce and Gordon Moore launch NM Electronics, renamed **Intel** shortly after, with US$ 2.5 million in venture capital. Intel would introduce the first commercially-available microprocessor, the Intel 4004, in 1971.

1969

The first data packets sent over the **ARPAnet**, between networked computers at UCLA and Stanford.

1971

The term "Silicon Valley" popularized by a series of articles, **"Silicon Valley USA"**, by Don Hoefler in the magazine Electronic News.

1972

The venture capital firm **Kleiner Perkins** established on Sand Hill Road, beginning the growth of the venture capital industry in the region.

1974

Vint Cerf and Robert Kahn publish the design of a Transmission Control Program (TCP), allowing different computer networks to connect and communicate. Cerf and Kahn coin the term **"Internet"**.

1975

Bill Gates and Paul Allen develop a version of BASIC for the Altair personal computer, creating **Microsoft**.

1976

Steve Jobs and Steve Wozniak establish **Apple Computer** out of Jobs's garage in Los Altos, California. Apple launched the Apple I, a motherboard, in 1976 and Apple II, a personal computer, in 1977. Apple went public in 1980, instantly creating 300 millionaires.

1991

The **World Wide Web** is officially made available to the public over the Internet.

1998

Stanford students Larry Page and Sergey Brin launch the search engine **Google** based on their PhD research.

2000

Tech Bubble bursts with the Nasdaq index falling almost 80% from a high of 5,032 on March 10, 2000 down to 1,100. The index would cross 5,000 next on March 2, 2015.

2001

Jimmy Wales founds **Wikipedia**, a multilingual encyclopedia that is collaboratively edited by the Internet community.

2003

Skype is founded in Europe by Niklas Zennstroem and Janus Friis to offer voice over IP, a system invented by Estonian engineers.

2004

Mark Zuckerberg founds the social networking service **Facebook** at Harvard University (soon relocated to Palo Alto).

2006

Jack Dorsey creates the social networking service **Twitter**.

2012

SpaceX launches the first commercial flight to the International Space Station.

REFERENCE: PRESENTATION ABOUT "PUBLIC EFFORTS TO CREATE A DOMESTIC VC INDUSTRY – CHALLENGES AND OPPORTUNITIES" DURING THE 8TH WAQF FUND ROUNDTABLE "VENTURE CAPITAL – BUILDING THE NEXT PHASE OF ECONOMIC DEVELOPMENT IN BAHRAIN", RALPH KEITEL, IFC FUNDS GROUP.

Monk's Hill Ventures

ABOUT MONK'S HILL VENTURES:
Monk's Hill Ventures is a technology venture capital firm focused on early-stage startups in Southeast Asia, and growth-stage startups looking to enter Asia. Founded by seasoned entrepreneurs with deep venture investment experiences, the firm's maiden fund, Monk's Hill Ventures Fund I is backed by world-class investors and institutions. The firm is based in Singapore and Jakarta. Monk's Hill Ventures is a member of the Singapore Venture Capital & Private Equity Association.

ABOUT SINGAPORE VENTURE CAPITAL & PRIVATE EQUITY ASSOCIATION:
The Singapore Venture Capital & Private Equity Association (SVCA) was formed in 1992 to promote the development of the venture capital (VC) and private equity (PE) industry. Its mission is to foster greater understanding of the importance of venture capital and private equity to the economy in support of entrepreneurship and innovation and to look after the interests of its members. The association strives to promote the professional development of the industry as well as facilitate interaction and collaboration among its members. The association also acts as a platform for dialogue on regulatory and policy issues pertaining to VC and PE and builds linkages to centers of VC and PE activities in the region.

What has been the government›s role in the venture capital industry in Singapore?

The government has been instrumental in kick-starting and driving the growth of the venture capital industry in Singapore. This started in the late 1990s when the government initiated several schemes including incubators, tax incentives for angel investments and a US$ 1 billion fund-of-funds which attracted many overseas and local venture capital firms to setup operations in Singapore. However, with the dot-com crash, the outbreak of the Severe Acute Respiratory Syndrome (SARS) in 2003, slow exit markets and the global financial crisis, momentum slowed considerably until the late 2000s when there was revived interest, particularly with the introduction of seed stage co-investment programs (e.g. the Media Development Agency's Interactive Digital Media's Jump-start and Mentor (i.JAM) and the National Research Foundation's Technology Incubation Scheme (TIS)). TIS, for example, is a 5:1 matching program between government and private investors, respectively.

Other government or government-linked programs, such as those from Infocomm Investments, Economic Development Board investments, the Standards, Productivity and Innovation for Growth Board's (SPRING) SEEDS program, National Research Foundation's early-stage venture fund program and Vertex, contributed to the ecosystem as well. These were targeted at different industries and stages, which added to the vibrancy and breadth of venture capital activities.

Are tax incentives the most common form of assistance for governments trying to attract venture capital expertise? What other areas are valuable to create an appealing market for venture capital investment?

Co-investment approaches have arguably been more effective than tax incentives in driving venture investments. These range from 1:1 to 5:1matching ratio (as mentioned for TIS above), which mitigates the risk of investing in an unproven and early ecosystem. With the TIS program, where the private investor has the option of buying out the government stake at an attractive price, especially when the company does well, downside is protected and upside significantly levered up.

Innovative programs focused at the younger members of the ecosystem, such as the National University of Singapore Overseas College (NOC) and the Young Entrepreneurs Scheme for Schools (YES! Schools) have provided the opportunity for young entrepreneurs and talents to emerge. This leads to subsequent venture investment opportunities and a strong corp of passionate startup founders and employees.

Another key development is the emergence of accelerators, which provided the structure and discipline for seed stage companies to grow. For example, startup accelerator JDFI Asia is a pioneer and broke early paths for subsequent players to follow.

What have been the most beneficial forms of government support to encourage venture capital investment from foreign VC investors?

The matching co-investment program has been particularly effective in attracting foreign venture investors. Investors will take advantage of a good deal when they see one, and the TIS program is one such example. While these initial players may not be name brand VCs and are often first time fund managers, they nonetheless contribute to the critical mass of companies getting funding.

Is there a good way to incentivize VC investors to ‹onshore› their activities to transfer the expertise needed for successful venture capital investing to build a local ecosystem?
Part of the requirements of the government co-investment programs is the onshoring and presence of the VCs in Singapore. This makes sense as well for the fund managers, since it is not possible to invest effectively at the early stages from a distance.

The government also provides other programs, e.g. tax and training incentives, to attract onshoring of VC investors. I'd argue, however, that the most effective approach is a combination of: (a) good deal flow; and (b) attractive downside risk mitigation, which has worked well in Singapore.

Besides access to capital, what is the most pressing thing needed to build the local ecosystem?
Concentration and sustained flow of talent, intellectual property creation and startup formation. The venture capital industry is a service industry; VCs don't arrive and wait for entrepreneurs (who are effectively their clients) to emerge.

How can a country that is known as a financial center build a venture capital ecosystem that develops the domestic economy rather than being a gateway into other markets?
The presence of underlying infrastructure, rule of law, robust regulation and service provider capabilities (e.g. fund accountants, attorneys, etc.) are strong contributory factors to a successful venture capital ecosystem. Nothing - absolutely nothing else - matters however, if there is no deal flow. As such, a multi-prong approach with a strong focus on skills development is vital for the VC ecosystem to thrive and be sustainable.

For a small country like Singapore in particular, the relative openness to global talent to locate and start companies is a key policy consideration. This may be politically sensitive and a balance should rightfully be struck, but the most successful entrepreneurial environments are also quintessentially the most open ones.

Singapore has always been a very open economy with a pro-business environment. It would be parochial to limit the VC fund managers here to invest only in domestic companies. Singapore is already a hub for private equity investments into the region. According to a study by the Singapore Venture Capital and Private Equity Association, PE fund managers with operations in Singapore are involved in more than 60% of investments into Southeast Asia. VC investment into the region would be a natural progression.

How does Singapore tap into the creativity and entrepreneurship of Singaporeans who have returned from studying and working in other countries? Can programs specifically targeted towards helping their start-up efforts have a disproportionate impact?
The ability to expose Singaporeans to startup culture and encouraging them to start companies in Singapore has been pivotal, for example, in a program like the NUS Overseas College effort. This has contributed to a strong talent pool and successive generations of entrepreneurs.

Given the relative high proportion of overseas Singaporeans, this pool of talent would have seemingly been an obvious target. The realization, however, is that life is more complicated. Personal situations and other motivations drive decisions beyond economics and opportunities. Nonetheless, in the interconnected world that we live in, impact from ‹offshore› talents is still possible.

Venture capital in Latin America: Brazil and Chile

↑ **Smog under the city of Santiago, capital of Chile, financial and economy center of South America at sunrise.**

Brazil and Chile have venture capital sectors that are relatively new, but have reached a point of development where they are considered to be on par with more established markets such as Spain and Israel. In Brazil, a big obstacle to venture capital is the perception of corruption, which has recently been reinforced with the scandal that began at state-owned oil company Petrobras.[6] The perception of corruption can have a negative impact on the investors, including venture capital investors, due to fears about enforceability of agreements, fair competition for business and large contracts, etc. This fear is particularly true for foreign investors, who would typically steer clear of such markets unless they feel they have a strong understanding of the business environment, and the ability to enforce their agreements.

In addition to the corruption issues, venture capital investors are hindered by low levels of protection of intellectual property.[7] On the positive side, Brazil is viewed favorably for the rules it has on registration of fund structures comfortable to venture capital investors.

In Chile, the challenges are different because corruption perceptions are lower, but there are fewer domestic institutional investors, and those that do exist rely more on high net worth individuals and family offices for capital. These sources of capital can accept the risks present in venture capital, but often demand greater control. One venture capital fund, Austral Capital, helped build the venture capital ecosystem by bringing their Chilean entrepreneurs to Silicon Valley for one week per month to help them build contacts with other entrepreneurs and funders, get insights from industry professionals and provide them with the opportunity to expand into the United States.[8]

In addition to the challenges facing venture capital in each country, the entire South American region has to manage a limited institutional investor base, limited entrepreneurial history and societal impediments. Lack of exit markets is also a significant issue in many of the region's countries. One way in which some countries have dealt with these issues (specifically the limited institutional investor base) is through providing funding from public sector institutions like the Brazilian Development Bank (BNDES) and the Chilean Innovation Development Agency (CORFO). Public financing has the potential to be both transformative and problematic, depending on the controls placed on the allocation of funds. As an example, BNDES has attracted criticism for its lending policies, which critics say transfer money from taxpayers to the corporate sector without providing enough additional benefit.[9]

6. Spagnuolo, Sergio. "Brazil police arrest 3 ex-congressmen, broaden corruption probe," *Reuters*, April 10, 2015. http://www.reuters.com/article/2015/04/10/us-brazil-petrobars-scandal-idUSKBN0N110A20150410 Accessed May 6, 2015.
7. Miranda, Gonzalo. 2014. "Venture Capital in Latin America: Connecting Opportunities," *Kaufmann Fellows Report*, volume 4 (fall/winter). http://www.kauffmanfellows.org/journal_posts/venture-capital-in-latin-america-connecting-opportunities/ Accessed May 6, 2015.
8. *Ibid.*
9. Leahy, Joe. "BNDES: Lender of first resort for Brazil's tycoons," *Financial Times*, January 11, 2015. http://www.ft.com/intl/cms/s/0/c510368e-968e-11e4-922f-00144feabdc0.html#axzz3ZPEQtTnl (Accessed May 6, 2015).


Octavio Frias de Oliveira bridge, Sao Paulo, Brazil

Why Venture Capital?

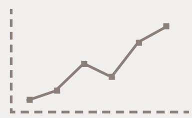
Research* shows that as compared to an average non-VC backed company, a VC-backed company in the US...

...GENERATES	...PAYS	...INVESTS
2x	**3x**	**3x**
SALES AND EXPORTS	MORE TAXES	MORE IN R&D

11% of US GDP and one out of every 9 jobs are generated by an originally VC-backed company

Venture capital played a significant role in creating industry clusters (software, biotechnology, Internet companies, etc.)

Strong correlation between VC activity in a state and its GDP and average annual wages



US$ 598 billion VC investment since 1995 to-date in the US; market capitalization of Apple alone is US$ 759 billion

* DRI-WEFA STUDY IN 2002, "MEASURING THE IMPORTANCE OF VENTURE CAPITAL AND ITS BENEFITS TO THE UNITED STATES ECONOMY," COMMISSIONED BY THE NATIONAL VENTURE CAPITAL ASSOCIATION. THE STUDY ANALYZED ALL VENTURE CAPITAL-FINANCED COMPANIES OVER THE PERIOD 1970-2000

FINANCIAL RETURNS

01. Revenue

02. Profitability

03. Margins

ECONOMIC RETURNS

01. GDP grown

02. Job creation

03. Technological growth

04. Taxes

05. Industry clusters

06. Global market share

SOCIAL RETURNS

01. Entrepreneurship

02. Innovation and research culture

03. Hope, optimism, dream-come-true

04. Employment

REFERENCE: PRESENTATION ABOUT "ISLAMIC VENTURE CAPITAL – OPPORTUNITIES AND CHALLENGES" DURING THE 8th WAQF FUND ROUNDTABLE "VENTURE CAPITAL – BUILDING THE NEXT PHASE OF ECONOMIC DEVELOPMENT IN BAHRAIN", SOHAIB UMAR, CENTRAL BANK OF BAHRAIN.

US VENTURE CAPITAL FUNDS INDEX SUMMARY: END-TO-END POOLED RETURN
NET TO LIMITED PARTNERS (AS OF 30 SEPTEMBER 2014)

Index	1-Quarter	YTD	1-Year	3-Year	5-Year	10-Year	15-Year	20-Year	25-Year	30-Year
Cambridge Associates LLC U.S. Venture Capital Index®[1]	2.44	10.80	24.46	15.20	14.92	9.95	10.01	34.09	21.74	17.51
U.S. Venture Capital — Early Stage Index[1]	2.75	11.18	27.27	15.69	15.51	9.34	13.36	53.92	28.92	21.09
U.S. Venture Capital — Late & Expansion Stage Index[1]	1.75	4.28	15.98	13.73	17.54	13.23	7.95	11.45	13.52	12.65
U.S. Venture Capital — Multi-Stage Index[1]	2.17	12.33	22.96	14.95	13.30	10.00	6.95	13.42	12.88	11.99
Barclays Government/Credit Bond Index	0.17	4.12	4.08	2.54	4.27	4.59	5.63	6.16	6.61	7.62
Dow Jones Industrial Average Index	1.87	4.60	15.29	19.02	14.85	8.15	5.86	10.22	10.34	12.23
Dow Jones U.S. Small Cap Index	-6.29	-0.07	8.53	22.42	15.63	9.63	9.89	10.76	NA	NA
Dow Jones U.S. TopCap Index	0.73	7.97	19.03	23.04	15.82	8.50	5.21	9.60	NA	NA
Nasdaq Composite Index*	1.93	7.59	19.14	22.99	16.18	9.01	3.34	9.26	9.42	10.11
Russell 1000® Index	0.65	7.97	19.01	23.23	15.90	8.46	5.33	9.76	9.66	11.30
Russell 2000® Index	-7.36	-4.41	3.93	21.26	14.29	8.19	7.93	9.03	9.12	9.82
S&P 500 Index	1.13	8.34	19.73	22.99	15.70	8.11	4.87	9.59	9.50	11.22
Wilshire 5000 Total Market Index	0.07	7.09	17.90	20.82	15.66	8.49	5.56	9.61	9.51	11.08

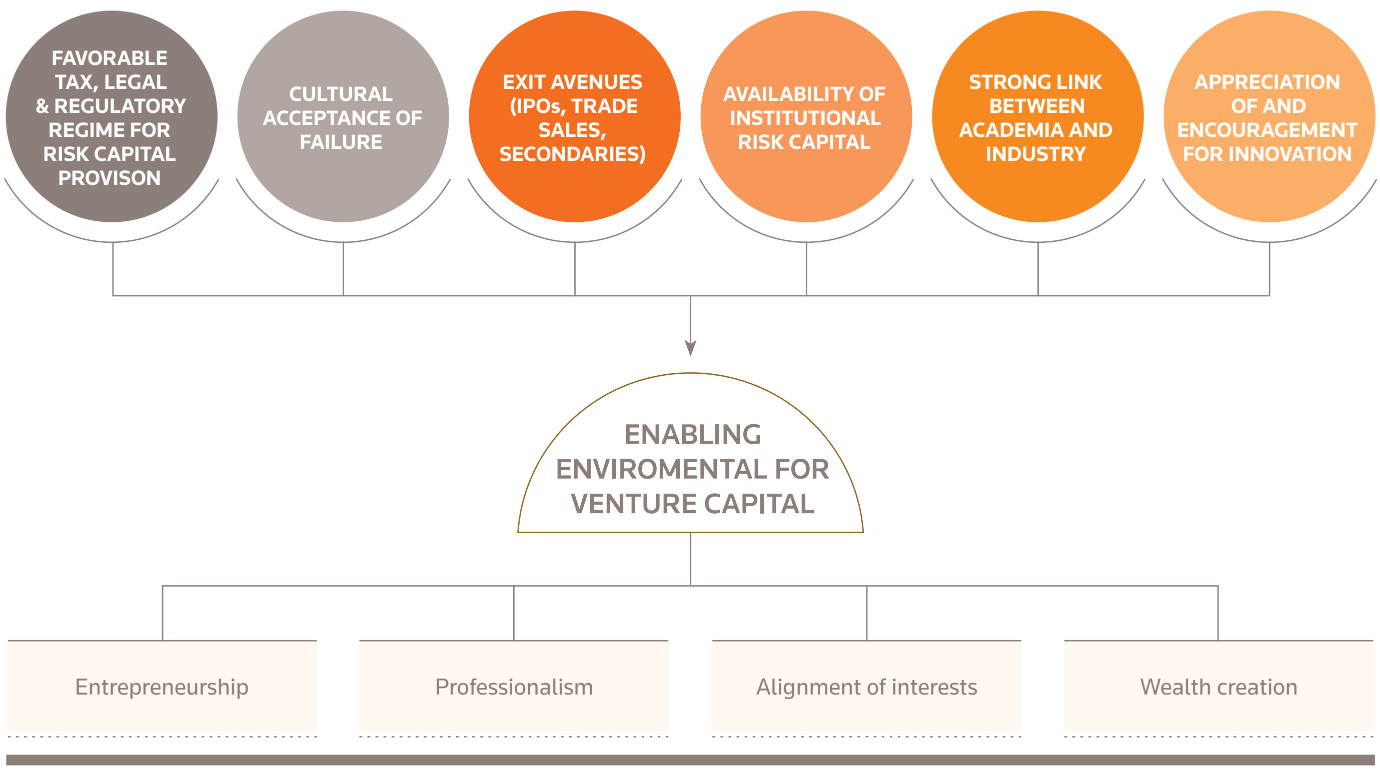
THE CAMBRIDGE ASSOCIATES LLC U.S. VENTURE CAPITAL INDEX® IS AN END-TO-END CALCULATION BASED ON DATA COMPILED FROM 1,522 U.S. VENTURE CAPITAL FUNDS (971 EARLY STAGE, 170 LATE & EXPANSION STAGE, 375 MULTI-STAGE AND 6 VENTURE DEBT FUNDS), INCLUDING FULLY LIQUIDATED PARTNERSHIPS, FORMED BETWEEN 1981 AND 2014.

1 POOLED END-TO-END RETURN, NET OF FEES, EXPENSES, AND CARRIED INTEREST.

SOURCES: CAMBRIDGE ASSOCIATES LLC, BARCLAYS, DOW JONES INDEXES, FRANK RUSSELL COMPANY, STANDARD & POOR'S, THOMSON REUTERS DATASTREAM, AND WILSHIRE ASSOCIATES, INC.

* CAPITAL CHANGE ONLY

KEY SUCCESS FACTORS/CHALLENGES FOR VC



David Parker

Bahrain Economic Development Board,
Executive Director (Business Development & Financial Services)

DAVID PARKER is currently Executive Director of Financial Services at the Economic Development Board. He is charged with supporting Bahrain's financial industry locally and internationally with a particular focus on attracting new inward investment opportunities to the Kingdom. David and his team work closely with key stakeholders in Bahrain to create a business friendly environment for indigenous businesses and inward investors alike.

David was previously Commercial Director with Oxford Intelligence Ltd, an international inward investment consulting firm, part of Ecorys Group.

During a career spanning 25 years David has worked on inward investment assignments in the financial and technology sectors across the globe. These assignments have included heading Invest Hong Kong in London and also heading International Business Wales in North America based out of New York. He has a particular passion for innovation in finance and fintech.

Recently, we have seen many GCC countries begin to develop viable FinTech ecosystems, and in Bahrain the Economic Development Board has kicked-off a series of initiatives to develop the country as a FinTech hub. What do you feel are the key challenges that you will be facing in developing Bahrain into a FinTech hub? How much FinTech development is required for Bahrain to position itself as a regional hub, and how much can Bahrain leverage the developments elsewhere in the region and globally?

Bahrain, like most countries around the world, is always trying to find new ways to create the right ecosystem for innovation and startups; as the needs are always changing. FinTech firms — just like other startups and innovators — will need the right support in terms of mentorship, funding, human capital and training.

There will also be specific requirements around regulation and we have had very positive discussions with the Central Bank of Bahrain around creating a regulatory sandbox that will help foster innovation without compromising the stability of the broader financial sector.

The development of FinTech in Bahrain will be supported by looking at best practice internationally but sometimes it will also be products and services being developed locally — for example in areas like Islamic finance, where Bahrain is one of the most advanced global centres and has long been a pioneer.

The technology start-up scene has changed dramatically in Bahrain the last few years. What are the key elements that supported this evolution and what improvements can be made to further increase this sector's contribution to GDP and job creation?

There are several government initiatives that have been established over the last few years in support of an entrepreneurial tech culture in Bahrain. We have seen the establishment of several accelerators – including the first cloud-based accelerator in the MENA region, established by UK-based C5 alongside AWS. We have also seen the development of a supportive ecosystem – including government support for training through Tamkeen, and a range of sources of finance (including angel investors).

It is important to note that the World Bank Group in its 'Doing Business Report 2017' named Bahrain as one of the ten countries most improved across three or more areas, in this year's case; 'starting a business', 'getting credit,' and 'trading across borders'. All of these areas support technology start-ups and the environment in which they operate.

Trading across borders became much easier by improving infrastructure and streamlining procedures at the King Fahd Causeway. The Kingdom also improved access to credit information by adopting new regulations that guarantee by law borrowers' rights to inspect their credit data. Clients of a credit bureau now have the right to obtain a free credit report once every 12 months, to add information to their credit report and to file a complaint or objection related to the accuracy or limitation of the information contained in their credit report. Regulatory changes also made it easier to start a business by reducing the paid-in minimum capital requirement. These reforms highlight several of the initiatives taken by the government over the last few years and it will certainly support prospective and current startups in the Kingdom.

What do you feel are the key components of the wider ecosystem that are required to support FinTech entrepreneurs and venture capital investors? How developed are these in Bahrain, and what is the plan to develop them further?

Bahrain has experienced some major developments over the last few years that support the wider ecosystems for FinTech entrepreneurs and venture capital investors. For example, in the funding space, the Bahrain Development Bank offers financial services that are tailored to meet an SME's needs. 500 Startups, a leading global venture capital seed fund and startup accelerator headquartered in Silicon Valley, recently announced the launch of the $30 million 500 Falcons fund, targeting the MENA region. Tamkeen, an organization dedicated to providing workforce training and education, provides several opportunities for entrepreneurs in Bahrain to receive mentorship and coaching to grow their ideas and expertise.

Outside of these initiatives, Bahrain still boasts the Middle East's most liberal and advanced ICT infrastructure and policies, with the experience and knowledge to allow regulation to evolve and work with innovative businesses in a fast-changing sector.

However, we know we can still make some improvements. That is why we are working with the Ministry of Industry, Commerce and Tourism and the Central Bank of Bahrain (CBB) to identify regulatory improvements that will continue to ease the process of doing business.

How does the entrepreneurship ecosystem in Bahrain compare to other markets in region. What can Bahrain take from the experience of others and what areas can other countries learn from the example set in Bahrain?

Perhaps the biggest differentiator is the people here — Bahrain-based startups benefit from a local culture of entrepreneurship. A survey from Ernst & Young found that 70% of young Bahrainis are interested in the idea of starting their own business, twice as much as anywhere else in the Gulf.

Additionally, due its size, openness, and forward-thinking approach, Bahrain has proven to be an ideal testing ground for the introduction of new technologies to the region and the Kingdom has experienced a fast rate of innovation.

The government has also worked hard to create a supportive environment that will allow entrepreneurs to thrive and the Bahrain model is endorsed by UNIDO, with over 40 countries following it.

This puts us in a strong position to attract entrepreneurs from around the region and to support their growth.

In your opinion, what consequences will global economic trends have on venture capital development in Bahrain? What are the challenges that should be tackled to provide a conducive environment for venture capital investment in Bahrain?

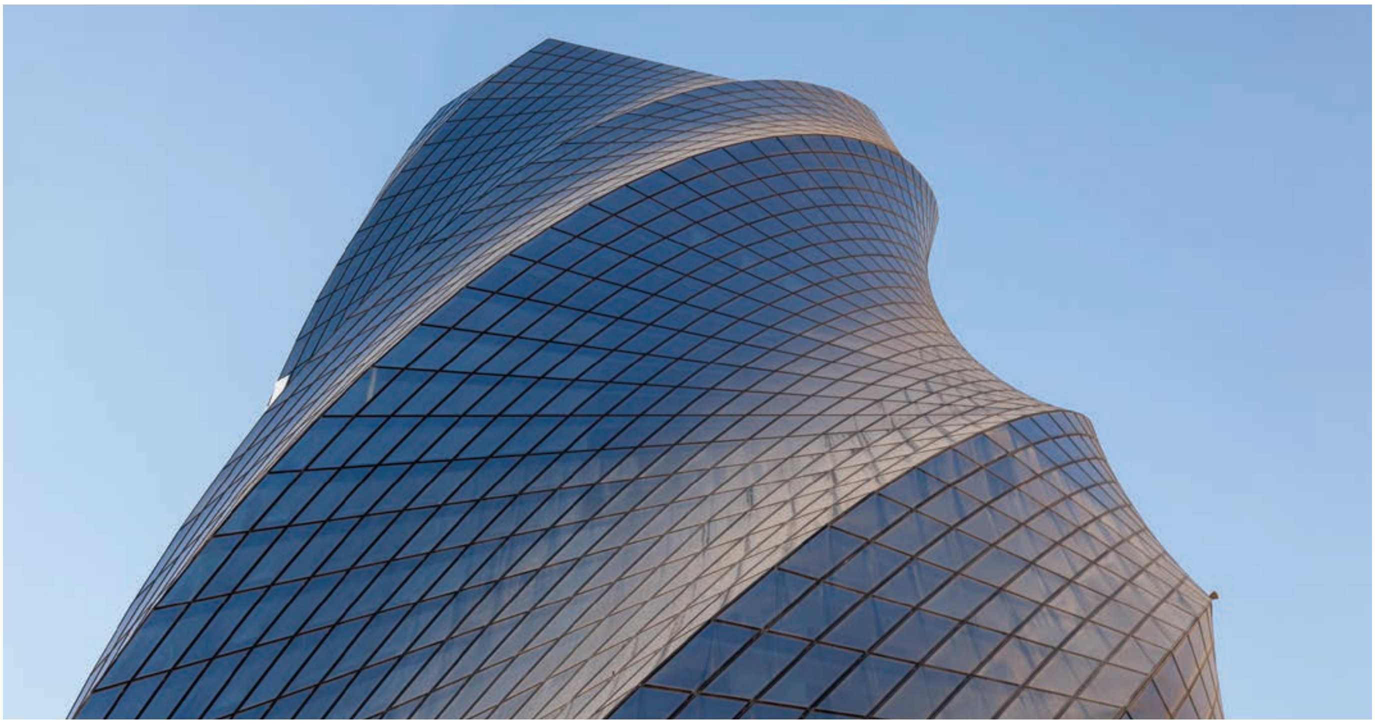
Any financial flows will be susceptible to global market conditions, but we are confident that the strong growth profile in the GCC will continue to underpin demand.

Investors will respond to opportunities — so the main challenge will be in ensuring there is an ecosystem that can help to create the investment opportunities businesses are seeking. Again, there may be some regulatory changes required to enhance the attractiveness of the environment, so the fact that Bahrain has a single, well-respected regulator with a long track record, is a strong point in our favour.

1

Regulatory Challenges and Requirements

- Bahrain's liberalized economy provides a good starting point for facilitating a VC ecosystem, but lack of rules on crowdfunding hinders new forms of capital raising.
- Onerous minimum requirements for limited liability companies (W.L.L.s) and single person companies impede entrepreneurial company formation.
- Requirement for companies to have most types of offerings approved by the Central Bank of Bahrain limits ability to raise capital for seed, pre-seed and early stage venture capital companies.
- Companies need greater flexibility to resolve difficulties — liquidation is not always the right answer and the ability of creditors to force liquidation of a solvent company facing working capital constraints hinders entrepreneurship.



↑ **New United Tower in the Bahrain Bay, Manama City.** PHILIP LANGE/SHUTTERSTOCK.COM

Introduction

Bahrain has a liberalized regulatory environment for starting companies and has fewer limits on foreign ownership than many other countries in the region. This opens up opportunities for entrepreneurial ventures, financed in part by domestic and foreign investors (from both the GCC and the broader MENA region). The following is not a comprehensive overview of the current regulatory system, but does provide an assessment of key areas where existing regulations are limiting the development of an entrepreneurial ecosystem that is required to attract venture capital investment. A relatively new area that will benefit greatly from the changes recommended below is crowdfunding[10], particularly equity crowdfunding, which is mostly used by small companies to raise capital.

Company types

One of the key features of the venture capital sector across the world is the requirement that failure is not just socially accepted within the venture capital ecosystem (see more on this in Chapter 5), but that it is financially feasible for an entrepreneur to launch a new venture after a failed one is wrapped up. However, the current regulations around company formation make it hard for entrepreneurs to set up and grow a company to the venture capital funding stage in a cost-effective manner.[11]

One of the common structures used for new businesses is a limited liability company which offers the protection that comes from limitation of personal liability, should a business fail and its assets are insufficient to cover any debts. There is a structure for this type of business in Bahrain (a 'With Limited Liability' or W.L.L.), but it requires onerous minimum capital levels (BD 250,000, equivalent to US$ 668,200) and other requirements like the need to have an auditor, a local office, at least two partners and two directors.[12] A single person company is possible, but still requires significant levels of minimum capital at BD 50,000 (US$ 133,640), and the requirement that the company needs to have an auditor.

10. A new trend in raising money made possible by advances in technology and internet; it is the practice of funding a project or venture by raising small amounts of money from a large number of people.
11. Cost-effectiveness here refers to both the minimum capital required to formally establish the business as well as the financial impact should the venture fail.
12. EY. 2011. "Doing Business in Bahrain 2011," EY: Manama, p. 45.

SUMMARY OF THE REQUIREMENTS OF COMPANY FORMATION

	Limited Liability Company	Single Person Company	Limited partnership company	Limited partnership by shares	General partnership company
Minimum capital	BD 250,000	BD50,000	None	BD20,000	None
Minimum Number of Promoters/Partners	2	1	2	4	2
Minimum Number of Directors	2	1	N/A	2	2
Auditor Required	Yes	Yes	No	Yes	No
Management	Managing Director or Board of Directors	By Owner	Joint partners	Joint partners	Partners
Liability	Limited	Limited to Capital Allocated to the Company	Full – Joint partners Limited –LPs	Full – Joint partners Limited – LPs	Joint and personal

SOURCE: ADAPTED FROM EY. 2011. "DOING BUSINESS IN BAHRAIN 2011," EY: MANAMA, PP. 45-47.

These requirements make it hard for entrepreneurs, particularly younger entrepreneurs, to set up new ventures (young entrepreneurs make up a large proportion of the founders of venture capital-backed companies in the U.S. and European markets). It is especially challenging for companies in the riskier areas of business, but who offer the most innovative products and have the highest returns that will attract venture capital. For example, Facebook which was, as of August 2015 worth over US$ 265 billion, began as a startup by a college student Mark Zuckerberg in early 2004 from his dorm room. Facebook entered the venture capital ecosystem with a US$ 500,000 investment from Peter Thiel in August 2004, which allowed the company the financial strength to move into an office (and presumably hire an auditor as well)[13].

Many other ventures have a much longer incubation period than Facebook experienced, during which they remain at a high risk of failure and where the entrepreneurs use all their funds to get the business off the ground. An entrepreneur in Bahrain, even with support from family and angel investors, may not be able to meet the minimum capital requirements for a W.L.L. or Single Person Company.

After a company is founded

One of the key stages where a business develops enough to be able to attract interest from venture capital investors is when there is a proof of concept. Prior to this point of development, the entrepreneur will rely on his or her own funds as well as seed money from friends and family and from angel investors (who often have track record in the concerned business area). A key regulatory need at this stage is a way to allow financing, which often occurs outside of the traditional process, without the involvement of investment bankers and lawyers, which would raise costs beyond what is possible for the scale of the investment.

The United States' issuance requirements provide for exemptions from securities laws (specifically the Securities Act of 1933), for certain issuance of private placements, provided they are issued to a limited number of investors meeting certain qualifications in terms of income or assets (these individuals are defined as 'accredited investors'). In these private placements (conducted using a Section 4(2) exemption from registration

13. Rosen, Ellen. "Student's Start-Up Draws Attention and US$ 13 Million," *New York Times*, May 26, 2005. http://www.nytimes.com/2005/05/26/business/26sbiz.html?_r=3&scp=1&sq=thefacebook+parker&st=nyt&

under rules laid out in Regulations A and D), the requirement which would otherwise be in place for registration of the securities with the Securities & Exchange Commission (and state regulators) is waived as long as certain other requirements are met. These exemptions do not apply to all regulations of private placements; for example, the antifraud rules pertaining to investments are still applicable in private placements.[14]

On the other hand, the CBB rules contained in Volume 6 of the CBB Rulebook require that most security issuances be done only following written approval from the Central Bank of Bahrain. While this provides some additional investor protection, it can also limit the ability of entrepreneurs to access capital from friends and family or from angel investors where the size of the offering makes it difficult (from a cost perspective) to comply with the CBB rules. The regulations in the U.S. have gone one step beyond just offering an exemption for private placements and now allow some advertisement for offerings, with additional requirements to ensure that the purchasers of securities qualify under the 'accredited investor' standard.[15]

Furthermore, crowdfunding is becoming an important area for small businesses to raise capital. The regulation of equity crowdfunding is expanding its usefulness for entrepreneurs as a way to get their idea off the ground and reach the 'proof of concept' stage, where angel or venture capital investors might consider investing. Many countries, including the United Kingdom and the United States, have implemented or are in the process of implementing equity crowdfunding rules.[16]

14. Private offerings exempt from registration in the United States raised US$ 903 billion in 2012 according an analysis performed by the Securities & Exchange Commission's Division of Economic and Risk Analysis in 2013 which found that the average size of these offerings was around US$ 30 million and the median size was US$ 1.5 million.
15. Ivanov, Vladimir and Scott Bauguess. 2013. "Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009–2012 (An update of the February 2012 study)" SEC Division of Economic and Risk Analysis, July 2013.
16. US: http://www.forbes.com/sites/kevinharrington/2015/02/03/will-jobs-act-equity-crowdfunding-ever-happen/2/

    US states: http://crowdfundinglegalhub.com/2015/01/16/state-of-the-states-list-of-current-active-and-proposed-intrastate-exemptions/comment-page-1/#comment-847

    UK: http://www.weblaw.co.uk/ebooks/crowdfunding-guide.pdf

Accepting and resolving failure

An important aspect of developing an entrepreneurial culture and encouraging people to take the risk of business ownership is accepting that there will be business failures. It should be possible for an entrepreneur to experience a failure and be able to start another business. There needs to be a system for resolving businesses that run into difficulty or fail, where creditors are protected, but where the entrepreneurs can also get some relief from their outstanding debts.

One part of this process is making it possible for entrepreneurs to set up limited liability companies that insulate them and their investors (in some cases) or only their investors (in other cases) from the demand for full repayment of all debts in bankruptcy. In addition, "Bankruptcy laws in the GCC are primarily liquidation laws and are insufficient to help an ailing company to restructure its debt so that it can continue in business".[17] For many venture capital investors at an early stage, there may not be as much of a need for restructuring law because the cost of administering the restructuring of a company will not be in line with the value from the process. However, this will not always be the case and it will be useful to have the possibility of restructuring companies as they get larger. This will provide greater clarity for investors making the *ex ante* decision about whether or not to invest growth capital, particularly to the extent debt capital is considered as an option.

According to the World Bank's "Resolving Insolvency Statistics," Bahrain is in a better position than other GCC and MENA countries in regards to some of the outcomes of the bankruptcy process. In Bahrain, it takes on average 2.5 years to complete the liquidation/

↑ **A view of the skyline of Manama at night October 20, 2010.**
REUTERS/HAMAD I MOHAMMED

17. Kuwait Financial Centre "Markaz". 2013. *Bankruptcy in the GCC*. Kuwait City: Markaz

LIQUIDATION TIME AND COST IN GCC, MENA AND OECD

Country	Time for liquidation / foreclosure (Years)	Cost (% of business value)	Recovery Rate (%)
Bahrain	2.5	10%	66.2
Kuwait	4.2	10%	31.7
Oman	4.0	4%	36.6
Qatar	2.8	22%	55.5
Saudi Arabia	2.8	22%	28.0
UAE	3.2	20%	29.4
MENA	3.4	13%	33.7
OECD	1.7	9%	70.6

ADAPTED FROM WORLD BANK — RESOLVING INSOLVENCY STATISTICS PRESENTED IN KUWAIT FINANCIAL CENTRE "MARKAZ". 2013. *BANKRUPTCY IN THE GCC*. KUWAIT CITY: MARKAZ, P. 10

foreclosure process (compared to 3.4 years in the MENA region and 1.7 years in the OECD). It costs 10% of the value of the business (compared with 13% in the MENA region and 9% in the OECD) and results in recovery rates of 66% (compared with 34% in the MENA region and 71% in the OECD).[18]

However, as mentioned above, having a liquidation process in place for businesses that run into difficulty may be necessary for attracting more investment, but is not sufficient. Not all businesses need to be liquidated, even if they appear to be in dire straits. In addition, the existing bankruptcy law is more restrictive by requiring that "if a merchant has not paid back his or her debts within 30 days, the debtor must turn himself or herself in for bankruptcy, or a creditor can force the debtor into bankruptcy".[19] This creates a potential situation that is not just challenging for a business that ends up being potentially insolvent; it can also spell the premature end for a fundamentally healthy business that is just facing a working capital shortfall.

One example of the former situation is Arcapita, which was unable to repay its debts that were coming due following the global financial crisis and the European debt crisis. Arcapita restructured itself using the U.S. Chapter 11 reorganization statute (the company had assets in the U.S. and was thus eligible to use the U.S. bankruptcy process). Although it emerged from bankruptcy with a confirmed plan under which its remaining assets are being wound down to fund recoveries for creditors, it had the option during the process to attempt to restructure itself with the possibility of emerging as a going concern. This would not have been possible under a law like Bahrain's Bankruptcy and Composition Law.[20]

18. World Bank's Resolving Insolvency Statistics from Markaz report.
19. Furr, Robert C. and Jessica L. Furr. 2013. "Draconian Bankruptcy Laws Inhibit Entrepreneurship in Bahrain, Oman and the UAE," *ABI Journal*, October, pp. 39-39. http://journal.abi.org/sites/default/files/2013/august/international2.pdf
20. Price, Richard and Christopher Walsh. 1988. "The Bahrain Bankruptcy and Composition Law," *Arab Law Quarterly*, Vol. 3, No. 3, August. http://www.jstor.org/discover/10.2307/3381824?sid=21105882710251&uid=3739856&uid=2&uid=4&uid=3739256

ESTIMATED RECOVERY FOR ARCAPITA BANK BSC CREDITORS UNDER LIQUIDATION OR REORGANIZATION

	Amount (US$ million)	Recovery (Liquidation)	Recovery (Reorganization)
Syndicated Facility & Arcsukuk Claims	US$ 977.3	4.1%	67.6%
General Unsecured Claims	US$ 1,904.7	4.1%	7.7%
Intercompany Claims	US$ 316.6	4.1%	Nominal

SOURCE: DRAFT LIQUIDATION ANALYSIS, ARCAPITA BANK BSC, APRIL 16, 2013, HTTP://CASES.GCGINC.COM/ARCAPITA/PDFLIB/983_11076.PDF (ACCESSED MAY 9, 2015)

CASE STUDY

Venture Capital Ecosystem: Paytabs & C5 Accelerator

↑ A female using touch screen device for online payment.

The venture capital ecosystem in the Middle East overall and Bahrain specifically is less developed than in other regions — there are fewer facilitator organizations to support entrepreneurs and investors. To be a successful center for innovation, the ecosystem requires several things from seed funding, angel investors, as well as growth capital. Funding also may be a necessary but not sufficient condition for the development of a successful entrepreneurial ecosystem. As discussed throughout this report, there is a need too for incubators to help nurture early-stage businesses and accelerators to take the most promising ideas and support them through the growth stage.

In the middle between these two phases is the so-called 'valley of death' which represents a gap between seed and growth capital which is where angel investors bring the most assistance in both funding as well as business expertise. The role of successful businesspeople is not limited to just business expertise but also provides an inspiration to entrepreneurs that yes, it is possible to grow a business from being new and small into something successful enough to get through to exit, which most commonly in the Middle East occurs through a trade sale to a larger company.

Within this ecosystem, two case studies stand out as particularly relevant for the future direction of Bahrain's venture capital ecosystem: PayTabs, an e-Commerce payment gateway, and C5 Accelerator, a technology investment firm focused on cloud computing. These two companies provide a look at both sides of the venture capital ecosystem — investors and entrepreneurs.

PayTabs

PayTabs was founded to meet a pressing need for a secure, easily usable payments platform for SMEs in the MENA region. Early on, Saudi Aramco Entrepreneurship Center (Wa'ed) saw the potential for not just a successful business but one that would support other businesses and create a multiplier effect.[21] Unlike traditional venture capital, Wa'ed has a social mission of employment creation; however, just like traditional VC funders, it found in PayTabs a disruptive business model.

After Wa'ed invested in PayTabs, the launch was followed by 1,000 customers in two months, meeting an early goal and showing acceptance of the product in the market. The success of PayTabs, which has increased the services it provides to include fraud monitoring services and an eCommerce platform compatible with social media, shows the benefit for entrepreneurs from venture capital. In addition to funding, Waed was very supportive providing the company mentors and helping its growth with marketing support across the Middle East and into Asia. Following the initial fundraising success, PayTabs is currently working with regional and global investors on a Series B round in excess of $10 million.

C5 Accelerator

One of the critical features of the venture capital ecosystem is funding, but as PayTabs shown there is room for more than just funding to nurture entrepreneurs so that they can bring innovative products to market in a way that creates a sustainable business. This is what C5 Accelerator, a London- and Bahrain-based investment firm launched in early 2016 does.[22]

Specifically C5 Accelerators is focused on three types of cloud computing businesses working on software as a service (SaaS) and backend as a service (BaaS), firms moving services (including education) onto the cloud, and disruptors using cloud computing technology. The accelerator program will provide seed funding of $10,000 to $25,000 per team (with 20 selected every year). To provide added value to the entrepreneurs, the accelerator will provide a home for the startups for a 4-month program supported by C5's partners Amazon Web Services, the Economic Development Board of Bahrain and Tamkeen.

The support an accelerator like C5 provides gets the growth going but often the startups leave with growth but unclear funding sources. This gap between seed capital and growth capital is referred to as the 'valley of death' because it represents a key challenge for entrepreneurs with potential to continue rapid enough growth coming out of an accelerator to attract a larger growth capital investor. C5 Accelerator provides some help with this because the participants in its program are eligible to receive funding through a $100 million venture fund.

By providing the potential of funding and support at multiple points (seed and growth capital), funds like C5 Accelerator can provide a supportive ecosystem for venture capital in Bahrain and the Middle East. However, its existence will be helped by other complimentary pieces. For example, Tamkeen, which supports SMEs offers a complimentary set of skills to startups outside of the cloud computing sector which, although not directly connected with C5, supports the development of an entrepreneurial mindset.

Similarly, organizations like Tenmou, which provides angel funding to startups in Bahrain, can also catalyze more entrepreneurship which is complementary to the other efforts like C5 Accelerator's seed and Venture Capital funding. As a venture capital ecosystem develops, it will have many players contributing in diverse ways through training, mentoring, coaching, incubation, acceleration, funding. All of these parts are needed.

21. PayTabs LLC Holding Company. "Why Saudi Aramco Entrepreneurship Center, Wa'ed, Invested in PayTabs," Press Release, November 9, 2014.

22. Hariharan, Sindhu. "Middle East and Africa Focused Cloud Accelerator Goes Live in Bahrain," *Entrepreneur Middle East*, February 1, 2016.

Recommendations

The recommendations represent the discussion with leading experts and market practitioners, desktop research, interviews and case studies.

- Introduce regulations to allow and regulate the process of equity crowdfunding for small businesses located in Bahrain and determine the appropriate scope of investors allowed to invest (Bahrain residents, GCC residents or anyone provided their national law does not restrict their ability to invest in equity crowdfunding ventures).

- Study the possibility of allowing more time to banks for carrying their unprofitable VC investments at cost on the books in order to encourage banks' participation in venture capital.

- Ease the process for entrepreneurs to set up legal entities for their businesses by reducing or eliminating the minimum capital levels for W.L.L. and Single Person Companies. Alternatively, establish a different business structure that functions like a W.L.L. but is exempt from the minimum capital level and auditor requirements below a certain level of revenue or assets.

- Consider exemptions from registration for certain issuers of private placements sold to friends, family and angel investors for entrepreneurial businesses in a way that maintains investor protection (such as not exempting the offerings from antifraud laws) while reducing the cost for small businesses to raise capital.

- Expand the bankruptcy law to provide an option for liquidation and restructuring, and provide the power to a bankruptcy court judge to decide after hearing from both creditors and debtors.

- Study existing bankruptcy law to determine whether modifications need to be made to provide an option, depending on the circumstances of the bankruptcy and in the absence of specific fraud, for the debtor, its management and shareholders to receive a "fresh start" following the conclusion of the bankruptcy.

2

Availability of Institutional Risk Capital and Private Equity

- The ideal investor base for venture capital is institutional investors with a long-term horizon that can act as ‘patient’ capital, even through volatile periods.
- Retail and commercial banks are not ideally suited to invest in start ups, as a result of their lower risk appetite, capital charges it would trigger, and a need to protect depositors’ funds. But they could invest limited amounts of their capital into external venture capital funds, or through their own venture capital subsidiaries.
- Government involvement in seed- and early-stage venture capital investments is crucial to cross the ‘valley of death’ and boost entrepreneurship.
- Early-stage venture capital is the form of venture capital most aligned with the popular understanding of what the sector offers and where the synergies with Islamic finance ideals are the greatest.
- The ability of entrepreneurs to rely on informal capital raising from friends and family, as well as crowdfunding, for pre-seed stage investments will be most influenced by social and cultural factors (discussed in Chapter 5).
- Established businesses also have the potential to act as VC investors, particularly if they are incentivised to act as ‘incubators’ for startups emerging from their own R&D activities. They may also wish to capture opportunities to benefit from funding businesses that could disrupt their own sector.

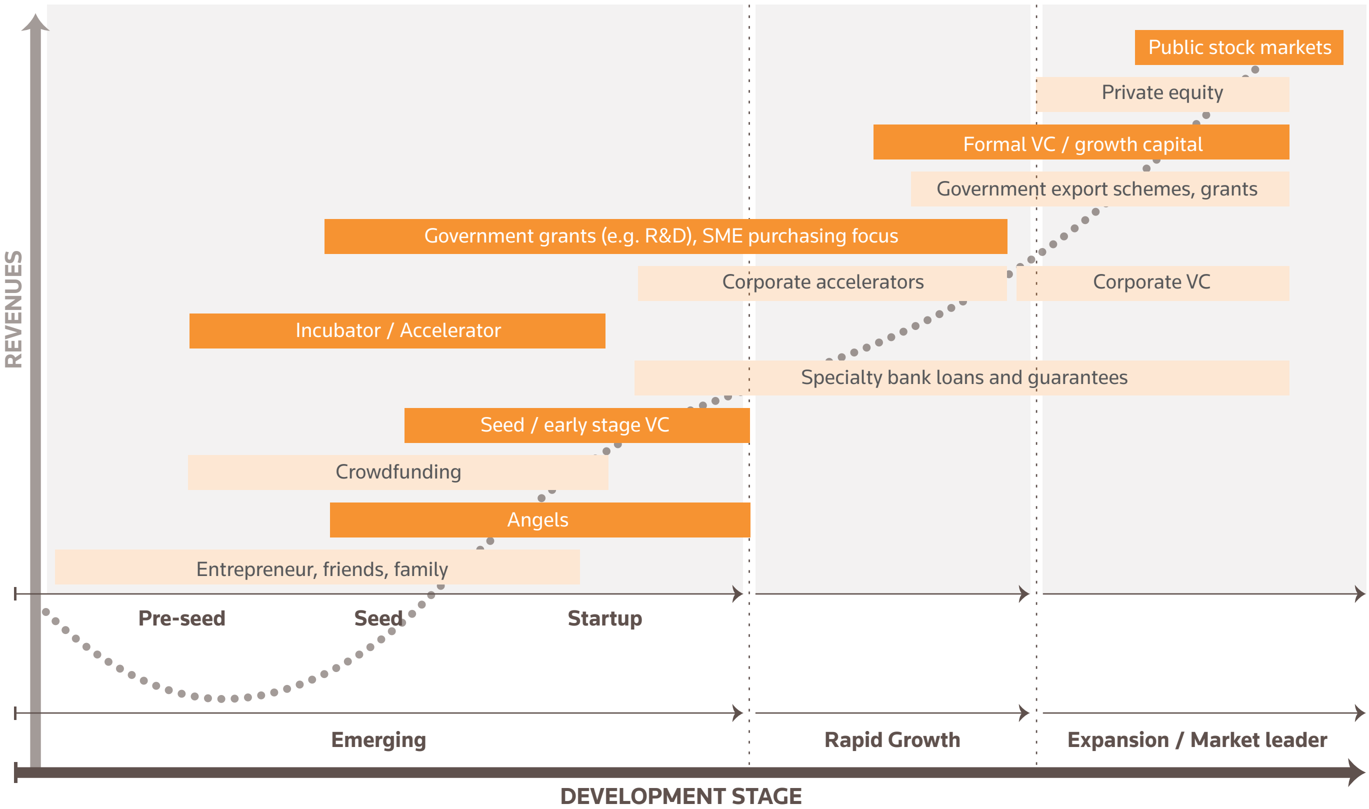
↑ **A trader is seen leaving his position during early hours after opening of the Bahrain stock market, in Manama, Bahrain.**
REUTERS/HAMAD I MOHAMMED

Institutional investors are key funders behind venture capital

An institutional investor base is one of the key components for the success of a venture capital ecosystem. According to the OECD, 40% of venture capital funding in the United States comes from pension and insurance funds, while in Europe, 50% of venture capital funding comes from banks.[23] This does not mean that the investment decisions are being made directly by these institutional investors. Instead, they usually invest via venture capital funds, to take advantage of the specialization of the fund managers and to gain diversification benefits for their investment portfolio.

The reason why this matters for developing venture capital within the GCC region, and specifically within Bahrain, is that it highlights the role that the deepening of financial markets overall can play in developing venture capital. The key factors that make insurance, pension funds and banks useful in the process of expanding venture capital is that they have a long-term horizon, and do not rely on the short-term performance of any individual investment; hence, they can be appropriately patient. Life insurers, family takaful operators and pensions funds have to meet obligations decades in the future. Banks in some cases have a shorter time horizon, but they often originate financing that spans a decade or more and so are not necessarily driven by the need to maximize only the short-term profits.

23. OECD (2008, 55).



SOURCE: THE EY G20 ENTREPRENEURSHIP BAROMETER 2013

Sophisticated institutional investors needed to attract top-quality VC fund managers

One challenge in this respect for the GCC in general, and Bahrain in particular, is that there exist only a limited number of takaful operators and pension funds which are amenable to long term risk capital investing comparable to their developed market counterparts which have not only invested in VC funds but in some cases launched their own VC initiatives.[24] In addition, the bank-led option that is common in Europe is inhibited in the region, as banks tend to prefer to make loans secured by tangible assets and have a shorter maturity profile than banks in Europe. Although this is true in many emerging markets at the earlier stages of financial market development, Bahrain is in a better position to address this, given its position as an advanced banking center offering a full spectrum of financial services. It has a more developed financial system than other countries in the region, with domestic banking assets reaching 155% of GDP, and continues to implement a number of initiatives aimed at increasing the depth and breadth of its financial institutions.[25]

Building a venture capital industry around developing institutional investors requires a particular set of skills from managers to invest the funds prudently, and has different requirements based on the stage of development. A successful venture capital industry will need to develop investors across the spectrum, covering each stage of the process from seed capital, early stage and later rounds of venture capital, including growth capital which can accelerate growth through to the exit. These categories are not entirely fixed, but they are different in their risk characteristics and attract different types of investors.

24. Weisul, Kimberly. "Why Pension Funds are the Next Venture Investors," *Inc.com*, July 18, 2014. http://www.inc.com/kimberly-weisul/the-end-of-vc-as-we-know-it.html (Accessed May 8, 2015)

25. CBB Statistical Bulletin, March 2015.

Henri Asseily

Leap Ventures, Founding Partner

HENRI ASSEILY has 20 years of experience as a serial entrepreneur focused on internet-related businesses and has particular expertise in relation to algorithmics and computer science. He is the founder of Bizrate.com / Shopzilla, acting as CTO until its sale in 2005 for US$ 569 million. He led the creation of the first product-centric online search engine. He is an active investor in (and mentor to) companies in the United States and MENA. Henri holds a BA in mathematics and economics from the University of Pennsylvania and an MBA from the Wharton School of the University of Pennsylvania.

Is there sufficient institutional capital available with the risk appetite for venture capital funds?

This is an oft-asked question that touches upon two key issues: "sufficient" institutional capital, and "risk appetite". First, we need to discuss the problem of risk appetite. The MENA region suffers, in my opinion, from a cultural distrust of anything long term, let alone long term high-risk high-reward capital gains from companies with zero hard assets. MENA discounts anything not physically visible or touchable, and that is clear not only culturally but also in the legal frameworks of most countries in the region.

For example, in Lebanon there is no concept of goodwill, and no value can be attached to goodwill. Similarly, few if any countries allow employee stock option plans: either you put money in the company and you receive shares, or you're working for the company and you get a salary.

Second, the issue of sufficient capital: the answer last year would have been a clear NO. This year, with the advent of Lebanon's central bank circular 331 injecting over US$ 400 million in this small country's knowledge economy, and all other countries wanting to follow suit or at least tracking closely its development, there is a lot more capital available. At least in Lebanon, and to a lesser extent the GCC, capital is now available.

Raising money in GCC for internet/tech is still difficult because few returns have been seen. I expect that to change instantly the day well-known local investors get a major exit, as the herd mentality is strong.

How much of an obstacle does the lack of a tangible asset as collateral (like in real estate private equity funds) present for building risk capital?

The main obstacles are in working capital lines of credit and bridge loans. Those are impossible to get due to the collateral issue. If a company doesn't need those, or has secured enough capital from a raise to handle this, there's no problem. Otherwise the obstacle is insurmountable.

In your opinion, would there be more of an appetite for investing in venture capital in businesses that serve the local/regional market versus one which is export-focused?

On the one hand, local/regional support is good and nationalism plays a big role, but on the other hand the world is a much bigger market, validates your business model much better, and allows for much more interesting exits.

Can banks play a role in either arranging for or financing venture capital investments? If they do have a role, can they make investment decisions in-house or should they hire external managers with more experience in investment selection of venture investments?

You can look at the Lebanese ecosystem today to answer this question. The central bank is injecting through the banks over US$ 400 million. The vast majority of that is going through VC funds because banks know very well that they cannot properly analyze VC investments. Their risk profiles are markedly different, and they do not wish to invest in building an in-house VC arm. Those banks (BLC comes to mind) that went at it alone are showing their limitations: extremely complex deal structures making further investments difficult, incredibly long cycles (over a year for a single investment) and a focus on reaping deal fees as opposed to long term returns.

In what sectors is demand highest for venture capital? How much overlap is there between the anticipated supply of risk capital (fund investors) and the demand for risk capital (businesses needing capital)?

Demand has been skewed by the lack of supply, so it's difficult to look at each independently. An all-too-common example is a startup founder looking to raise US$ 700k "because I've been told that there's no chance I can raise US$ 2 million". Such founder should have probably raised US$ 4 million to give himself proper leeway to achieve the necessary milestones.

That said, demand and supply are high in marketplaces of all kinds, and in hardware. Apps makers have a problem with supply and are self-censoring themselves because there's very little appetite to fund companies that will spend most of that in marketing. The F&B business is in high supply (investors love food), and in general successful B2C businesses easily attract capital thanks to their buzz.

The MENA region suffers from a cultural distrust of anything long term, let alone long term high-risk high-reward capital gains from companies with zero hard assets

Seed and pre-seed capital

The companies that appeal to venture capital investors, particularly early stage investors, do not spring up on their own. The financing and development of these early stage companies is required to create the pipeline for venture capital investors, particularly the institutional investors.

This early stage financing comes in several forms, ranging from friends and family who support new ventures at their earliest stages to angel investor networks which can offer financing plus some of the managerial and sector-specific experience. Venture capital investors also offer these benefits, but with certain requirements placed on their investee companies in pursuing a liquidity event, which is not ideal for their growth at this stage.

The investors who make up an angel investor community often have the time and money to put towards new ventures because they have had a successful venture themselves that they have exited from and are interested in supporting new entrepreneurs. In the U.S. and other developed markets the angel network is increasingly important to build a wider base of entrepreneurial startups.

While the GCC region has not seen formal angel investor networks develop as rapidly as in other regions, it has the potential to expand quickly because of the relatively large number of high net worth individuals who could be a base for VC finance, and offset the limited institutional investor base.

Family-owned enterprises as business incubators

Many of the high net worth individuals own family businesses which account for the bulk of the non-oil economies in the GCC. OECD (2008) cites a 2006 estimate by the European Union that family-owned enterprises in the GCC represented 75% of the economy this figure has remained constant by most estimates today). A 2013 estimate from the International Finance Corporation says micro-enterprises and SMEs account for 80-90% of all businesses in the MENA region and employ between 10% and 40% of all formal employees.[26] Hertog (undated) provides a higher estimate of the SME share in private sector employment based on a study from 2008 to 2010 in the GCC which ranges from 40-63%, with the difference coming from a very high rate of informal employment levels across the MENA region (particularly in non-GCC countries).[27]

Family owned enterprises may be able to provide informal incubator services, and potentially funding as well, to startup ventures the way that many large corporates in countries like the United States had a significant role in R&D activities in the middle-to-late 20th century. Examples include divisions of large companies like Bell Laboratories, which was part of AT&T in its heyday and which is now part of Alcatel-Lucent after being spun out of AT&T in the 1990s.[28]

What has caused the demise of many R&D centers within large companies is a constant cost-cutting drive to meet short-term profit expectations. To the degree that family owned enterprises are insulated from this type of short-termism, and to the extent that they can maintain an innovation culture, they could cooperate with business incubators and angel networks to provide the capital for early stage companies that operate in similar sectors to them.

26. Saleem, Qamar. 2013. *Overcoming constraints to SME Development in MENA Countries and Enhancing Access to Finance*. Washington, DC: IFC.
27. Hertog, Steffan. Undated. "Challenges for Small and Medium Family Companies in the GCC," *Tharawat Magazine*. http://www.tharawat-magazine.com/en/family-business-articles/smes/1578-challenges-for-small-and-medium-family-companies-in-the-gcc (Accessed May 17, 2015).
28. Cite: http://www.wired.com/2014/09/coupland-bell-labs/

Crowdfunding and pre-seed funding

Another source of capital that could be better developed to provide the initial funding for companies that are still building towards the proof of concept stage is crowdfunding. Earlier varieties of crowdfunding structures were more reward- or preorderbased. In these instances, the reward for providing funding is a free or discounted item whose development is being funded. For example, if a company had developed a prototype for a product, but could only get manufacturing done in bulk, which requires a large upfront payment, it could raise money through crowdfunding by asking people to preorder the product. This would provide the advance money needed by the entrepreneur to manufacture a supply of the product and test the market demand for it.

A newer variation on crowdfunding, which requires more regulatory development, is equity crowdfunding, where instead of a 'reward' or preorder for a product, investors are provided with ownership of shares of the business. The difference between rewards/preorder-based crowdfunding and equity crowdfunding is that the former is based on effectively selling an item or service while the latter is based on selling securities, which is subject to more regulation. This also means that efforts to develop it have taken more time than reward/preorder-based crowdfunding.

Early-stage Venture Capital

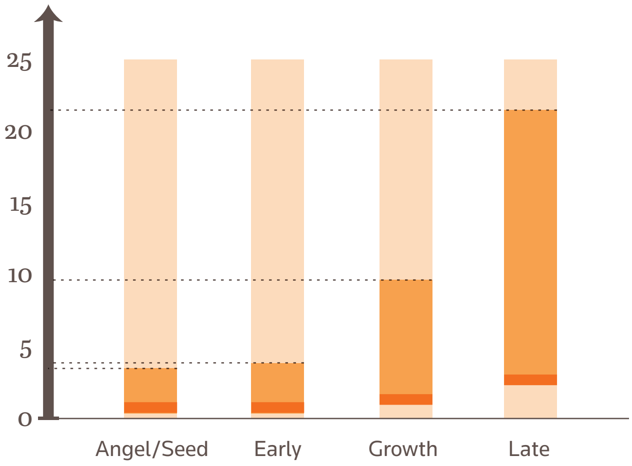
Moving from seed and pre-seed to early stages of venture capital, the risks decline, as do the potential returns, and the structure becomes more closely aligned with what is traditionally thought of as 'venture capital'

Early stage venture capital is characterized by investments made to explore if the business can generate accelerated growth that will allow it to get to an exit or attract growth capital to get to an exit. It is designed to maximize the potential upside, while maintaining some operational control over the business. This control is in part for the protection of the investor (to avoid having their interest in the business diluted) but is also an opportunity for them to provide management expertise gained from their experiences (often directly in other startups).

The early stage venture capital requires more experience in the particular sectors for the VC-funded businesses to succeed. This provides a challenge for the existing institutional investors (primarily banks) which do not have the skill set to provide the needed management expertise to support venture capital-backed investee companies. This management expertise will not spring up overnight and will require skill transfer from foreign VC investors. Existing rules require that any company employing ten or more expatriate workers in Bahrain is subject to a Bahrainisation quota which is not currently set into written legislation but is at the discretion of the Labour Market Regulatory Authority.[29] Because foreign investors are likely to evade these restrictions by employing their workers outside of Bahrain, and because the benefit in terms of skill transfer is dependent upon face-to-face interaction, an alternative arrangement should be established. For example, a foreign VC firm that operates within Bahrain could be provided greater leeway in its Bahrainisation quota if it were an active participant with an established domestic business incubator, and offered internship programs to university students.

29. Ministry of Industry & Commerce, Kingdom of Bahrain. http://www.moic.gov.bh/En/MoIC%20Centers/BahrainInvestorsCenter/Post%20Registration%20Services/WorkPermits/Pages/Work%20Permits.aspx

VENTURE CAPITAL FUND SIZE RANGE (US$ MILLION)



SOURCE: MENA PEA 2011 VENTURE CAPITAL IN THE MIDDLE EAST AND NORTH AFRICA REPORT AND AUTHOR'S CALCULATIONS

Growth Capital

Growth capital is often provided to companies that are already at or nearing the break-even point and have capital needs to accelerate their growth to reach a point where they are attractive for exit, either through a public offering or a private sale. Because growth capital investments are often made with minority stakes in the business, they have unique governance aspects that would not necessarily be obtained by earlier stage investors who might end up with a higher (if not majority) stake in the business.

The primary purpose of growth capital is to fund acceleration of revenues, which usually (but not always) results in the company achieving profitability prior to exit. The intent is to avoid a potential undervaluation of the business in an exit transaction because the full potential in terms of revenue growth acceleration or profitability has not been demonstrated. Such growth capital is often provided through the issuance of senior preferred securities with additional operational control rights, as well as redemption (put) rights.[30] This structure effectively caps the investor's returns, while also receiving some downside protection. It introduces some Shariah challenges, which are discussed in Chapter 4.

In contrast with early-stage venture capital, growth capital is equated more with private equity than with venture capital, albeit without the leverage used typically to increase returns from private equity. Whereas early stage venture capital may be just emerging from proof of concept without necessarily even demonstrating the ability to generate revenue, the business model in growth capital investments is fairly well developed and companies have reached the point of break-even in many cases.

While it would be inappropriate to suggest that growth capital provides an exposure that would be within the natural comfort zone of a bank (whether conventional or Islamic), there are many factors that make growth capital more accessible to banks than other forms of venture capital. The covenants that are generally involved, including specific triggers for a redemption put, make banks more comfortable with some of the risks associated with growth capital.

As a result, it may be an option to encourage banks to participate in venture capital investment in companies that are in the growth capital stage. This could be through participation in growth capital funds. Banks can also invest directly in businesses that are at the growth capital stage, although for many banks the additional risk and consequent capital charge (due to high risk weighting) may be prohibitive.

30. Stewart, Matthew. 2012 *Growth Equity: The Intersection of Venture Capital and Control Buyouts.* San Francisco: Fenwick & West LLP.

Beautiful illuminated trees and Riffa Clock Tower at Riffa, Bahrain.
DR AJAY KUMAR SINGH / SHUTTERSTOCK.COM

Government as Private Equity Fund Manager

Rudy Yaksick, Economist

RUDY YAKSICK is a financial economist with 25 years experience in investment banking and private equity. Currently, he is a Visiting Assistant Professor at Gulf University of Science & Technology (Kuwait). He began his career as a VP of product development at Chase Manhattan Bank. He went on to found, and is the CEO of, Concord Capital Partners (CCP), a financial advisory firm that provides mentoring, business model design and capital raising services to start-up ventures and SMEs. Mr. Yaksick earned a Master's degree and completed all examinations and coursework for a Ph.D. (ABD) in Regional Science from the University of Pennsylvania. He also holds a Master's degree in Regional Economics from Boston College and a BA in Economics from the University of Pittsburgh.

The Arabian Gulf countries that form the Gulf Cooperation Council (GCC) have inherited the world's largest known reserves of petroleum and natural gas. Unfortunately, these reserves are finite resources that constantly face the challenge of competing energy production and conservation technologies. Hence, this article addresses the following issue: How should the inherited energy wealth of GCC countries be managed in order to create sustainable prosperity for the citizens of the GCC countries?

Our approach to managing inherited energy wealth is that the GCC countries should become diversified based on the idea of competitive (as opposed to comparative) advantage of new ventures and Micro and Small and Medium-Sized Enterprises (MSMEs).

This new approach requires governments to replace the current trust fund mentality (i.e., risk-averse investing in order to protect and preserve inherited wealth) with a more entrepreneurial, private equity approach. From this perspective, the Government takes investment and development decisions acting as a Private Equity Fund Manager, tasked by its "investors" (in this context, GCC citizens are the Limited Partners) to diversify the resource-based economy by stimulating the formation, growth and exit of new ventures and MSMEs.

Regional Development Strategy: What Is a Competitive Advantage?

According to Michael Porter (world's leading expert in competitive strategy and Harvard Business School Professor) continued growth in productivity is the fundamental source of national and regional competitiveness in a globalized economy; not cheap labor or access to natural resources. Instead, Porter's theory of regional development stresses that sustainable, superior economic performance is determined by a country's/region's competitive advantage.

What is competitive advantage? The term competitive advantage describes the ability of new ventures and existing MSMEs to outperform their competitors in the same industry or market. Simply put, competitive advantage is the ability to stay ahead of current or future potential competitors. How do new ventures and existing MSMEs obtain a competitive advantage?

Broadly speaking, the new ventures and MSMEs must design a scalable business model and implement a corporate strategy which enables them to increase productivity by:

- Reorganizing production processes or adopting superior production technology,
- Producing more sophisticated products,
- Acquiring new, more complex production activities (vertical upgrading), and
- Transferring competencies acquired in a particular segment of a cluster or value chain to a new, more valuable segment (horizontal upgrading).

Moreover, rivals must NOT be able to match these advantages!

Hence, new ventures and MSMEs that create these advantages have a higher probability of survival and sustained growth. In turn, GCC economies benefit in terms of increased employment (quality jobs) and household income.

Government's Value Proposition

Acting as a Fund Manager, the Government's fiduciary duty to its investors (citizens) is to identify and eliminate "Pain Points" in each stage of the birth, maturation, and exit stages of new ventures and MSMEs. Also, the Government should provide "gains" in the form of enabling new ventures and existing MSMEs to obtain several competitive advantages. In this section, we briefly describe the Government's Value Proposition to its citizens, both current and future generations.

A. Venture Formation: Building the Pipeline

According to a recent report by Marmore MENA intelligence ("Starting a Business in Kuwait", April 2015), GCC governments have much room for improvement in simplifying the process of formally launching and registering a business. Some of the suggested policy improvements include:

- Reduce or eliminate minimum capital requirements: More than 100 economies worldwide do NOT require any paid-in capital, including Saudi Arabia and the UAE. The remaining four GCC countries have a paid-in minimum capital requirement.
- Establish a single authority (one-stop-shop concept) for registering a business and obtaining necessary licenses Kuwaitis must deal with 11 governmental agencies, taking an average of 31 days to complete the process.
- Enable on-line registration of company names and applications, with single ID assigned to the company.
- Provide partial funding for employees' skill development and training
- Provide export subsidies and marketing assistance
- Enable write off of early attempt loss (bankruptcy law tailored to startups).

B. Venture Scaling: Upgrading via Industrial Clusters

How should governments — in their role as Private Equity Fund Managers — promote new venture and MSME venture scaling (upgrading)? According to Porter's development strategy, a very important source of competitive advantage is membership in industrial clusters. Industrial clusters are co-located firms that coordinate economic activity (product design-production-distribution, etc) needed to transform raw materials into finished products/services that are sold to customers. Cluster membership provides several competitive advantages, including:

- Lower transport, transaction, and search costs

GCC governments have much room for improvement in simplifying the process of formally launching and registering a business.

Governments should provide incentives and a business formation environment that remove obstacles hindering the launch of new ventures as well as upgrading in clusters and global value chains.

- Scale economies
- Transfer of tacit knowledge, permitting faster, cheaper process innovation and product upgrading
- Stronger pricing power
- Functional (vertical) and inter-sectoral (horizontal) upgrading

In this context, the appropriate role for the government is twofold: First, to provide incentives for the formation of industrial clusters—linked to well-governed global value chains that encourage inter-firm cooperation within the value chain. Second, to facilitate the entry of new ventures and MSMEs into industrial clusters. This will enable them to acquire sustainable competitive advantages by increasing their productive efficiency and exploiting internal and external economies of scale.

Policy Recommendations

This article proposes a new approach for GCC countries tasked with managing their inherited energy (petroleum) wealth: diversify GCC economies based on the idea of creating competitive (as opposed to comparative) advantages for new ventures and MSMEs. In this context, the policy objective is to ensure the formation of a diversified economy that delivers continued growth in productivity.

To achieve this objective, we recommend that government should behave as a Private Equity Fund Manager. That is, the fundamental role of government is to aid new ventures and existing MSMEs to make "good" upgrading choices when striving to attain a competitive advantage.

Specifically, governments should provide incentives and a business formation environment that remove obstacles hindering the launch of new ventures as well as upgrading in clusters and global value chains. Likewise, governments should promote healthy competition-cooperation amongst SMEs.

We also recommend several policy interventions designed to promote cluster formation amongst new ventures and MSMEs, including:

- Create and enhance trust amongst firms
- Promote the establishment of collective projects
- Create and strengthen business associations
- Strengthen the local supply of equity-based financial programs
- Facilitate the external connections of the cluster
- Promote product and process innovation

Government policy interventions will be deemed effective when new ventures and MSMEs make the necessary investment in innovation, organizational learning, and prudent risk-management behavior required to develop a sustainable competitive advantage.

Recommendations

The recommendations represent the discussion with leading experts and market practitioners, desktop research, interviews and case studies.

- Develop a mechanism to allow, encourage and facilitate bank participation in growth capital, either as a part of their permissible banking activities or through external growth capital managers. Provide advantageous regulatory treatment for capital adequacy purposes for venture capital investments or impose a specific mandated percentage of capital dedicated to venture capital funds.
- Attract venture capital firms to establish offices in Bahrain by providing matching funds and establishing a lower Bahrainisation requirement if they support a business incubator and offer business students internship opportunities.
- Develop a deal flow connection portal that assists VC firms in gaining access to intermediaries and various sources of funds such as banks, finance houses, investors, etc.
- Encourage connections between VC firms and local professionals who can offer marketing, accounting, financial planning, governance, internal audit and legal/ regulatory advisory services to VC firms' domestic investee companies.
- Ease immigration / visa procedures for VC managers that establish their offices in Bahrain. Build upon existing angel investor networks to bring in more sector-specific expertise to start-ups and early stage companies.
- Open exit routes by encouraging larger family owned enterprises to invest in and/ or acquire promising companies related to their core sectors.

3

Exit Avenues: Developing Exit Markets in Bahrain

- The main exit mechanisms for VC investors worldwide are IPOs and trade sales.
- M&A activity in the GCC is gaining in significance, but limited within Bahrain, with most being small domestic deals involving the financial sector or government-related entities as acquirer.
- The IPO market is also gaining depth in the GCC but has been slow in Bahrain with just seven IPOs since 2010.
- Limited secondary market activity complicates efforts to promote more listings. However, the government is trying to push for more listings through initiatives including the new Bahrain Investment Market, which follows the development of a junior exchange in Qatar.

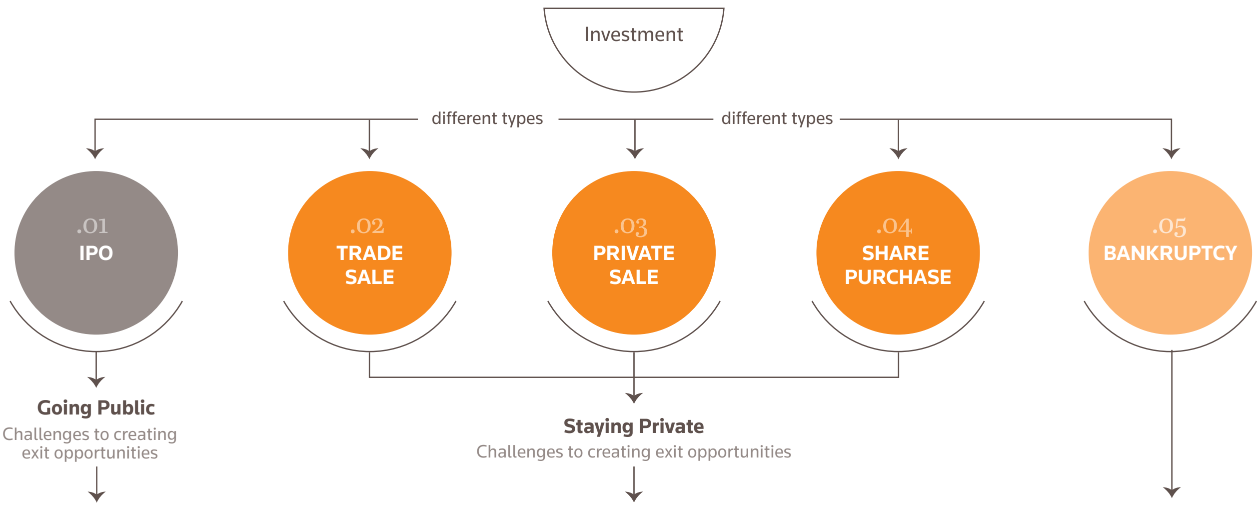
Introduction

As discussed in the previous chapter, there are many stages through which venture capital investments travel during the life cycle of the investee companies. There are also different levels of formality in what the investors require of the business between the early stage investments by the entrepreneur to highly structured growth capital financing. Despite these differences, a common concern about eventually gaining liquidity for their investments is shared by investors, whether they are individual investors (possibly angel investors) or professional fund managers providing growth capital. There are four methods of exit: initial public offering, trade sale, private sale or share purchase.[31] There is a fifth exit possibility—bankruptcy or closure—but since it is not a desirable exit, and because the issue of bankruptcy resolution was addressed in Chapter 2, it is not discussed further in this chapter.

The four methods of exit covered in this chapter can be separated further into two broad categories: private sales and public listing. While some trade sales will result in shareholders receiving publically traded shares of the acquiring company (thus becoming a public exit), it is more appropriate for these investors to treat it with other forms of private sale with a caveat, that it remains up to the investor whether to hold onto the shares paid or to sell immediately. In contrast, if the exit comes via an IPO, the investor will have the choice between selling his shares in the IPO or retaining shares in the original venture in the hopes of receiving a higher price, either directly selling into the market or selling in a secondary offering (or possibly a future acquisition by another company). The remainder of this chapter will discuss the opportunities within Bahrain and regional markets for exit through one of two discrete outcomes: private sale (an M&A transaction) or public listing (an IPO).

31. OECD. 2008 "Venture Capital Development in MENA countries: Taking advantage of the current opportunity" in *Making Reports Succeed: Moving Forward with the MENA Investment Policy Agenda*. Paris: OECD publishing. http://www.keepeek.com/Digital-Asset-Management/oecd/finance-and-investment/making-reforms-succeed_9789264052826-en#page56 (Accessed May 20, 2015)

EXIT OPTIONS FOR A NEW ENTREPRENEURIAL START-UP



Going Public	Staying Private				Bankruptcy
01. Maturity level (the company has a relatively predictable revenue stream and some track record of profitability). **02.** Need liquid market **03.** Cost of IPO **04.** Cost of regulatory compliance as a public company	**01.** Need to agree on price with acquirer	**02.** Rules relating to acquisition by foreign company	**03.** Share lockup if the acquirer is public company and not all-cash deal	**04.** Limited M&A activity in the GCC and cyclically sensitive	Refer to Chapter 1

Recent data on M&A in the GCC

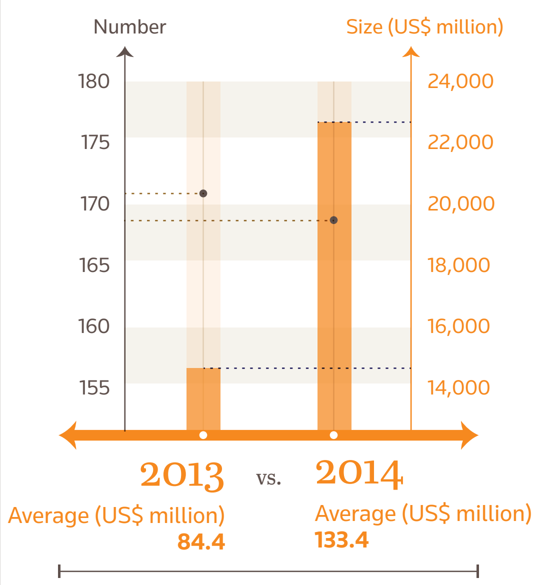
According to *Zawya M&A Monitor*, the number of M&A transactions in the GCC decreased slightly in 2014 to 168 compared with 171 in 2013, although the total value of these transactions increased significantly from US$ 14.4 billion in 2013 to US$ 22.4 billion in 2014. The growth in the value of these transactions drove the average transaction amount up from US$ 84 million in 2013 to US$ 133 million in 2014. The average size of the transactions varied significantly from country to country. For example, the 16 acquisitions of companies in Qatar had an average size of over US$ 350 million while the average size in the UAE and Bahrain were US$ 101 million and US$ 70 million, respectively. Kuwait's 24 transactions averaged just US$ 17 million each.

Looking more closely at Bahrain, there was significantly less activity. The number of deals dropped from 19 to 14 from 2013 to 2014, whereas the value of these transactions increased from US$ 689 million to US$ 980 million. This increased the size of the average transaction from US$ 36 million in 2013 to US$ 70 million in 2014. The transactions in 2014 included a mix of trade sales and private sales to financial institutions, which is likely to be broadly representative of the types of M&A transactions that can provide exit opportunities for venture capital investors. Furthermore, the average size of transactions, being under US$ 100 million, is consistent with a reasonable range for exit transactions for venture capital-backed companies. However, with such a limited number of deals, the exit route is still a source of significant uncertainty on the private transaction side. It would benefit from investors with experience building companies with an intent to sell to a larger company, particularly one engaged in a similar area of business.

The significant uncertainty associated with exit through private sales should be viewed as a challenge for policymakers, venture capital participants and investment banks, which can benefit from a source of revenue that is associated with relatively low capital intensity (albeit a highly cyclical one). Low capital intensive businesses in banking include M&A advisory and trading on behalf of customers in FX, equities or commodities; in contrast, there is higher capital intensity in underwriting and structured finance as well as direct equity investments into venture capital companies. Policymakers should work on resolving the constraints on building the pipeline of companies that can be the target of acquisitions when they reach a higher stage of maturity. In Bahrain, foreign ownership has been considerably liberalized relative to other countries, but policymakers should be as attuned to the needs of investors as they are to the pipeline of venture-backed SMEs, to identify any remaining constraints limiting acquisition activity.

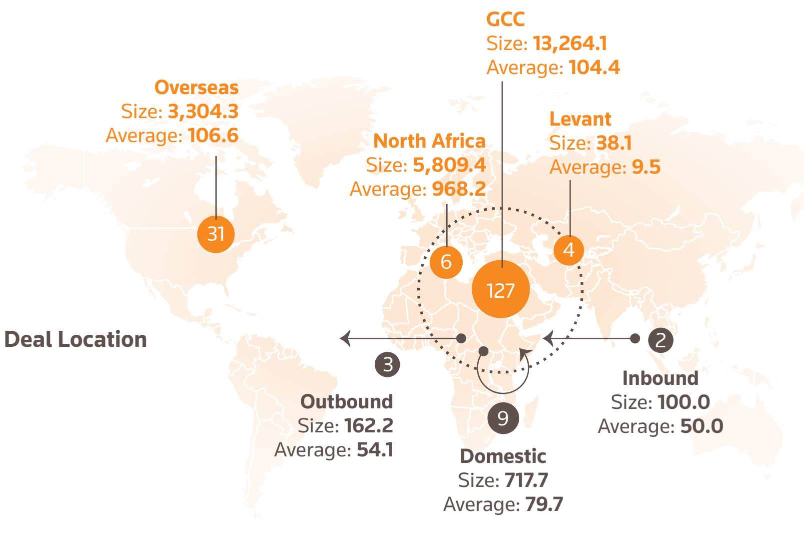
→ **Mercedes Formula One driver Lewis Hamilton of Britain takes the "Michael Schumacher turn" as he drives his car during day four of Formula One's final pre-season test at Bahrain International Circuit (BIC) in Sakhir, south of Manama.**
REUTERS/Hamad I Mohammed

MENA MERGERS & ACQUISITIONS, 2013-14



Geographical Location Of GCC Deals — 2014

(Size/Average in US$ million)



ACQUIRER SECTOR — 2014				TARGET SECTOR — 2014		
Number	Size (US$ million)	Average (US$ million)	SECTOR	Average (US$ million)	Size (US$ million)	Number
15	5,708.6	380.6	Real Estate	850.9	7,658.1	9
4	5,706.3	1,426.6	Telecommunications	1,426.6	5,706.3	4
-		-	Oil & Gas	214.9	2,149.2	10
62	4,235.2	68.3	Financial Services	49.9	1,696.2	34
-		-	Construction	91.5	1,098.1	12
19	3,842.6	202.2	Transport	59.2	887.9	15
7	503.1	71.9	Power & Utilities	75.4	603.1	8
60	871.6	15.8	Other	17.0	1,068.6	71

SOURCE: ZAWYA M&A MONITOR

Agreements on Valuation Remains a Challenge

Within the financial sector, one of the major constraints has been difficulty in reaching suitable valuations, acceptable to both the acquirer and the target.[32] Although venture capital funds cannot change this particular valuation challenge, it may be beneficial to encourage participation by experienced foreign venture capital firms. In most well developed venture capital markets, investors have specific timelines under which they must make investments, grow companies and reach a liquidity event, which can help unstick differences of valuations. Also, experienced limited partners can influence fund managers' exit decisions and help break deadlocks by increasing the value of liquidity over realizing an incrementally higher return.

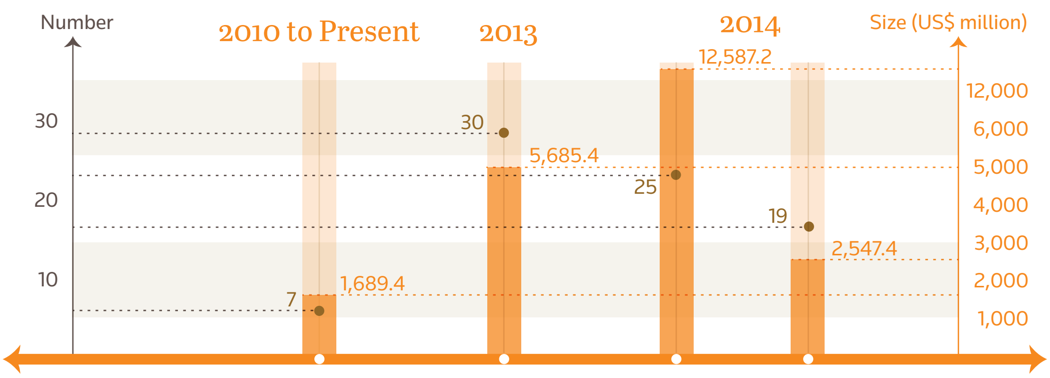
Large IPOs dominate in GCC

The alternative to an exit via a private sale (whether to another investor or to a supplier, customer, competitor or another company that operates in the same sector) is an initial public offering (IPO). A significant source for IPOs in the GCC region in the post-financial crisis years has been large companies encouraged to go public or, in some cases, government-owned companies moved into the public market as a form of wealth transfer to the population and to increase the depth of financial markets.

As with the M&A data presented earlier, the number of IPOs in 2014 dropped to 25 from 30 the year before, but the total value of IPOs rose dramatically to US$ 12.6 billion from US$ 5.7 billion in 2013. The increase in the total size was almost entirely due to the National Commercial Bank IPO in Saudi Arabia, which raised SAR 22.5 billion (US$ 6 billion). Other mega-IPOs (where more than US$ 500 million were offered) included the AED 5.8 billion (US$ 1.6 billion) IPO of Emaar Malls and the SAR 5.6 billion (US$ 1.5 billion) IPO of Ma'aden. Removing these mega-IPOs provide a better degree of comparability between the average size of IPOs in the GCC countries. The size of average IPOs (measured by value of the shares sold) by country ranges from US$ 24 million in Bahrain to US$ 207 million in the UAE. The regional average size was US$ 134 million and, on average, the companies sold about 40% of their total market cap in their IPOs. This compares well with the average U.S. IPO size of US$ 107 million.

Even excluding the largest companies,

MENA INITIAL PUBLIC OFFERINGS, 2013-14



	IPO — Bahrain	IPO — GCC	IPO — GCC	IPO — GCC*
Average Size	**241.3**	**189.5**	**503.5**	**134.1**
Average Oversubscription	**1x**	**5.879x**	**14.558x**	**na**

* (excluding Mega IPO)

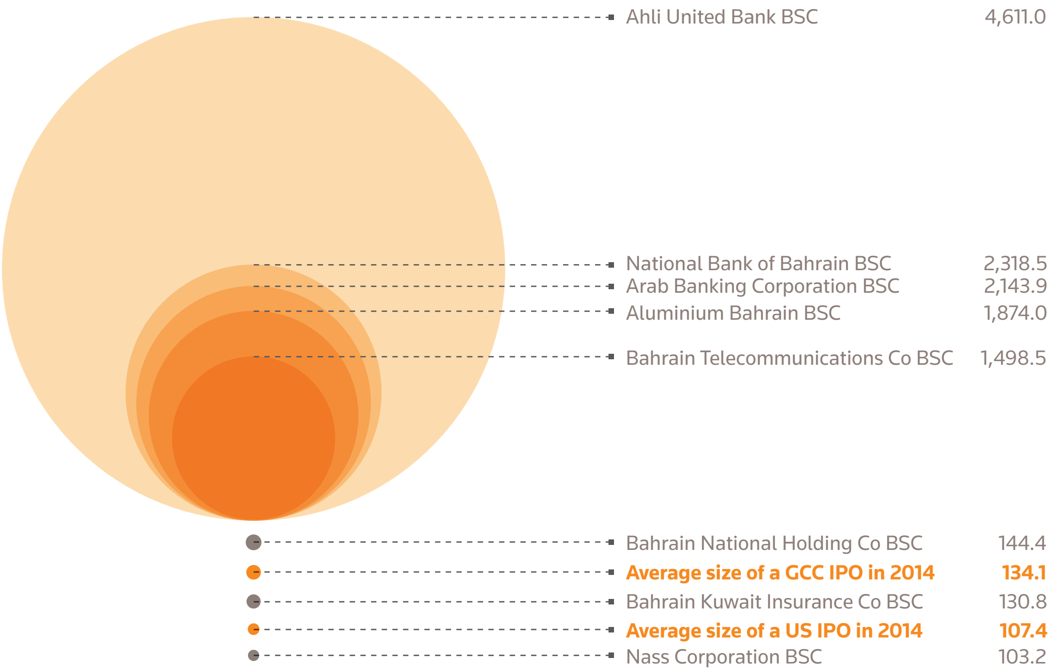
*NOTE: A MEGA-IPO IS DEFINED AS ONE THAT RAISES MORE THAN US$500 MILLION.
SOURCE: ZAWYA ISLAMIC IPO MONITOR.

32. Reuters staff writer. "Bahrain Islamic, Al Salam end US$ 4.5 billion merger talks," *Reuters*, February 16, 2012 http://www.reuters.com/article/2012/02/16/bahrain-merger-idUSL5E8DG3N520120216 (Accessed May 8, 2015)

33. Whether or not the mega-IPOs are included, identifying trends from the historical data is challenging due to the small sample size.

34. WilmerHale. 2014. *2014 IPO Report*. Washington, DC: WilmerHale, p. 2.

IPO AVERAGE SIZE COMPARED TO BHB-LISTED COMPANIES (US$ MILLION)



SOURCE: ZAWYA ISLAMIC IPO MONITOR, THOMSON REUTERS EIKON WILMERHALE 2014 IPO REPORT AND THOMSON REUTERS ANALYSIS.

there is a challenge in using the above data to predict whether future public offerings can provide liquidity for venture capital-backed companies. The size difference has the biggest impact for whether companies can access public markets—whether to provide investors with liquidity or raise growth capital—because many of these costs are likely to be fixed regardless of the size of the offering. The requirements on most main markets are cost prohibitive for smaller issuers. Furthermore, in Bahrain in particular, the secondary market is limited, with trading volumes in 2014 being just 3% of the market capitalization of listed companies and under 3% of GDP (even with a slump in trading volumes, a comparable number in the United States exceeds 100% of GDP).[35] This has led some exchanges in the region to create second tier listing venues, specifically designed to ease these requirements while also maintaining investor protection.

New 'Junior' Exchanges Could Open Doors for VC Exits

Two efforts within the GCC are making an impact on opening capital markets to smaller issuers: one in Bahrain (where Zain Bahrain was the only company to complete an IPO on the main market in 2014) and one in Qatar (where only the QR 3.2 billion (US$ 890 million) mega-IPO was completed in 2014 and it is included in 2013 data because the subscription period began in December). In Qatar, the Qatar Exchange Venture Market is specifically for smaller companies with an operating history; a one-year track record with audited financials is required for listing.[36] There is no specific minimum level of working capital required for

35. Bahrain Association of Banks. "Bahrain Bourse index records 14pc growth in 2014," *Bahrain Association of Banks*, February 9, 2015. http://banksbahrain.org/news&key=bahrain_bourse_index_records_14pc_growth_in_2014 (Accessed May 9, 2015). US data is based on data through 2012 in the World Bank's *World Development Indicators*.

36. Qatar Exchange. "Listing SMEs on Qatar Exchange," http://qatar.smetoolkit.org/qatar/en/content/en/53616/Listing-SME%E2%80%99s-on-Qatar-Exchange- (Accessed May 17, 2015)

Hasan Haider

Tenmou, Chief Executive Officer

HASAN HAIDER is currently the Chief Executive Officer at Tenmou — the first Business Angels Company in Bahrain. Hasan started his entrepreneurial activities by launching FILM2GO, an innovative start-up venture that provides online DVD rentals, with free delivery and pickup. Hasan also has several years of investment experience, most recently as a Portfolio Manager at SICO Investment Bank. He graduated with a BSc (Hon) in Economics from University College London (UCL), and is a CFA Level 2 candidate.

What would investors expect in terms of the holding period for a venture capital fund? Would they expect/prefer an exit via acquisition by a global firm, acquisition by a local/regional firm, listing on a local/regional stock exchange or listing on a global exchange?

Typical LP interests in VC funds have a holding period of 10 years, with possible 2 year extensions. A report has recently identified that the majority of funds have a holding period exceeding that term, up to 14 years in total. However, the GPs themselves tend to have a 5-7 year term for each investment to exit. In the MENA region, the best expectation of an exit is an acquisition by a company not in the region looking to expand. We haven't seen any regional tech startups exit via an IPO yet.

What risks are investors willing to bear in terms of extending the length of their investment in a portfolio company because an exit route is not well developed?

Investing in any emerging market ecosystem, the probability of an exit at significant valuations of >US$ 100 million is not a rational excpectation. The majority of acquisitions happen in the US$ 20 million – US$ 50 million range. As such, all investments should be made with that exit valuation range in mind. The best philosophy for investing in VC in emerging markets is that pioneered by Silicon Valley-based 500 Startups, using modern portfolio theory to invest in a massively diversified portfolio of early stage investments to diversify out the risk inherent in VC. The holding period for VC funds in emerging markets is a minimum of 10 years.

How has the investment landscape and investor perception changed vis-à-vis the prospects for exits and the anticipated return for a "successful" investment in Bahrain?

Bahrain has developed a strong angel investment following, with an awareness of the term, which has led to a positive perception in most investors' minds when looking at investing in startup projects. However, Bahrain, and the region as a whole, still has gaps in the equity financing lifecycle to get a startup to a position of exit. Greater investment by angel investors, the development of a region-wide seed fund using 500 Startups investment philosophy, as well as more series A and B VC funds are required. Bahrain has some promising startups, but we are several years away from the first successful exit in Bahrain.

Are previous acquisitions of Gulf-based firms by global multinationals representative of what companies would be able to expect in the future?

The acquisition of Talabat.com by the Rocket Internet Group was a positive development for the region. However, that is more than likely the outlier rather than the typical investment exit that one should develop their expectations on. Nevertheless, it was a positive sign that the development of the ecosystem is progressing towards a more sustainable environment for startups.

A Bahraini woman checks stock exchange levels at Bahrain Stock Exchange in Manama. REUTERS/HAMAD I MOHAMMED HM/SA

SELECTED LISTING AND REPORTING REQUIREMENTS FOR GCC AND GLOBAL EXCHANGES

	Qatar Exchange Venture Market	Bahrain Investment Market (proposed)	Bahrain Bourse Main Market	London Stock Exchange AIM Market	NASDAQ Capital Market
Minimum subscribed capital	QR 5 million (US$ 1.37 million)	BD 200,000 (US$ 530,000)	BD 500,000 (US$ 1.33 million)	None	US$ 5 million
Working capital requirement	None but an 'adequacy' statement is required	Sufficient for 12 months after listing	Maintain financial soundness including assets more than 20% above paid-in capital	None	None
Minimum market capitalization	None	None	Should exceed value of paid-in capital	None	US$ 50 million (US$ 15 million of publically-held shares)
Minimum free float	10%	10%	n/a	None	At least 300 shareholders
Sponsor required	No	Yes	No	Yes	No
Reporting period	30 days (quarter) 45 days (semi-annual) 90 days (audited annual)	90 days (annual) No time requirement specified (semi-annual)	90 days (annual) No time requirement specified (semi-annual)	6 months (annual) 3 months (semi-annual)	90 days (annual) 45 days (quarter)

SOURCE: BAHRAIN BOURSE, QATAR EXCHANGE, LONDON STOCK EXCHANGE, NASDAQ.

companies to conduct an IPO but the company must have an "adequacy of working capital" statement prior to listing.

The minimum subscribed capital for a company to become public on the Qatar Exchange Venture Market is QR 5 million (US$ 1.37 million). It requires 50% of the nominal value of the paid-in (100% for companies selling shares in a public offering). It also requires a minimum of 10% of the total outstanding shares to be free float (shares available for trading). Companies must disclose all events which affect the price of securities, as well as any pending lawsuits against the company. They must provide notice of annual general and extraordinary general meetings 15 days in advance, as well as quarterly reports 30 days after quarter-end, semiannual reports 45 days after the period end and audited financials within 90 days after year-end. The Qatar Exchange Venture Market said that it has a short-list of companies planning to launch on the new exchange, but the exact number has not yet been announced.[37]

The effort within Bahrain is at an earlier stage, with a Consultation Paper released by Bahrain Bourse in December 2014, and a pending launch in 2015.[38] The rules for the Bahrain Investment Market, which seeks to target "growing companies seeking access to growth capital", are not finalized, but cover similar requirements as the Qatar Exchange Venture Market.

The Bahrain Investment Market relies upon Sponsors as the gatekeepers, to ensure that companies are suitable for listing and that they follow the disclosure requirements. These disclosure requirements include a requirement for material information to be disclosed through the Sponsor and to market participants. It requires directors to act in the interests of shareholders as a whole, as well as limiting the sales by directors, pre-listing shareholders and larger shareholders with a two-year lockup. It also requires that the distribution of shareholding should provide an orderly secondary market "and be unlikely to lead to a corner situation in the Shares".[39]

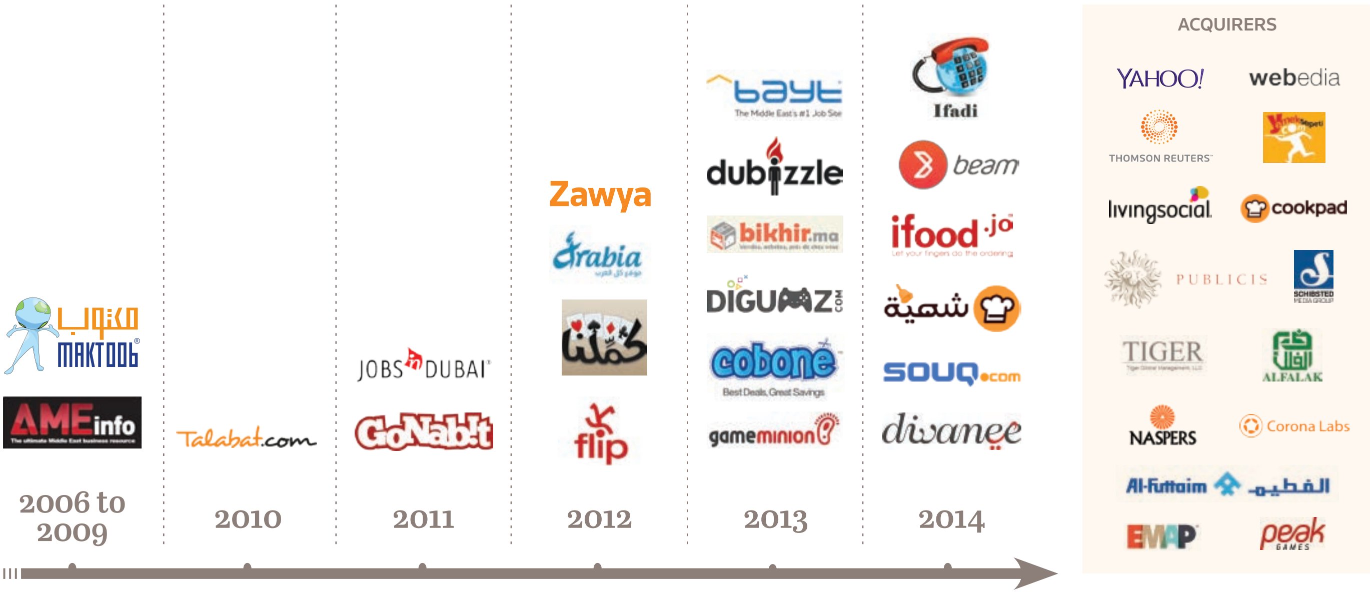
Additional requirements include audited financials at the end of the year, and unaudited semiannual reports signed by two directors. The sponsors, who remain the gatekeepers for the market, must have a physical office in Bahrain and must meet fit and proper criteria that include no disciplinary action in any markets where they operate outside of Bahrain. There is no market capitalization requirement, a minimum share capital of BD 200,000

37. Amlôt, Dominic. "Short-list being drawn up for Qatar's Venture Market,"*CPI Financial*, March 10, 2015. http://www.cpifinancial.net/news/post/30464/short-list-being-drawn-up-for-qatars-venture-market (Accessed May 8, 2015).

38. Staff writer. "Islamic REITs to be launched," *Gulf Daily News*, April 23, 2015. http://www.gulf-daily-news.com/NewsDetails.aspx?storyid=400536 (Accessed May 8, 2015).

39. Bahrain Bourse. *Consultation Paper: Bahrain Investment Market (BIM Rules)*, December 2014, p. 13, §3.3.3.3.

EXITS ARE INCREASING IN THE ARAB INTERNET SPACE: RETURNS ARE MATERIALIZING



REFERENCE: PRESENTATION ABOUT "VC EXPERIENCE" DURING THE 8TH WAQF FUND ROUNDTABLE "VENTURE CAPITAL — BUILDING THE NEXT PHASE OF ECONOMIC DEVELOPMENT IN BAHRAIN", IHSAN JAWAD, HONEYBEE TECH VENTURES.

(US$ 530,000) is needed, there should be no qualification on the audit statement and the company ought to have sufficient working capital for the 12 months following listing.

The requirements for companies to be listed on the Bahrain Investment Market are lenient compared to the main market and, in some ways but not in others, comparable to markets such as the NASDAQ Capital Market or London Stock Exchange's AIM Market. More lenient listing requirements are intended to provide greater opportunity for SMEs, including those financed by venture capital investors, access to the capital markets to raise capital and to eventually be able to monetize the investments. The requirement of the two-year lockup for substantial shareholders following direct offerings on the Bahrain Investment Market is likely to be somewhat onerous for investors looking for liquidity, and is longer than lockup periods in other markets that provide much shorter windows such as between 90 and 180 days, which is typical in U.S. markets (though not required by law for registered offerings including IPOs). For unregistered offerings, substantial shareholders and insiders have a longer lock-up period under Rule 144, but it typically does not exceed a 12-month holding period.

There are valid reasons for a more stringent policy in making a relatively underdeveloped secondary market work by limiting the offerings to those that have a high chance of success. However, depending on the input from market participants and the experience of the market once activity commences, a review of these rules may be warranted. This is particularly true given the limited opportunities that exist today, especially in Bahrain, for companies to generate liquidity for their investors, whether through a private sale or a public offering.

Recommendations

The recommendations represent the discussion with leading experts and market practitioners, desktop research, interviews and case studies.

- Revision of existing rules that limit foreign ownership of technology companies, specifically in sectors that are frequently financed by venture capital. Foreign ownership in Bahrain is determined based on economic activity, with few sectors restricted to citizens/GCC nationals. This includes technology companies operating in these sectors. The policymakers should allow special exceptions to enable foreign owners in technology companies to compete with business in these traditionally restricted sectors, e.g. Uber competing with car rental companies, technology firms operating in the media space etc.

- Survey global and regional companies that have made acquisitions of GCC companies to identify remaining barriers to acquisition of businesses in the region. Survey target companies to identify why they preferred a private transaction versus a public listing.

- Promote greater liquidity for VC investors without requiring companies be listed by facilitating the development of the OTC market that enables investors to sell shares in private companies to other qualified investors.

- Incorporate rules required for the facilitation of venture capital businesses within the Bahrain Investment Market framework that is being developed by Bahrain Bourse. This can be facilitated by assessing all activities in the secondary market for companies that are bought in IPOs with market capitalization of less than US$ 500 million and for companies listed through the Qatar Exchange Venture Market.

- Explore the viability of publicly listing more government-related companies to increase the size and the trading volume of the Bahrain Bourse, creating a vibrant exit market for venture capital.

4

Shariah Considerations

- Venture capital in its present form is not as closely connected to mudarabah and musharakah as often believed because of the underlying structure and other provisions used by investors to protect themselves from expropriation when they make minority investments in startups.
- Some of the structures used in venture capital were originally developed for tax efficiencies that are not necessarily relevant in the (income and corporate) tax-free jurisdictions like Bahrain; hence alternative structures can be considered.
- AAOIFI standards for modern corporations allow for the mixing of conventional and Islamic investors in venture capital, but prohibit commonly used preference share structures.
- Some of the protections to minority investors that preference shares offer can be replicated using Shariah-compliant governance structures instead of redemption (put) rights.

↑ **Visitors discuss property deals near a model of a project during the Gulf Property Show at the Bahrain International Exhibition Center in Manama.**
REUTERS/HAMAD I MOHAMMED

Introduction

The similarities between venture capital and the profit-and-loss sharing concept in Islamic finance have been frequently elaborated.[40] Yet the presence of Islamic venture capital is marginal at best. If the industry aims to make profit-and-loss sharing truly a greater part of the Islamic finance industry, it will have to address this issue.

One could partially explain the existing lack of Islamic venture capital by looking at country-specific factors about the lack of legal certainty and investor protection in many countries where Islamic finance exists today[41]. The limitation could also be due to more risk-averse social and cultural factors in these countries (discussed in Chapter 5).

Limits to 'Venture Capital as Mudarabah'

An alternative explanation, which ties into the specific way in which venture capital operates, might be that Shariah compliance adds to the challenges holding back the Islamic venture capital industry.

While many of the optimistic assessments of the similarities between Islamic finance and venture capital make light of the similarity with mudarabah contracts, in actual practice, the structure differs from a mudarabah. Due to issues of VC investors wanting to lock in additional security into their investments to protect themselves in a liquidation scenario, venture capital funds make their investments primarily in the form of convertible preferred shares.

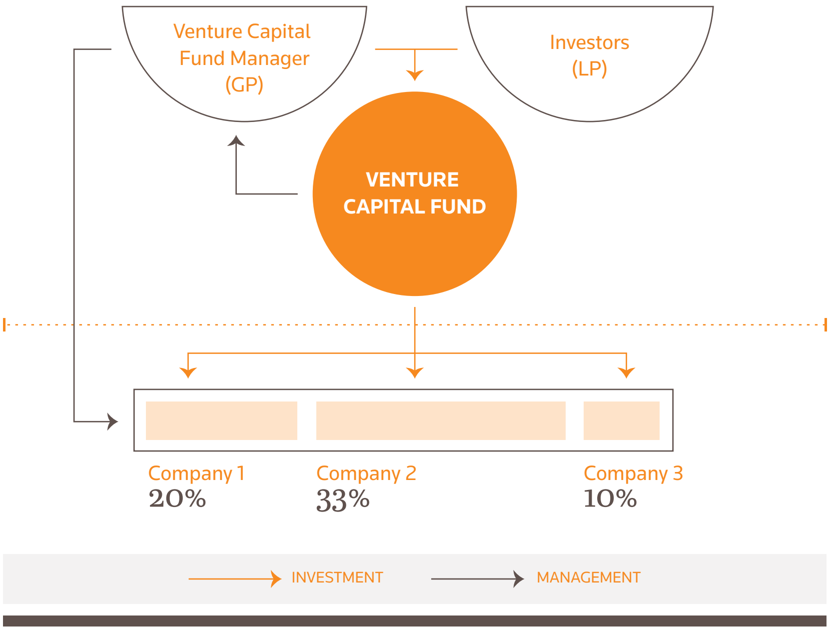
40. See for example Elseify, Elsayed. 2014. "Towards a model for Islamic venture capital," Paper presented at the 9th International Conference on Islamic Economics and Finance, Istanbul, Turkey, September 9-11, 2013 or Luyndijk, Joris. 2011. "Voices of finance: fundraiser at sharia-compliant venture capital firm," *The Guardian*, October 31, 2011. http://www.theguardian.com/commentisfree/2011/oct/31/voices-of-finance-venture-capital-fundraiser (Accessed May 17, 2015).

41. World Bank. *Doing Business 2015 Regional Profile 2015: Middle East and North Africa.* Washington, DC: World Bank, pp. 7-8.

Stanford Law School's Ronald Gilson and others argue that the convertible preferred share structure is used because it provides the company's founders and its employees with better tax treatment of the incentive compensation they are paid.[42]

Whatever the reason, the use of convertible preferred shares has become a standard practice for venture capital and is used well beyond the U.S. market where it developed (and even in markets where the tax appeal of the convertible preferred shares does not exist). In the case of the GCC region, the impediment created by the Shariah non-compliance of convertible preferred shares, as well as its irrelevance from a tax perspective, could be substantial.

STYLIZED DIAGRAM OF RELATIONSHIP BETWEEN INVESTORS, VENTURE CAPITAL FIRM AND INVESTEE COMPANIES



SOURCE: AUTHOR'S DIAGRAM BASED ON MUTALIP, ABDULL, AND LUTFI, AHMAD (2009), ISLAMIC VENTURE CAPITAL AND PRIVATE EQUITY: LEGAL ISSUES AND CHALLENGES, GLOBAL FINANCIAL SERVICES AND ISLAMIC BANKING, AZMI & ASSOCIATES

Risk sharing in Islamic venture capital

Islamic venture capital is strongly aligned to the principle of profit-and-loss sharing, based on risk sharing between a mudarib and a rabb-ul-mal or, more frequently, between two different partners in a musharakah. Venture capital funds are typically structured as limited liability partnerships (LLPs) where the venture capital management company serves either as a mudarib or wakeel (depending on whether the structure is based on profit-sharing or agency or both). If the venture capital managers also put capital to work alongside external investors (which is common), the relationship shifts to be a musharakah with the venture capital management company acting as a managing partner and the investors as non-managing sleeping partners.

AAOIFI's Shariah Standard No. 12 covers modern corporations, including the types of musharakah arrangements that Islamic venture capital would use in a traditional limited partnership, provided that the articles of association allow for a mechanism of Shariah oversight. The oversight would be particularly important if the investors were a mixture of Shariah sensitive and conventional investors, including conventional banks, to ensure that the funding is not invested in non-compliant activities.[43]

The difficulty comes primarily around how the venture capital fund invests in its investee companies, including through the use of preferred convertible structures borrowed from conventional venture capital. It is easy to simply state that an Islamic venture capital firm should have no problem by simply switching to straight equity investments, but this may limit the investor appetite for such a fund. In particular, investors would lose their protection against dilution from future capital raising and could face potential loss of control from being a minority investor. Thus, Islamic VC funds would struggle against the conventional funds that have greater protection of their investments.

42. Ronald J. Gilson and David Schizer, Understanding Venture Capital Structure: A Tax Explanation for Convertible Preferred Stock, Stanford Law and Economics Olin Working Paper No. 230 (February 2002). 51 pages. https://www.law.stanford.edu/publications/understanding-venture-capital-structure-a-tax-explanation-for-convertible-preferred-stock

43. AAOIFI Shariah Standard 12, § 3/1/1/1-3

Sheikh Esam Ishaq

Shariah Scholar

SHEIKH ESAM ISHAQ is globally recognized as a leading Shariah scholar in the Islamic finance industry. He serves on the Shariah boards of standard setting bodies such as Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI) as well as several leading Islamic financial institutions including Al Baraka Islamic Bank (Bahrain), BankMuscat (Oman), Meezan Islamic Bank (Pakistan) and Gulf African Bank (Kenya). He holds a bachelors degree in Political Science from McGill University, Canada.

What is the significance of venture capital in the broader Islamic finance industry? Is there an alignment between the principles of venture capital and Islamic finance? And if so, how should a developed Islamic finance industry facilitate the growth of venture capital?

There are broad areas in the world of conventional finance where you have concepts similar to Islamic finance, but the format or structure is not aligned. Insurance is one such example where the purpose is Shariah compliant but the structure is not. For Islamic finance to be acceptable, we must fulfill both the practical form and content requirements or purpose. In venture capital we have the purpose fulfilled and have actual risk sharing, but it is formulated in a way that ends up with these preference shares or other instruments, and so the form is not in alignment. We have to avoid any structure where the capital or profit is guaranteed, as this is not acceptable in Shariah.

Shariah has a number of established institutions that promote similar concepts to venture capital, one of them being Zakat. Zakat is a form of tax, a wealth tax not an income one, where you are dis-incentivized to sit on cash, even if you are saving it for an acceptable purpose. We can say that the concept of Zakat encourages savers to take risk and participate in business ventures with their capital, in line with Shariah principles.

In terms of facilitating growth, I think that without the active intervention of governments or regulators, Islamic venture capital will not take off in Muslim countries. All industries have had some sort of protection in their early years until they can stand on their own. Even today in conventional finance, most laws are formulated to protect their local banks and the domestic banking industry.

What are the Shariah issues with preferences shares which are widely used in venture capital?

In Shariah, preference share are not acceptable if they are designed to provide a guarantee for the shareholder to have first access to the liquidation proceeds, in preference to other shareholders, regardless of structure. This is because it results in the guarantee of capital or returns, and this is not permissible. Investors are not entitled to any returns without risk, and risk is eliminated when a guarantee is imposed.

When it is a performing venture, investors share in the profits. But if even a portion of the capital or return is guaranteed, this will be considered Riba, and is not permissible.

The losses have to be shared in line with the capital contribution but the distribution of profit does not have to reflect capital contribution or equity ownership. Most contemporary scholars accept that profit distribution can be in any ratio agreed among partners, and it may also be an inverse of the capital provided. This opinion gives a big margin to maneuver. This is fine as long as in the first distribution all parties share in the profits.

So we could have a structure where losses must be shared based on capital contribution, but in terms of profit distribution, we could create a tiered structure above a specified hurdle rate?
You can give the investor that incentive, provided the entrepreneur is willing to make this sacrifice in order to get the investor on board. However, it is strongly encouraged that as the profit increases and you move up the tiers, the profit distribution becomes fairer between the parties. The point is in that in the end, it should be fair.

It is acceptable to incentivize the investor for participating in a high risk venture by giving him a higher return compared to his capital contribution. But if the venture keeps performing well, it should move towards a more equitable distribution.

What is your opinion regarding preferred access to certain assets in terms of liquidation? Do you have the scope to expand what you consider to be the due responsibilities of the entrepreneur? And in case they fail, could we have different liquidation procedures in terms of the assets?
This is not acceptable and is unanimous amongst scholars. You cannot stipulate that if a firm is liquidated, some shareholders have first access or recourse to certain assets such as motor vehicles, software copyrights etc. Partners must share equally in all assets of the venture.

Without the active intervention of governments or regulators, Islamic venture capital will not take off in Muslim countries. All industries have had some sort of protection in their early years until they can stand on their own.

Investors can always ask for some sort of security against negligence or breach of the terms of the contract, but this can only be against agreed principles of business practices. This cannot be based on target rate of return or profitability of the venture.

Most clauses are stipulated in order to protect investors in case of negligence of the entrepreneur. How do we achieve this without transgressing Shariah? Where is the line drawn that you cannot cross over?

I suppose this will change from industry to industry. Negligence in the field of medicine is different than manufacturing or farming. In the event of negligence and dispute, independent experts must be involved to decide whether this is considered a normal situation or a result of negligence. There will always be grey areas, regardless of how much you stipulate as explicitly as possible.

Furthermore, stipulations agreed upon by all parties in an agreement do not mean that they are valid. Mutual agreement is a necessary condition for validity, but it is not sufficient. In the end, especially if there is a dispute, some clauses may not be regarded as Shariah compliant, and would not be considered valid.

Can investors protect themselves against a scenario where an entrepreneur decides to sell the business at a valuation which causes financial loss to the investor? We have to bear in mind that most privately owned start-ups especially in the technology sector do not have a ready market to determine their valuation independently.

You can stipulate that the entrepreneur cannot exit before having realized a certain return (this was recently proposed in a discussion about perpetual Mudaraba contract). However, this does not become binding in case of force majeure. In addition, this cannot be a perpetual condition, but valid for a certain time frame or with other considerations. The purpose of this is to prevent negligence and be used as extra security for the investors.

Personally, I think that there should be some caveats on the entrepreneur selling the company if it causes financial loss to the investor (and I mean real financial loss not the loss of profit or opportunity cost). The objective is to ensure that no party is being systematically disadvantaged or unfairly treated in the deal. However, more work needs to be done before a Shariah verdict can be given on this issue.

What about preferential voting rights? Can you stipulate that you cannot make certain business decisions without the approval of the investor or through a super majority? Can a hurdle rate be imposed by investors (e.g. 6% per annum to investors before dividends are distributed in any given period)?

From a broad and general point of view, yes you can as long as they are managerial and administrative decisions. Also, these rights should not have the effect of providing a guarantee or a specific rate of return on the principal investment.

With regards to the hurdle rate, I don't see why it would not be acceptable. In the end, the capital provider wants to ensure the best performance from the entrepreneur.

What is the Shariah perspective on special rights sometimes given to investors or entrepreneurs? These may include drag along or tag along provisions.

You can add ownership rights in terms of disposition, but not in terms of guaranteeing any returns.

Alternatively, clauses can be added to stipulate that some rights will only be exercised once a certain provision is achieved, such as a specified return. There is no explicit problem in general, but we will have to see on a case by case basis. In case of drag along, for example, a majority shareholder can force a minority shareholder to join (drag along) in the sale of a company, but the minority shareholder gets the same price, terms and conditions as the majority shareholder. Usually venture capital investors want to seek this right for themselves in order to make sure that they are able to sell the company at the best valuation possible. I do not see any Shariah issue here as long as it is agreed among the parties at the time of the contract.

Similarly, there are no Shariah issues in tag along rights which are used to protect a minority shareholder who gets the right to sell (tag along) his stake in the company if the majority shareholder is selling his stake. As in drag along, the terms and conditions remain the same for both majority and minority shareholders.

Do you see any other Shariah related issues to venture capital activities, and what would be the recommendations to address them?

The main issues relate to guaranteeing capital or returns, and preference for certain parties in case of a loss. As long as these issues are not being circumvented, most others venture capital norms can be adopted in a Shariah compliant manner.

PREFERENCE SHARES VS. STRAIGHT EQUITY STRUCTURE FOR VC INVESTORS

	Conventional VC fund	Islamic VC fund
Initial investment	US$ 10 million convertible preferred 40% ownership (valuation of US$ 25 million) Anti-dilution protection 5% annual cumulative dividend	US$ 10 million common equity 40% ownership (valuation of US$ 25 million)
Potential distressed sale at a reduced valuation	Sale of business for US$ 15 million in 1 year with agreement of VC investor	Sale of business for US$ 15 million in 1 year; no agreement by VC needed
Proceeds to VC investor	US$ 10.5 million (Gain = US$ 500,000)	US$ 6 million (Loss = US$ 4 million)
Proceeds to entrepreneur	US$ 4.5 million	US$ 9 million

Why simple equity structures are not used in venture capital

The table above illustrates why straight equity investments by an Islamic venture capital fund may not work and would be at a disadvantage to its conventional counterpart.

As shown in the above table, conventional VCs would be in a beneficial position vs. Islamic VCs in certain scenarios. If the entrepreneur decides to sell the company for US$ 15 million (lower than the US$ 25 million market valuation), the conventional VC fund will simply get his principal (US$ 10 million) back plus one-year generated dividends (5% of US$ 10 million or US$ 0.5 million). On the other hand, Islamic VC fund which owns 40% equity in the business will receive US$ 6 million (40% of US$ 15 million), incurring a loss of US$ 4 million on its investment.

Finding alternative ways to get the benefits of venture capital structures

Some of the potential Shariah compliant solutions that can be considered include implementing supermajority clauses, share lock ups or warrants. Supermajority clauses, with larger voting majorities than the simple majority for certain business decisions, could be used to protect investors where the entrepreneur does not command a supermajority of the voting rights.

A share lockup by the senior management could also be considered so that the entrepreneur cannot immediately flip the company to another investor and benefit disproportionately to his/her capital contributions. However, Elseify (2014) notes that in a musharakah investment, "parties are allowed to withdraw at any time [provided they] compensate for any damage caused to other partners". It should be noted, though, that this compensation is limited to actual damage and not potential losses.

Another potential mechanism would be the use of warrants granted by the entrepreneur to the venture capital investor allowing but not obligating the investor, under limited situations, to exercise the warrants.[45] The conditions under which the warrants would be exercisable would have to be sufficiently narrow to avoid the venture capital investor being able to use the warrants to capture more of the gain from the company's success than he/she were entitled to under the original agreement.

These options need to be considered and evaluated in more detail by Shariah scholars, who can propose potential Shariah compliant structures or solutions that address the needs of both the entrepreneur and the investors.

44. http://www.zawya.com/shariah-legal/standard/profile/20140325121814WL/AAOIFI__Sharia_Standard_No12__Sharika_Musharakaand_Modern_Corporations/

45. Elseify (2014) stated that "from [a] Shariah perspective warrants are permissible if used as a one side promise provided it underlays an equity type of investment not a loan".

Shariah issues relating to preference shares in conventional VC deals

Dr. Elsayed Elsiefy, Professor, Qatar Faculty of Islamic Studies

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We cannot use conventional venture capital without modification and claim it to be Shariah-compliant. Conventional VC investment can take different legal forms. The way in which funding is provided to the enterprise will determine many of the rights for the parties involved and will impact the method and timing of their return on the investments.

In addition, different VC investment structures can have different legal rights and different tax treatments. All of this, of course, depends largely on the law of the country in which VC investments operate. The most common forms of VC investments are equity (shares), convertible debt (a loan that can be converted into shares) and preferred shares. Whereas the concept of common equity shares in general is compatible with Shariah principles, preference shares and loans with interest are not accepted in Islamic finance.

Issue of preference shares

A key issue of difference between conventional VC and Islamic finance is preference shares. Regular shares are compatible with the Shariah and scholars accept the concept of limited liabilities; they consider shares a modified form of Islamic partnership contracts (musharakah and mudarabah). On the other hand, preference shares are not Shariah-compliant and rejected by most scholars. According to Islamic scholars, the main issue with preference shares is that they give rights to the owners of these shares without justifiable liabilities.

As a simple definition, preference shares have preference over common shares in the event of liquidation of the company. Preference stock has a face value which is paid out before looking at common shares.

VC investors typically require preference shares as a precondition to their investment that they receive certain protections and rights that are superior to those of the founders or early angel investors. Preference shares may give exceptional rights regarding the allocation of proceeds upon a sale, protection against future dilution, guaranteed board representation and certain negative controls.

Preference shares violate Shariah principles

If we look at the issues from the VC investor's point of view, they are investing in risky businesses that are still under development. The control of business is the entrepreneur's responsibility and it is usually the case that it would be the entrepreneur's first project. Investors would seek protection, which a normal partnership (using ordinary shares) would not offer, so they turn to a mixture of a partnership contract along with the security of a debt contract using preferred shares. A lot of money will be pumped in and there is a high probability of the VC investors losing that investment. So from their point

VC investment is a special kind of investment that we cannot consider fully as normal partnership that partners agree to set up

of view, it is justifiable to place conditions on the entrepreneur and be given preferred treatment over him. VC investors believe that the entrepreneur is the main party responsible for the failure or success of the project because it is his or her idea and he or she is the main person managing the business.

From a Shariah point of view, there can be no mixing of debt and partnership contracts. It is either equity finance contracts or debt finance contracts, each with their own sets of rights and obligations. It is unfair, from a Shariah point of view, for one partner to have more benefits than others, without justification.

In my opinion, VC investment is a special kind of investment that we cannot consider fully as normal partnership that partners agree to set up. It is usually investment in intangible assets and in ideas that are still under development. It is very difficult for VC investors to prove neglect or misconduct on the part of the entrepreneur. That is why VC investors ask for more than just being partners, and they seek more protection using different methods, one of them being preference shares.

The issue needs serious consideration by Shariah scholars and perhaps they can come up with an alternative Shariah compliant structure/solution that addresses VC investors' legitimate concerns without being unfair to the entrepreneur.

Recommendations

The recommendations represent the discussion with leading experts and market practitioners, desktop research, interviews and case studies.

- Undertake research on the permissibility, from a Shariah perspective, of convertible preference shares and similar other arrangements, keeping in mind the 'fairness' aspect for both entrepreneurs and investors.

- Convene a Shariah session to discuss alternatives to convertible preference shares and/or redeemable preferred shares, use of supermajority clauses, share lock ups and warrants.

5

Cultural and Social Fundamentals: an Ecosystem to Encourage Entrepreneurship

This chapter focuses on two major areas that affect the entrepreneurship culture in Bahrain:

1. Educational environment in Bahrain to foster entrepreneurship
2. Major factors driving SMEs

Side view of the 8th Waqf Fund Roundtable "Venture Capital — Building the Next Phase of Economic Development in Bahrain"

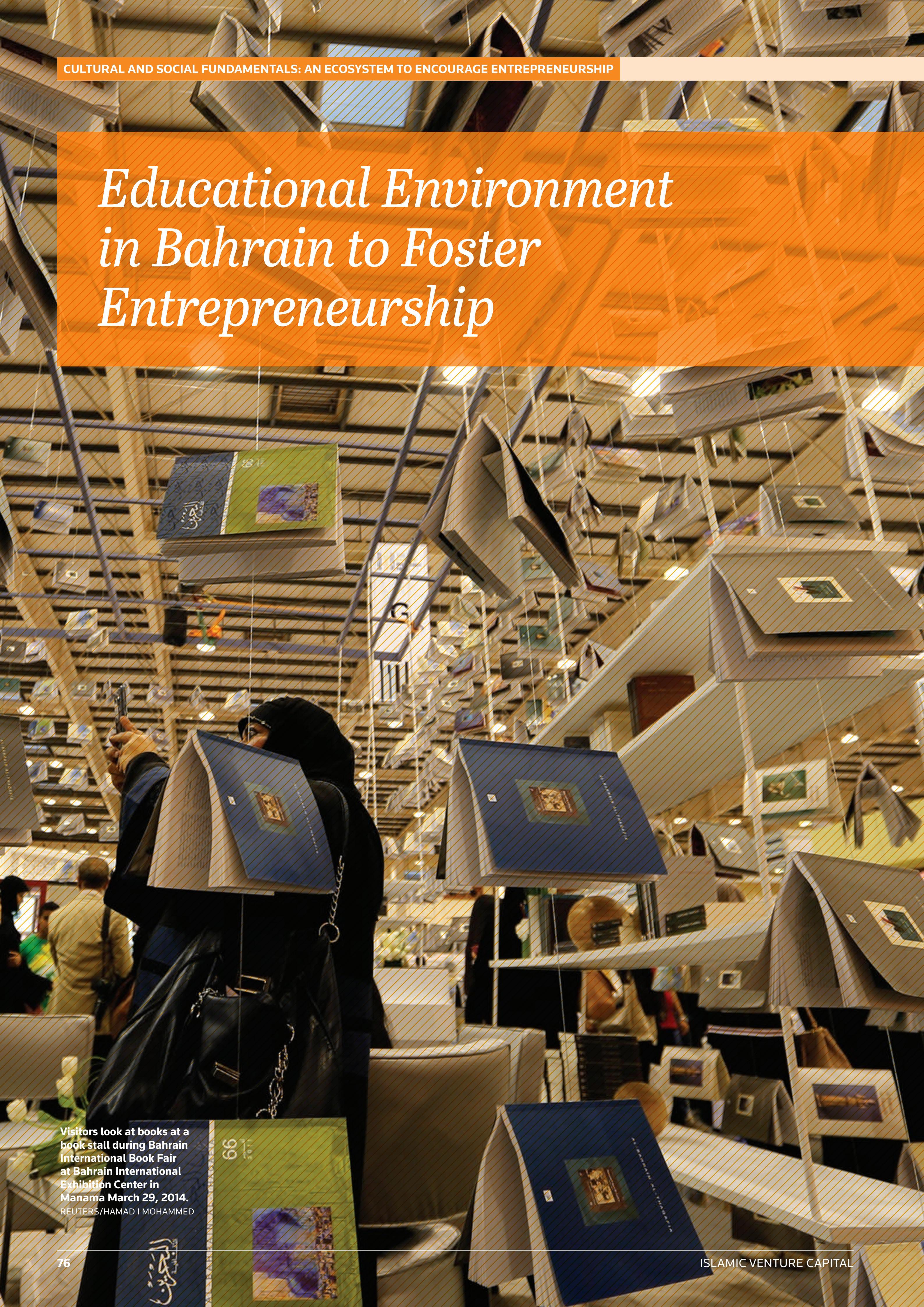
Factors that foster an entrepreneurial mindset and culture

The cycle of a business starts with an existing or anticipated future market need that has to be fulfilled. Those who undertake this task are called entrepreneurs. It is important to understand that entrepreneurship is more than mere creation of a business. It is a dynamic process of vision, change and creation.

Bahrain Vision 2030 aims for Bahrain to become a private sector-driven economy which is self-sustaining. Over the last 10 years, there have been major investments, both from the government and the private sector, in fostering a pro-business environment in Bahrain.

In the current economic environment, Bahrain faces a number of challenges that can only be met if it has well-educated, innovative and entrepreneurial citizens who have the spirit and inquisitiveness to think in new ways, and the courage to overcome the challenges facing them.

Educational Environment in Bahrain to Foster Entrepreneurship



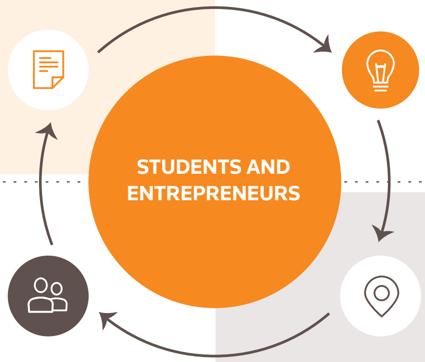
Visitors look at books at a book stall during Bahrain International Book Fair at Bahrain International Exhibition Center in Manama March 29, 2014.
REUTERS/HAMAD I MOHAMMED

Education is an integral part of creating and fostering an entrepreneurial mindset in individuals. The role education plays in developing the economy on a macro level is very significant.

There has been a growing debate about the role the education system plays in Bahrain in shaping graduates' entrepreneurial skills and mindset. The following sections in this report explain the evolution of entrepreneurship education in Bahrain, its importance for the economy and the challenges faced.

KEY AREAS IN TERMS OF WHAT, HOW, WHERE AND WHO TO TEACH ENTREPRENEURSHIP:

WHAT	HOW
Enhancing entrepreneurial behaviour and mindset	Interactive, learning-centered pedagogies
Building self-confidence, self efficiency and leadership	Multi-disciplinary programs and projects
Creativity, innovation, and ability to think "out of the box" to solve problems	Case studies, games, simulations, business plan competitions, etc
Managing complexity and unpredictability	Extensive use of visuals, digital tools, multimedia
Basic business and financial skills: "Business literacy"	Learning by doing / hands on
Opportunity identification	Experimental learning / labs (trial end error)
How to build, finance and grow ventures	Projects, internships with startups
Developing negotiation skills	Monitoring and coaching
Building relationships, networks and social capital	Interactions with entrepreneurs



WHO	WHERE
Students	At all levels
Teachers and school administrators	Across all disciplines
Business people amd leaders in other sectors	Compulsory and elective courses
Entrepreneurs	Informal systems (after school and other)
Mentors, coaches and advisors	Local schools and training institutions
Policy makers	Formal school systems (primary, secondary and tertiary)
	Community centers, NGOs, government agencies, banks, etc.

SOURCE: EDUCATING THE NEXT WAVE OF ENTREPRENEURS, WORLD ECONOMIC FORUM, 2009

Current practices/ initiatives

There are many initiatives in the market that target the educational development of young entrepreneurs through various stages of their education. The list below outlines some of these initiatives, their nature and the target audience:

High-School and University Education

InJaz Bahrain — "Be Entrepreneurial" and "Company Program": InJaz Bahrain focuses on nurturing the entrepreneurial spirit in the economy targeting young high-school students all the way through to university. Their programs "Company Program" and "Be Entrepreneurial" help students understand the challenges of being an entrepreneur or business owner. This is supported by insights from the educators, who are industry volunteers sharing their firsthand experience with the young, future generation.

Tamkeen Supported Educational Programs: There are various Tamkeen-backed educational programs that support young entrepreneurs to develop their knowledge, skills and experience (through practical participation). These are either facilitated by or funded through Tamkeen.

Trainings and Seminars

Universities, such as University of Bahrain, Applied Sciences University and Bahrain Polytechnic University, all hold various seminars, symposiums and training sessions on entrepreneurship open to students and the wider public. These sessions are led by markets leaders and leading educators.

Batelco Entrepreneur Programme. Formed in 2014, the Batelco Entrepreneur Program runs over five continuous Saturdays. It features talks by Bahraini entrepreneurs and business professionals, interactive lectures and inspirational training sessions, covering everything from finance and accounting basics, to marketing and business planning. The course shares real world experience from prominent business people who have had success in establishing a business.

Entrepreneurship Orientation Program (EOP) - Bahrain Development Bank. The orientation program supports potential Bahraini entrepreneurs who require training and guidance in starting their business. The program focuses on:

1. How to develop a business plan (business idea generation, business planning, implementation);
2. Analyzing the market;
3. Managing financials;
4. Considering new ideas for enhancing the business; and
5. Improving managerial skills and business knowledge.

The program is conducted over one week.

Incubation Centers

There are two main incubation centers in Bahrain:

Bahrain Business Incubation Center and University of Bahrain Business Incubation Center. The aim of these centers is to support the growth of the economy through:

1. Supporting the creation of new businesses
2. Improving the performance of existing SMEs
3. Supporting innovation
4. Promoting and developing synergies between larger firms and small enterprises.

UNIDO's Enterprise Development & Investment Promotion Program (EDIP). The prime function of EDIP is to stimulate the emergence of new enterprises and growth of existing ones that produce goods and services for trade, provide employment and income for people, and thereby contribute to poverty alleviation and overall economic growth.

The EDIP program has two main components: Enterprise Creation and Enterprise Growth. A third component of the program aims to develop institutional capacity to handle these two elements as well as to build up strong networks to ensure the program's long-term sustainability.

The EDIP program is organized in four stages and is aimed at helping potential entrepreneurs and investors translate their ideas into commercial ventures in the manufacturing and service sectors.
The four stages are:

1. Preparation & Empowerment (lasting 3-4 weeks)

2. Counseling & Technology Tie-Up possibly leading to a full-fledged Joint Venture (lasting up to 12 weeks)

3. Financial Linkages (no timeframe), and

4. Incubation, Growth Programs & Market Access (no timeframe)

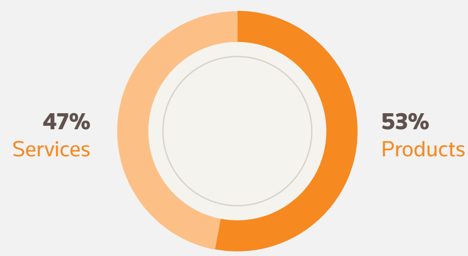
BUSINESS INCUBATION SPACE OFFERED AT BAHRAIN BUSINESS INCUBATOR CENTRE (BBIC)

Unit Type	Unit Quantity	Unit Area
Pre-Incubation (Virtual)	5	None
Pre-Incubation (Office)	13	10 sq m
Offices	39	25 – 48 sq m
Workshops	47	50 – 215 sq m
Enterprise	30	> 350 sq m

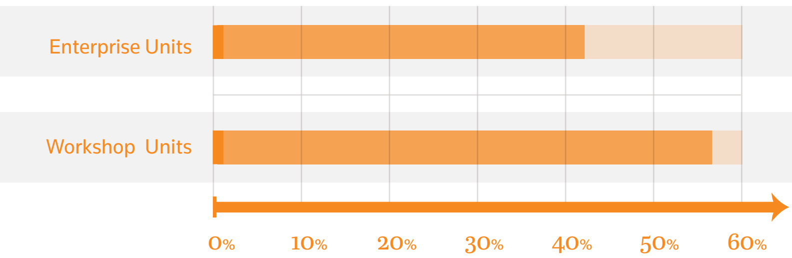
SOURCE: BBIC

BBIC STATISTICS 2014

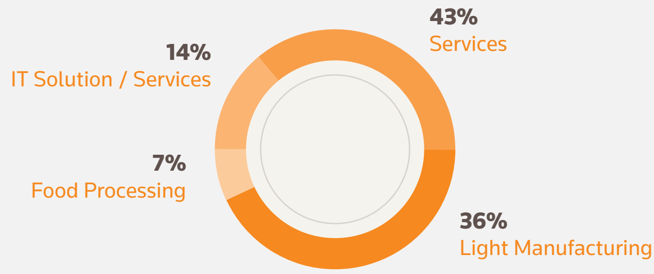
Type Of Business



Breakdown of Exporting Business
(14% of all Businesses Export)



Type of Sector



SOURCE: BBIC

Practices in other countries

↑ Donaukanal (Danube Canal) of Vienna, Austria. At the right the new UNIQA-Tower and opposite the historic building Urania, a public educational institute and observatory.

The following outlines some of the leading practices by either government or private sector entities in the field of entrepreneurship education:

Abu Dhabi University — United Arab Emirates

Abu Dhabi University incorporates "leadership and innovation" within the academic curriculum. In 2015, 20 Masters students, studying engineering, undertook courses on "Innovation and Entrepreneurship". These courses aim to foster a spirit of innovation and promote a culture of creativity and leadership among students. They also enable them to take advantage of research methodologies and encourage creative thinking as part of a commitment to respond to the directives of the leadership of the UAE. This initiative was formed under the banner of 2015 being the "year of innovation".

Government Strategy for Entrepreneurship in Education and Training — Norway

The Norwegian government has devised a strategy where entrepreneurship is ingrained in their educational system. The strategy focuses on ensuring that educational institutions collaborate with businesses and other relevant parties to promote an entrepreneurial culture. Students at all educational levels are included within the strategy and there are various levels for the different age groups.
The strategy ensures all areas of delivery are covered as follows:

1. Improving the knowledge base for teachers and educational establishments
2. Running conferences and seminars to raise awareness; exchanges of experience and best practice, and
3. Collaboration with organizations and networks outside government and international networking

Initiative for Teaching Entrepreneurship (IFTE) — Austria

The aim of this initiative is to develop and train teachers who facilitate entrepreneurship-related educational programs. An annual Entrepreneurship Summer School is held in Austria for the teachers to develop their skills and knowledge to facilitate vocational and academic training at both high school and university levels. The content of the program covers a broad spectrum with topics such as educational philosophy, business ethics, idea creation, how to implement new concepts and how to create innovative educational systems.

Institut Catholique des Hautes Etudes — Belgium

The Brussels Management School set up the DREAM program, a youth project in Belgium for 16-19 year olds that enables volunteer entrepreneurs or employers to share their experiences in the classroom or workplace.

The program has four goals:

1. Encourage young people to think about what job they want to do, or really 'dream' of

2. Provide advice on the skills necessary to make their dream happen

3. Stimulate and teach entrepreneurial spirit and attitude

4. Reinforce contacts between the school and the business community.

Bahrain Development Bank: Fostering an entrepreneurial culture

Areije Al-Shakar, Vice President, Bahrain Development Bank

AREIJE AL SHAKAR is Assistant Vice President, Deputy Head, Development Services at Bahrain Development Bank (BDB). She has recently completed her fifth year at BDB where her role and involvement at the bank includes training, coaching, business guidance and advisory, and business development. Areije has over 10 years of experience in banking and advisory. Previously she worked with BNP Paribas and Lehman Brothers on the Investment Management and Advisory side. She holds a Masters of Science in Public Policy and Management from the School of Oriental and African Studies, University of London and is a Certified Business Coach and Mentor from the Chartered Management Institute, UK.

The term "entrepreneurial culture" has steadily become a buzz phrase. It is an important factor to encourage innovation and creativity. The term is not foreign to our island Bahrain, which has been steadily developing an entrepreneurial culture, or as some may argue, re-surfacing this culture as Bahrain has historically been an island based on trade and entrepreneurship prior to the discovery of oil.

With the economic vision 2030 set in 2008 to shift from an economy built on oil wealth to a productive globally-competitive economy driven by a pioneering private sector[46], Bahrain has seen its entrepreneurial culture strengthening over the past 5-7 years. This cultural shift has been driven by various initiatives put in place by the government to encourage the private sector and create a knowledge-based economy fueled by innovation and creativity.

Bahrain Development Bank (BDB) is a public policy instrument which assists in the creation and development of SMEs in the Kingdom. Over the years, the services provided by BDB have been fundamental in the development of the SME segment in Bahrain and are catalysts for the establishment of start-ups and in the growth of existing SMEs. One of the aims of BDB is to foster an entrepreneurial, enterprising and innovative society. This drive has been led primarily by the Development Services Division within the bank.

Over the years the bank has worked to foster entrepreneurship. With a shift in economic focus away from the oil sector it is imperative to tease out this cultural mindset in order for it to grow more organically. It is never an easy task to bring about a change in culture or to establish a new culture but for Bahrain the transition should be easier since it is simply reverting to its historical roots as a trading hub.

Bottom-up approach

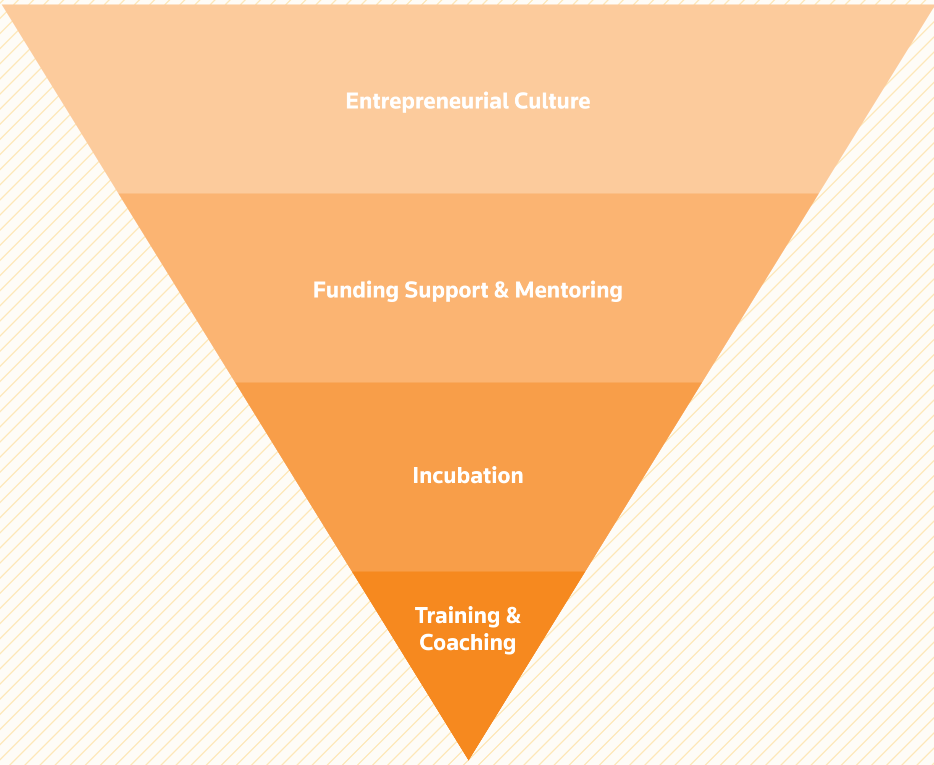
BDB contributes to fostering and promoting an entrepreneurial culture starting with training and coaching, highlighting success stories, mentorship programs, incubation and funding support (see Fig.1).The bank has adopted a bottom-up approach starting with the individual, i.e. the entrepreneur. The journey begins early with BDB's youth training programs.

Since 2009 BDB has focused on training the youth through the Entrepreneurship Orientation Program and other specialized youth training in partnership with local schools and universities. To date these initiatives have reached over 7,000[47] young people. We start at the high school level by planting the seeds of entrepreneurship in students. This has helped build awareness about what entrepreneurship fundamentally is and how it can be a career route after university. The bank started a specialized program called Takween with the Ministry of Education that began with a group of 20 students. This year the Takween program was extended to 700 students and has seen the success of many final year business projects actually entering the market as the students start university.

46. Bahrain Economic Vision 2030, Bahrain Economic Development Board http://www.bahrainedb.com/en/about/Pages/economic%20vision%202030.aspx#.VadshaSqqkp

47. Bahrain Development Bank Monthly/Yearly Development Services Report June 2015.

BDB APPROACH IN FOSTERING AND PROMOTING AN ENTREPRENEURIAL CULTURE



Entrepreneurs reflect the characteristics of the time and place they have evolved and Bahrain has been actively creating an environment for entrepreneurship to thrive and for entrepreneurs to reside not only locally, but to reach out to new frontiers in the global economy

Workers clean the windows of the Bahrain Business Center building in Manama March 8, 2011. REUTERS/ HAMAD I MOHAMMED

There is the argument for a trickle-down effect whereby an entrepreneurial culture creates wealth and jobs, and allows the public sector to redistribute some of that wealth to those unable to work

Training

Training has been identified as a key driver in developing an entrepreneurial culture as it sets the basis of understanding of what entrepreneurship entails and how it can be pursued as a career path. The bank offers training programs to all age groups and has specialized workshops offered throughout the year to help build awareness.

Coaching and mentoring

The next level up from training is coaching and mentoring. Once the entrepreneurial mindset has been instilled in the individual he/she needs support and guidance in starting up their business. The BDB offers coaching and mentoring through the holistic program Rowad which was officially launch in January 2015. Rowad consists of three main pillars: training and coaching, incubation and funding.

Through coaching and mentoring the individual or the founding team is further guided and empowered to start up their company through assistance provided in the form of business plan guidance, funding support, business incubation, etc. The bank also supports startups by offering offer space at an affordable rent.

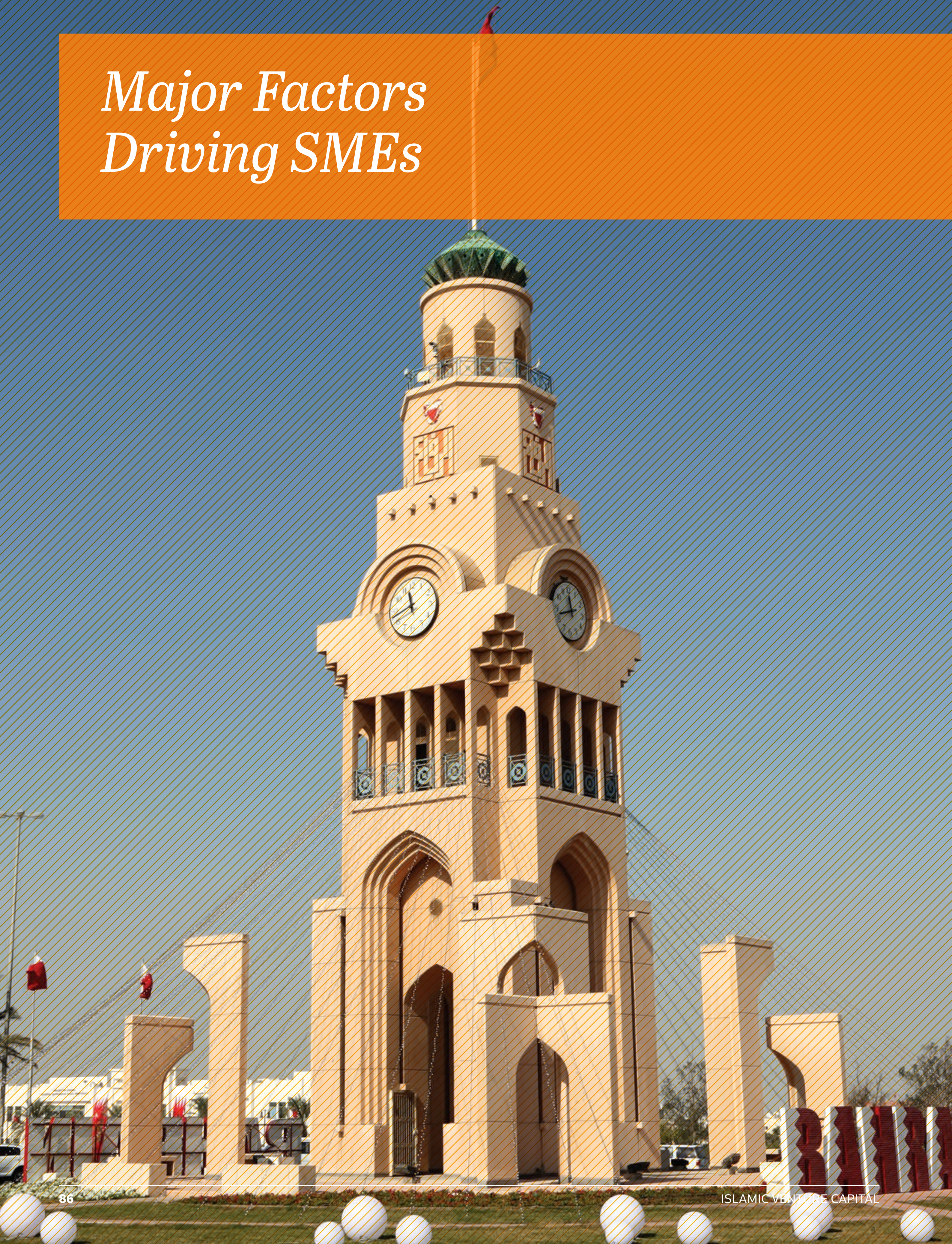
Developing clusters

In 2015 BDB shifted its focus slightly from just incubation to clusters. This element has furthered the bank's aim of fostering an entrepreneurial and enterprising society by creating specialized environments for industries to thrive. The specialized element began with the establishment of Rukn.me the ICT incubator currently in its soft launch. Another incubator being developed is an arts cluster at Al Andalus Garden in Salmaniya, Bahrain. Clusters have been known to encourage innovation, creativity and growth amongst companies within the same industry. The cluster model has been seen in the Silicon Valley and in educational districts or cities.

Translating entrepreneurial culture into macro-level success

It is quite evident that the initiatives put in place by the public sector in Bahrain are contributing to building an entrepreneurial culture in the country. How do these initiatives influence the macro environment? The existence of entrepreneurial role models and 'rags to riches' success stories have an effect on the long term psyche of the youth who wish to emulate the success of these people. Together with a conducive and supportive policy environment, a thriving venture capital inv dustry and global demand, it forms a virtuous cycle leading to macro level transformation of the economy and the society.

Major Factors Driving SMEs



There are many factors that drive individuals to start a business. It can come from a desire to start something from the ground up, to keep full control of different aspect of the business, to fulfill a market need with a new invention, or to achieve financial independence.

Over the last ten years, the business landscape evolved significantly globally and in Bahrain. There are many factors that have affected the behavior of established and aspiring entrepreneurs. We have classified them under the following categories:

Economic driven initiatives

Enterprise Support Fund (ESF) — Tamkeen. In 2011-12, Tamkeen launched the ESF program to support distressed SMEs with financial aid to cover some of their immediate debts to ensure the companies weather the economic slowdown and avoid insolvency.

Inventions/market needs

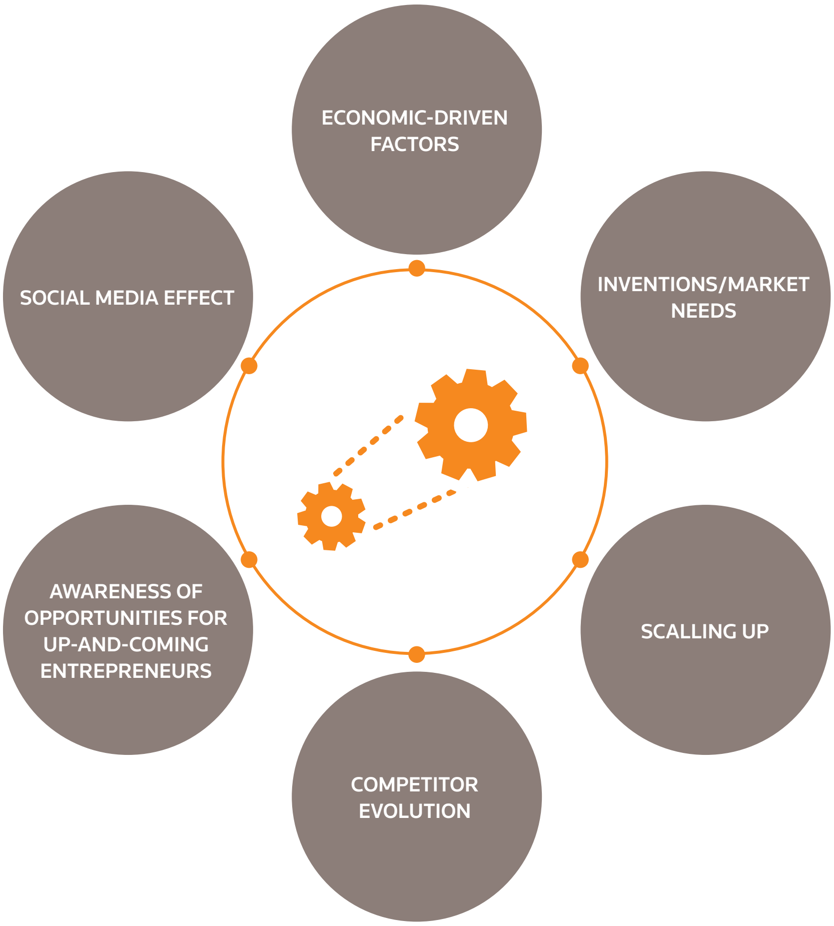
The following programs aim to foster innovation either directly or indirectly:

Mashroo3i — Business Competition. Mashroo3i, organized by Tamkeen, is an initiative founded by the Bahraini government to support the country's private sector. It aims to promote an entrepreneurial culture and instill a 'can do' attitude among young Bahrainis between the ages of 15 and 26.

Through Tamkeen's Mashroo3i Business Awards, Bahraini youth as well as the public get an opportunity to practically understand business planning and the path towards entrepreneurship.

Sheikh Nasser bin Hamad International Youth Creativity Award. The Sheikh Nasser Bin Hamad Award for creativity aims to help promote and develop innovation within Bahrain. It offers a platform to the youth to express themselves, showcase their talents, and get involved in the development of their nation.

MAJOR FACTORS DRIVING SMEs



SOURCE: THOMSON REUTERS

Innovation Association — Bahrain (Ebtikar Association)
Working with local, regional and international networks, Ebtikar provides a platform to support an innovation-led community in Bahrain. The main aim of the association is to coordinate the efforts between the various organs of the existing ecosystem to help boost innovation and development in the Kingdom of Bahrain in various sectors. Its founders are an eclectic group from both the government and the private sector, who include industrialists, businessmen, financiers and educationists.

Fab Lab (fabrication laboratory) Bahrain. The Bahrain chapter of the Fab Lab supports innovation by allowing creative people to turn their ideas into real physical objects through 3D printing, CNC milling, circuit production,

← **The Clock Tower Roundabout in Riffa.**
SHUTTERSTOCK/PHILIP LANGE

laser cutting/engraving and vinyl plotter services. This is part of a network connected to the Fab Foundation, set up by MIT's Center for Bits and Atoms to support the development of fab labs around the world.[48]

Tenmou. As the first Business Angels Company, Tenmou targets high potential entrepreneurs and offers full cycle support, from supporting the expansion of an idea to mentoring and raising financing.

Feasibility Study Support Scheme - Bahrain Development Bank Program. This program is part of BDB's offerings to support a company in taking its business forward. The study covers every aspect of a business that would be required to make a venture successful.

Scale-up

Enterprise Development Support Program — Tamkeen

Bahrain Development Bank (financing)

Finance Scheme — Tamkeen. This scheme has been developed by Tamkeen to support growth SMEs through subsidized financing from financial institutions. 50% of the interest that would be due to the lending/financing institution is covered by Tamkeen.

UNIDO - Enterprise Upgrading Program. The UNIDO program is designed to:

1. Help existing entrepreneurs redefine business processes by analyzing current performance of their enterprises;
2. Facilitate entrepreneurs in opportunity mapping for growth in relation to the inherent potential that an enterprise has and the impact of external factors on growth; and
3. Ultimately, help entrepreneurs develop core competencies and strategic awareness leading to sustainable growth.

Awareness of opportunities for up-and-coming entrepreneurs

The list below outlines some of the initiatives that are on offer to aspiring and established entrepreneurs:

Government-backed programs:

- Tamkeen-backed programs are marketed in every media outlet available for wide exposure (e.g. social media, websites, newspapers, flyers, billboards, ads in magazines).
- Bahrain Development Bank programs and financing are also heavily advertised through various media outlets.
- UNIDO programs are not as heavily advertised but most entrepreneurs would be informed about the UNIDO programs from the Tamkeen and BDB programs.

Reality TV — Business shows. The following are examples of TV shows in Bahrain that develop the skills of Bahraini youths and promote the entrepreneurship culture:

- The Mission
- Hala Bahrain

Literature. The following are examples of literature available to entrepreneurs in the market:

- Startup Bahrain
- Entrepreneur's Journal - BDB Magazine
- BizBahrain
- Co-ED

Recognition. Below are the main recognition initiatives to celebrate the success of Bahraini entrepreneurs:

- Bahrain Entrepreneurship Award
- Sheikh Nasser bin Hamad International Youth Creativity Award

48. Fab Foundation. "Setting up a Fab Lab," http://www.fabfoundation.org/fab-labs/setting-up-a-fab-lab/ (Accessed May 17, 2015).

A traditional fishing boat (Dhow) lies at the sea-shore due to bad weather and low-tides at the cost line of Bahraini capital Manama, June 13, 2005. REUTERS/ HAMAD I MOHAMMED

Practices in other countries

Illuminated boats float on Hong Kong's Victoria Harbour during the opening ceremony of the East Asian Games December 5, 2009.
REUTERS/BOBBY YIP

The following outlines some of the leading practices in other countries by either government or private sector to spur entrepreneurship investment, innovation and creativity:

SME Creativity Center — Hong Kong (China)

The SME Creativity Center (SCC) is an initiative that focuses on creating a platform for SMEs to explore creativity and innovation. The center acts as a think-tank, incubation center and social entrepreneurship center combined to provide guidance to local SMEs.

Innovation and Entrepreneurship — The Governor's Office of Business and Economic Development (USA)

The Innovation and Entrepreneurship unit focuses on creating an environment that fosters entrepreneurship. It aims to advance the wider objective of long term economic growth through constant innovation. This is achieved through the program Innovation Hub (iHub) in California.

Entrepreneur of the Year Award — Ernst & Young

Considered the leading entrepreneurship award in the world, the EY Entrepreneur of the Year program is a global program that is run by EY in over 50 countries across six continents. Each year, entrepreneurs are invited to enter in one of three categories: emerging, industry and international. The candidates go through an interview and a judging process, after which 24 entrepreneurs are shortlisted. The shortlisted finalists are put through a strategic program to determine the winner.

Television programs featuring entrepreneurs

There are a few very popular television shows that feature entrepreneurs and their journey seeking funding. It started with "Money Tigers" in Japan, which later became "Dragons' Den" in the UK. "Shark Tank" is currently on U.S. television screens.

Recommendations

The recommendations represent the discussion with leading experts and market practitioners, desktop research, interviews and case studies.

- Introduce training programs for teachers delivering training on entrepreneurship to students, ensuring that they have the necessary skill sets, experience and training.
- Educational institutions should promote specialized entrepreneurship undergraduate and postgraduate degrees. Additionally, the option of dual majors should be encouraged, especially to those students that excel in a certain academic area and also have an entrepreneurial mindset.
- Hire industry professionals at market competitive salaries to teach entrepreneurship at university level.
- Entrepreneurship education should be provided to primary, intermediary and secondary school students to have a prolonged exposure to the concepts and practices of entrepreneurship, rather than only being taught in higher education or university studies.
- Although simulation business programs currently exist (such as mini-enterprise, mashroo3i and InJaz Company Program), additional virtual programs should be created, which replicate all the functions of real businesses in both structure and practice. Under the guidance of teacher-facilitators and business mentors, students should be able to create and manage their virtual businesses from product development, production and distribution to marketing, sales, human resources and accounting/finance.
- Businesses in Bahrain should be encouraged to scale up and branch out to other GCC / MENA countries. The Ministry of Industry and Commerce (MOIC) or Economic Development Board (EDB) should support businesses by identifying and strategizing how they could penetrate new markets and assist in facilitating these scaling up initiatives.
- Government backed business incubators should support companies in exploring less capital intensive growth strategies including franchising, joint ventures and licensing agreements.
- A special program should be created to help businesses understand how to use social media to promote their activities. This could be a combination of workshops/training programs and amending regulations to further facilitate e-business solutions.
- Create strategies for specific sectors that have a development gap in Bahrain’s economy and where investors are aiming to fund startups to meet the market demand.
- Create a portal where aspiring entrepreneurs would have direct access to established business mentors with industry-specific expertise readily accessible to guide the next generation.

Angel Investor Angel Investor is an individual who provides capital to one or more startup companies. Unlike a partner, the angel investor is rarely involved in management. Angel investors can usually add value through their contacts and expertise.

Bridge Loans Bridge loans are short-term financing agreements that fund a company's operations until it can arrange a more comprehensive longer-term financing.

Business Incubator An organization designed to accelerate the growth and success of entrepreneurial companies through an array of business support resources and services that could include physical space, capital, coaching, common services, and networking connections.

Capital Gain Capital gain is the gain to investor from selling a stock, bond or mutual fund at a higher price than the purchase price. The capital gain is usually the amount realized (net sale price) less the investment (adjusted tax basis).

Crowd Funding A new trend in raising money. It is the practice of funding a project or venture by raising small amounts of money from a large number of people.

Deal Flow The rate at which investment offers are presented to funding institutions.

Entrepreneur An individual who, rather than working as an employee, runs his/her ownbusiness and assumes all the risk and reward of the business venture. The entrepreneur is commonly seen as a business leader and innovator of new ideas and business processes.

Entrepreneurship The process of starting a business (start-up), typically based around an innovative product, process or service.

Holding Period The length of time that an investment is held.

Hurdle Rate The minimum rate of return on a project or investment required by a manager or investor.

Mudarabah A kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the other, who is called "Mudarib" and the profits generated are shared in a predetermined ratio.

Musharakah A joint enterprise or partnership structure with profit/loss sharing implications that is used in Islamic finance instead of interest-bearing loans.

Pre-Seed Capital Usually the first investment the startup receives; generally from an angel investor, but can also be from incubators and accelerators.

Private Equity Refers to the holding of stock in unlisted companies — companies that are not quoted on a stock exchange. It includes forms of venture capital

Private Placement When securities are sold without a public offering. Generally, this means that the stock is placed with a select number of private investors.

Risk Capital Funds made available for startup firms and small businesses with a high degree of risk.

Seed Capital The initial capital used to start a business. Seed capital often comes from the company founders' personal assets or from friends and family.

Shariah Is the Islamic legal system derived from the religious precepts of Islam, particularly the Quran and the Hadith.

Silicon Valley Is a nickname for the southern part of the San Francisco Bay Area in California, United States. It is home to many of the world's largest high-technology corporations, as well as thousands of technology startup companies.

Trade Sale Sale of one firm to another, the common exit route of venture capital investment.

Venture Capital Capital invested in a project in which there is a substantial element of risk, typically a new or expanding business.

Venture Capitalist An investor who either provides capital to startup ventures or supports small companies that wish to expand but do not have access to public funding.

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Roundable overview

The Waqf Fund organized its 8th Roundtable Discussion on 28th April 2015 at the premises of the Central Bank of Bahrain. The topic of the Roundtable was "Venture Capital — Building the Next Phase of Economic Development in Bahrain". The half-day session was attended by a select group of forty senior professionals including CEOs of Islamic banks, entrepreneurs, academics, Shariah scholars, CBB officials, AAOIFI, CIBAFI, International Finance Corporation, audit firms, law firms and Waqf Fund board members.

The format of the Roundtable was a number of presentations covering the various aspects of the topic, followed by open discussion among the participants. The focus was on coming up with a set of recommendations, duly supported by further research and executive interviews conducted by the Thomson-Reuters team subsequent to the Roundtable. The recommendations given at the end of each chapter combine the discussion at the Roundtable and other primary and secondary sources.

Speakers

MR. IHSAN JAWAD
Honeybee Tech Ventures,
Founder

MR. RALPH KIETEL
Acting Global Manager,
IFC/World Bank

MR. SOHAIB UMAR
Advisor, Islamic Financial Services Development,
Central Bank of Bahrain

MR. SOHAIL MALIK
Executive Director,
Venture Capital Bank

Roundtable attendees

No.	Organization	Name	Designation
1	Bahrain Bourse	Shaikh Khalifa bin Ebrahim Al Khalifa	CEO
2	Bahrain Development Bank	Emilio Escartin	Head of Investments
3	Bahrain Institute of Banking & Finance (BIBF)	Ahmed Al Rayes	Head
4	Economic Development Board	Jarmo Kotilaine	Chief Economist
5	General Council for Islamic & Financial Institutions (CIBAFI)	Dr. Ginanjar Dewandaru	Economist
6	Honeybee Tech Ventures	Ihsan Jawad	Founder
7	Individual	Shaikh Nizam Yaquby	Shariah scholar
8	Individual	Shaikh Esam Ishaq	Shariah scholar
9	International Finance Corporation/ World Bank Group	Ralph Kietel	Acting Global Manager
10	International Investment Bank	Aabed Al Zeera	CEO
11	International Investment Bank	Dr. Farid Bader	Board Member
12	Investcorp	Rishi Kapoor	CFO
13	J. Equity Partners	Dr. Ahmed Al Jawhary	Founder
14	Kuwait Finance House	Abdulhakeem Al-Khayyat	CEO
15	QFIS- Hamad Bin Khalifa University, Qatar Foundation	Dr. Elsayed Elsiefy	Professor
16	The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	Dr. Hamed Hassan Merah	CEO
17	Trowers & Hamlin	Nick Green	Partner
18	Venture Capital Bank	Sohail Malik	Executive Director
19	Central Bank of Bahrain	Khalid Hamad	Executive Director Banking Supervision/Chairman, Waqf Fund
20	Central Bank of Bahrain	Sohaib Umar	Advisor, Islamic Financial Services Development
21	Central Bank of Bahrain	Naveed Muzaffar	Specialist
22	Central Bank of Bahrain	Fahad Yateem	Head
23	Central Bank of Bahrain	Fatima Al Fadhel	Head
24	Central Bank of Bahrain	Khadija Ahmed	Superintendent
25	Central Bank of Bahrain	Mariam Jowhary	Superintendent
26	Central Bank of Bahrain	Ali Al Mahmood	Senior Analyst
27	Central Bank of Bahrain	Fajer Al Busmait	Senior Analyst
28	Central Bank of Bahrain	Fatema Al Saad	Senior Analyst
29	Central Bank of Bahrain	Basma Al Jar	Analyst
30	Central Bank of Bahrain	Hassan Al Kaabi	Financial Analyst
31	Central Bank of Bahrain	Mubarak AlBuflasa	Analyst
32	Central Bank of Bahrain	Nabeel Juma	Analyst
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39	University of Bahrain	Dr. Farid Hadi	Head of Islamic Banking Department
40	National Bank of Kuwait	Mohamed Saleh	Deputy General Manager

Notes

VENTURE CAPITAL

BUILDING THE NEXT PHASE OF ECONOMIC DEVELOPMENT IN BAHRAIN

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