

1. Creating an enabling environment for SMEs

Introduction

Small and Medium Sized Enterprises (SMEs) constitute up to 85 percent of the private sector in the MENA region. The contribution of formal SMEs to the economy is estimated to be up to 60 percent of GDP and up to 70 percent of employment on average across the MENA region.

SMEs create spill-over effects in society in terms of dynamics between each other, and they create an overall higher level of productivity. They are not locked in bureaucratic ways of operating and are thus faster in the implementation of new technologies and approaches. This implies that, besides creating jobs, SMEs are contributing to moving a society in a more modern and dynamic direction.

Nevertheless, SMEs find it very difficult to set up and grow their business as they face a long list of financial and non-financial constraints. For this reason we must seek to assist SMEs in dealing with their specific challenges, by focusing on the following:

- To increase the formal business sector
- To increase the number of entrepreneurs
- To increase growth among SMEs
- To increase share of SMEs with international activities
- To increase the incentives to run a formal business

Current status

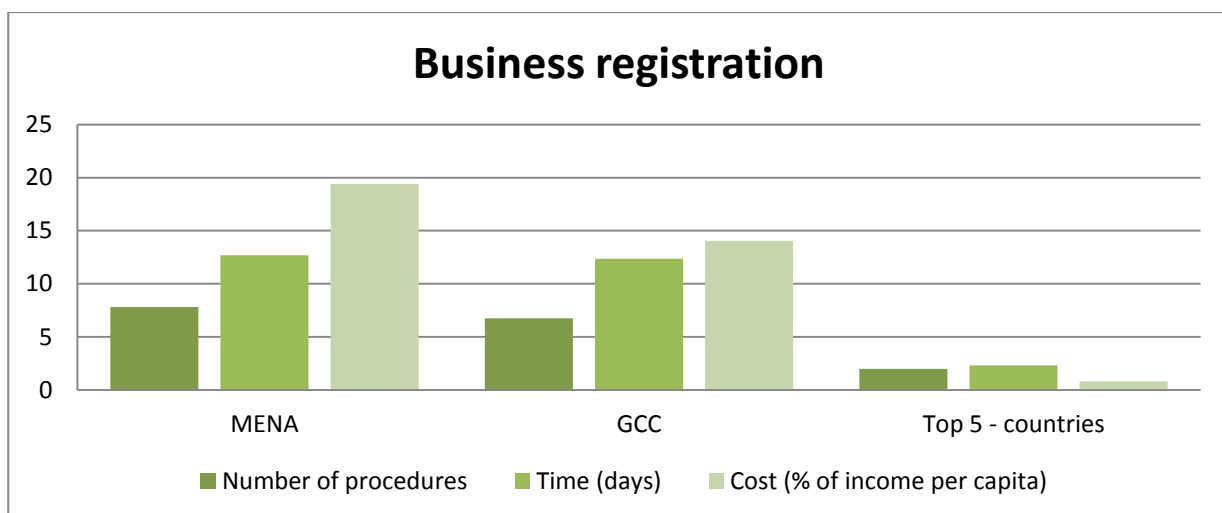
On the basis of feedback from SME member companies in the region, a varied image is presented showing constraints, potentials and improvements in relation to creating an enabling environment for the SMEs. The overall image presented shows a need for better business conditions, but also acknowledges reforms already implemented to improve these conditions.

The Arab world lags behind other regions in access to credit and in the deployment of movable collateral systems. According to World Bank Enterprise Surveys (2010), the Arab world had the smallest share of firms (25 percent) with credit lines or loans from financial institutions, and substantial collateral requirements (82 percent of loans require some type of collateral). Although most banks are already engaged in SME

lending to some degree, feedback from member companies shows that this accounts for a very small fraction of total loans and is still at an infant stage.

Many of the companies in the region that have managed to work around the issues of credit, express that they experience limitations in terms of exporting their products which is not only a limitation to the company in question, but also to society at large.

Exporting in the Arab world takes an average of 21.3 days, and importing 24.9 days. In OECD high-income economies exporting and importing take less than 11 days on average. A study focusing on Asia-Pacific Economic Cooperation (APEC) economies estimates that cutting the days needed to clear exports by half could enable an SME to increase its share of exports of total sales from 1.6 percent to 4.5 percent. A study in Sub-Saharan Africa estimates that reducing exporting costs by 10 percent through improvements in the efficiency of the trade process increases exports by 4.7 percent.



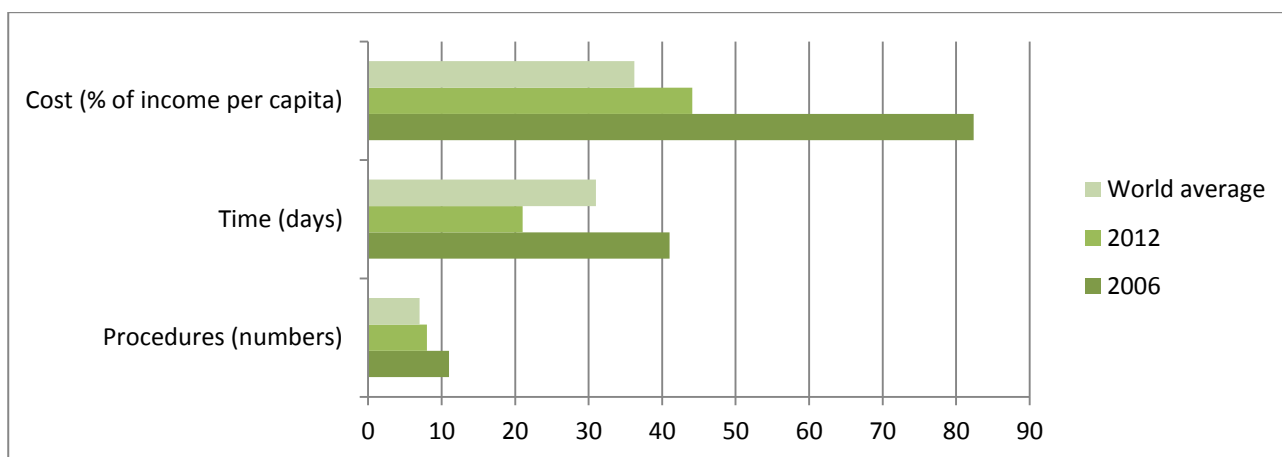
Source: World Bank, 2012

For SMEs to thrive, the basis for growth and innovation need to be in place, and in this respect member companies of the AE-Network have experienced constraints, especially in terms of labor skills and expenditure on R&D.

A survey conducted by the World Bank on the constraints on growth in the MENA region supports this, as the survey showed that constraints on labor skills appeared to have the largest negative impact on growth in the region.

These constraints increase the so-called innovation gap between developed and developing countries which is a comparison of the expenditures on research and development in the different regions. Gross Domestic Expenditure on Research and Development (GERD) as a percentage of GDP highlights this as it shows that developing countries on an average spend 0.6 percent of GDP, Arab states in Africa 0.2 percent and developed countries 2.2 percent. This entails that GERD per capita in developing countries is around \$20, in Arab states in Africa \$7, and in developed countries \$377.

The member companies of the AE-Network, however, acknowledge the efforts already made, and overall the MENA region have, through a number of different reforms, made it easier to start a business in the region. This is shown in the figure below.



Source: World Bank

Key challenges to SME development:

Access to Information

“Many of our member companies argue that their business suffers from insufficiency in the provision of information, mainly due to slow and cumbersome processes, limitations in scope, and only access from isolated institutions.” Member AE-network

For the achievement of broader development goals, including economic development, poverty alleviation and social cohesion, SMEs are crucial instruments. It is imperative that SMEs have access to adequate business information to facilitate market access and improve productivity.

Best practice from the region

Jordan seeks to get more new businesses and investments in the formal economy and has, as part of this, set grand goals for information dissemination and improvement of business entry procedures.

Jordan is now using information and communication technology to automate business processes, and procedures have become more effective, simplifying registration processes, and cutting the number of procedures in half, unifying company databases and streamlining workflows. Future steps include putting the application process online and uniting the various entities involved on one website.

Access to Foreign Markets

“We focus on our home market as we do not have the necessary resources to access the foreign markets, and this seems to be the case for most of my business network”, Member AE-network

Many SMEs still depend largely, or solely, on their domestic markets. At the same time many SMEs are already exposed to strong international competition even within their own domestic markets. Studies have shown a direct link between internationalization and increased performance. Internationalization reinforces growth, enhances competitiveness and supports the long-term sustainability of the company. It is important to raise awareness not only about the benefits of internationalization, but also about the awareness of existing programs to support SMEs when they decide to go international.

Best practice from the region

Tangier Free Zone (TFZ), near the Ibn Battouta International Airport in Morocco was established as leverage for developing investment and export in the country. TFZ is operating as an export processing zone and includes agri-food, textiles and leather, metallurgy, mechanical, electronics, chemical and high technology. The ambition is to create 47,000 jobs in 10 years and increase the competitiveness of domestic industries. Goods entering and leaving the TFZ are not subject to the national legislation on foreign exchange, and commercial and industrial activities as well as services for overseas markets enjoy total exchange freedom whatever the nationality and residence of the operator. Furthermore The Tangier Free Zone functions as a one-stop-shop for investors in the sense that all the administrative procedures are done on site.

Access to Finance

“Our experience is that our members have trouble getting access to the funds they need for growth or innovation, and often the requirements to financial structure and collateral are unrealistic”, Member AE-network

Even before the economic downturn began in 2008, some small firms had trouble getting funds for their business activities. Whether they need a car loan to start a delivery business or venture capital for a production start-up, SMEs often find it difficult to access finance.

Best practice from the region

In Lebanon different programs exist, which are directed towards SME's access to finance. One such program is Kafalat, which is a Lebanese financial company with a public concern that assists SMEs to access commercial bank funding. Kafalat helps SMEs by providing loan guarantees based on business plans and feasibility studies that show the viability of the proposed business activity. The guarantee that is made in favor of the lending bank, allows the borrower to provide the bank with collateral, which makes the loan safer for the bank. With the Kafalat loan guarantee, the bank may require less additional collateral for the loan. Kafalat constantly urges banks not to ask for other guarantees and to be content with the credit decision made based on the business plan and the feasibility of the project.

Human Resources

“How we can get more qualified workers, is a question we hear frequently from our members, and unfortunately the answer will often be unsatisfying for them, as skilled workers are hard to find”, Member AE-network

It is widely acknowledged that lack of information and knowledge prevents SMEs to reach their potential and to grow. However, it's seldom enough to just to make the information available. The issue is more complex. Without the necessary management skills, many viable companies with good product offers never reach their potential or might even risk being run out of business by competition.

Best practice from the region

To ensure a better educated youth Morocco undertook a national program “Education of Employment” (EFE) that seeks high-level institutional change by partnering with some of Morocco's largest universities. EFE has collaborated with more than 180 employers and 30 educational and institutional partners to create and deliver tailored curricula, place youth in jobs, and enhance the ability of traditional education institutions to improve the school-to-job transition.

EFE-Maroc is catalyzing Through partnerships with the University Hassan II in Casablanca and El Jadida, Chouaib Doukkali University in El Jadida and Abdelmalek Essaadi University in Tangier, Tetouan, and Assilah, EFE is sharing best practices and curriculum to help these universities improve the employment outlook of their graduates.

Best practice from the region

In 1996, the National agency for enhancing youth employment (ANSEJ) was created in Algeria, in order to support self entrepreneurship through young people and especially through new graduates of universities. A system was built up, in which projects agreed by ANSEJ and presented by young Algerians (whose age is between 19 and 35), can benefit from a very advantageous financing formula.

Amount of these projects can reach up to 10 000 Euros. 30% of the amount is granted by ANSEJ and state funds, and 70 % of the financing is completed by a bank loan with a guarantee of a specialized public institution.

At the end of the year 2011, 232 508 small enterprises were created thanks to this system (ANSEJ). 14% of the financed projects benefited to women.

Innovation

“We would like to engage our members more in partnerships and initiatives challenging and developing our industry, but funding and relevant information is almost impossible to get”, Member AE-network

SMEs face increasing competition not only for sales, but also for technical know-how and skills. Many SMEs lack the necessary resources (human, knowledge and financial) to participate in innovation project, and at the same time the SMEs often also lack information about relevant partners (e.g. companies, universities and research institutions). In the current financial situation, SMEs also experiences difficulties in getting the necessary funding.

Best practice from the region

Lebanese Industrial Research Achievements' (LIRA) objectives are to encourage university-industry cooperation towards building a knowledge-based economy, match university research with industry needs, and offer a national platform for potential new products and services (supporting university-based research labs). The instruments to help achieve the objectives consist of an annual Conference and Exhibition for Research Achievements, regular contact with industrialists and universities/vocational schools, and coordination and cooperation with other Arab and International organizations that share similar objectives

Following several workshops in the MENA region with the participating BMOs of the AE-network and leading international experts, as well as feedback from the vast member base of the Arab-EU Network, the main constraints towards the development of an enabling environment for SMEs have been identified. On the basis of this the network has identified four recommendations that are easy to implement and that are based on best practices from the region.

Recommendations for the governments of the MENA region

- Actively and financially support Industrialists to participate in international sectorial exhibitions to help them access foreign markets and promote domestic products.
- Put in place financial support schemes specifically targeting exporters, supplemented by programs aimed at assisting exporters in tapping into new export markets (including technical capacity building and promotional support programs).
- Assist SMEs to access commercial bank funding by providing loan guarantees to reduce the risk of the loan for the bank and thereby provide incentives for commercial banks to be less risk averse. This should ensure access to credit for sound business projects without having to provide collateral.
- Encourage university-industry cooperation towards the building a knowledge-based economy as well as launch programs to match university research with industry needs.

MENA Small Business Act

SME development should be the first, and main, priority for the governments in the MENA region when drafting any new law or policy. In order to assist the governments of the MENA region with this task, the AE-Network has set up 10 guiding principles that, if followed when drafting new legislation, will improve the environment for SME for the benefit of the entire economy and society at large through inclusive growth and job creation.

To create a level playing field for SMEs and ensure that these can utilize their full potential, the Arab-EU Network set up 10 principles which should guide the design and implementation of policies and laws in the MENA region every time a law is being drafted.

1. Create an environment in which formal businesses can thrive and are rewarded
2. Policies should promote good corporate governance and fight corruption and improve transparency
3. Encourage and support SMEs in the MENA region to benefit from European Market
4. Facilitate SME's access to finance and develop a legal and business environment supportive to timely payments
5. Fixed dates for when business regulation will come into force
6. Design rules according to the "Think Small

