Arab Development Symposium II: Invigorating SMEs in the Arab World

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Introduction: In March 2010, the Arab Fund for Economic and Social Development and the World Bank (Middle East and North Africa Region) agreed to hold joint high-level development seminars around issues pertaining to the Arab World. These would be held on a regular basis, every 18 months or so, at the Arab Fund premises in Kuwait. The first symposium focused on “Food and Water Security in the Arab World” and took place in March 2011. The second, the topic of this MENA K&L Quick Note, analyzed “Micro, Small and Medium-Scale Enterprises (MSMEs) in the Arab World” and was held in June 2012.

Employment and Poverty Challenges in the MENA Region: Over the next decade, the MENA region, which has the highest youth unemployment rate in the world, needs to generate 40 to 50 million jobs just to absorb the new entrants into the labor market. This is four to five times the current rate of job creation. Meanwhile, 12% of the 350 million people living in the Arab World are below the poverty level of USD 2 per day. The rural-urban dichotomy has also widened measurably due to the steady migration of rural populations to urban centers in search of employment.

MSMEs in the MENA Region: Currently, there are around 19 to 23 million MSMEs in the MENA region, 10% of which are in the formal sector with the remaining 90% in the informal sector. SMEs employ 4 to 35% of total employment, and account for 20-35% of private sector employment compared to 49% in the OECD set of countries. The finance gap facing medium size enterprises is estimated at $200-250 billion with $50-70 billion for small size enterprises.

Global Lessons on SMEs, Growth and Employment: There are major definitional problems regarding SMEs across countries in the world and,
in some cases, within the same countries (depending on the nature of the institutions dealing with SMEs). Such disparities tend to distort the role and impact of SMEs. Notwithstanding this issue, the empirical evidence is mixed about the role of small and medium size enterprises in growth, job creation and innovation. In OECD countries, studies show that small enterprises create more jobs (60-70%), contribute more to growth (approximately 50%) and introduce more process and product/service innovations than large firms.

In 2005, the European Commission reported that approximately 23 million SMEs provide about 75 million jobs and represented 99% of all enterprises in the enlarged EU. The Boltin Committee in the UK claimed that small enterprises are the ‘seabed’ and ‘incubators’ for innovation, entrepreneurship, and worker learning. The Small Business Administration in the US attributes most of the growth and employment generation to small enterprises. With modest growth prospects and exceedingly high unemployment rates, especially among young males and females in the Arab countries, how can SMEs be energized to help generate job opportunities, bolster shared growth, improve competition, and reduce poverty?

Other studies show that large size enterprises are the real engine of growth and job creation (net). A 2012 study by Bob Rijkers on MSMEs in Tunisia\(^2\) concludes that the firms most responsible for job creation during the period between 1996 and 2010 have been small startups (11-100 employees) and large firms (over 100 employees). This conclusion is corroborated in other empirical studies on Morocco, Ethiopia and Indonesia. Caroline Freund (2012)\(^3\) indicates that SMEs are less productive and account for a smaller share of productivity growth, and that mature SMEs have a low survivability rate. On the other hand, large firms have the capacity to attract more resources, adopt newer technologies, increase levels of resource productivities, penetrate new markets and grow faster than SMEs.

**Challenges and Opportunities for SME Development:** There are several reasons behind the modest contribution of SMEs to growth and employment in the MENA region: weak institutions, poor regulatory environment, scarcity of skilled labor, and access to finance. At the same time, the literature and empirical analysis are mixed about the merits of direct government support for SMEs.

This notwithstanding, there is a clear appreciation of the role of SMEs in economic development, particularly at a time when the region is going through unprecedented turmoil precipitated by poor governance and dire unemployment. The reinvigoration of SMEs would therefore provide some response to the crisis. A regional approach to promoting SMEs would have the added benefit of enhancing regional integration among MENA countries—a region which is one of the least integrated in the world. Finally, micro enterprises have an important development role as they stimulate economic inclusion, particularly among women and youth.

**Recommendations:** The main recommendations are divided into two areas: policies and institutions. The following represent the critical set of institutional business enablers that are necessary for the growth of MSMEs: i) a credit risk guarantee entity, ii) a credit bureau and registries, iii) a central micro-finance coordinating entity, iv) private venture capital firms, v) a specialized micro financing bank, and vi) a professional association to represent MSMEs. On the policy side, there are two sets of policy recommendations: financial and non-financial.

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