WHAT'S HOLDING BACK THE PRIVATE SECTOR IN MENA?

LESSONS FROM THE ENTERPRISE SURVEY

KEY FINDINGS

European Bank for Reconstruction and Development
European Investment Bank The EU bank
WORLD BANK GROUP

European Bank for Reconstruction and Development
1 Exchange Square
London EC2A 2JN

Telephone: (+44) 020 7338 6000
Internet: www.ebrd.com

European Investment Bank
98-100, boulevard Konrad Adenauer,
L-2950 Luxembourg

Telephone: (+352) 43 79 22000
Internet: www.eib.org

International Bank for Reconstruction and Development / The World Bank
1818 H Street NW
Washington, DC 20433

Telephone: (+1) 202 473 1000
Internet: www.worldbank.org

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EXECUTIVE SUMMARY

Over the last few years, the Middle East and North Africa (MENA) region has witnessed unprecedented transformation. In the Arab Uprisings, thousands of young people took to the streets to voice their frustration with the lack of economic and social opportunities. These events reflected demands for improvements in living conditions, infrastructure, job quality, education, and healthcare services, as well as better governance.

The Arab Uprisings were a response to the failure of the region's economic models to satisfy people's needs and expectations. These models typically featured strong protectionism, lack of integration into international markets, misguided state intervention, and inadequate support for a business environment that fosters innovation, entrepreneurship, and good management practices.

Enhancing the prospects for more inclusive growth—with accessible opportunities for sustainable employment, particularly for young people and women—is vital to raise living standards, to underpin stability, and to offer an alternative to economic migration out of the region. There is an overwhelming consensus among economists that the development of a vibrant private sector is essential for delivering that growth. Creating an environment that is conducive to private sector development depends on a detailed understanding of the key drivers of private firms' performance and the major challenges of the business environment in which they operate.

LESSONS FROM THE MENA ENTERPRISE SURVEY

This report is an assessment of the constraints on private sector development, which has been jointly conducted by the three leading international institutions active in the MENA region. The report presents the results of the MENA Enterprise Survey (MENA ES) conducted in 2013 and 2014 in eight middle-income economies in the region: Djibouti, the Arab Republic of Egypt, Jordan, Lebanon, Morocco, Tunisia, the West Bank and Gaza, and the Republic of Yemen. Implemented and co-financed by the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the World Bank Group (WBG), the MENA ES provides data on a representative sample of the formal private sector.

Covering more than 6,000 private firms in the manufacturing and services sectors, the MENA ES includes data on the experiences of firms with a broad range of dimensions of the business environment, including access to finance, corruption, infrastructure, crime, and competition. The surveys also provide information on firm characteristics and the cost of labor and other inputs; workforce composition and women's participation in the labor market; trade, innovation, and management practices.

This unique set of information is an extremely valuable complement to the macroeconomic data most commonly used by researchers. Firm-level data permit fine-grained analysis of the drivers of firm performance, disaggregating effects by key firm characteristics, such as their size, their sector, their inputs and output, and their involvement in innovation and international trade. The data also provide a window on how managers and CEOs themselves perceive the challenges and opportunities that they face. While the region is far from homogeneous, with managers reporting widely different experiences, analysis of the data helps to provide a basis for sound policies for private sector development.

FIRM PRODUCTIVITY AND THE BUSINESS ENVIRONMENT

While the formal private sector represents a small part of the MENA ES economies, it has the potential to become the driver of a more sustainable model of growth

Firms in the MENA ES have comparatively higher labor productivity than their middle-income peer economies outside the region; yet following global financial turmoil and the Arab Uprisings, their labor productivity has been declining. Moreover, higher labor productivity belies lower total factor productivity (TFP), in part due to relatively high use of capital.

Large firms, which provide the majority of formal private jobs in the MENA ES, tend to be more efficient, but their activities are skewed toward more capital-intensive production. In general private sector firms are typically small, old, and faced with limited growth opportunities.

On the positive side, economic fundamentals seem to be at work in the formal private sector. For example, it is the more productive firms that are the most likely to grow. After taking size into account, the most productive firms also have higher wage bills and greater access to finance. Encouragingly, these positive relationships reveal that in certain areas at least, market forces are working as might be expected. Policies should allow these forces to operate more efficiently.

Addressing key constraints in the business environment is vital to help the private sector grow

Addressing some of the key concerns of firms about the environment in which they operate is a way to unlock their transformative potential. In the MENA ES region, four particular areas of concern stand out: political instability, corruption, unreliable electricity supply, and inadequate access to finance.

Political instability is the leading concern for firms in most of the region, and it has a negative impact on sales and productivity growth

Reflecting the effects of the Arab Uprisings, unresolved social tensions, and conflicts in the wider region, political instability stands out as the greatest concern of firm managers and CEOs in Egypt, Lebanon, Tunisia, the West Bank and Gaza, and the Republic of Yemen. In most of these economies, political instability seems to have negatively affected firm and productivity growth.

High perceived levels of corruption are associated with lower growth of sales and employment, as well as lower labor productivity

Corruption stands out as a key concern of firm managers and CEOs. High perceived corruption is associated with lower sales, employment growth, and labor productivity. There is also evidence that corruption deters firms' interactions with public authorities, preventing them from making full use of available opportunities. In addition, concerns about corruption seem to go beyond petty corruption, possibly indicating deeper problems in the economies concerned, such as state capture by interest groups or elites, corruption at high levels, or even under-reporting for fear of potentially adverse consequences.

An unreliable electricity supply is a serious obstacle for firms in several economies

Unreliable electricity supply remains a significant problem for firms in Egypt, Lebanon, the West Bank and Gaza, and the Republic of Yemen despite efforts by some governments to tackle this problem. An irregular power supply accounts for a significant loss of sales for many firms, and is associated with lower productivity levels.

The relevance of poor electricity access as a constraint on firm growth should be read in the context of the overall institutional framework that characterizes the energy sector in the region. Many economies have used energy subsidies as a safety net when their systems of social welfare have proved inadequate or ineffective. But this is costly and, by distorting prices, there have been systematic incentives to move toward more capital-intensive technologies, linked with a lack of incentives for investment in critical infrastructure, while creating room for vested interests. As part of the reform program in recent years, various international institutions, including the IMF and the World Bank, have called for a comprehensive reform of subsidies to open the way to a more efficient energy sector.

Inefficiencies in the business environment are felt disproportionately by small and medium-sized enterprises

While several elements of the business environment—notably political instability, unreliable electricity supply, and inadequate access to finance—are widely reported as constraints on firms, inefficiencies stemming from these factors have a more negative impact on smaller firms. SMEs are more likely than large firms to report these three elements as major obstacles to their operations, though they are no more likely to report corruption as a major obstacle.

ACCESS TO FINANCE

Financial and banking sectors in the region are relatively large, but credit is mostly channeled to a small number of large firms

The financial sector of the MENA ES economies is dominated by a relatively large banking sector, with loans-to-GDP ratios above the standards in peer economies. Bank lending is highly concentrated, however, with credit targeting only a limited number of large companies, leaving the bulk of firms with little or no access to credit.

MENA ES firms finance their operations and investments in a similar way to firms in peer economies

There is considerable variation in the use of internal funds to finance operations and investments across the region. The use of bank credit and credit from suppliers and customers is in line with peer economies. Equity finance plays a negligible role in the region, while other sources of finance, including microfinance, are only significant in Tunisia and the West Bank and Gaza.

A large share of firms are not credit-constrained

The MENA ES economies have a smaller share of credit-constrained firms than other regions of the world. But this is not driven by successful loan applications; instead, many firms report that they have enough capital and thus do not need a loan.

There is a notable disconnect between firms and banks in the region

A significant share of firms that are not credit-constrained have disconnected from the banking sector altogether. Compared with firms that have encountered difficulties obtaining credit, the disconnected firms are more likely to be small, less likely to have audited financial reports, and less likely to use the banking system even for payments.

Disconnected firms resemble credit-constrained firms, as they both have low propensity to invest and are less likely to plan for expansion, even when capacity constraints are binding. The difference is that disconnected firms seem content with their current situation and do not complain about access to finance.

The business cycle alone cannot account for this pattern as a downturn may prompt firms to seek loans for purposes of liquidity management. It seems that many of the disconnected firms have adapted production strategies to an environment in which they do not consider banks as a financing option, albeit at the cost of reduced growth prospects.

Collateral standards affect firms' propensity to disconnect from the banking sector and ultimately their growth prospects

In the MENA ES economies, more than four in five loans require collateral with an average value of just over twice the loan amount, slightly above that in peer economies. The higher the relative collateral requirements, the more likely young firms are to disconnect from the banking sector. Older firms, on average, have more assets that they can use to secure loans and are relatively less affected by collateral standards. But they also create jobs at a slower rate than young firms and, as such, collateral practices may constrain employment growth.

Regardless of age, firms are less likely to disconnect from the banking sector and more likely to create new jobs if banks accept movable assets as collateral. Since a large share of firms' assets consists of machinery and equipment, banks' willingness to accept movable assets as collateral can be considered a business-friendly collateral standard. This suggests a potential link between the adoption of business-friendly collateral standards and the potential for job creation.

JOBS AND SKILLS

Compared with other regions, formal private sector employment is concentrated in manufacturing and exporting firms; but employment of women is low; and youth employment is strongest in young innovative firms

The structure of employment in the region's formal private sector is in many ways similar to comparable economies elsewhere, although the manufacturing sector and exporting firms play a comparatively larger role in providing employment, with the retail sector lagging behind.

The employment of women in a typical firm is much lower than elsewhere in the world, and the same is true for women as top managers and firm owners. Within the region, the share of women's employment is higher in labor-intensive sectors and among exporting firms. Youth employment is higher among firms that are young and fast-growing, and which tend to innovate.

Firm dynamics are generally weak, but high labor productivity firms are still more likely to grow fast

Overall, firm dynamics are weak in the region: comparatively few firms move between size categories, whether expanding or downsizing. In a difficult period for the private sector in the MENA region, medium-sized firms have been more likely to become small firms and less likely to grow over a three-year period, compared with other regions. Fast-growing firms over the period 2009-2012, however, had higher levels of initial labor productivity, an indication of reallocation of resources toward the more productive firms and a signal of potentially positive private sector developments.

Skills shortages affect the fastest-growing firms

Across the region, firms that have grown the fastest are more likely to perceive the lack of an adequately educated workforce as a major constraint. Unlike other firms, fast-growing firms are also more likely to invest in the formal training of employees, suggesting that the supply of relevant knowledge and skills is a severe constraint for the most promising, high-growth firms in the region.

More productive firms pay higher wages, but larger firms do not

The MENA ES results confirm the expectation that more productive firms pay higher wages. This suggests that labor markets are, to some extent, able to facilitate the reallocation of labor resources to the firms with the most potential to grow and provide rewarding jobs. Nonetheless, such high-productivity, high-paying private sector jobs remain scarce, which is likely to encourage jobseekers to pursue public sector jobs instead.

In most economies, larger firms pay higher wages, but that standard result does not hold in the MENA ES region. It seems that larger firms, which are more productive mostly due to inefficiently high capital intensity, focus on stronger capital remuneration rather than labor remuneration. This gives an indication that distorting incentives, which are at the base of the decision to favor more capital-intensive production, might also affect the quality and remuneration of jobs.

COMPETITIVENESS: TRADE, INNOVATION, AND MANAGEMENT

The growth of the region's small yet productive private sector may be constrained by wider considerations of competitiveness

The MENA ES economies generally perform worse on various global competitiveness rankings than their peer economies in other regions. The apparent inability of the region's small yet productive firms to scale up their operations may indicate distortions and uncertainties underlying the competitiveness of these economies.

The region's exporters are numerous but small, with labor productivity gains concentrated in large "superstar" exporters

Trade per se is not the problem underlying relatively weak competitiveness: firms in the MENA ES economies are more likely to export, to import, or to do both than their counterparts elsewhere, but these firms are also more likely to be SMEs. Furthermore, the average size and productivity differentials between exporting and non-exporting firms are smaller than in other regions. Indeed, the region's exporter size and productivity premia are achieved almost entirely by a small number of superstar exporters. The inability or unwillingness of small exporters to scale up their operations may indicate barriers to market entry or distortions, such as subsidized energy costs.

Access to foreign technology and supply chains can raise the productivity of importing firms

In terms of productivity gains from trade, the winners in the region are importers. This could be due to the access to foreign technology and supply chains from which they benefit. This is despite the fact that importers face considerable obstacles in terms of relatively high tariffs, non-tariff restrictions on trade, and the time it takes for imports to clear customs.

Nearly a third of firms in the region engage in basic forms of innovation

Firms in the region engage in both technological and non-technological innovation, introducing new products, new processes, and new organizational or marketing methods at a similar rate. Much of this innovation activity involves adapting existing products to local conditions or upgrading machinery and equipment, practices that are typical of firms in developing economies.

Innovation by firms is associated with certain supporting conditions: human capital, access to knowledge, and access to finance

Firm-specific human capital—obtained through formal training or by giving employees time to develop new approaches and ideas—is associated with innovation, as is access to knowledge and information and communications technology facilitated by firms. Two-way traders

(firms that both import and export), in particular, are more likely to license foreign technology and more likely to introduce technological innovations. Firms with access to credit are more likely to introduce new products and processes.

Innovation is positively linked to increases in labor productivity

Labor productivity gains from innovation are in line with those found in developed economies, but lower than those observed in developing economies. This may be explained by the general lack of competition in many MENA ES economies compared with other developing economies. Returns to innovation vary by sector, with high-tech manufacturers benefitting most from product innovation and low-tech firms benefitting more from non-technological innovations.

Poorly managed firms benefit more from improving their management practices than from innovation

The quality of management practices is positively correlated with GDP per capita but not significantly associated with firm-level labor productivity, except for firms that score below the median for their management practices. While better-managed firms are more likely to benefit from innovation, poorly managed firms are more likely to benefit from improving their management practices.

In economies with lower energy subsidies, better management practices are associated with lower energy intensity and higher labor productivity

Where energy subsidies are high, better management is associated with the opposite effect: higher energy intensity and lower labor productivity.

CONCLUSIONS

The formal private sector in the MENA ES economies is relatively small, but its size belies its significance for economic development. The labor productivity of formal private firms in the region is higher than that of their counterparts in comparable regions of the world; yet TFP lags behind. Many firms are successful in enhancing their productivity though significant engagement in innovation and international trade. The more productive firms in the region are able to grow faster and pay higher wages to attract workers. This suggests an encouraging potential for MENA economies to reallocate resources to the most promising firms.

In this way, it is possible to see the potential of the private sector in the region to grow and meet the aspirations of the growing workforce for rewarding employment. Indeed, it is through more widespread employment creation that private sector growth can principally be expected to contribute to a more inclusive growth model in the region.

At the same time, it is essential to understand that firms operate under conditions that are often very difficult. Distortive incentives push large firms toward inefficient more capital-intensive production models; SMEs face limited growth opportunities and are more negatively affected by the business environment. Almost all firms in the region are severely affected by issues of political instability, corruption, and unreliable electricity supply. Firm innovation and growth are also constrained by barriers to trade and a scarcity of appropriately trained workers. In many places, there is a striking disconnect between firms and formal financing channels, with the result that firms are not seeking external finance, inevitably reducing their growth potential.

Strategies to support firms in enhancing their productivity—as well as the process of resource reallocation toward more productive firms—should be a high priority for public authorities in the region. The report suggests some key areas for policy attention. These include looking at the complex system of distortive incentives, privileges, and barriers to competition, as well as their intended and unintended consequences.

Policies to improve the business environment

Achieving political stability is obviously a critical issue. Across many of the economies, tackling corruption and an unreliable electricity supply are also likely to be important priorities. Corruption may be deterring many firms from strategies that require engagement with public authorities, limiting their opportunities. Dealing with the reliability of electricity may also depend on a policy approach that addresses corruption and vested interests.

More generally, the region is known for a large number of distorting incentives, which form the basis of the current system of transfers. Unintended consequences are often addressed by adopting new and potentially distorting incentives. A serious reassessment of distorting incentives, transfers, privileges, and barriers to competition is of central importance.

Policies to enhance firms' access to finance

While disconnecting from the financial sector is a choice that many firms make, the fact that this has an impact on their growth potential reveals the need for policy action. Several issues may need to be addressed to facilitate firms' access to finance, to encourage them to connect with the formal financial sector, and to seize opportunities for growth that rely on external financing.

Capacity building for banks to strengthen their credit risk assessment would help those interested in lending to SMEs, without putting financial stability at risk. This should be accompanied by reforms to establish modern secured transactions laws and an efficient collateral registry; to introduce credit guarantee schemes to alleviate collateral constraints; and to build capacity for SMEs to improve their transparency and reduce the information asymmetries.

Policies for better education, employment and skills

With regard to employment in the formal private sector, there is considerable scope for improvements, particularly in relation to women's employment. Supporting the expansion of labor-intensive and exporting sectors may help to provide more jobs for women, but opportunities are also required in capital-intensive sectors. Measures that support the emergence and growth of young innovative firms are likely to be particularly positive for the employment of young people. They will also boost aggregate productivity growth and raise living standards through better-paid jobs.

A re-orientation of the region's education systems toward learning skills that are relevant for private sector employment—with greater status given to vocational training—will facilitate the growth of high quality employment. Fast-growing and more productive firms are already providing more training to their employees as well as better-paid jobs. More appropriate education and training of young people before they join the labor market would help to address skill shortages in these firms.

Policies to promote trade, competition, and innovation

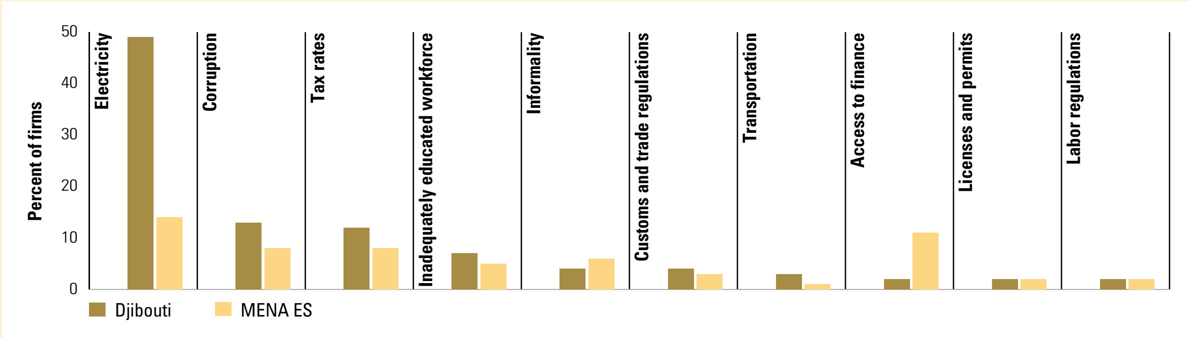
Enhancing the productivity of firms in the region requires greater openness to international trade. In particular, this means more effective customs and trade regulations—both in terms of imports and exports—and reducing entry costs for all firms. Importing should not be viewed solely through the lens of trade deficits and foreign exchange reserves; imports allow firms to source component parts of better quality or lower cost than those available in the domestic market. They also facilitate the acquisition of knowledge about new products and processes.

Other essential measures include promoting greater competition by reducing restrictions on firm entry and exit, and on foreign investment. Measures that give incumbent firms undue advantage—for example, privileged access to markets, licensing, and contracts—should be eliminated, along with regulations protecting state-owned or politically connected firms. Improving access to finance and improving the skills of the workforce will also support the ability of firms to innovate and grow.

ENTERPRISE SURVEY—ECONOMY FICHES

DJIBOUTI

FIGURE 1: Ranking of the top business environment obstacles for firms in Djibouti



Firms in Djibouti are heavily dependent on generators for electricity

Nearly half of firms in Djibouti choose electricity as their top obstacle in the business environment (figure 1). Firms cope with an unreliable electricity supply by using power from generators, represented by the 69 percent of firms in Djibouti who own or share a generator, much higher than the MENA ES average of 36 percent (figure 2). Probably due to the high prevalence of generators, firms report fewer power outages in a typical month: on average just under two, compared with a MENA ES average of almost 15 per month (figure 3). In addition to an unreliable supply of electricity in the business environment, firms face issues with corruption as well as tax rates: respectively, 13 percent and 12 percent of firms indicate that these are top obstacles.

FIGURE 2: Firms owning or sharing a generator

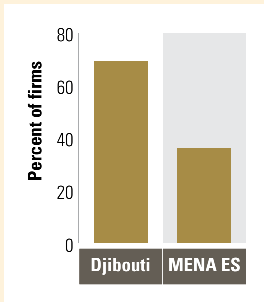
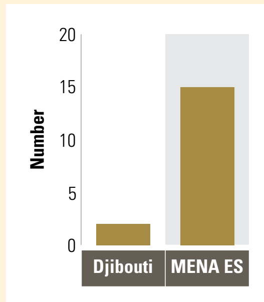


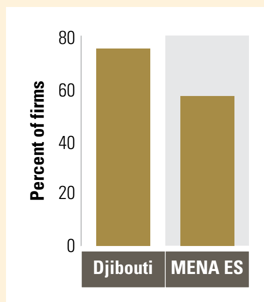
FIGURE 3: Electrical outages in a typical month



Within the MENA ES region, Djibouti has the largest percentage of firms reporting that they do not need a loan

Djibouti's financial sector has grown dramatically since the early 2000s, and today it is quite robust when compared with its peers. The increase in the number of banks in operation, the introduction of Islamic financial instruments, and the opening of accounts for small savers have increased bank deposits. Almost 92 percent of firms in Djibouti have a checking or savings account, well above the MENA ES average of 80 percent. In terms of access to credit, about 12 percent of working capital needs are financed by banks. This is higher than the other MENA ES lower-middle-income economies, with the exception of Morocco. Djibouti also stands out in that 75 percent of firms indicate that they do not need a loan (figure 4). This is the highest percentage in the region. Indeed, only 2 percent of firms rank access to finance as their top business environment obstacle.

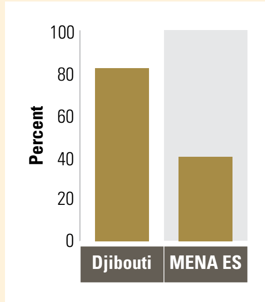
FIGURE 4: Firms not needing a loan



The majority of jobs in Djibouti's private sector are in services

Djibouti's economy differs from its MENA ES peers, as the majority of the private sector is composed of the services sector. With an economy dominated by its deep-water port, 82 percent of jobs in Djibouti's formal private sector covered by the survey are in transport and related services sector. This is much higher than the average of 40 percent across all MENA ES economies (figure 5). With an estimated unemployment rate of over 50 percent, job creation remains a challenging national priority. Among MENA ES economies, Djibouti has the highest share of firms (14 percent) indicating that labor regulations are a major or very severe obstacle to the operations of their establishment.

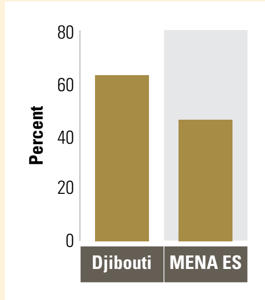
FIGURE 5: The proportion of jobs in the services sector



Compared with the MENA ES region, firms in Djibouti are more reliant on foreign inputs

Manufacturing firms in Djibouti are relatively more reliant on inputs of foreign origin, which is a result of the country's lack of natural resources and harsh climate. On average, 63 percent of manufacturing inputs are of foreign origin, well above the average for all MENA ES economies (46 percent, figure 6). This is despite the fact that its import tariff rates are among the highest in the region. In terms of innovation across all business sectors, almost a third of firms in Djibouti introduce new processes, higher than elsewhere in the MENA ES region. The majority of process innovations occur through upgrading existing machinery and equipment, as well as software.

FIGURE 6: The proportion of inputs that are of foreign origin



Djibouti has the highest proportion of firms with women in top management positions in the MENA ES region

When compared with the rest of the world, the MENA ES region lags behind in terms of women's participation in the workforce, firm ownership and top management positions. Within this group, Djibouti stands out in terms of having a relatively large percentage of firms with a woman top manager: 14 percent (figure 7), which was much higher than the MENA ES region average of 5 percent. Djibouti also has the highest percentage of firms with majority female ownership: 7 percent, which is almost twice the regional average (4 percent). The proportion of permanent full-time employees that are women is also higher than the MENA ES average (figure 8). The relatively strong participation of women in the local workforce and firm management may be partly the result of the preponderance of the services sector in Djibouti's economy, since services firms are typically more open to women.

FIGURE 7: Firms with a woman top manager

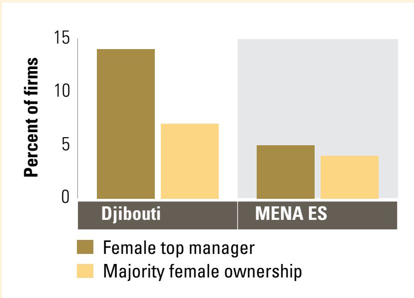
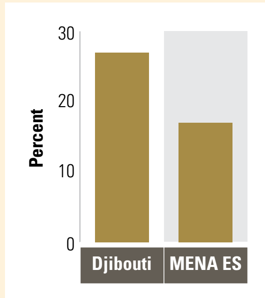


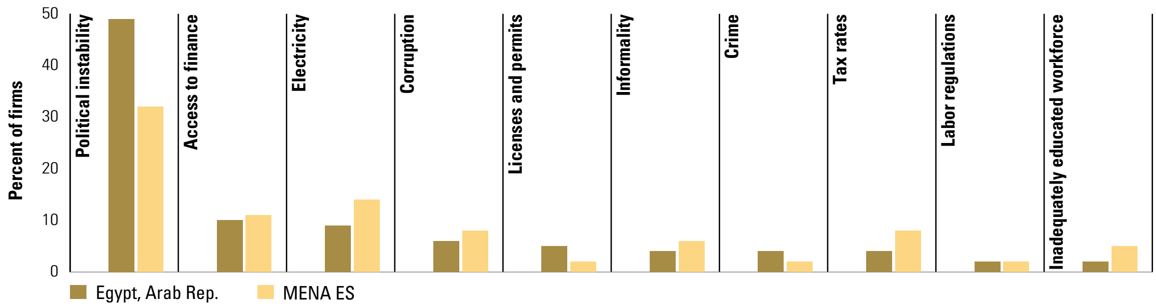
FIGURE 8: Permanent full-time employees that are women



The Economy Fiches summarize the economy-specific findings of the report "What's Holding Back the Private Sector in MENA?" Note that annualized sales and employment growth statistics are calculated using the reference years 2009 and 2012; these reference years are used due to when the Enterprise Survey was administered. The findings, interpretations, and conclusions expressed in this fiche are entirely those of the authors. They do not necessarily represent the views of the European Bank for Reconstruction and Development/European Investment Bank/World Bank and its affiliated organizations, or those of their Executive Directors or the governments they represent.

ARAB REPUBLIC OF EGYPT

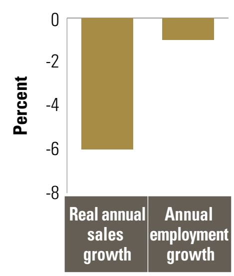
FIGURE 1: Ranking of the top business environment obstacles for firms in Egypt



Political instability is the top obstacle reported by Egyptian firms

Nearly half of Egyptian firms choose political instability as their top obstacle, which was higher than the MENA ES average (figure 1). The uncertain business environment that followed the 2011 uprising and developments in the summer of 2013 was reflected in firms' economic performance: between 2009 and 2012, the typical firm in Egypt saw revenues decline by 6.4 percent per year and employment by more than one percent per year (figure 2). Access to finance is named as the top obstacle by one in every ten firms—not surprising, given that fewer than 60 percent of firms have a checking or savings account and only 6 percent of them have a bank loan or a line of credit. Electricity issues emerge in third place, linked to a major deterioration in electricity supply reliability in 2012, the reference year for the survey. Although named as the top obstacle by only 6 percent of firms, corruption is widespread: 17 percent of firms report being exposed to at least one bribe request.

FIGURE 2: Sales and employment growth



Access to finance remains a key issue for Egyptian firms

Banks account for only 2 percent of firm finance in Egypt, well below the MENA ES average of 12 percent. The low prevalence of bank finance is mirrored by a high share of disconnected firms—those that did not apply for a loan because they have sufficient capital (figure 3). The fact that 40 percent of formal private sector firms do not have a checking or savings account (figure 4) and therefore do not use the financial system even for payment services suggests that the disconnect is structural. Anecdotal evidence suggests that Egyptians themselves characterize their economy as a cash economy. This is in line with the strong role typically ascribed to Egypt's informal economy—estimates from the Egyptian Center for Economic Studies suggest that it constitutes around 40 percent of GDP and 66 percent of total non-agricultural private sector employment.

FIGURE 3: Degree of connection to the banking sector

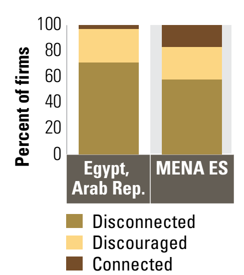
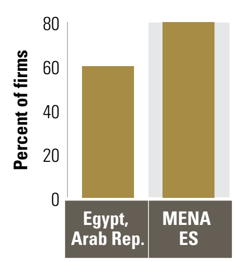


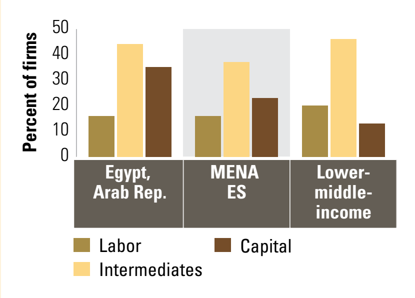
FIGURE 4: Firms with a checking or savings account



Egyptian manufacturers have high capital intensity and the use of capital seems inefficient

Egyptian firms have labor productivity levels on par with firms in lower-middle-income economies. Where they lag behind is in total factor productivity (TFP), which measures the efficiency of use of not only labor, but also capital and intermediate inputs. When comparing the median factor shares of the three main inputs used by manufacturers—their labor, intermediate inputs, and capital costs—Egyptian manufacturers are more capital-intensive than the average manufacturer in MENA ES as well as in their peer economies (figure 5). Among the MENA ES economies, only Tunisian manufacturers are more capital-intensive. This can partly be explained by the presence of energy subsidies, which distort production structures by promoting energy- and capital-intensive industries.

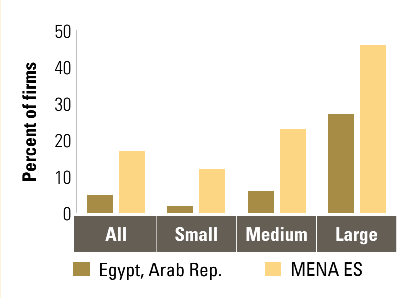
FIGURE 5: Median factor shares



Compared with larger firms, SMEs in Egypt are less likely to provide training to their employees

Egypt is suffering from a mismatch between labor supply and demand, particularly in the area of technical and vocational skills. Post-secondary vocational education and training are often perceived as low status and low quality, without systematic engagement of employers in developing the programs and curricula. Moreover, only 5 percent of Egyptian firms offer formal training, far lower than the MENA ES average of 17 percent. The difference is driven primarily by the low percentage of SMEs providing formal training for their employees—only 2 and 6 percent of them do so, compared with 12 and 23 percent in the MENA ES region on average respectively (figure 6). Lack of skilled workers affects fast-growing firms in particular, and as such, has important implications for aggregate growth and productivity.

FIGURE 6: Firms offering formal training



Due to the large domestic market, fewer firms are engaged in international trade

Given the large size of its domestic market, it is not surprising that Egypt has one of the highest proportions of non-trading firms in the MENA ES region. Almost half of all manufacturing firms do not engage in either export or import activities (figure 7). Moreover, only a quarter of firms in Egypt are engaged in at least one type of innovation, compared with more than two-thirds in the MENA ES region (figure 8). This may be due to the fact that the Egyptian market is vast and underserved, which means that firms do not need to compete for customers and hence do not feel the pressure to innovate. Moreover, only 3 percent of firms engage in knowledge acquisition, either through R&D or other sources. Compared with other MENA ES economies, this proportion is particularly low in high- and medium-high-tech manufacturing sectors.

FIGURE 7: Firms by trade status

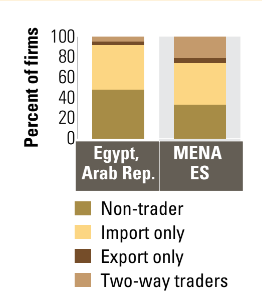
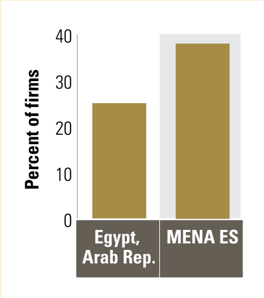


FIGURE 8: Firms engaged in at least one type of innovation



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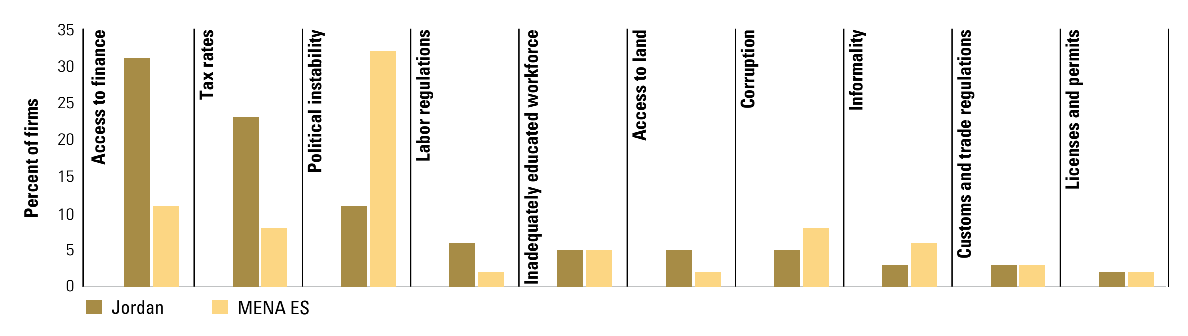
JORDAN

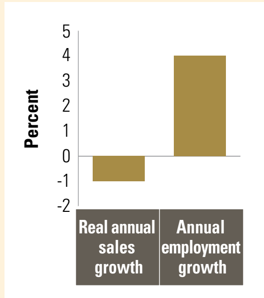
FIGURE 1: Ranking of the top business environment obstacles for firms in Jordan



Access to finance is the top obstacle reported by Jordanian firms

Almost a third of all Jordanian firms report access to finance as the top obstacle to their operations (figure 1), the highest proportion among the MENA ES economies. Cyclical factors might partly explain this result. In 2012, the reference period of the survey, Jordan experienced several adverse shocks. Reductions in gas supply from Egypt forced Jordan to resort to more expensive fuel imports, putting pressure on the current account and reserves as well as the budget. Public debt increased from 71 percent of GDP in 2011 to 82 percent in 2012, potentially crowding out the private sector. These adverse shocks also decreased firms' propensity to invest and hence reduced their demand for credit. Tax rates are the top obstacle for nearly a quarter of all firms, possibly linked to an increase in the time it takes to prepare, file, and pay taxes. Political instability is in third place. Jordan faces security challenges mostly as a result of spillovers of regional turmoil. These problems notwithstanding, firms in Jordan experienced a relatively small drop in sales and robust growth in employment between 2009 and 2012 (figure 2).

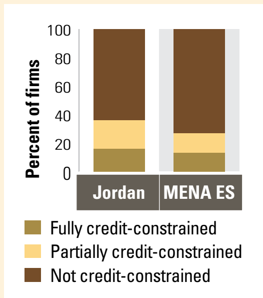
FIGURE 2: Sales and employment growth



Jordanian firms are among the most credit-constrained in the MENA ES region

MENA ES data indicate that problems of access to finance seem to go beyond cyclical considerations and their potential impact on demand for and the supply of credit. While Jordan has comparatively deep financial and banking sectors, with private sector credit to GDP accounting for about 70 percent of GDP from a peak of around 90 percent of GDP in 2007, bank finance accounts for only 10 percent of SME financing in Jordan. The banking sector's exposure to the government and public sector entities increased since 2010. Data indicate that loans to SMEs account for about 10 percent of total loans, which could explain the divergence between measures of financial depth and financial access. Only 64 percent of firms—second lowest after the Republic of Yemen—are not credit-constrained, compared with 73 percent in the MENA ES region (figure 3). Moreover, more than a third of Jordanian firms report being discouraged from applying for a loan due to terms and conditions. Jordan also ranks last in terms of the *Doing Business* measure for ease of getting credit (185 out of 185, tying with the Republic of Yemen).

FIGURE 3: Degree of credit constraint



Women's employment in Jordan is below the MENA ES average

The proportion of women among the full-time permanent employees in the MENA ES region is very low by international standards, and Jordan compares relatively poorly with other economies in the region. Only 8 percent of the workforce in a typical Jordanian firm is composed of women, compared with an average of 17 percent for MENA ES economies (figure 4). Jordan also stands out among the MENA ES economies as having the lowest percentage of firms that provide training to their employees—only 3 percent of Jordanian firms do so, compared with the MENA ES average of 17 percent (figure 5).

FIGURE 4: Permanent full-time employees that are women

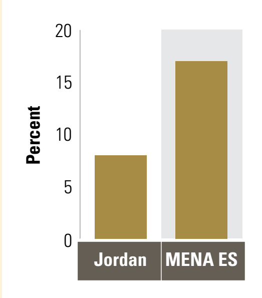
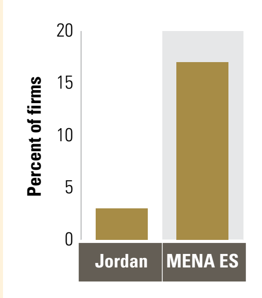


FIGURE 5: Firms offering formal training



Jordanian manufacturing firms are competitive by regional standards

At 68th place, Jordan was the highest ranked MENA ES economy in the World Economic Forum *Global Competitiveness Report 2013–2014*. Jordan's manufacturing firms are relatively well integrated into international trade, with 26 percent of them both importing and exporting, compared with the averages of 20 percent in the region (figure 6) and 13 percent in upper-middle-income economies. The firms benefit from relatively low manufacturing tariff rates on both intermediates and raw materials. In addition, the reported number of days to clear imports through customs is also among the lowest in the MENA ES region (figure 7).

FIGURE 6: Firms by trading status

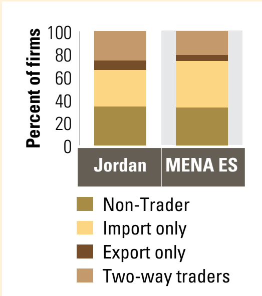
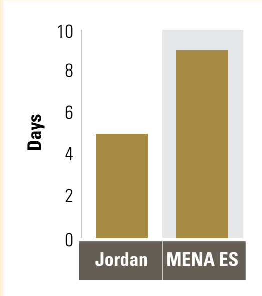


FIGURE 7: Days to clear imports through customs



Among the MENA ES economies, the proportion of firms engaged in at least one type of innovation is the lowest in Jordan

About a fifth of Jordanian firms are engaged in at least one type of innovation (the lowest proportion in the MENA ES region) and less than 5 percent of them acquire knowledge by engaging in R&D and purchasing or licensing patented technologies, non-patented inventions, and know-how. There are, however, large differences across sectors. In higher-tech industries, almost a quarter of firms acquire knowledge (figure 8) and more than half introduce new products, processes, and organizational or marketing methods (figure 9), on par with the MENA ES average. In other sectors, less than 5 percent of firms acquire knowledge, and the proportion of firms engaged in at least one type of innovation also lags behind the MENA ES average. These discrepancies could be driven by differences in trade integration: among firms in high- and medium-high-tech industries, more than 60 percent are exporters and more than 90 percent import their inputs. In the medium-low and low-tech industries, roughly 40 percent of the firms are exporters and about half import their inputs.

FIGURE 8: Firms engaged in knowledge acquisition

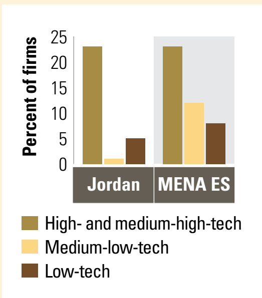
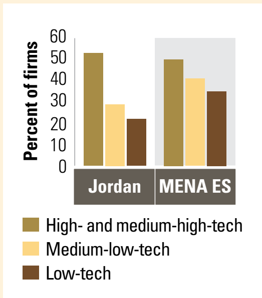


FIGURE 9: Firms engaged in at least one type of innovation



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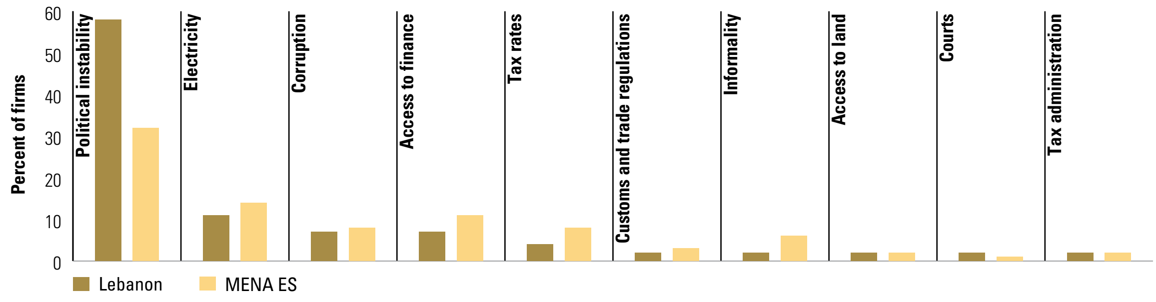
LEBANON

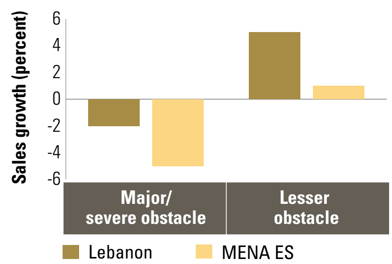
FIGURE 1: Ranking of the top business environment obstacle for firms in Lebanon



Political instability is the top obstacle reported by Lebanese firms

Lebanese firms perceive political instability as the most important obstacle (figure 1). This probably refers to negative spillovers from the conflict in Syria, as well as more generally to the country's confessional governance and the consequent inertia in structural reforms and weakening of institutions. The country has not had a President since May 2014, and Parliament has voted twice to extend its own term. The four-year term scheduled to end in 2013 is now foreseen to end in 2017. In this difficult political and economic environment, the performance of firms has come under pressure. In a question that considers obstacles independently from each other, political instability is identified as a major or severe obstacle by 91 percent of firms in Lebanon. Those firms performed worse in terms of sales growth over the survey reference period 2009 to 2012 than firms that identify political instability as a lesser obstacle (figure 2).

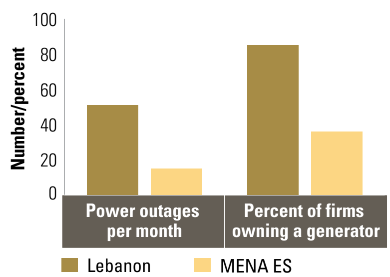
FIGURE 2: Political instability and sales growth



Electricity remains a key issue for Lebanese firms

For 11 percent of Lebanese firms, electricity is the most important obstacle (figure 1). Political divisions have forestalled reform of the energy sector, preventing much needed investments in generating capacity and transmission. Moreover, tariffs have not been adjusted since the 1990s, implying substantial fiscal transfers to the state-owned Electricité du Liban (EdL). As a result, firms suffer from frequent power outages. Firms experience on average 51 power outages per month, far exceeding the MENA ES average (figure 3). The poor quality of electricity supply forces firms to rely on expensive electricity from generators. Not surprisingly, they are much more prevalent in Lebanon—where 85 percent of firms own or share one—than in the other MENA ES economies.

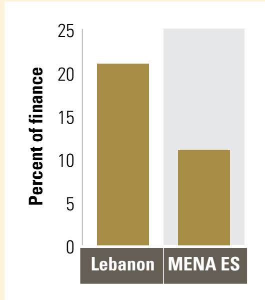
FIGURE 3: Quality of electricity supply



Bank finance plays an important role for financing working capital and fixed capital

Lebanon has one of the highest levels of financial depth among the MENA ES economies, reflecting persistent, large-scale deposit inflows that result from its traditional role as a financial hub for the region and a large and loyal diaspora. Overall, financial intermediation seems to be working well in Lebanon. Banks account for 21 percent of firm financing, exceeding the MENA ES average by a wide margin (figure 4). There is a mixed picture for the collateral framework. On the one hand, Lebanese banks are more willing to lend unsecured than banks in an average MENA ES economy; on the other hand, banks rarely lend against movable collateral. Only 4 percent of loans are secured by machinery and equipment or receivables, compared with a MENA ES average of 14 percent. A reform of the secured transactions framework could further improve access to finance for Lebanese firms.

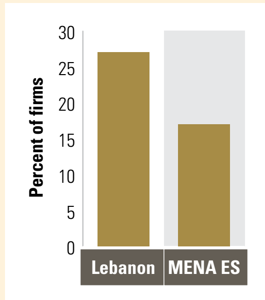
FIGURE 4: Firm finance coming from banks



Workforce skills do not seem to be a major constraint for Lebanese firms

Less than 1 percent of firms in Lebanon consider workforce skills as the most important obstacle, while 15 percent see it as a serious impediment to operations. This relatively good outcome may reflect the fact that Lebanon has one of the highest tertiary school enrollment ratios in the region. Moreover, it is one of the MENA ES economies with the highest training intensity. About 27 percent of firms offer formal training, compared with a MENA ES average of 17 percent (figure 5). Moreover, Lebanon has the second highest share of firms with women's ownership in the MENA ES region at 43 percent, outperformed only by Tunisia (50 percent). This compares with a regional average of 25 percent. When considering the percentage of firms with a woman top manager, Lebanon (4 percent) lags well behind Tunisia (8 percent) and below the regional average (5 percent).

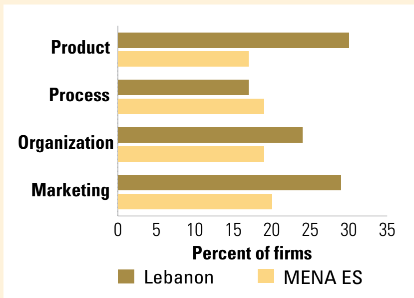
FIGURE 5: Firms providing formal training



Lebanese firms are among those most likely to engage in at least one type of innovation across the MENA ES economies

Lebanon has the highest proportion of firms engaged in innovation in the MENA ES region, with half of them introducing at least one type of innovation. Lebanese firms are more likely to introduce new products than firms in any other MENA ES economy (figure 6). They also exceed the MENA ES average for the proportion of firms engaged in marketing and organizational innovations. In terms of involvement in international markets, Lebanon's firms are outperforming most economies in the region. Only 20 percent of manufacturing firms do not engage in any trade activities, compared with 33 percent in the MENA ES region on average. Lebanon has a strikingly high share of domestically owned exporters (95 percent compared with a regional average of 85 percent). This could be explained by the traditionally very high political and security uncertainty in the country, which leads domestic firms to seek stable markets for their products and foreign investors to stay away.

FIGURE 6: Different types of innovation



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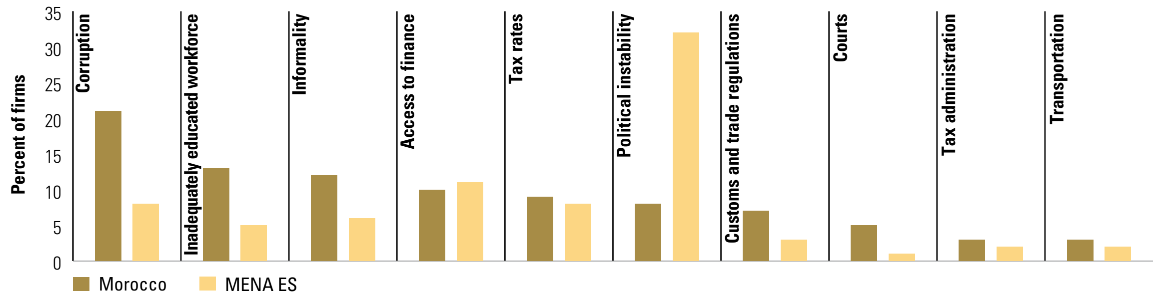
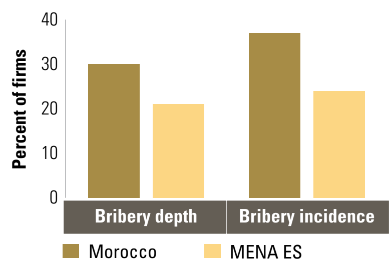
MOROCCO

FIGURE 1: Ranking of the top business environment obstacle for firms in Morocco



Corruption is the top obstacle reported by Moroccan firms

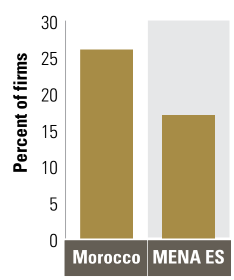
FIGURE 2: Bribery depth and incidence



Morocco is one of the few economies in the MENA ES region where political instability does not rank highly as a top obstacle. Instead, Moroccan firms perceive corruption as the most important impediment to the business environment (figure 1): 21 percent of firms identify corruption as the top obstacle, compared with the MENA ES average of only 8 percent. Indeed, Morocco has one of the highest reported bribery depths in the MENA ES region, at 30 percent (compared with a MENA ES average of 21 percent). Bribery depth reflects the percentage of transactions where a firm is asked or expected to pay a bribe when soliciting public services, permits, or licenses. Bribery incidence—the percentage of firms experiencing at least one bribe payment request—is, at 37 percent, above the MENA ES average of 24 percent. Morocco also compares poorly with other lower-middle-income economies, where the averages for bribery depth and incidence are 16 and 21 percent respectively. An inadequately educated workforce ranks second as top obstacle in Morocco, and practices of competitors in the informal sector emerge in third place. Indeed, 47 percent of firms in Morocco report that they are competing against unregistered or informal firms, which is significantly higher than the regional average of 16 percent and trailing only the Republic of Yemen.

Morocco lacks an adequately educated workforce

FIGURE 3: Firms offering formal training



Of surveyed firms in Morocco, 13 percent identify an inadequately educated workforce as the top business obstacle. Morocco has one of the lowest tertiary school enrollments in the region, with only the Republic of Yemen and Djibouti performing worse. In Morocco, gross enrolment at the tertiary level is only 16 percent of the total tertiary age population, which compares poorly to 30 percent in the MENA ES region as a whole. Moreover, the quality of education lags behind and often does not correspond to the business needs of the private sector. At the same time, Morocco is one of the MENA ES economies where the intensity of training provided by firms is one of the highest, with 26 percent of firms offering formal training compared with a regional average of 17 percent (figure 3). This formal training provision remains well below the lower-middle-income average of 37 percent.

Financial intermediation in Morocco compares well with other economies in the MENA ES region

Morocco has one of the highest levels of financial depth among MENA ES economies, despite being a lower-middle-income economy, and is one of only two economies in the region that have fully functioning credit bureaus. Overall, financial intermediation seems to be working well in Morocco. Twenty-one percent of working capital and investment is financed through banks (figure 4), the highest proportion among MENA ES economies and by far exceeding the lower-middle-income average of 12 percent. The high prevalence of bank finance is mirrored by the highest share of not credit-constrained firms (those that either did not need a loan or whose loan was approved in full): 87 percent, compared with the average of 73 percent in the MENA ES region (figure 5). Moreover, a low share of firms are discouraged from applying for a loan due to unfavorable terms and conditions such as complex application procedures, unfavorable interest rates, high collateral requirements, or insufficient size of loan and maturity. In fact, the share of discouraged firms in Morocco is the lowest among all MENA ES economies, as only 10 percent indicate being discouraged from applying for a loan while this proportion ranges from 13 percent in Djibouti to 49 percent in the Republic of Yemen. Morocco also has one of the lowest collateral ratios (the ratio of the value of collateral to the value of the loan) in the MENA ES region at 166 percent. The higher regional average of 208 percent is driven by the very high collateral ratios of the Republic of Yemen (281 percent), Egypt (272 percent) and Tunisia (252 percent).

FIGURE 4: Use of banks as financing source

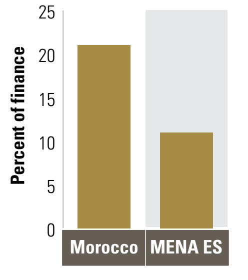
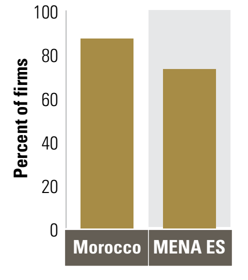


FIGURE 5: Not credit-constrained firms



Moroccan firms engage more frequently in marketing than in other types of innovation

Morocco has one of the highest shares of foreign-owned manufacturing exporters in the MENA ES region (27 percent in Morocco compared with 15 percent in the MENA ES region on average, figure 6). This can, at least partly, be explained by the country's political stability, its capacity to attract foreign investors, and its proximity to Europe. In terms of innovative activities, Moroccan firms engage most frequently, at 28 percent each, in process and marketing innovation, which is well ahead of the regional averages of 19 and 20 percent respectively. Moreover, a higher proportion of firms in Morocco report engaging in R&D or buying external knowledge (10 percent) than in the MENA ES region on average (7 percent) (figure 7). This could be explained by greater integration of Moroccan firms into GVCs than their regional peers (with the exception of Tunisia) as well as the higher share of foreign ownership.

FIGURE 6: Foreign ownership of exporting manufacturing firms

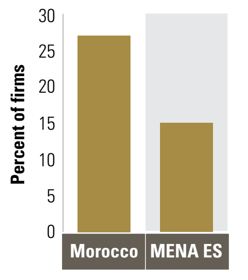
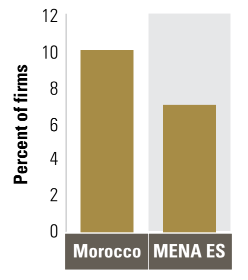


FIGURE 7: Firms engaged in R&D (inhouse or contracted)



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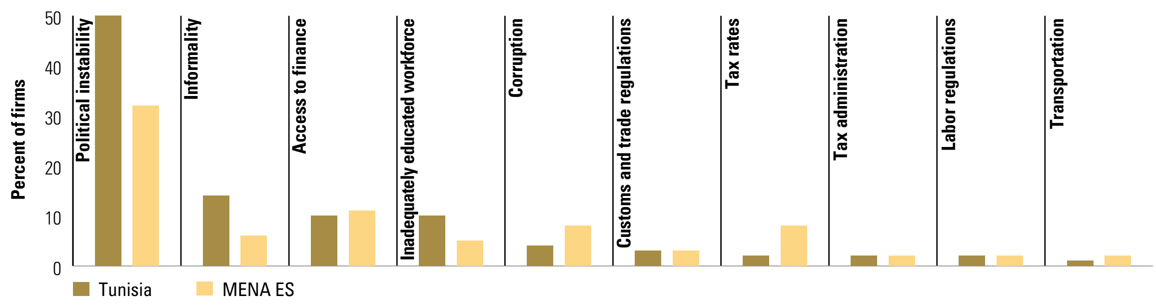
TUNISIA

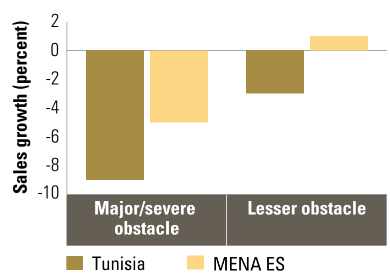
FIGURE 1: Ranking of the top business environment obstacle for firms in Tunisia



Political instability is the top obstacle reported by Tunisian firms

Tunisian firms perceive political instability as the most important obstacle to business activity, with half of all firms identifying this issue as their top obstacle (figure 1). Many firms suffered from the uncertain business environment that followed the Jasmine revolution in 2011, notably the uncertainty about policy directions. Economic performance was at a low and most firms saw their sales contract significantly in this difficult environment. Considered independently of the other obstacles, political instability is identified as a major or severe obstacle by 60 percent of firms in Tunisia. Those firms saw their sales decline most dramatically over the survey reference period 2009 to 2012, by 9 percent, compared with a decline in sales of 3 percent for the firms that identify political instability as a lesser obstacle (figure 2). Informality ranks second as top obstacle in Tunisia, where 45 percent of firms report competing against unregistered or informal firms. Access to finance emerges in third place, despite Tunisian firms relying more heavily on external financing than firms in any other MENA ES economy, with only 59 percent of working capital and investment financed through internal sources.

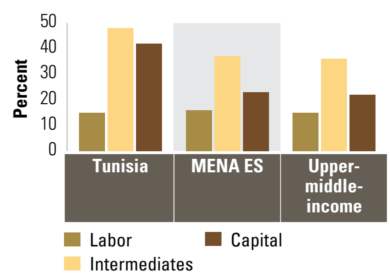
FIGURE 2: Political instability and sales growth



Tunisian manufacturers have high capital intensity and the use of capital seems inefficient

Manufacturing firms in Tunisia are significantly more capital-intensive than firms in upper-middle-income economies on average (figure 3). When comparing the median factor shares of three main inputs used by manufacturers, that is, their labor, intermediate inputs, and capital costs, Tunisian manufacturers stand out as the most capital-intensive in the MENA ES region. This can partly be explained by the presence of energy subsidies, which distort production structures by promoting energy and capital-intensive industries. Indeed, while Tunisian manufacturers have labor productivity levels comparable to those of manufacturers in upper-middle-income economies, their TFP lags behind, indicating that capital is used inefficiently.

FIGURE 3: Median factor shares



Tunisian firms have a lower degree of financial disconnect, but high collateralization of loans is hampering access to finance

FIGURE 4: Financial sector disconnect

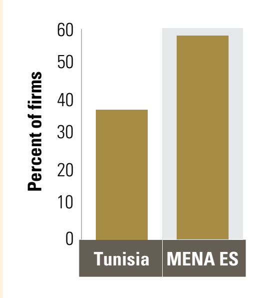
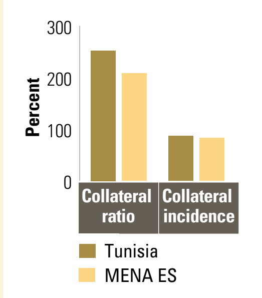


FIGURE 5: Collateral characteristics



Despite ranking third, access to finance is identified as top obstacle by only 10 percent of Tunisian firms. This compares favorably with the averages of both the MENA ES region (11 percent) as well as upper-middle-income economies (16 percent). Tunisian firms report a relatively low degree of disconnect of the private sector from financial markets, with 37 percent of firms disconnected in Tunisia compared with 58 percent of firms in the MENA ES region on average (figure 4). Disconnected firms are those that did not apply for any loan in the survey reference year and explicitly state that they did not need a loan thanks to sufficient capital. Tunisian financial institutions rely heavily on the use of collateral as guarantees for loans. Both the collateral ratio (the ratio of the value of collateral to the value of the loan) and the collateral incidence (the share of loans that are collateralized) are high, the former being above any other MENA ES upper-middle-income economy at about 252 percent, and the latter (at 87 percent) being above the MENA ES average of 83 percent (figure 5). These two measures of collateral requirements also compare poorly with upper-middle-income averages (190 percent for the collateral ratio and 75 percent for the collateral incidence).

Tunisian firms are competitive by regional standards

FIGURE 6: Firms by trade status

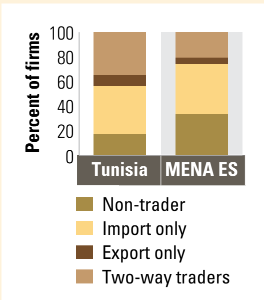
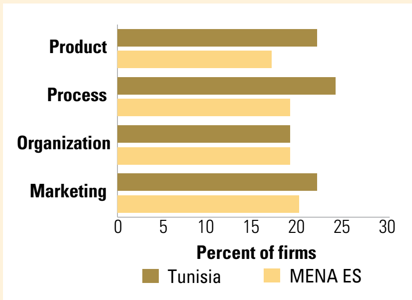


FIGURE 7: Different types of innovation



Tunisia has the highest proportion of two-way traders—firms that both export and import—in the MENA ES region, with 35 percent of firms exporting 10 percent or more of their sales directly and importing 10 percent or more of intermediate inputs (figure 6). This can partly be explained by the importance of the offshore industry in Tunisia, which comprises fully export-oriented firms that benefit from tax exemptions, duty free access to inputs and equipment, and streamlined customs procedures. Given this special status, these firms tend to be well integrated into GVCs. Moreover, a higher percentage of Tunisian firms are engaged in innovation than in the MENA ES region on average (figure 7). The proportion of firms undertaking process innovation is particularly high at almost a quarter of all firms—this may be related to the knowledge transfer from their GVC partners.

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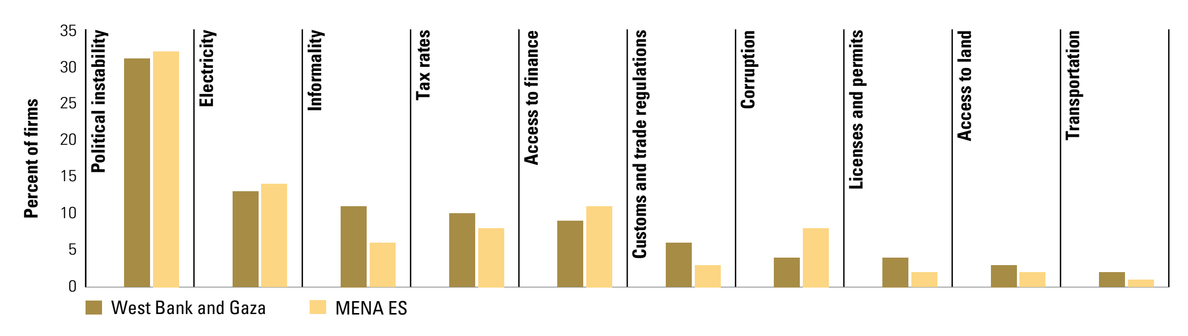
WEST BANK AND GAZA

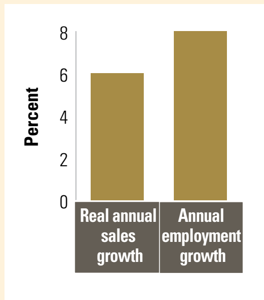
FIGURE 1: Ranking of top business environment obstacles for firms in the West Bank and Gaza



Political instability is the top obstacle reported by firms in the West Bank and Gaza

Roughly one in three firms in the West Bank and Gaza report political instability as the top obstacle in the business environment, in line with the average in the MENA ES economies (figure 1). Electricity and practices of the informal sector are the second and third ranked top obstacle. Despite persistent instability, firms in the West Bank and Gaza experienced robust growth rates in the period 2009–2012, in terms of both sales revenues, which increased at nearly 6 percent per year, and employment, with an annual growth rate of nearly 8 percent (figure 2). Although not ranked as the top obstacle, corruption is considered a major or very severe obstacle to their operations by half of all firms. In addition, over half of all firms consider both access to finance and electricity as major/very severe obstacles to their current operations. The current and future economic outlook, however, is much more uncertain as overall donor aid and disbursements have decreased, Israeli-Palestinian peace talks remain stalled, and fiscal pressures on the Palestinian Authority continue to grow. Given continuing political instability in the West Bank and Gaza and the uncertain economic outlook, policies are needed to promote private sector growth.

FIGURE 2: Sales and employment growth



The unreliable provision of electricity is particularly acute in Gaza

Firms in the West Bank and Gaza report losses due to power outages of above 6 percent of annual sales, larger than losses reported by any other MENA ES economy's firms (figure 3). The supply of electricity is particularly unreliable in Gaza, where losses due to power outages average over 22 percent of annual sales and firms experience nearly 29 outages per month, compared with reported losses of just above 1 percent and almost two power outages each month in the West Bank (figure 4). The blockade of the Gaza strip, political infighting, perpetual fuel shortages, a crumbling infrastructure, and perpetual conflict and insecurity all result in the very unreliable supply of electricity in Gaza.

FIGURE 3: Losses due to electrical outages

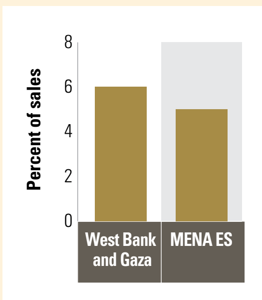
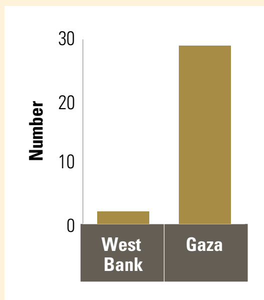


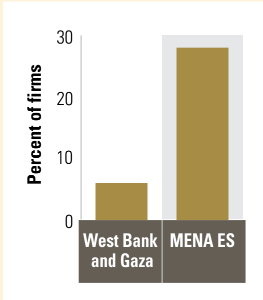
FIGURE 4: Electrical outages in a typical month



Many firms in the West Bank and Gaza are disconnected from financial services

The majority of firms' working capital is financed by internal funds and supplier credit. Banks account for only 3 percent of working capital financing in the West Bank and Gaza, which is well below the MENA ES average of 10 percent. Almost three-quarters of firms did not apply for a loan as they have sufficient capital and are thus classified as disconnected from the financial sector, the second highest share of firms in the MENA ES. The fact that almost 30 percent of formal private sector firms do not have a checking or savings account and therefore do not use the financial system even for payment services suggests that the disconnect is structural. Indeed, only 6 percent of firms indicate having a loan or line of credit (figure 5). Despite the low prevalence of business loans, the West Bank and Gaza does stand out in terms of client-friendly collateral practices. The share of movable collateral, such as machinery and equipment or receivables, is the highest among the MENA ES economies. At the same time, the average collateral ratio is the second lowest among the MENA ES economies.

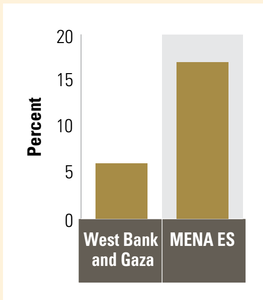
FIGURE 5: Firms with a bank loan or line of credit



Women's participation in the private sector lags behind other MENA ES economies

The West Bank and Gaza has some of the lowest rates of women's participation both in the workforce and in firm ownership or management among the MENA ES economies. Of permanent full-time workers, only 6 percent are women, lower than the MENA ES average of 17 percent (figure 6). In addition, only 13 percent of firms have women's participation in ownership and 1 percent of firms have a woman top manager; the comparable averages for the MENA ES region are 25 percent and 6 percent. Commonly cited reasons for this lack of women's participation include a dearth of opportunities as well as social, cultural, and institutional norms. Due to persistent conflict and instability, additional concerns of personal safety and mobility restrictions further inhibit women's participation in the formal private sector.

FIGURE 6: Permanent full-time workers that are women



Firms in the West Bank and Gaza spend less on R&D

In the West Bank and Gaza, exporters account for approximately 40 percent of all manufacturers and more than half of those firms' inputs are of foreign origin (figure 7). Nonetheless, importers face by far the longest customs waiting times in the MENA ES region: 17 days. In addition, compared with the MENA ES region as a whole, a slightly lower percentage of firms in the West Bank and Gaza are spending on R&D or the acquisition of external knowledge (figure 8). Almost a third of higher technology manufacturing firms do so, on par with Tunisia and Djibouti.

FIGURE 7: Degree of foreign engagement in manufacturing

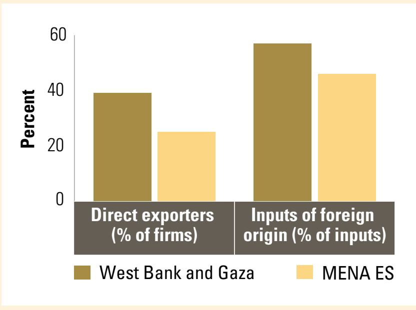
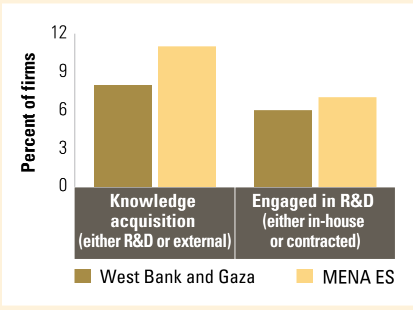


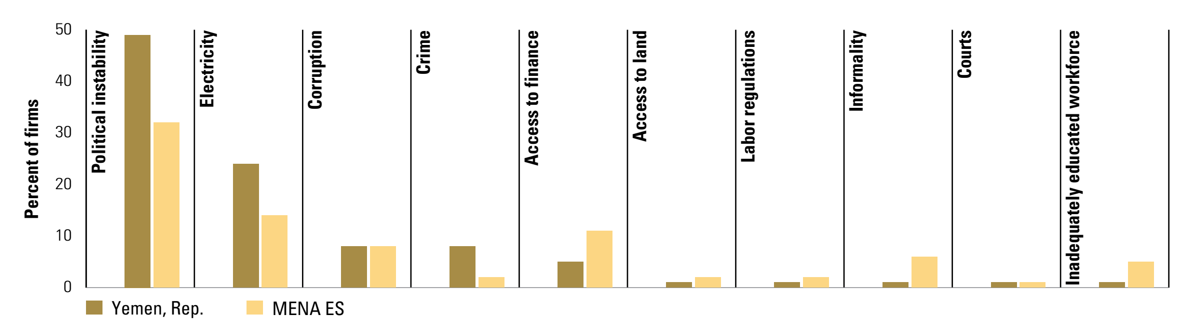
FIGURE 8: Different types of knowledge acquisition



The Economy Fiches summarize the economy-specific findings of the report "What's Holding Back the Private Sector in MENA?" Note that annualized sales and employment growth statistics are calculated using the reference years 2009 and 2012; these reference years are used due to when the Enterprise Survey was administered. The findings, interpretations, and conclusions expressed in this fiche are entirely those of the authors. They do not necessarily represent the views of the European Bank for Reconstruction and Development/European Investment Bank/World Bank and its affiliated organizations, or those of their Executive Directors or the governments they represent.

REPUBLIC OF YEMEN

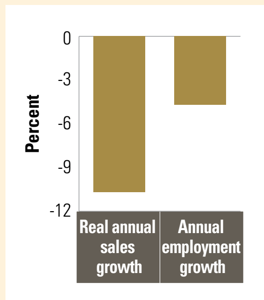
FIGURE 1: Ranking of top business environment obstacles for firms in the Republic of Yemen



Political instability is the top obstacle reported by firms in the Republic of Yemen

The ES fieldwork took place between March 2013 and July 2014, during a period of instability in the Republic of Yemen, which deteriorated into civil war in early 2015. Unsurprisingly, nearly half of all firms identify political instability as their top obstacle in the business environment (figure 1). Nearly a quarter of firms indicate electricity as their top obstacle. Although not ranked as the top obstacle, corruption is considered a major or very severe obstacle by 97 percent of firms; among all economies with ES data, this is the highest percentage. In addition, over 60 percent of all firms consider crime as a major/very severe obstacle to their current operations; and 17 percent of firms experience losses due to theft and vandalism, the highest percentage among MENA ES economies. Not surprisingly, following this deterioration of the business environment, private sector activity over the period contracted. A typical firm, between 2009 and 2012, saw sales revenues strongly decline by nearly 11 percent per year and an employment contraction of 5 percent per year (figure 2).

FIGURE 2: Sales and employment growth



Electricity remains a key issue for firms in the Republic of Yemen

After political instability, electricity is the second most-often cited top obstacle to firms in the Republic of Yemen. Private sector firms experience nearly 40 power outages in a typical month and lose over 16 percent of their annual sales as a result of these power outages (figure 3). Closely linked to this, the private sector reports heavy reliance on private generators: eight in 10 firms in the Republic of Yemen own or share a generator (figure 4), and overall, 39 percent of the private sector's power provision comes from these generators.

FIGURE 3: Electrical outages and losses

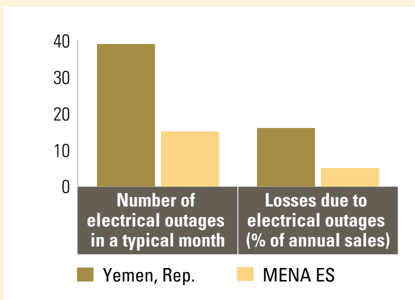
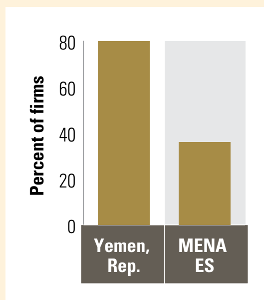


FIGURE 4: Firms owning or sharing a generator



Firms in the Republic of Yemen remain largely disconnected from the financial sector

The Republic of Yemen has the highest share of credit-constrained firms—those that were rejected (or partially approved) on loan applications and/or were discouraged from applying due to unfavorable terms and conditions—among MENA ES economies (figure 5). This is driven by a high share of firms that are discouraged from applying for loans. Moreover, only 1 percent of financing is sourced from banks, the lowest proportion among all MENA ES economies. The fact that over 50 percent of formal private sector firms do not have a checking or savings account (figure 6) and therefore do not use the financial system even for payment services suggests that the disconnect is structural.

FIGURE 5: Degree of credit constraint

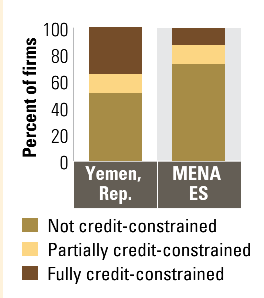
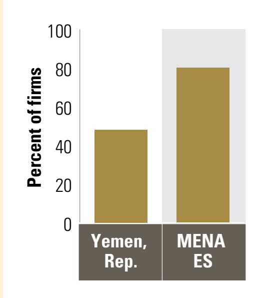


FIGURE 6: Firms with a checking or savings account



Republic of Yemen manufacturers are the least integrated into global markets

Well behind the MENA ES average, only 37 percent of the Republic of Yemen manufacturers import at least a tenth of their material inputs or supplies from abroad (figure 7). In contrast, this rate is on average over 60 percent in the MENA ES region. Manufacturers are even less integrated on the exporting side. Only 5 percent of the economy's manufacturers export at least 10 percent of their sales abroad, a fifth of the MENA ES average. Not surprisingly, the Republic of Yemen has the lowest proportion of two-way trading manufacturing firms (those that import and export), indicating that this sector is quite removed from GVCs. In addition, Republic of Yemen firms face longer waiting times to clear customs when directly exporting, compared with firms across the MENA ES region (figure 8).

FIGURE 7: Degree of foreign engagement in manufacturing

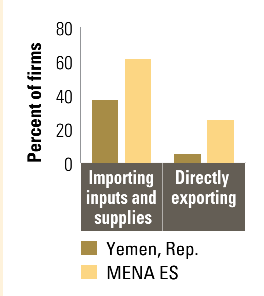
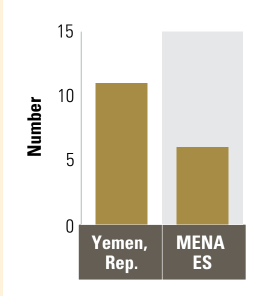


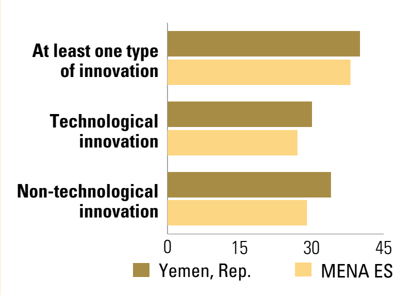
FIGURE 8: Days to clear direct exports through customs



Innovation rates in the Republic of Yemen are comparable with MENA ES averages

More than 40 percent of firms in the Republic of Yemen engage in at least one type of innovation (figure 9). These are introductions of new or significantly improved products or processes (technological innovations) or new or significantly improved organizational or marketing methods (non-technological innovations). Most of the innovations are new to the firm rather than new to the Republic of Yemen or to international markets. In the Republic of Yemen, firms primarily introduce new marketing and organizational methods rather than new products and processes; but firms also report technical innovation at rates slightly above the MENA ES average.

FIGURE 9: Firms engaged in innovation



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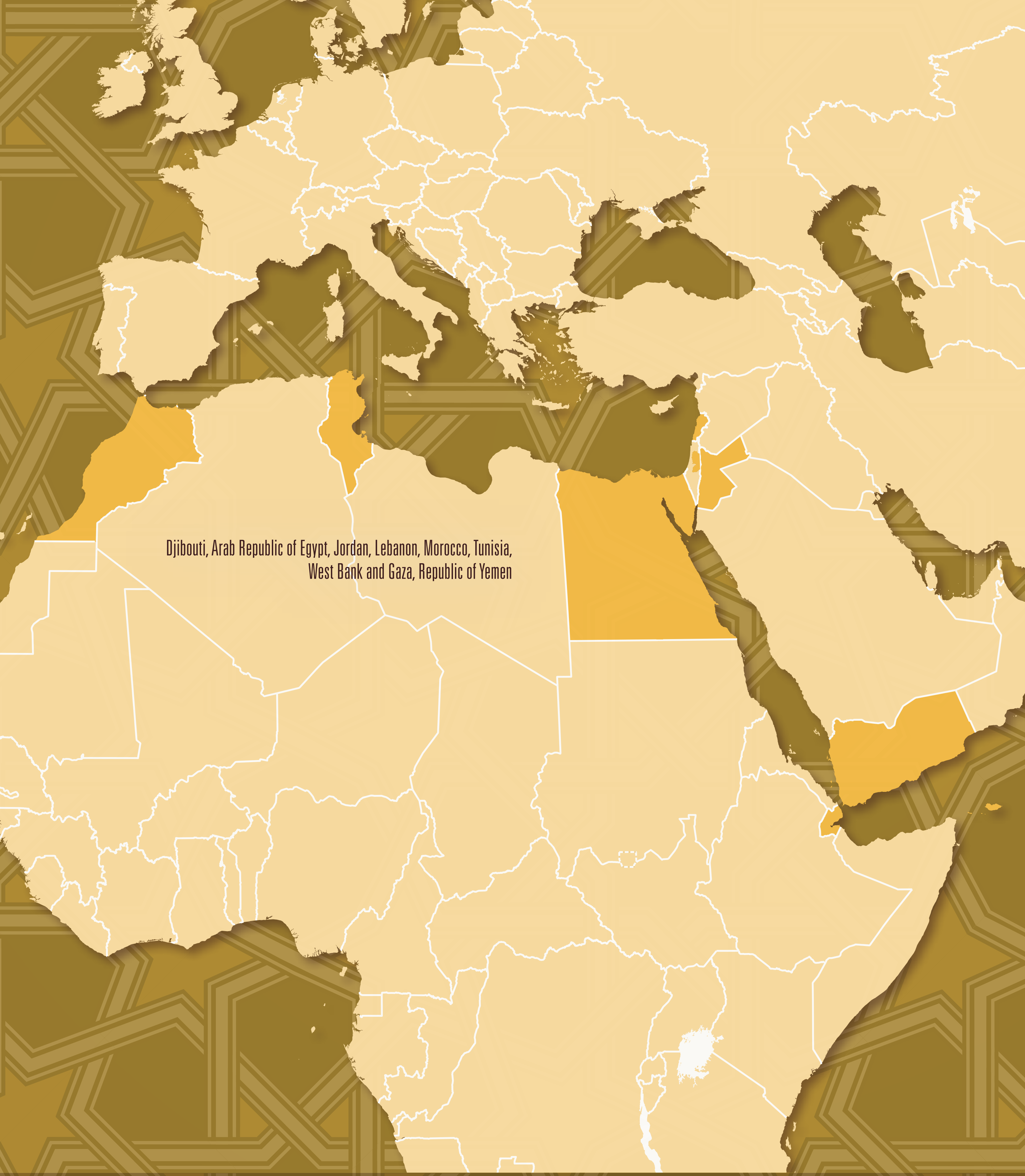

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