What's holding back the private sector in MENA?

Lessons from the Enterprise Survey

European Bank
for Reconstruction and Development

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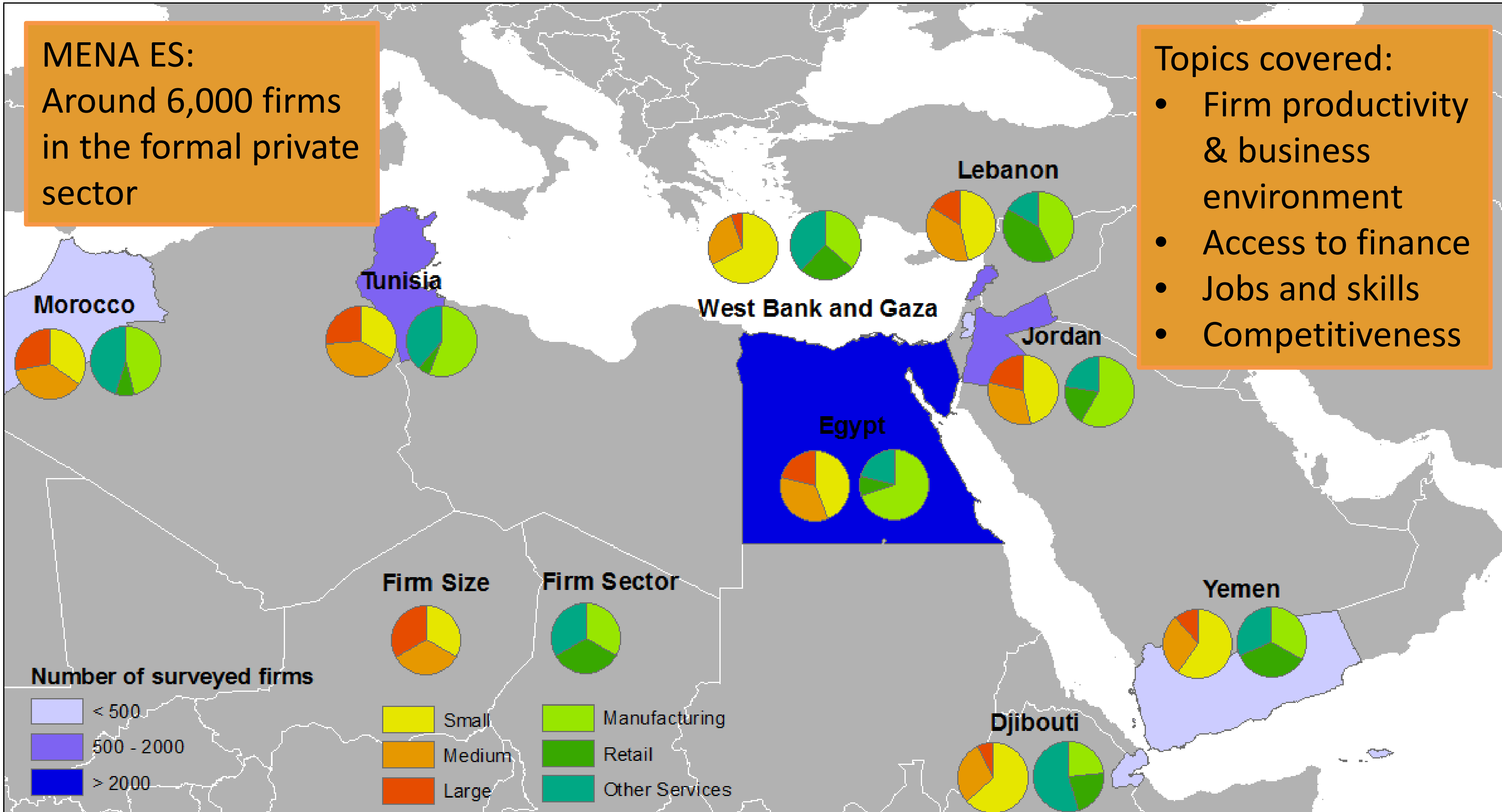
EBRD-EIB-WBG MENA Enterprise Survey and Report

MENA ES:
Around 6,000 firms in the formal private sector

Topics covered:
- Firm productivity & business environment
- Access to finance
- Jobs and skills
- Competitiveness

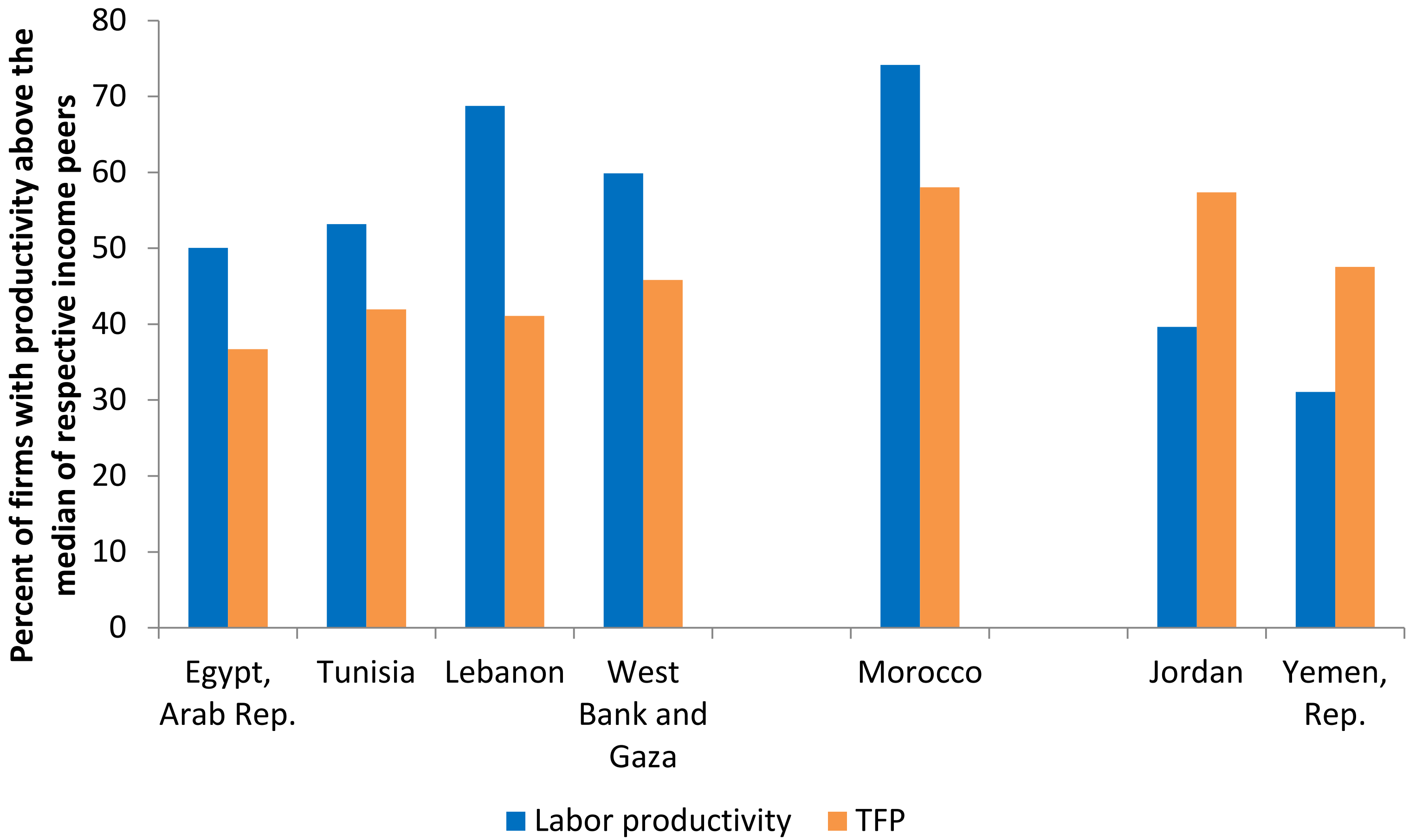


Firm productivity and the business environment

The formal private sector as a seed for more inclusive growth

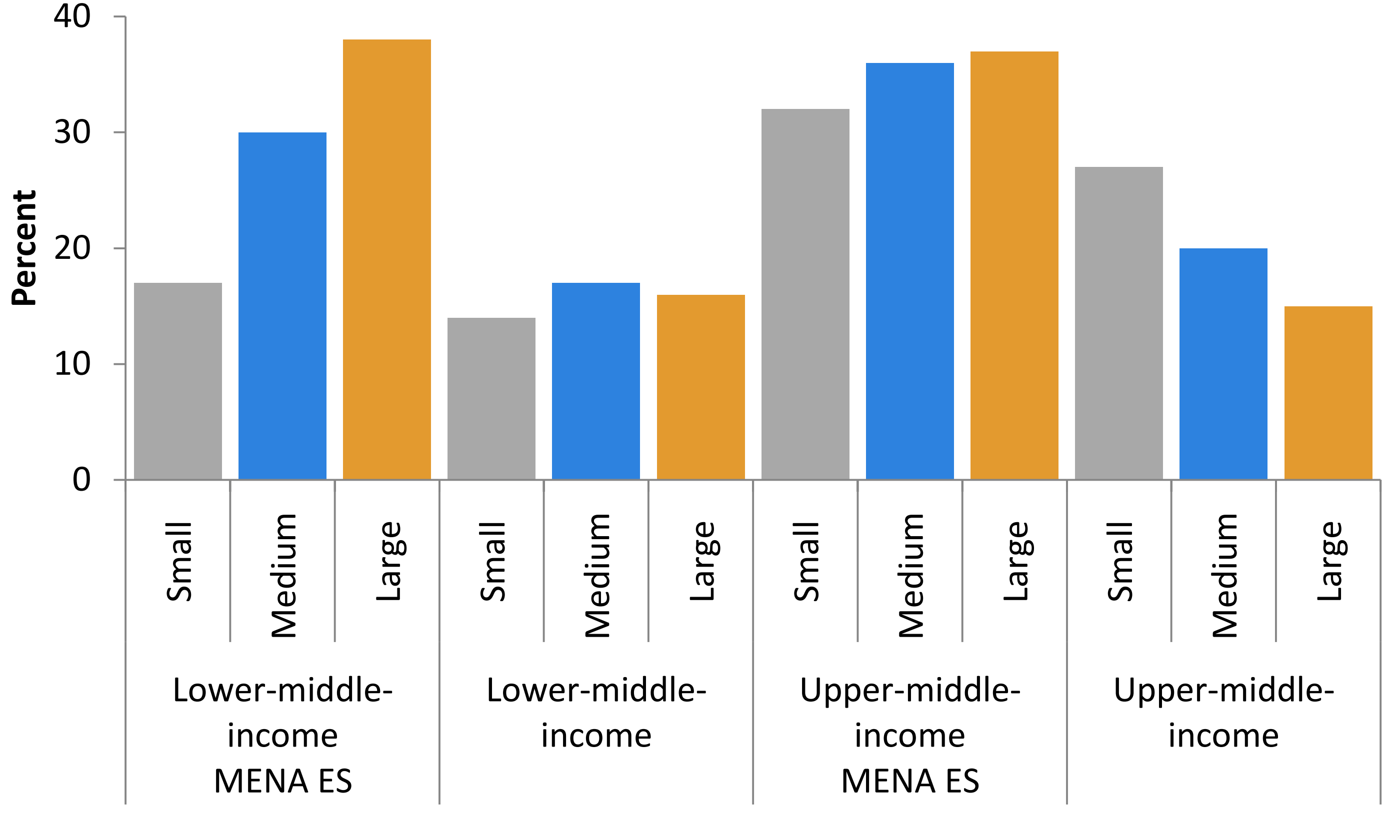
Firms in MENA have relatively high labor productivity, but not higher TFP…

Labor productivity and total factor productivity (TFP)

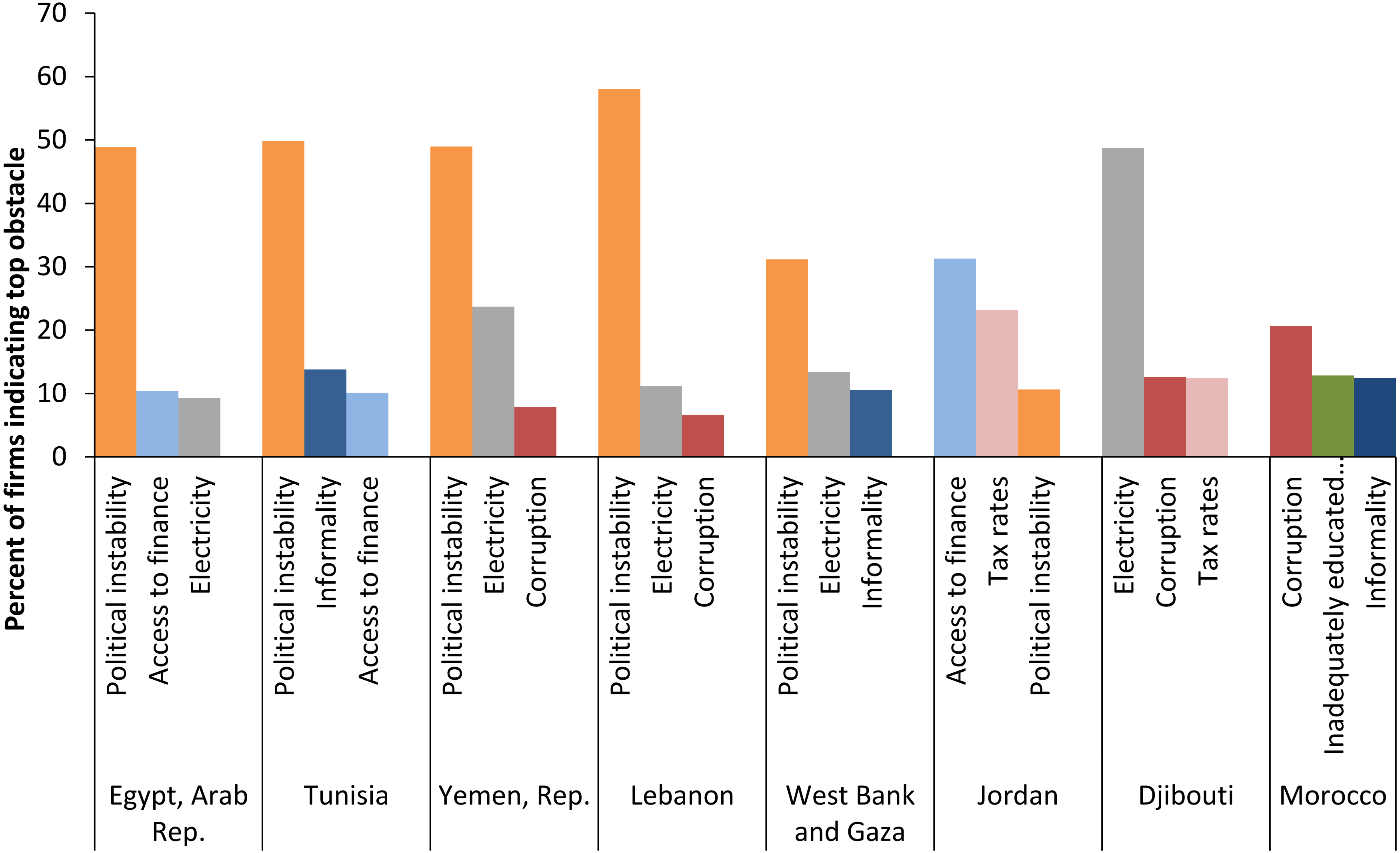


…mostly due to inefficiently high capital shares, particularly in medium and large firms

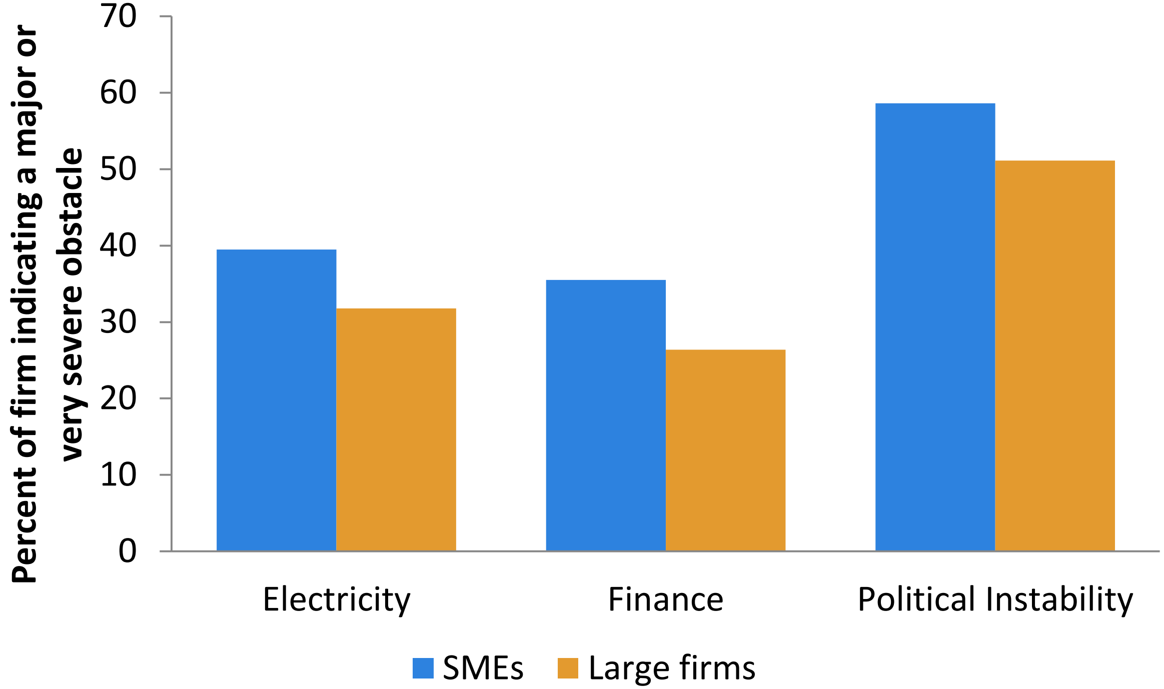
Median capital share, by size of the firm



Political instability, electricity, corruption, access to finance are the main perceived obstacles to operations



Small firms suffer more from political instability and issues related to electricity and access to finance



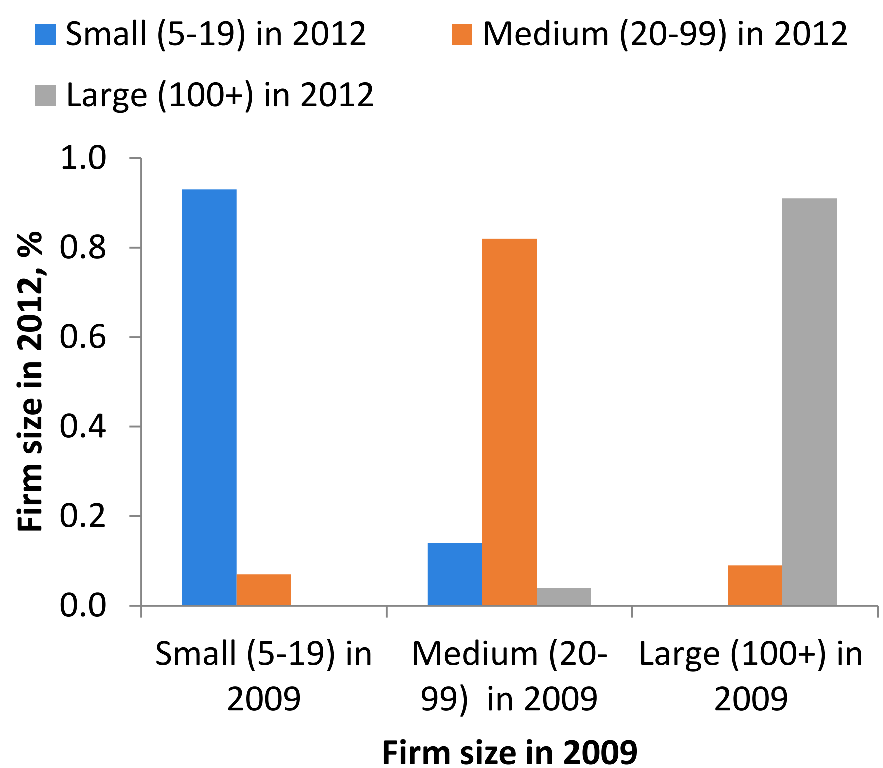
In addition, SMEs are:

- More likely to experience a power outage and less likely to use a generator
- More likely to be credit constrained

Firm dynamics is weak, but productive firms grow faster and pay higher salaries

- During 2009-2012 labor productivity declined, as sales growth lagged behind employment growth
- Medium-sized firms faced particular difficulties, reflecting poor firm dynamics
- Evidence from market forces at work:
  - Productive firms grow faster
  - More productive firms pay higher salaries

Firm size transition between 2009 and 2012



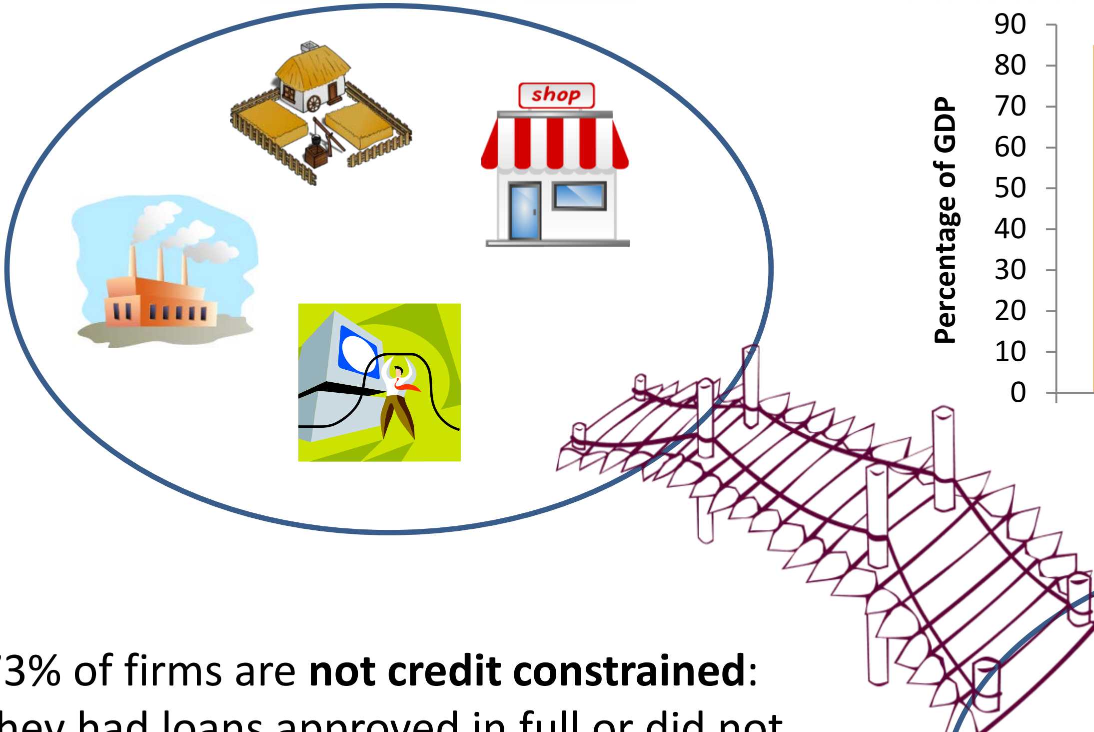
Policy implications

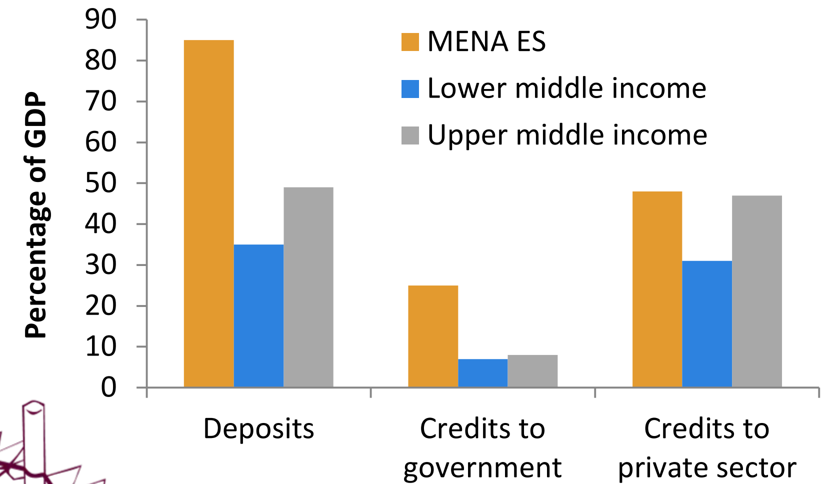
1. The formal private sector can be a seed for more inclusive growth in MENA
2. Dealing with political instability, corruption, electricity and access to finance is key to support the growth of the formal private sector
   - This is particularly relevant for smaller firms, as they report that they are more constrained by the existing operating environment
3. Distortions matter
   - Need to carefully assess distortions, such as privileges, subsidies, transfers and, more generally, competition policies

Access to finance

Banks and firms happily apart

Banking sectors are large, but lending is concentrated and firms tend to disconnect from the financial sector



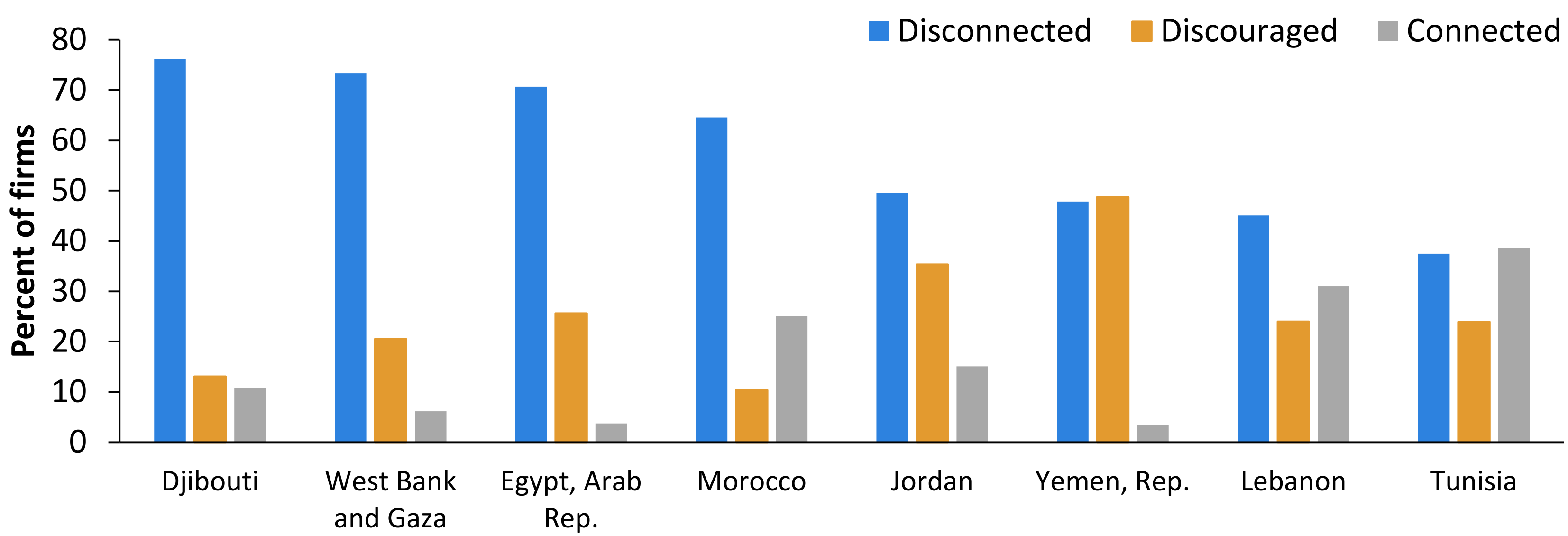


- 73% of firms are **not credit constrained**: they had loans approved in full or did not apply for a loan as they have enough capital
- 58% of firms are **disconnected**: did not apply for a loan because of sufficient funds

Loan concentration (share of top 20 exposures in bank equity), is the highest in the world

Disconnected firms lose growth opportunities

- Disconnected firms resemble credit constrained firms
  - Low propensity to invest
  - Low likelihood of having expansion plans – even when capacity utilization is high
  - However, they are not complaining about this situation, while credit constrained firms are



Banks’ collateral policies can induce firms to disconnect and prevent growth

- Collateral requirements are particularly stringent in MENA, in terms of incidence of collateral requirement and assets accepted as collateral
- Firms are more likely to disconnect when collateral demands are stringent, particularly when they are young
- Firms grow faster when collateral requirements are less demanding

Policy implications

1. It is necessary to construct the bridge:
   - Reduce the net costs of formalization and increase firms transparency
   - Better risk assessment capabilities for banks
2. Credit guarantee schemes can facilitate lending to borrowers that otherwise would be too risky
3. Reform of the secured transactions framework can alleviate collateral constraints

Jobs and skills in the formal private sector

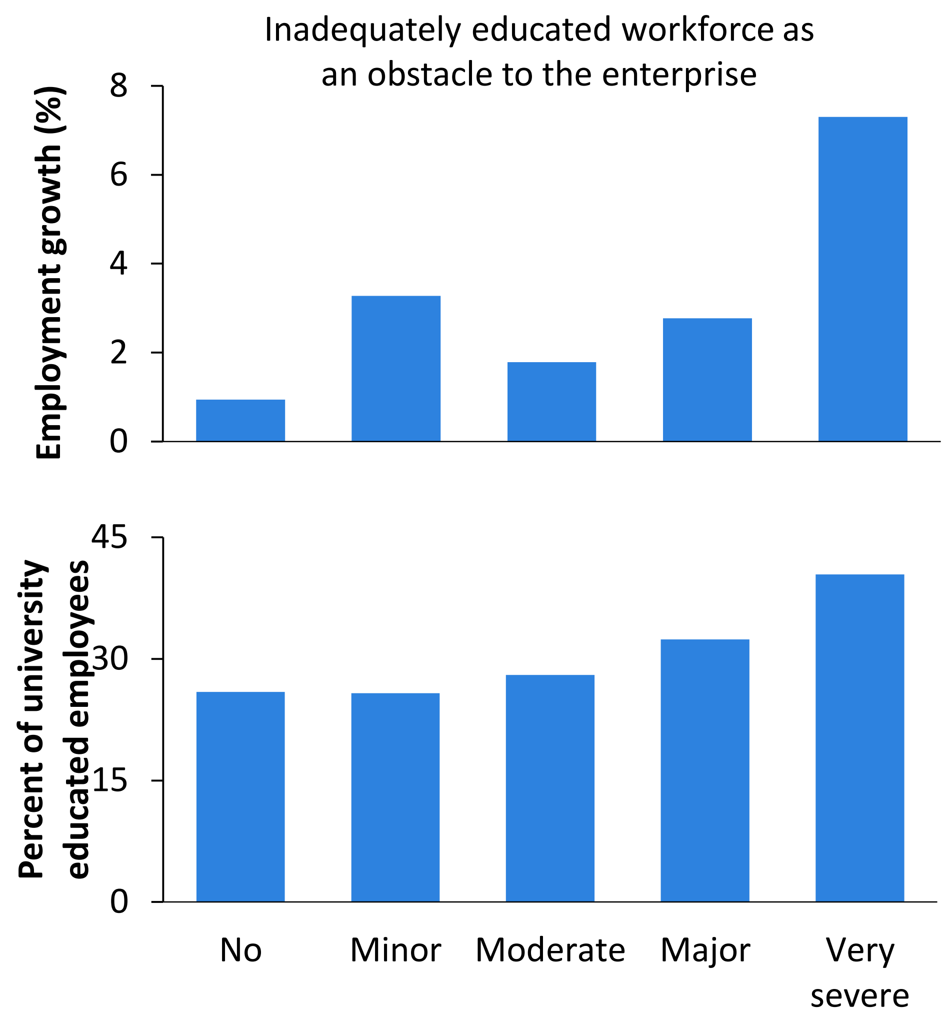
A call for higher and more inclusive growth

Jobs for female and young

- Females account for 18% of the jobs in firms, vs 34% in other regions, own only 3% and are top managers in only 5% of firms
  - Firm performance (labor productivity, sales growth or employment growth) and the business environment are not related to the gender of top managers, owners or employees -> this could reflect a very strong survivorship bias
  - Firms managed by women have a higher proportion of female employees
- Younger or larger firms employ more young workers
  - Firms with a higher share of young workers report more skills mismatches and provide more training

Skills shortages are particularly in fast growing firms; possible educational mismatches

- Inadequately educated workforce mostly an issue in Yemen, Morocco and Tunisia (above income peers)
- Skill shortages are a greater concern for firms that grow rapidly
- Firms that complain of skills shortages rely more on university educated employees
- Only 17% of firms train their workers: very low by international standards (around 38% in their peers)



Policy implications

1. Remove distortions preventing entry into the labor market
   - Impediments preventing women participation
   - More focused and targeted education for the young
2. Reduce the mismatch between the skills learned in formal education and those required by the business community
3. Provide incentives to increase the training intensity in firms

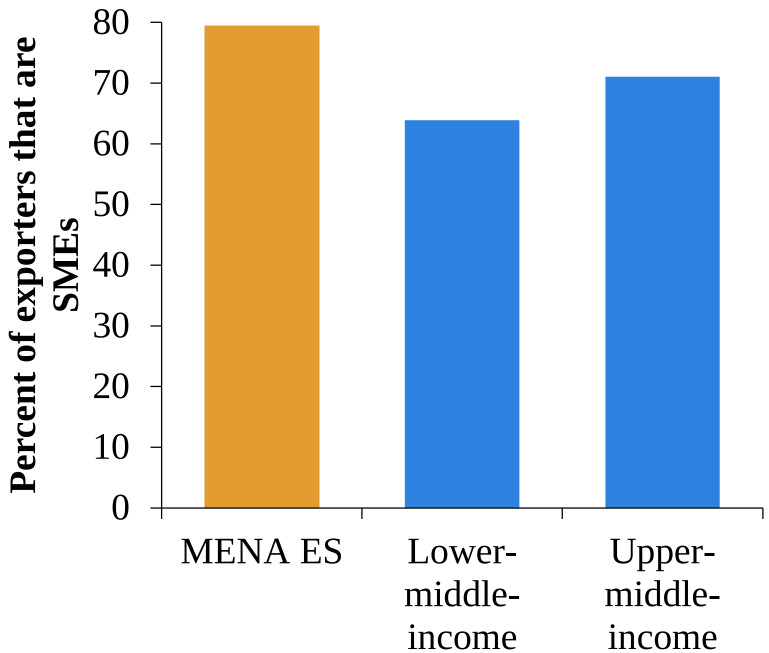
Competitiveness in MENA

Trade, innovation and management practices as drivers for productivity growth

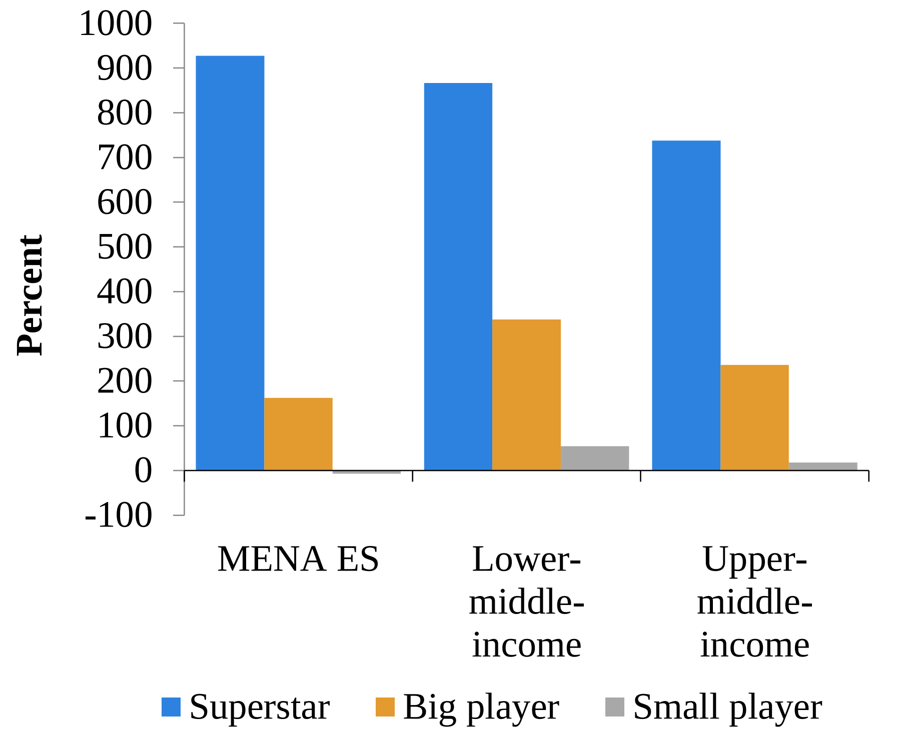
MENA ES firms are more likely to export, but those exporting firms are small and show low productivity premia

- MENA ES exporters are numerous (25% of firms are exporters in MENA ES vs 14% in lower- and 18% in upper-middle-income economies)

Most exporters in MENA ES are SMEs

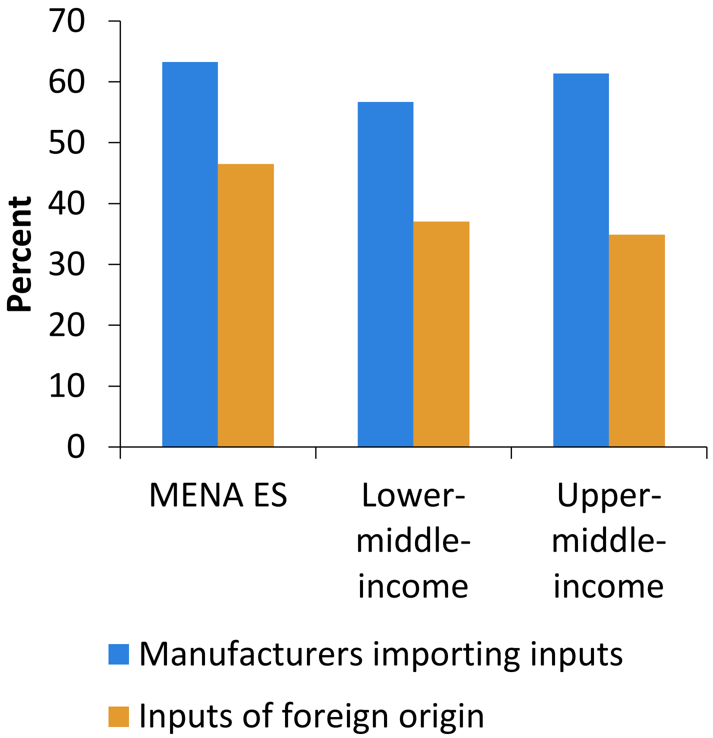


Labor productivity premium, exporting groups vs non-exporters

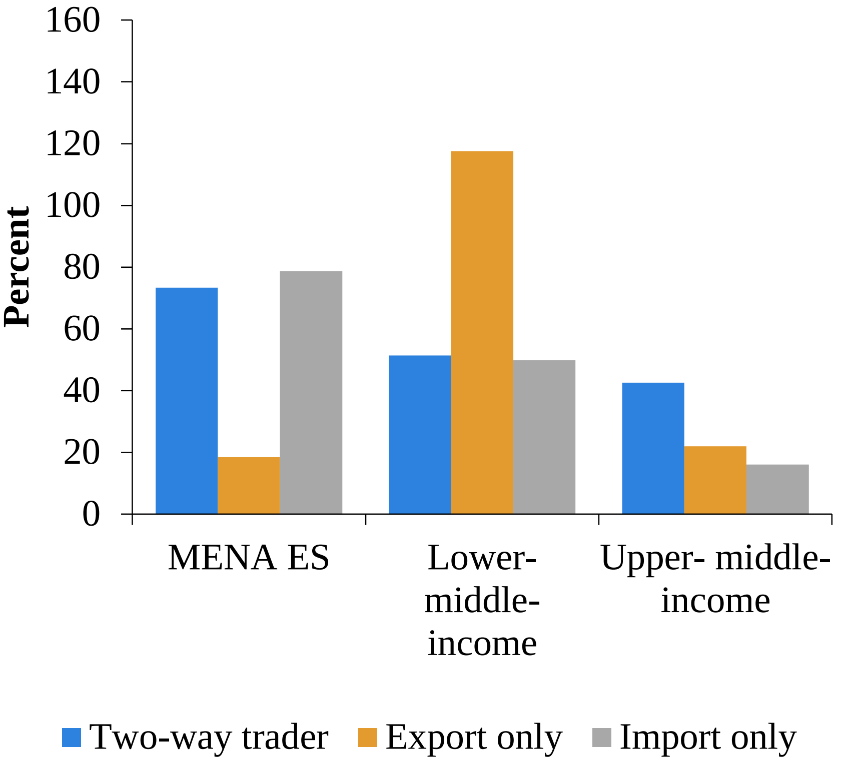


Manufacturers in the MENA ES are particularly import reliant, and importers have higher productivity premia than exporters

Import reliance of manufacturers



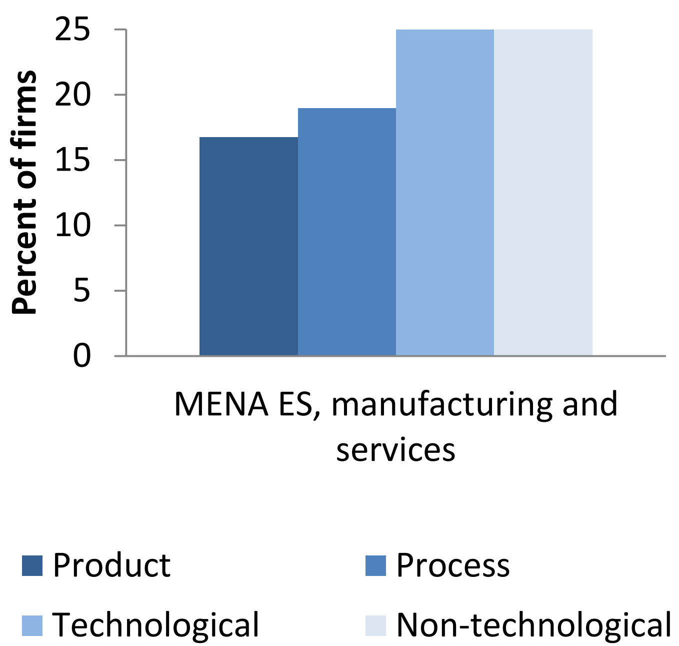
Labor productivity premium of traders vs. non-traders

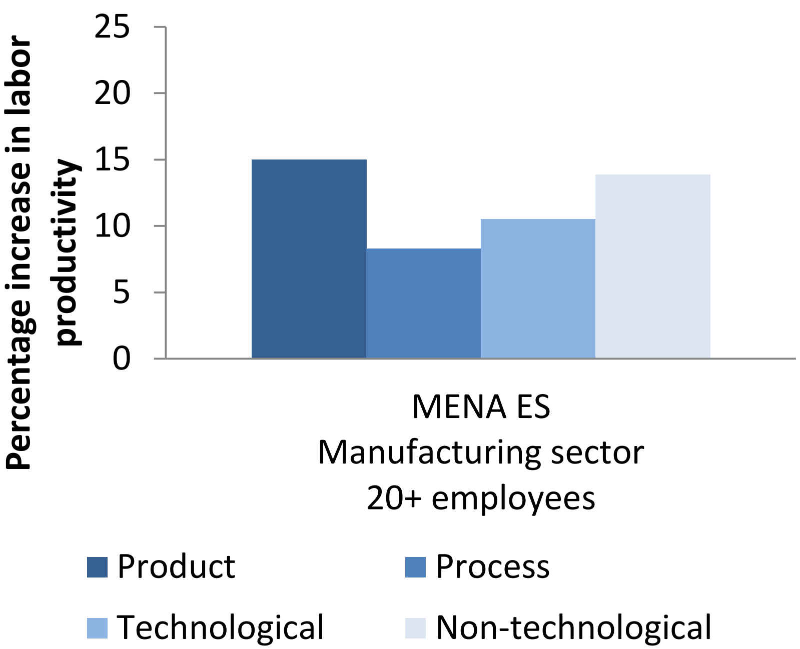


Source: Enterprise Surveys.

Firms innovate, mostly adopting existing technologies, but labor productivity gains from innovation are small

38 percent of firms in MENA ES introduced at least one type of innovation

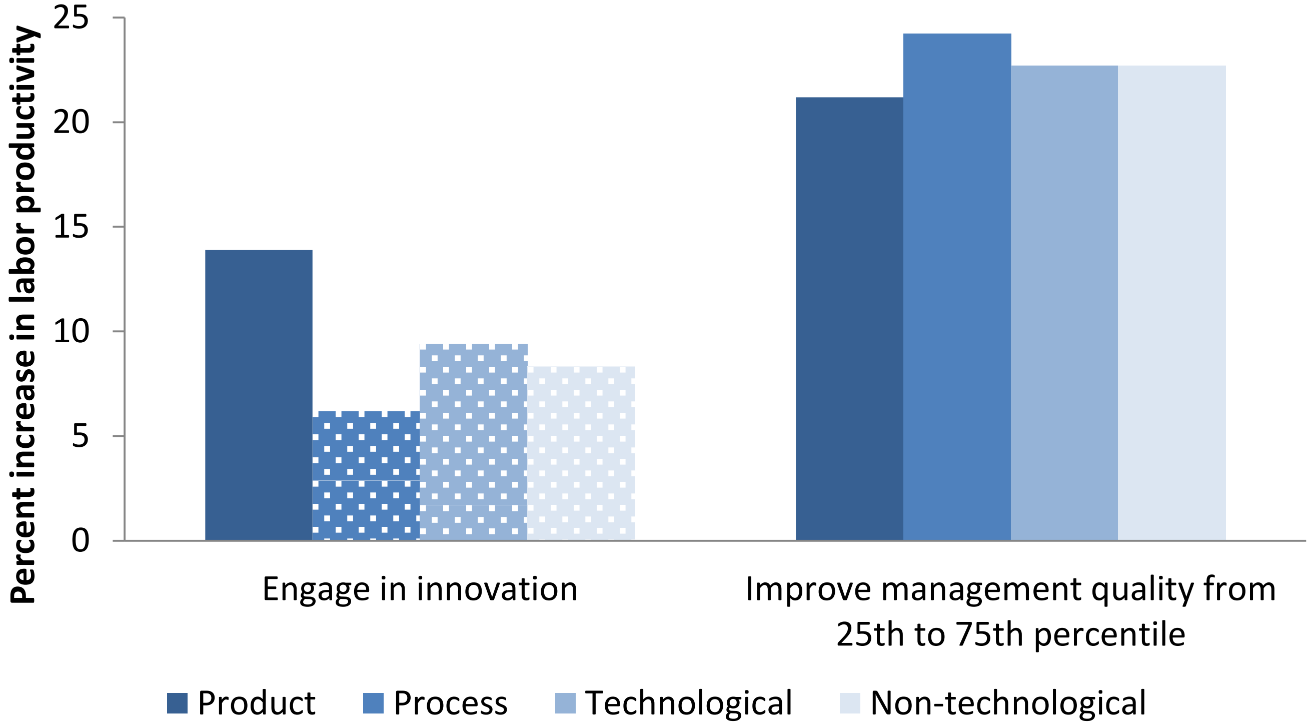




Firm-specific human capital, access to knowledge and access to finance have a positive impact on innovation

Firm-specific human capital	Access to knowledge	Access to finance
• Providing formal training to employees • Giving employees time to develop new ideas	• Foreign ownership • Importing and exporting • Licensing of foreign technology • ICT use	• Line of credit or loan

Poorly managed firms would benefit more from improving their management practices than from innovating



- … while well managed firms benefit more from innovation than from further improvement of management practices

Policy implications

1. Remove restrictions to firm entry and exit as well as restrictions that give incumbent firms undue advantage
2. Greater openness to international trade; more effective customs and trade regulations for importers and exporters
3. Importing should not be viewed solely through the (negative) lens of trade deficit and foreign exchange reserves; it can be a means to encourage more high-value added production
4. More open approach to FDI, as foreign ownership is also a means for acquiring knowledge and introduce innovation in the market