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SMALL AND MEDIUM SIZED ENTERPRISES IN MENA:

Leveraging Growth Finance for Sustainable Development

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Faced with high population growth, high rates of unemployment and poverty, and the declining capacity of the public sector as a viable employer of last resort, many countries in the Middle East and North Africa (MENA) are turning to Small and Medium Enterprises (SMEs) as a potential lifeline to generate jobs and promote economic development. However, in order for SMEs to contribute meaningfully to GDP growth and play a critical role in economic development and job creation in the coming years, they must be provided with the right tools and resources.

This study assesses the state of a significant, albeit underserved, segment of the SME market, known as the "Missing Middle" to better understand their needs and the challenges they face. It addresses how governments and other stakeholders can help them reach their potential for growth and job creation to positively impact the MENA region. Missing Middle SMEs are formally registered firms that have passed the initial start-up stage. These SMEs typically have modest revenues of US$100,000–$5 million, employ an average of 6–150 employees and require between US$50,000 and $2 million in flexible growth finance, along with business development assistance, to survive and grow.

This study shows that although there are a number of existing SME support programs in the region, they need to go beyond the provision of limited subsidized loans and pre-investment training to adequately support the Missing Middle SMEs throughout their business lifecycle. More specifically, the findings suggest that Missing Middle SMEs have four critical inter-related needs for sustainable success: 1) flexible patient capital structured to fit the needs of each SME; 2) sustainable and customized business development assistance targeted to each SME's needs; 3) market linkages to supply chains to ensure SMEs have an adequate access to market opportunities; and 4) an enabling business environment that addresses the barriers to their development and growth. There is near unanimous agreement among SMEs and intermediaries interviewed in this study that addressing these needs in a focused and sustained manner would increase the survival rates and sustainability of SME businesses.

An integrated system that offers a one-stop-shop facility where SMEs can access a range of services from information about starting a business to support on how to effectively manage and sustain a growing business is much needed. Organizations in charge of these programs also need to build stronger execution capacity that enables them to provide services in a rigorous and sustained manner, to identify the deficiencies of entrepreneurs and managers of SMEs and address their specific skill set needs. To make SME support programs more effective, a more coordinated, customized and sustained model of support that is sustained throughout the various stages of business development and growth, and is capable of addressing not only barriers to starting up a business, but also barriers to operating a business and achieving growth, should be adopted.

Beyond improving the core capabilities and offerings of SME support programs, there is a need to increase the synergy and coordination between them as well as to improve communication and information sharing between support programs and the clients they seek to serve — entrepreneurs and SMEs. The lack of coordination between service providers has resulted in a system where organizations and government agencies that work in the same sector and deliver similar services often do not know what others are doing or offering, resulting in high levels of duplication and overlap, and inefficiencies.

The majority of SMEs are also currently unaware of the services and support programs available to them. Stronger, more effective partnerships between public authorities and private, regional and international service providers can add value through better mobilization, delivery and optimization of resources, which will enhance the capacity of SME support programs. Specialized SME authorities that centralize many of the government services and coordinate among the numerous service providers in a country can help address many of these problems. Unfortunately, most countries in the MENA region currently do not have an integrated approach or specialized authorities where SMEs can access information about and apply for available funding and services, and handle necessary transactions with government agencies, such as obtaining appropriate business permits and licenses. However, there is growing recognition that the flaws of the existing system must be addressed to help SMEs flourish, and many countries in the MENA region are exploring ways to address that challenge, including the establishment of such specialized authorities.

This study shows that although there is a number of existing SME support programs in the region, they need to go beyond the provision of limited subsidized loans and pre-investment training to adequately support the Missing Middle SMEs throughout their business lifecycle.

Governments in the Middle East and North Africa (MENA) region face daunting social-economic challenges. A burgeoning youth population, high unemployment rates, poor governance and management in government institutions, and uneven rates of economic development within MENA countries have led to declining incomes and social unrest, making the need to create jobs and raise living standards a top priority. There is a growing recognition that small and medium enterprises (SMEs) can be a vital resource to combating some of the challenges facing the region by contributing to job growth and the economy, and bridging some of the regional economic development imbalances that have emerged within countries. SMEs have been widely recognized as effective and successful in developed markets, where they are responsible for much of the growth in new jobs, and contribute to over 60%–70% of employment and more than 50% of GDP.

However, in spite of the acknowledgment that SMEs are critical to economic development, the MENA region remains among the least effective at cultivating a business environment that is friendly to SMEs. Many SMEs face substantial barriers to growth and sustainability ranging from limited access to finance and an unfavorable regulatory environment, to the lack of business management skills and market linkages needed to grow and succeed. They often struggle to obtain the financing they need to expand and achieve sustainability due to their stage of development. Enterprises in the "Missing Middle" are underserved by investors and government-sponsored SME support initiatives in the region, which often focus on either start-ups or large, well-established SMEs. A deeper understanding of the needs and challenges of Missing Middle SMEs is important because they are poised for growth and have the greatest potential to create jobs. Their development and success can help to address some of the many economic and social challenges that the MENA region faces, which arise from a growing population and burgeoning youth bulge.

Research for this report was conducted in four countries that spanned different pockets of the region: Egypt, Jordan, the Kingdom of Saudi Arabia (Saudi Arabia or KSA) and the United Arab Emirates (UAE). The study comprised over 50 interviews with experts, a quantitative survey of over 150 local SME owners, and secondary research. The initial 50 interviews spanned experts from "intermediaries" across the four countries, including governments, banks, academia, international donors operating locally and SME-focused nonprofit organizations. The quantitative survey focused specifically on Missing Middle SME owners and key financial decision makers, to allow us to better understand their experiences, challenges and needs. All survey respondents were local citizens who ran companies that met the thresholds for Missing Middle SMEs as defined by the number of employees (6–150 employees) revenue ($100,000–$5 million), and capital needs ($50,000 and $2 million). Data collection occurred between late 2011 through early 2012. Due to political and social unrest in Egypt during the period the survey was conducted, Egypt was excluded from the quantitative survey.

The study found that Missing Middle SMEs are hampered by the lack of several important things — a sufficient business track record, adequate collateral, suitable guarantors and strong linkages to the market — which often precludes them from accessing capital from banks. Current market conditions also favor more established businesses and work against Missing Middle SMEs. Hence, historically, they have been overlooked by the formal financial sector. This is especially true in the MENA region, which has particularly low levels of SME lending — the lowest in the world outside of Africa.[2] Though there are multiple finance providers to SMEs in the MENA region, mostly government-funded agencies, the success rate, barriers, challenges and funding gaps of these existing programs is mostly unknown.

Current SME support initiatives in MENA do provide a range of financing and nonfinancial services but they have weaknesses that impede their ability to support sustainable businesses that can create jobs and contribute to economic growth over the long term. These weaknesses can be summarized in three categories:

1) Poor coordination: SME support organizations suffer from poor coordination and limited execution capacity;

2) Inadequate products and services: The products and services provided lack suitable terms and capital structure and sustained business assistance;

3) Weak ecosystem: There are broad environmental factors including the lack of effective policy environment for SME formation and growth, inadequate educational programs and a high ratio of government employment, that make entrepreneurship unattractive and a less prestigious professional track.

We hope that this report will not only provide a better understanding of the current landscape and challenges of this sector, but also, through our recommendations, spawn proactive discussions and meaningful solutions from policymakers and the public and private sectors to enable SMEs, particularly those in the Missing Middle, to operate in a business and regulatory environment that supports their development, and to receive needed growth financing and business development assistance. This will allow them to grow sustainably, create jobs and ultimately contribute to economic growth and prosperity for the MENA region.

In recent years, the need to support SMEs has become a top government priority in the MENA region. SMEs have been deemed a key tool to combating the present challenges facing the region, including the need to diversify the economy, improve competitiveness, raise living standards, create jobs and bridge the regional development imbalances within countries.[3] International experience shows that SMEs contribute significantly to employment and economic activity, and are a critical lever for job creation, innovation and competitiveness. In developed countries, SMEs contribute to more than 50% of GDP and over 60%–70% of employment. Virtually all net U.S. private-sector jobs were created by new companies between 1977–2005.[4] The World Bank called SMEs essential engines of growth that contribute to effective markets and reduce poverty in developing countries where populations were growing rapidly and jobs desperately needed. However, in low-income countries, SME contribution to GDP and employment is less than half the rates in developed countries.[5] This gap arises due to the many barriers facing SMEs in low-income countries; particularly those in the Missing Middle segment, including a costly business environment, restrictive regulations and lack of appropriate financing options and business support.

More so than any other region in the world, the MENA region needs to create employment opportunities, especially for youth 15–30 years old. Due to rapid population growth, over the next 15 years, more than 80 million more jobs are needed to prevent deterioration in income and rising unemployment. This rapid growth, which began in the 1950s, has created a large youth bulge in the region.[6] Unemployment in the region falls disproportionately on youth, whose share of unemployment ranges from 36% in Morocco to 73% in Syria. Those who are employed predominately work in the informal sector.[7] Simultaneously, MENA has also witnessed the fastest expansion in educational attainment in the world between 1980 and 2010. As a result, the new generations of workers, male and female, are the most educated in the region's history. This adds to the region's pressure to not only create jobs, but also high-quality job opportunities that match the skill sets of a new, highly educated young workforce, making job creation one of the most critical development challenges facing MENA today.[8]

The Arab Spring that swept Egypt, Libya and Tunisia, and the current crisis in Syria, triggered initially by public dissatisfaction with government failure to curb corruption and provide more jobs and other economic opportunities, also highlights why SME growth and success is all the more critical in MENA. Public employment has been the typical response of government to domestic pressure for political and economic reform in the region to date. Such policy is no longer viable given the nonproductive nature of adding unnecessary public employment and the limited resources available to governments to respond to the growing needs of the unemployed population. Thus, reallocating public financial resources to invest in SMEs, the engine to create jobs and combat high unemployment, can be more effective in the long term than merely adding jobs in the public sector as part of the long-standing social contract.

DEFINING SMES AND THE "MISSING MIDDLE" IN MENA

There is no universally recognized definition of SMEs. Countries vary in their criteria for defining SMEs, which typically include number of employees, capital needs, revenue and fixed assets of the company. Definitions can also vary based on factors like sector and whether business is high or low growth. The most popular definitions from each market, based on interviews with expert SME intermediaries, are listed in Table 1.

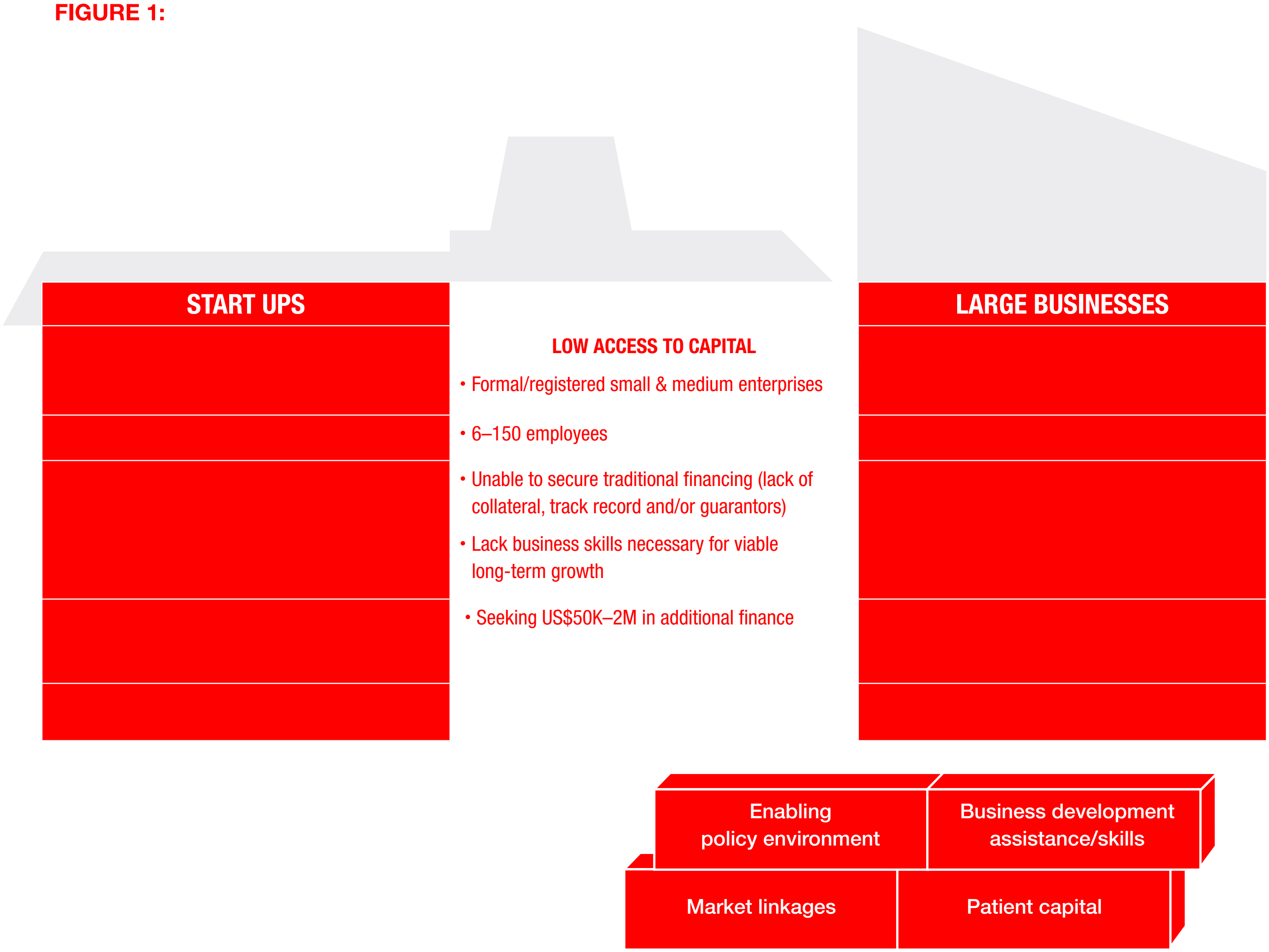
Missing Middle SMEs (Figure 1) are formally registered small and medium businesses that have passed the initial start-up stage. According to the experts interviewed for this study, the Missing Middle represents 40%–70% of the SME market depending on the country in question. These SMEs typically have modest revenues of US $100,000–5 million, employ an average of 6–150 employees and require between US $50,000 and $2 million in growth finance. They occupy the middle of a spectrum based on size and revenue and lack the long track records and collateral required to obtain traditional financing. Hence, they are often overlooked and underserved by formal financial institutions and SME support organizations, particularly due to the challenges to address their needs in ways that are scalable and sustainable. This leaves many of them struggling to access capital to sustain and expand their business operations. In spite of their incredible potential to contribute economically and create jobs, less attention has been paid to the Missing Middle segment of the SME market. In addition, the global economic recession has heightened the risk aversion of potential investors, contributing to the need to make capital and assistance available to this segment even more pronounced.

TABLE 1:

Company Category	# of Employees	Annual Revenue in USD
Saudi Arabia		
UAE (service sector only)		
Jordan		
Egypt		

More so than any other region in the world, the MENA region needs to create employment opportunities, especially for youth 15–30 years old.

FIGURE 1:



There is a long-held axiom that there is a "three year rule" in business — if you can survive the first three years, then chances of success become exponentially higher. International studies indicate that 70%–80% of businesses fail after an average of only 20 months. A prominent SME expert in MENA estimated that the rate of failure in the MENA region might be even higher than that — as high as 90%.[9]

Nevertheless, the existence of a large Missing Middle in MENA is a good indication that entrepreneurial spirit abounds in the region. The 2011 Global Entrepreneurship Monitor Report showed that in emerging economies, entrepreneurial activity is very high at the start-up phase but then steeply drops, suggesting that many individuals start businesses but few are able to sustain them. Many Missing Middle SMEs fail to survive beyond the start-up phase due to the lack of vital human and financial resources needed to expand, their inability to stand up to competition and the lack of a solid track record with which to entice customers, investors and lenders.[10] This transition period is often referred to as the "valley of death." This highlights the critical need to support SMEs through this growth phase.

SMEs that are growing and in the midst of product expansion or development and commercialization require investments of capital and capabilities, often in advance of growth in revenues and associated profits. They need specialized and targeted support services and patient financing. Our research shows that SMEs in the Missing Middle have four common, interrelated needs that require a focused and integrated framework to address them simultaneously. These are described below. The likelihood of SME survival past the start-up phase would drastically increase if Missing Middle SMEs were able to access the resources needed to address these needs.

1. Access to flexible patient capital: Debt and equity financing on appropriate terms (capital requirement, pricing and tenor) structured to fit the specific needs of each SME across the lifecycle of the business.

2. Business development assistance: Customized, robust and sustained business training and solutions, including market information, marketing, management and finance, strategic planning and technology to bolster the business skills and knowledge of the entrepreneurs.

3. Market linkages: Linking SMEs to supply chains and to the vast potential business and community development opportunities and investment projects that will ensure the growth and sustainability of SMEs.

4. Enabling business environment: Removing regulatory barriers that are harder for small and mid-sized enterprises to overcome than for large enterprises.

EXISTING SME SUPPORT PROGRAMS

There are numerous existing programs and initiatives that serve SMEs in MENA. In recent years, due to growing attention given to job creation, workforce nationalization (replacing expatriate workers with nationals) and poverty reduction by governments in the region and international donors in Europe and North America, more resources and funding has been poured into initiatives and programs that support SMEs and promote entrepreneurship. They generally provide a range of services, such as subsidized or guaranteed loans and grants, and business training, advice and facilitation. Table 2 provides a list of key government-linked SME support programs and the services they provide. These programs primarily target SMEs in the start-up phase and do not adequately serve the Missing Middle. The absence of targeted and continuous business and financial support services, which meet the needs of SMEs across their business life cycle, contributes to the short lifespan of many Missing Middle SMEs.

WEAKNESSES OF CURRENT SME SUPPORT PROGRAMS

In spite of the additional resources and efforts devoted to SME development initiatives by governments and international donors in MENA, several weaknesses impede their ability to address the needs of SMEs in the Missing Middle:

- **Most SME support initiatives and organizations lack the capacity and sophistication to provide customized and sustained business development assistance.** The needs of SMEs change dramatically over the course of its business life cycle — start-up, expansion, commercialization and sustainability. However, existing programs generally offer generic pre-investment training, such as how to develop a business plan, which may not be relevant or useful to businesses beyond the start-up stage. A deeper breadth of services, customized to the needs of SMEs as they advance through their business life cycle, would help entrepreneurs tackle the new challenges they may face as they grow their business. Currently, most government and NGO programs seldom meet the specific skill needs and deficiencies of the enterprises in the Missing Middle.
- **The offerings of SME programs are not designed or suited to fit the needs of the Missing Middle.** While the MENA region does offer an abundance of subsidized capital in many countries, it is often inaccessible to the Missing Middle SMEs that have passed the start-up stage. Funding and other support services were often limited and inadequate in duration. For example, Missing Middle SMEs need patient, flexible capital with a longer time horizon, but programs often only provide small grants or loans below the level of need of SME entrepreneurs and

TABLE 2:

Government-linked SME support programs	Country	Services provided

Note: This list is not comprehensive. Many of the programs funded by international donors and private sector firms are not listed here.

at terms that were too short in duration or overly high in interest. Even when funding is available, it is often not linked to business development assistance that is also required to help businesses stay on track.

- **SME support programs lack effective "implementation" or "execution" capacity.** At a high level, some elements required to address the SMEs' needs, such as finance and training, are already recognized by SME support programs. However, these programs fall short because their services are not implemented in an effective way. Capabilities such as screening and assessing applications, developing financial and non-financial schemes appropriate to each SME's requirements, credit registries, and dispute and payment settlement processes are underdeveloped. Furthermore, there is an absence of synergy and coordination between various SME support programs, which weakens their ability to build specialized expertise to meet the various needs of SMEs, and especially Missing Middle SMEs, across their development stages. Rather than sharing information, programs protected their SME contacts, leading to a sense of competition, fragmentation and lack of complementarity in the market.

This fragmented system, combined with the lack of effective communication and information sharing capability between service providers and the SMEs, often results in lack of awareness among SMEs of services that are available. Most SMEs surveyed in our study indicated they did not know who is offering what, to whom and how. While select SMEs located in major cities and are more "well connected" were more likely to be aware of existing support programs, the majority of SMEs lack knowledge and awareness of the resources that exist and are available to help them.

Missing Middle SMEs need patient, flexible capital with a longer time horizon, but programs often only provide small grants or loans below the level of need of SME entrepreneurs and at terms that were too short in duration or overly high in interest.

There are significant barriers in the current environment that face Missing Middle SMEs. This section addresses the barriers to the four common needs of SMEs that we identified in the previous section.

A. ACCESS TO FLEXIBLE PATIENT CAPITAL

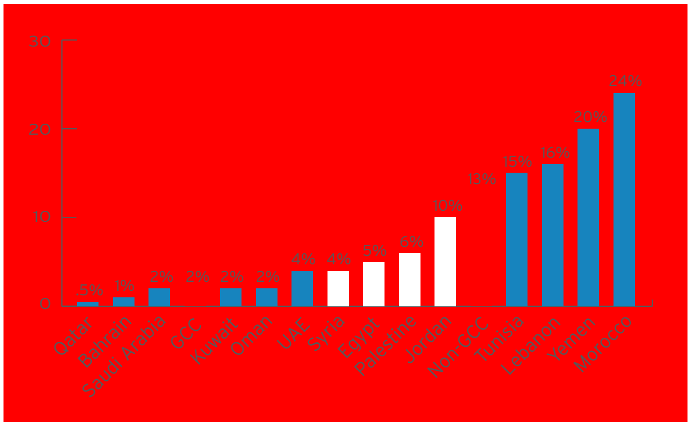
Capital Need

Access to flexible patient capital is critical to support the growth of Missing Middle SMEs. Over half of the SMEs surveyed reported needing between US$50,000 to $150,000 in additional financing to meet the needs of their growing businesses. The amount needed was higher for respondents in Saudi Arabia, where more than half of the Saudi owners reporting that financing needs of $500,000 or more (Figure 6). This is in large part due to the large size of the Saudi economy and the current economic boom.

Limited Bank Lending to SMEs

Over half of SMEs turn to banks and other lending institutions for additional funding (Figure 7). However, of those that have sought funding from banks, over half have been denied a loan. This is in line with data from the 2010 and 2011 World Bank Enterprise Surveys[11] and World Bank's Financial Access and Stability Review, which indicate that access to finance for SMEs is more constrained in MENA than other emerging regions, except Africa, with only one in five SMEs having a loan or line of credit.[12] Although banks increasingly view the SME segment as potentially profitable, the average rate of SME lending as a share of total lending is very low at 8% overall compared to their contributions to GDP ranging from 30% in Saudi Arabia, UAE and Jordan to 70% in Egypt, and to employment ranging from 30% in UAE, 40% in Saudi Arabia and Egypt to 50% in Jordan. Within Gulf Cooperation Council (GCC) countries, this rate only averages 2%. It is only slightly higher in the rest of the Arab countries at 13%. (Figure 2) Furthermore, the loan terms for capital that is available are often unsuited to the needs of Missing Middle SMEs. Hence, these businesses were often forced to rely on self-financing and less formal financial resources such as family, friends and informal moneylenders.

FIGURE 2:



Reported numbers are weighted averages and Non-GCC average includes Iraqi banks that were not reported in the graph as the coverage Iraq is not more than 30%

Source: R. Rocha, et al 2011. The joint survey of the Union of Arab Bank and the World Bank.

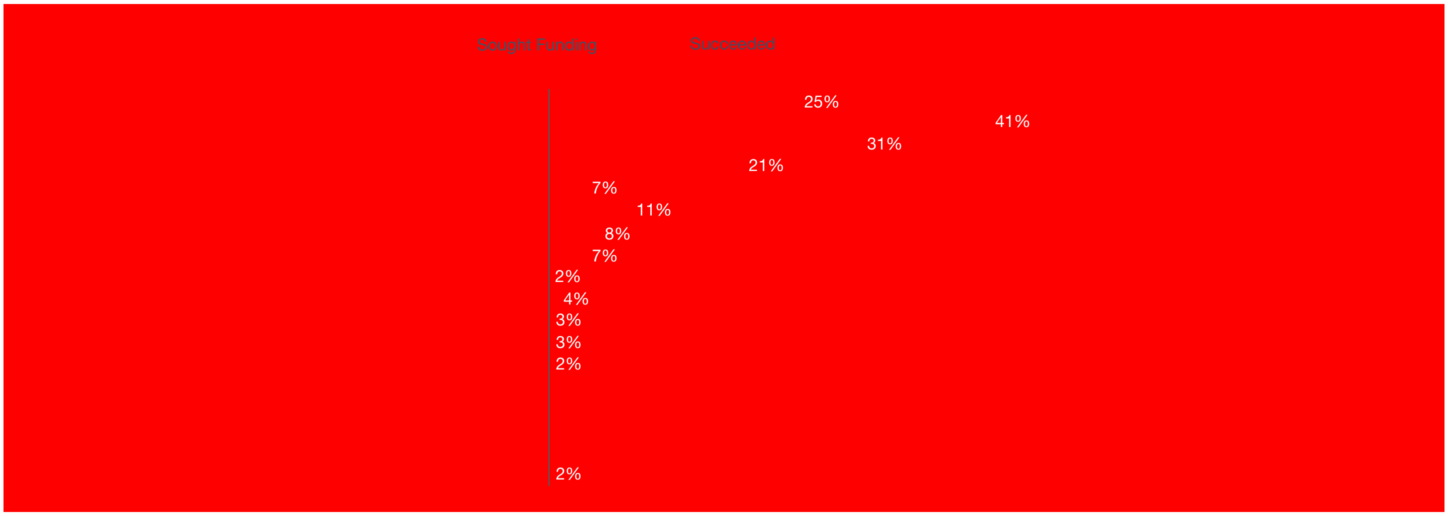
Saudi owners in particular struggle to obtain bank loans, with close to nine in ten (89%) reporting it is difficult to get a bank loan. The data show that only 2% of total loans in Saudi Arabia were directed at SMEs. To overcome the limitations they face, entrepreneurs have come up with creative financing schemes to access needed capital. For example, in Saudi Arabia, some entrepreneurs who are employed would buy cars using loans, then sell the vehicles and use the funds to their start businesses.

FIGURE 6:

Additional Financing Sought		Jordan	Saudi Arabia	
	54%			63%
	25%			29%
	14%			8%
	8%			–

BASE: TOTAL RESPONDENTS (n=154)
Q: How much additional financing are you currently seeking for your business now or in the near future?

FIGURE 7:



BASE: TOTAL RESPONDENTS (n=154)

Q: Earlier you noted that you are currently seeking [INSERT RESPONSE FROM Q1050] in additional financing for your business. Which, if any, of the following sources of financing have you pursued to secure this level of funding for your business?

Q: Have you been denied finance or funding from any of the sources you pursued for this level of funding? Select any that have rejected request for funding.

The difficulty SMEs face in obtaining bank lending disproportionately impacts the Missing Middle segment, which has few alternative funding sources. Unlike start-ups, Missing Middle SMEs are typically not small enough to be served by various microfinance schemes even though microfinance is abundant in the region. The microcredit model is not effective when larger and riskier investments are needed and cash flows are not immediate. Hence, small loans from microfinance providers are not well suited to meet the needs of Missing Middle SMEs. Missing Middle SMEs are also too big to qualify for many of the support programs that provide considerable financial and technical assistance to start-ups, such as the Oasis 500 and I-Park incubation programs in Jordan, and the Bab RizJamel, AGFUND, Centennial Fund, and Riyadah in Saudi Arabia. However, they are also not big or well established enough to be attractive to venture capital or private equity firms. These firms are reluctant to invest in Missing Middle SMEs due to the higher risks and lower risk-adjusted returns of investing in smaller, unproven SMEs and the difficulties of exiting such investments. Thus, the funding challenge for SMEs really begins when start-ups enter the growth and commercialization stage and begin to face fierce competition but lack the vital financial and human resources needed to grow and expand market share.

“How to transition from small grocery shop to supermarket can be challenging to traditional owners. I know a small but successful business that failed when it tried to transform itself into a bigger business for lack of business and management skills. The owner did not have the skills to set up an accounting and HR system.” — An Egyptian SME expert

Barriers to Obtaining Bank Financing

Respondents indicated that bank loans are typically denied to the Missing Middle segment because banks are unwilling to finance companies without long track records (typically a minimum length of 5–10 years), sufficiently large collateral (typically between 120%–150% of the loan amount) and guarantors with enough capital to protect against default risk. Even for those who meet the criteria, banks still only fund a small fraction of SMEs, likely due to the availability of safer investment opportunities or lack of sufficient loan capital. Respondents indicated that those that are lucky to receive loans face high interest rates that are as high as 10%–14% compared to only 4%–8% for large companies.

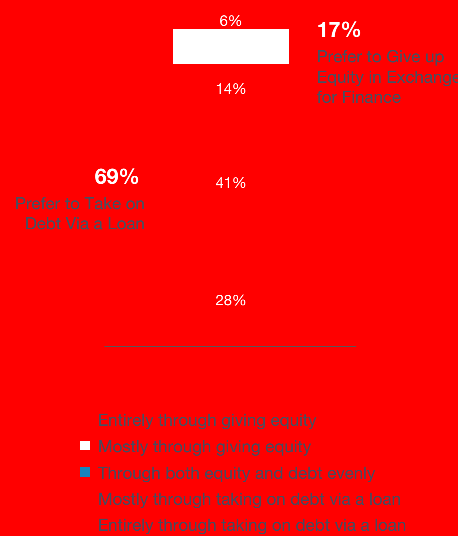
Despite the challenge of obtaining bank financing, SMEs in our study still prefer debt vs. equity financing.

SME PREFERENCE FOR DEBT VS. EQUITY FINANCING

The choice between taking on debt and giving up equity to fund a company's growth is one of the most daunting decisions SME owners can make. Despite the challenges that SME owners face in obtaining bank financing, our study found that SMEs surveyed still had a strong preference for taking on debt over giving up equity by a factor of four (Figure 3).This preference is reflected in their approach to financing their businesses. Sixty-two percent (62%) of SMEs in our study reported that they have or had a loan at one point. That percentage is even higher in Jordan and the UAE, where three quarters of SME owners reported having an interest-bearing loan (Figure 4). As shown in Figure 5, current interest levels for loans typically range anywhere from 8%–14%

Among those who prefer to finance with debt, agreement is nearly unanimous that the reason for doing so is to avoid having to share the business with a partner and deal with potential conflicts over business decisions and exits. Those who finance through equity do so to avoid risk or because they were unable to qualify for bank loans. Table 3 shows some of the reasons provided by respondents. In contrast to other countries, in Jordan, many indicated that they would prefer equity financing, instead of debt, if it is with a more credible and capable partner, and if it leads to better business development and logistical support to ensure success. This may be attributable to the small size of the Jordanian economy, which intensifies competition and increases the already high risk of failure among SMEs. However, the preference for debt versus equity is also dependent on the stage of the business in Jordan. When a company has a longer track record and is more established, and the risk of failure is drastically diminished, making it easier to acquire a bank loan, the preference for debt still rings true in Jordan. In general we believe that different debt financing options can be appropriate in the region. This includes short- or medium-term financing that is linked to fixed repayment schedules, mezzanine finance (e.g., where repayment is linked to cash flow) or indeed the principles underlying Sharia'h finance (i.e., striving to achieve a money multiple rather than set interest).

Preference for Debt vs. Equity Funding



62%
Have taken on an interest-bearing loan that needs/needed to be paid back

21%
Have given up equity in the business

BASE: TOTAL RESPONDENTS (n=154)

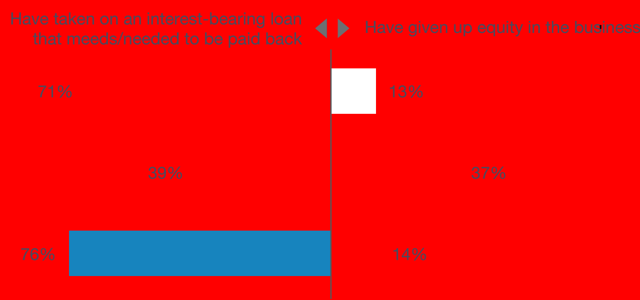
Q: Ideally, if you were able to secure outside funding in the range you specified earlier, and you had the choice between giving away equity/shares in your company or taking on a loan that had to be paid back with interest, which format would you prefer? Please choose the one you most lean toward even if this is hypothetical.

Q: Up until now, has your business given up equity and/or taken on an interest-bearing loan that needs to be paid back? Please check all that apply.

Reasons for Taking Loans or Giving Equity

Reasons for Preference to Take on Debt Via a Loan.	Reasons for Preference to Give Equity Ownership/Share

Current Debt vs. Equity by Country

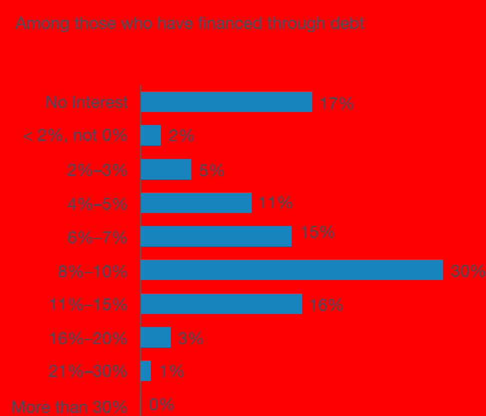


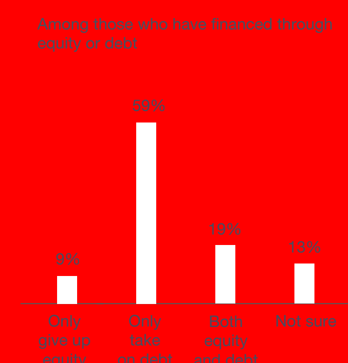
BASE: JORDAN (n=52), SAUDI ARABIA (n=51), U. A. E. (n=51)
Q: Up until now, has your business given up equity and/or taken on an interest-bearing loan that needs to be paid back? Please check all that apply.

Exit Strategies for Equity Based Financing

Among those who have financed through equity

52%
Have an Exit Strategy





BASE: FINANCING THROUGH EQUITY; TOTAL RESPONDENTS (n=33)
Q: Do you have an exit strategy for transitioning away from an equity-based financing model? Meaning, is there a clear agreement and schedule of how equity will be earned back or phased out over time?

BASE: FINANCING THROUGH DEBT; TOTAL RESPONDENTS (n=96)
Q: What is the current level of interest for this loan?

BASE: FINANCING THROUGH EQUITY OR DEBT; TOTAL RESPONDENTS (n=119)
Q: If you had it to do over again, would you choose to only give up equity in your company or would you choose to only take on debt?

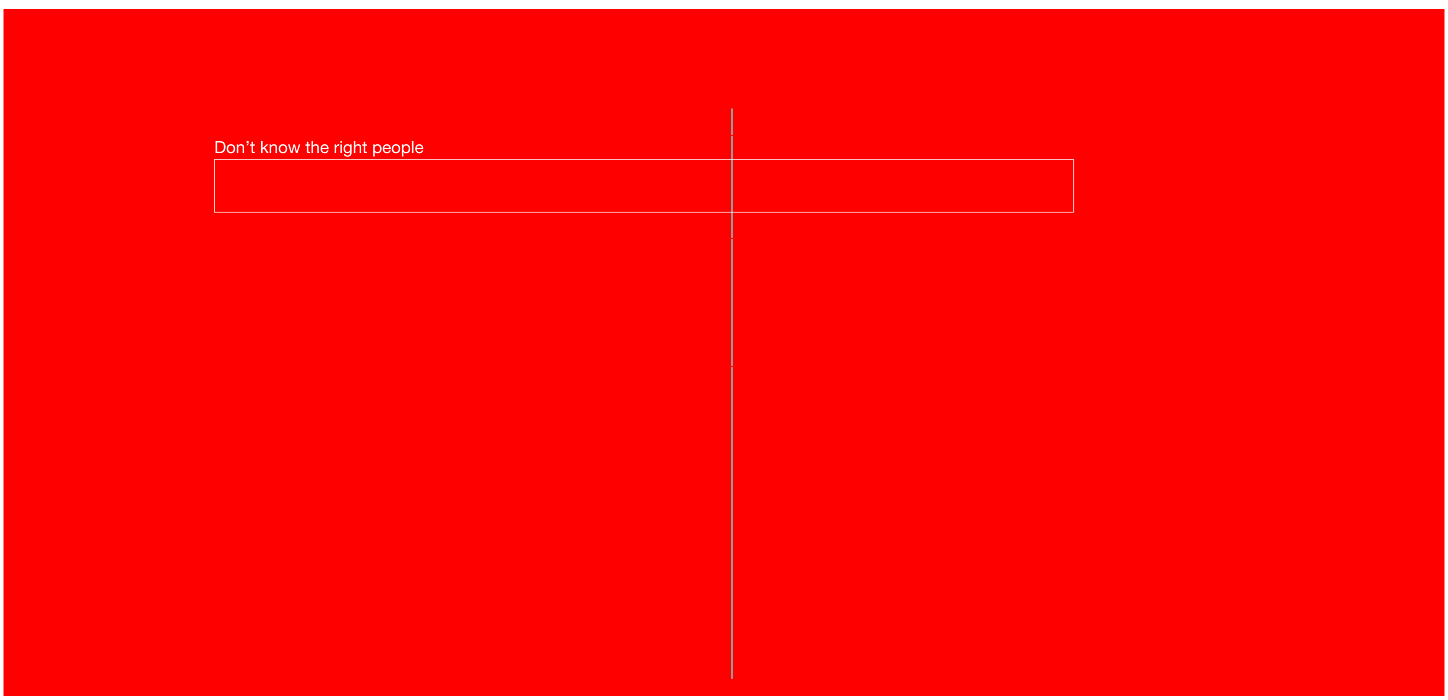
Barriers to Obtaining Bank Financing (continued)

Lack of appropriate collateral was noted as the single biggest obstacle to receiving funding from a bank followed by high interest rates, the lack of needed contacts and the lack of business skills (Figure 8). Banks often impose more stringent collateral requirements on SMEs, relative to large corporations. This can be attributed to structural challenges, such as the lack of transparency in the SME market, and weak financial infrastructure, including limited credit information, and the lack of a collateral registry and mechanism for legal enforcement of contracts in case of default. Other barriers include concerns about management competency of SMEs and weak risk management at banks. As a result, there is a strong preference for large, well-established businesses. Furthermore, lending to SMEs often requires more time and resources on the part of financial institutions, which increases the banks' operating costs. As a result, lenders often charge a premium to SME customers or neglect them entirely. Lastly, SMEs are risky investments due to their stage of development. Even in cases where finance is provided to SMEs, sustainability and success are not guaranteed. SMEs face many other challenges that may lead to failure, including the lack of business and managerial skills, insufficient access to markets, lack of a vibrant entrepreneurial culture in their own countries/communities and competition from bigger, more powerful businesses.

Within the MENA region, there are notable differences across countries. More than four out of five Saudi SME owners point to insufficient collateral as the key barrier, while Jordanian owners are mostly concerned with high interest rates upwards of 10%–14%, compared to 4%–8% for large businesses in real terms, as well as the requirement for two guarantors (Figure 10). Barriers in the UAE appear to be much lower — nearly a quarter of the nationals surveyed responded that they were "not aware of any barriers to receiving bank financing."

SMEs face many other challenges that may lead to failure, including the lack of business and managerial skills, insufficient access to markets, lack of a vibrant entrepreneurial culture and competition from bigger, more powerful businesses.

FIGURE 8:



BASE: TOTAL RESPONDENTS (n=154)
Q: Which, if any, of the following do you consider barriers or obstacles facing your business in terms of your ability to receive this level of funding ([INSERT RANGE SELECTED IN Q1050]) from a bank?

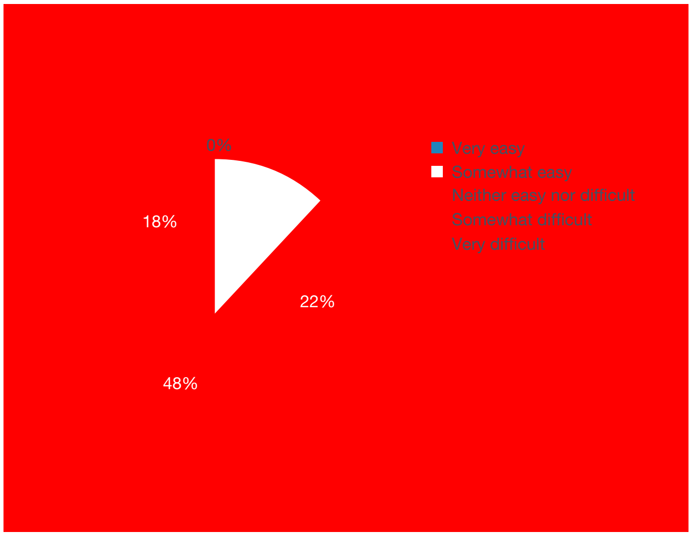
FIGURE 10:

Barriers or Obstacles to Receiving Bank Funding	Jordan	Saudi Arabia	
			33%
			31%
			16%
			29%
			20%
			31%
			20%
			22%
			18%
			4%
			–
			8%
			6%
			4%
			4%
			4%
			4%
			8%
			6%
			–
			2%
			24%

BASE: JORDAN (n=52), SAUDI ARABIA (n=51), U. A. E. (n=51)
Q: Which, if any, of the following do you consider barriers or obstacles facing your business in terms of your ability to receive this level of funding ([INSERT RANGE SELECTED IN Q1050]) from a bank?

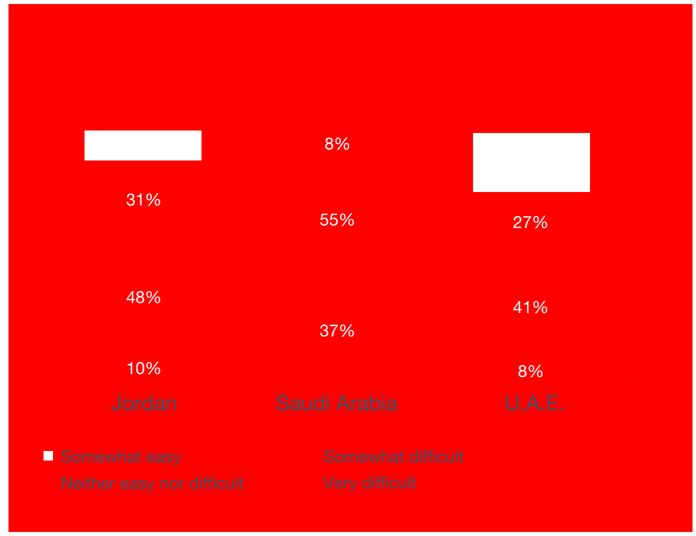
Within the MENA region, there are notable differences across countries.

FIGURE 11:



BASE: TOTAL RESPONDENTS (n=154)
Q: How would you rate your overall experience in trying to secure this range of funding ([INSERT RANGE SELECTED IN Q1050]) for your business?

FIGURE 12:



BASE: TOTAL RESPONDENTS (n=154)
Q: How would you rate your overall experience in trying to secure this range of funding ([INSERT RANGE SELECTED IN Q1050]) for your business?

Regardless of the amount of funding sought, only 12% would consider it "somewhat easy" to secure the funding while two thirds (66%) considered it "difficult" (Figure 11).

Again, there were variations across countries. Nearly one quarter (24%) of Emirati owners and one in ten (12%) Jordanian owners described the process of securing funds as "somewhat easy" but in Saudi Arabia, none described the process as "somewhat easy" (Figure 12). Instead, nearly all Saudi respondents (92%) noted some level of difficulty in securing funds. In interviews with lenders, information asymmetry between lender and borrower was noted as an impediment to SME lending as it drives up the risk premium. Interest rates also tend to be high because lack of credit information makes it difficult for banks to distinguish between low- and high-risk debtors. Throughout MENA, intermediaries reported that market information was lacking, which explains some of the difficulty SME owners experience when trying to secure funding.

B. BUSINESS DEVELOPMENT ASSISTANCE

Business development assistance encompasses a range of services from developing a business plan to building market linkages. The study found that business skills and development assistance are perceived by many SME owners to be nearly as important as obtaining financing for their businesses. During a "chip allocation" exercise, where SME owners were asked to weight the importance of business development assistance in relation to financing to the long-term success of their SME by allocating chips, SME owners gave nearly equal weight to business development assistance (46 chips out of a possible 100) versus financing (54 chips out of a possible 100). SME owners in the UAE placed the most importance on business development assistance (61 chips), perhaps due to easier access to financing for local citizens (Figure 13). Across the region, business development assistance is most attractive to younger SME owners and to female SME owners.

"What Emirati SME owners need is not finance but entrepreneurial attitudes and continued business assistance and mentoring for business to be mature and stable. I wish I had known or had someone advise me about accounting, cash flow, marketing and customer service when I started my business. I would have [acquired] more customers and lots more money in little time." — An Emirati SME owner

Intermediaries noted that there is a strong need for a model that offers both business development assistance and financing to SMEs, a sentiment seconded by SME owners who believe that such an integrated model will help to ensure better SME sustainability. SME owners recognize that lack of business and managerial skills, an impediment to getting bank loans, is also a major reason why businesses fail. Agreement is nearly unanimous (97%) among SME owners and intermediaries that SMEs would be more likely to succeed if they received business development assistance in addition to funding. The more employees an SME has, the more likely its owners "strongly agree" that such support services improve its chances of long-term success.

SME owners, in recognizing the need for and importance of business development assistance, seek a diverse range of services. From a lengthy list of skills and capabilities presented in the survey, better access to customers and markets, marketing, strategic positioning, customer service, business planning, finance and accounting were deemed the most critical by business owners (Figure 14). However, the most effective form of business development assistance is one in which services are tailored to the individual needs of each SME over the life cycle of the business. SME owners have varying levels of business acumen and managerial capabilities and the needs of their businesses may also vary drastically across sectors and markets. Generic trainings and other support services are insufficient to meet the needs of Missing Middle SMEs, which must tackle numerous business and market challenges to survive and succeed.

C. MARKET LINKAGES

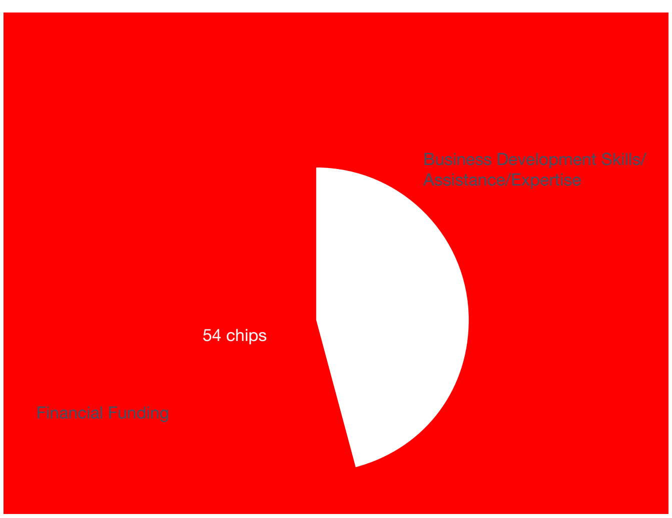
A dearth of market linkages and supply chain opportunities for SMEs also hampers their ability to survive in MENA. In developed economies, large firms increasingly place part of their work outside the organization since subcontracting and outsourcing can reduce production costs. This provides opportunities for smaller firms to fill those needs. In MENA, however, large firms tend to build their own supply chain and support systems in-house, which cover a broad range of functions like human resources, web development, marketing, and maintenance to distribution, insurance and customer service, rather than outsourcing. Without domestic supply chain opportunities that are created by large firms trying to cut costs and focus on core businesses, SMEs in MENA have more limited market prospects and a greater risk of failing. Creating new market opportunities and establishing market linkages is critical to the survival of many SMEs. This is a key area where SME support programs can provide much-needed assistance, by providing access to new markets and customers, including export markets and multinational firms.

D. ENABLING BUSINESS ENVIRONMENT

A favorable regulatory environment is also crucial to SME success. Government inefficiencies and burdensome regulatory obligations can severely hamper SMEs' ability to survive. Establishing effective policies that address market failures, which stack the odds against SMEs, is also important to building a system in which SMEs can flourish. The "Intermediary" respondents provided important insights on the limitations of the government's policy to support the SME sector. Most of the comments provided by respondents center on two key issues:

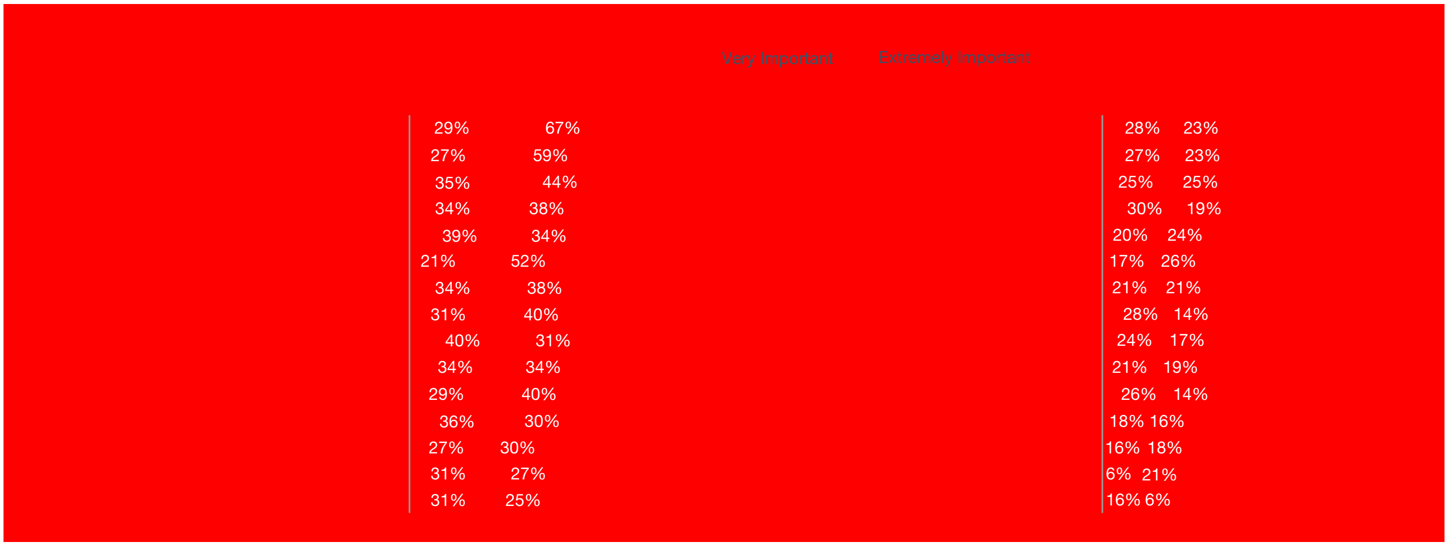
- **Government inefficiencies related to procedures of starting and running a business**. Many SMEs choose to remain informal because the costs of regulatory process of registering businesses and joining the formal economy sometimes outweigh the economic benefits. In Egypt, an estimated 75% of micro and SMEs operate in the informal market.[13] According to the Egypt Labor Market Survey, these enterprises provided around 80% of the jobs in the nonagricultural private sector.

FIGURE 13:



BASE: JORDAN (n=52), SAUDI ARABIA (n=51), U. A. E. (n=51)
Q: Imagine you have 100 chips to allocate. Thinking specifically about the long-term success of your business, how many chips would you allocate to the importance of receiving financial funding and how many chips would you allocate to the importance of receiving business development skills and expertise to creating a sustainable and long lasting-business? You may allocate any number between 1 and 100 to each item as long as the overall total adds to 100.

FIGURE 14:



BASE: TOTAL RESPONDENTS (n=154)
Q: For each of the following business skills/support services, rate how important they are for helping your company grow and succeed for the long term.

- **Administrative and regulatory obligations are time- and cost-consuming burdens for SMEs.** Jordanian and Egyptian participants noted that a tax system that does not provide tax exemption for SMEs is a major hurdle to SME success and competitiveness. As such, the tax system discriminates against SMEs. Most OECD countries offer lower tax rates for SMEs that enhance entrepreneurship and job creation.[14]

The Need for a Specialized SME Authority

The creation of specialized SME authorities, which understand the special needs and challenges of SMEs, represents and lobbies for them, champions SME-enabling policies, and oversees and coordinates the provision of targeted services and programs to the sector, can help address many of the structural challenges faced by SMEs in MENA. Successful global experiences from developed and emerging economies, including the U.S., Canada and Singapore, suggest that independent SME Authorities are effective in:

1. Facilitating the development of policies that encourage SME sector growth.

2. Enabling the accurate evaluation of the sector so that the impact of regulatory reform and financial and nonfinancial programs can be monitored and assessed.

3. Developing a better understanding of the impact of SMEs in economic development.

4. Helping the collection of data on the sector in order to make intercountry and interregional comparisons.

5. Coordinating multistakeholder approaches, as needed, to ensure all are targeting the correct client group.[15]

There are recent signs that governments in the region are realizing the benefits of establishing such authorities. Qatar recently announced the launch of an SME authority — Enterprise Qatar — that will champion SME policies and coordinate debt, equity, training and business services programs. Saudi Arabia is considering a new SME agency and the UAE is drafting a national SME promotion law. Lastly, members of Kuwait's parliament, which is working to create new engines for job creation and diversify its economic base, have presented a draft bill on the establishment of an independent SME authority for the country.

With a deeper understanding of the unique needs of and challenges facing Missing Middle SMEs, policymakers, practitioners and academics can turn their attention to solutions that address those needs, mitigate the challenges, eliminate barriers and ultimately create an enabling environment for SMEs to flourish. An ideal support model for SME development is one that is integrated and coordinated, and provides both patient growth capital, structured with terms that are appropriate to the needs of SMEs, as well as customized business development assistance over the life cycle of the business.

In adopting an integrated model, the following features should be considered:

- Loan applications that are assessed on the basis of the potential of the businesses and credibility of the entrepreneurs, not solely on the basis of collateral, guarantors or length of operations.
- Specialized SME loan funds or loan guarantee schemes that would encourage more lending to the Missing Middle.
- Access to focused, well-coordinated local support and expertise. SMEs face unique challenges particular to their sector and market. They need access to teams of specialists who understand the unique set of challenges facing a business in a particular local market.
- A wide menu of SME support services that can be tailored to the needs of individual SMEs and is available throughout its business life cycle. Continuous support to SMEs, whose needs change over time, increases the likelihood of success. SME support providers should work with individual SMEs to develop specific strategies that address the issues challenging the business. This includes:
  - Providing support and guidance to rigorously plan and professionally manage businesses in a manner that drives positive cash flows, higher revenues and profits, greater likelihood of business success and, ultimately, business sustainability.
  - Introducing good corporate governance to SMEs to enhance transparency and confidence in management, which will in turn make them more likely to get the support they seek from banks and potential investors.
- Better communications and information systems to reach SMEs and inform them of available support programs and how to access them.
- More effective partnerships between SME support providers to improve synergy and cooperation, and reduce duplication and waste of resources.

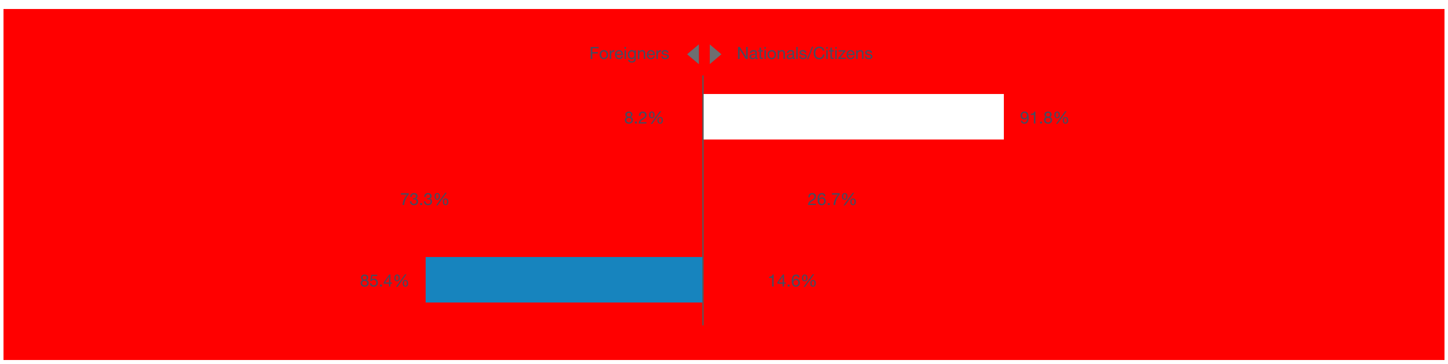
FIGURE 15:

Number of Employees		Jordan	Saudi Arabia	
	38%			39%
	54%			53%
	6%			4%
	3%			4%

BASE: TOTAL RESPONDENTS (n=154)
Q: How many employees, full-time and/or part-time, are employed at your business?

Figure 15 shows that the majority of SMEs surveyed had between ten and 49 employees (54%). Those in Jordan tend to have smaller numbers (below ten) than the other markets. Saudi SMEs in particular were more likely to have larger numbers of employees. This might be related to the larger size of the Saudi market and economic activities. It was also found Jordanian owners are most likely to employ nationals as 92% are composed of citizens. KSA and the U.A.E. are the complete opposite, showing a much stronger propensity to employ foreign workers (Figure 16). It was also found that larger the SME, the more likely it is to employ more expats than nationals.

FIGURE 16:



BASE: JORDAN (n=52), SAUDI ARABIA (n=51), U. A. E. (n=51)
Q: Approximately what percentage of your employees are nationals/citizens of…?

Q: Approximately what percentage of your employees are foreigners/not nationals or citizens of…?

In terms of revenue size (annual sales), most SMEs cite revenue levels between \$50,000 and \$250,000 USD. SMEs in KSA and the U.A.E. skew slightly higher on revenue.

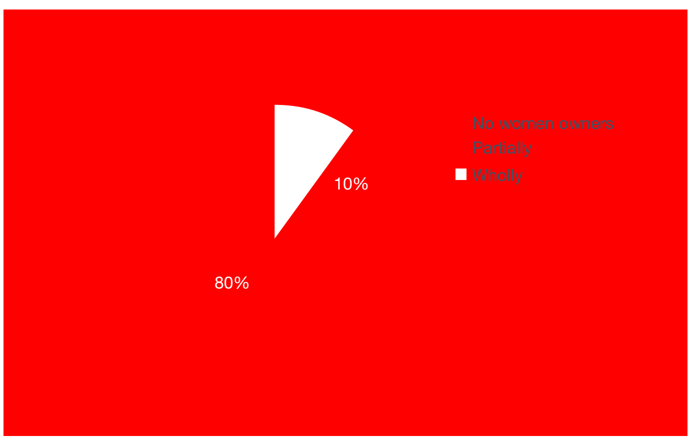
FIGURE 17:

2010 Business Revenue		Jordan	Saudi Arabia	
	1%			–
	37%			25%
	29%			31%
	20%			29%
	11%			14%
	2%			–
	0%			–
	1%			–

BASE: TOTAL RESPONDENTS (n=154)
Q:- Which of the following best describes your business's approximate total revenue in 2010?

In terms of ownership, SMEs in the study were mostly male-owned. Women own only 20% of the SMEs surveyed in this study either wholly or partially. Female employees, on average, comprise 16% of SME workforces of companies in the study, though nearly half (44%) employ solely men. The Jordan and U.A.E. companies in the study are most likely to have wholly owned female businesses. KSA is the least likely with only 2% wholly owned by women.

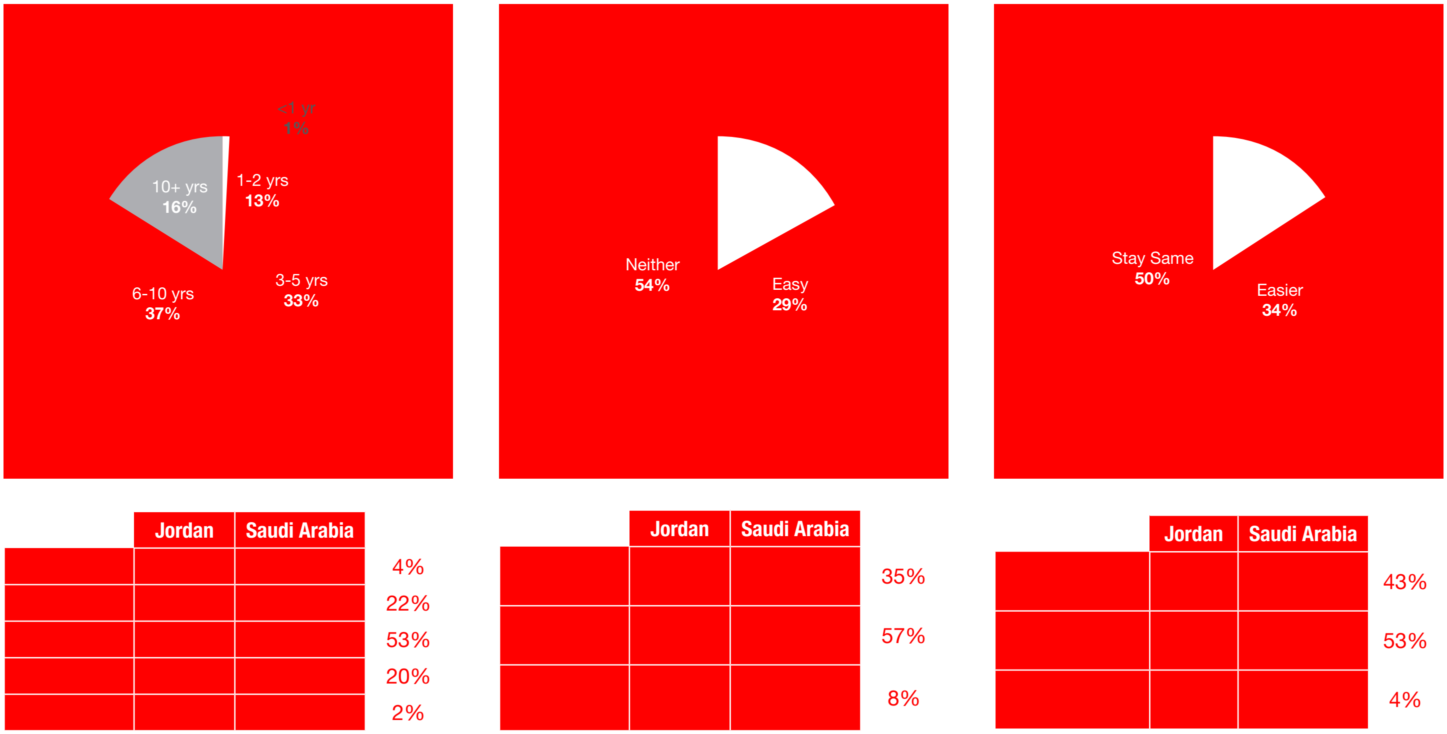
FIGURE 18:



BASE: TOTAL RESPONDENTS (n=154)
Q: Is your business partially or wholly owned by a woman/women?

Q: Approximately what percentage of your employees are women?

FIGURE 19:



BASE: TOTAL (n=154), JORDAN (n=52), SAUDI ARABIA (n=51), U. A. E. (n=51)
Q: How many years has your business been in operation?
Q: How would you describe the process of registering your business in this country?
Q: Do you believe the process of registering businesses in this country is getting easier, is the same as it always was or is getting more difficult?

[1]To communicate with authors: khalidoalyahya@gmail.com and Jairey@heartandmindstrategies.com

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[3]R. Rocha, S. Farazi, R. Khouri, D. Pearce. 2011. The status of bank lending to SMEs in the Middle East and North Africa region: The results of a joint survey of the Union of Arab Bank and the World Bank (2011), Policy Research Working Paper World Bank.

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[5]Ayyagari, Beck, & Demirguc-Kunt. 2007. “Small and medium enterprises across the globe: A new database,” Small Business Economics 29, 415-434; Klapper, Leaven & Rajan “Entry regulation as a barrier to entrepreneurship,” Rauch “Modeling the informal sector formally.”

[6]Ragui Assaad and Farzaneh Roudi-Fahimi. *Youth in the MENA: Demographic Opportunity or Challenge?* Population Reference Bureau, 2007.

[7]ILO KILMnet Dataset, 2011.

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[10]The global experience shows that due to a lack of suitable exit strategies and consequent investment lock-ins in old deals, new private equity and venture capital investments declined in 2008. According to National Venture Capital Association, the total value of VC funding declined by 13% in 2008 to $4bn.

[11]World Bank’s Enterprise Survey. http://www.enterprisesurveys.org/?d96a349c52fc4f68eea46a47ccb3d360

[12]http://www.enterprisesurveys.org/

[13]Ministry of Foreign Trade http://www.sme.gov.eg/English_publications/MSME_Profile_2003.pdf

[14]Chang Woon Nam and Doina Maria Radulescu. 2007. *Effects of Corporate Tax Reforms on SMEs*. Small Business Economics. 29:101-118.

[15]Saudi-US Relations Information Service. *An “SME” Authority for Saudi Arabia*. Feb 2, 2011. http://www.susris.com/2011/02/02/a-sme-authority-for-saudi-arabia/

Citi Foundation and Shell Foundation collaborated to commission independent research from Heart and Mind Strategies, an international research and consulting firm, to conduct research in the Middle East in late 2011 through early 2012. The research sought to capture the current SME finance environment and "market offerings" for the Missing Middle in the Middle East with a view to understanding the opportunities for promoting growth finance into the region.

This research looked beyond what is already "known" to assess what current financing strategies SMEs are using, the size of the funding gap, the potential for growth and the kind of service offering that would suit their needs.

A key intention of the research program is to provide a thought leadership platform for engaging relevant parties to encourage discussions and potentially reforms to ensure that this section of the market can source adequate funding in the future and sustainable socioeconomic growth opportunities can be maximized. This funding should comprise much more than the traditional SME funding product offering that simply offers finance in the absence of critical strategic advisory services.

ABOUT SHELL FOUNDATION

Shell Foundation is an independent charitable foundation that was established by the Shell Group in 2000 to catalyze *scalable* and *sustainable* solutions to global development challenges. We apply business thinking to a range of social and environmental issues linked to the energy industry — seeking to harness links to Shell where possible to deliver greater development impact.

Over the last 12 years we have developed an "enterprise-based" approach to: identify the market failures that prevent products and services that can support sustainable development from reaching the poor; co-create new business models with long-term "social enterprise" partners to service these markets; and to provide extensive business development support to help these partners develop the skills, capacity and incentives to operate at scale and achieve financial independence.

By applying this approach to major global challenges such as job creation through small and medium enterprises, access to modern energy, urban mobility, cleaner cooking solutions and sustainable supply chains — and by learning from both success and failure — Shell Foundation has created several strategic partners that are now delivering large-scale impact in multiple countries across Africa, Asia and Latin America. Additional information can be found at www.shellfoundation.org

ABOUT CITI FOUNDATION

The Citi Foundation is committed to the economic empowerment and financial inclusion of individuals and families, particularly those in need, in the communities where we work so that they can improve their standard of living. Globally, the Citi Foundation targets its strategic giving to priority focus areas: Microfinance, Enterprise Development, Youth Education and Livelihoods, and Financial Capability and Asset Building. The Citi Foundation works with its partners in Microfinance and Enterprise Development to support environmental programs and innovations. Additional information can be found at www.citifoundation.com

ABOUT HEART+MIND STRATEGIES

At Heart+Mind Strategies, our mission is to provide strategic decision-making insight and advice to help our clients understand the hearts and minds of the people that matter most to their enterprise, and transform that understanding into measurable success.

Our approach is grounded in a rigorous framework and experience-driven set of principles that have elected presidents and prime ministers, strengthened corporations, bolstered declining industries, and reinvigorated global brands.

Headquartered in Northern Virginia, USA, the core leadership of our team has worked together for over 20 years, and we apply state-of-the-art and forward-looking qualitative and quantitative market research techniques within our unique framework and set of principles. Additional information can be found at www.heartandmindstrategies.com

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