

The Role of SMEs in Mediterranean Economies: The Egyptian Experience

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Small and Medium-sized Enterprises: A Vehicle to the Future

The year 2011 is a year of change. The future for the Southern Mediterranean countries, from Morocco to Turkey, is still highly uncertain, especially in light of the recent uprisings and political changes taking place in Tunisia and Egypt. The reasons for these movements and protests are basically the same everywhere and include not only poverty but also the struggle that young people face to find jobs and the hardships usually encountered by entrepreneurs, all of which is coupled with corruption and suppression. Just how severe the impact of this turmoil will be on the region's economy has yet to be seen, although there are already some alarming signs, such as the acute currency devaluation and the downgrading of Egypt and Tunisia by the international rating agencies.

In these difficult circumstances, the compulsory solution for the economy becomes the full development of small and medium-sized enterprises (SMEs). SMEs have been shown to be the backbone of any economy, especially emerging market economies, and they have proven to be highly resilient to the recent international financial crisis. SMEs make significant contributions to job creation and are behind the expansion and creation of value-added in a number of sectors that drive not only economic growth but also development. The SME sector becomes more important as economies develop; the share of formal SMEs increases substantially with the level of development. The contribution of SMEs to gross domes-

tic product (GDP) rises from an average of 15.6% in low-income countries to an average of 51.5% in high-income countries.

In Egypt, as in other Mediterranean countries, SMEs dominate the economic structure. Estimates vary, but according to the most reliable sources, in Egypt they account for more than 80% of enterprises, yet their contribution to GDP does not exceed 25%. Accordingly, to help Egyptian SMEs realise their potential, a number of very successful yet fragmented strategies, policies and interventions have been implemented over the past few years. However, Egypt is a country with a massive population scattered over a vast geographical area, and in light of the recent political changes and the expected economic repercussions, there is now a critical need to make more coordinated efforts to ensure that this important sector lives up to its full potential.

Challenges Facing SMEs: The Egyptian Case

Egypt is a lower-middle-income country with an estimated population of 80 million that is growing at an annual rate of just over 2%. The real GDP growth rate reached 7.2% in 2008, while annual GDP growth averaged 4.7% over the period from 2000 to 2008. Recent reforms in Egypt resulted in spectacular progress at the macro level. This was reflected in very healthy economic indicators, such as high growth, a stable exchange rate, commendable accumulation of foreign reserves, a balance-of-payments surplus and an unprecedented spurt of both domestic and foreign investment. However, the impressive growth rates witnessed over the past few years did not translate to lower poverty levels, improved income distribution or higher per capita expenditure. This is explained by

the fact that this growth was mainly the result of an increase in revenue from the Suez Canal, tourism, oil and worker remittances from the Gulf and was by no means coming from the development of the SME sector or the growth of innovative entrepreneurship.

The economic and political landscape has dramatically changed in Egypt since January 2011 and, as a result, the economy is currently facing major challenges: **first**, how to overcome the economic and financial losses incurred at both the macro and micro levels as a result of the complete standstill that the country came to for more than three weeks; **second**, how to achieve and maintain a rate of GDP growth that will be sufficient to absorb the increase in the labour force, especially in light of the possible withdrawal of most foreign investment; and, **third**, and most important, how to achieve a level of economic growth that is inclusive enough for the results to trickle down and the fruits to be shared by the broad base of society.

This raises the important question of where to find new sources of job creation at a time when the traditional sources – agriculture and government – are no longer sufficient

Given the above challenges, the only vehicle to a better future is SMEs. The SME sector globally proved to be remarkably resilient throughout the financial crisis of 2008 and 2009; SMEs grew, safeguarding and creating jobs in the midst of a profound economic downturn. Nevertheless, although SMEs dominate the Egyptian economy as they do most others, their small size places them at a disadvantage compared to larger enterprises. They characteristically have fewer internal resources and less capacity to compete in global markets. Moreover, their capacity to function effectively is also limited by external factors, such as the policies, laws and regulations affecting SMEs. It is time to realise that an unpaved road to SME growth hinders investment and leads to lower pro-poor growth. Governments should thus target SMEs as a vehicle for economic growth: SME-related policies should be given the same weight in national development plans as for-

eign direct investment (FDI) and the large-scale projects of domestic investors.

Experience has shown that domestic SMEs present a real opportunity for the development of the private sector and for achieving a level of economic growth that is inclusive and whose fruits are shared by the majority of the people. For this to be even partially achieved in Egypt, the national development strategy should explicitly focus on “employment-intensive growth,” since employment is the most effective mechanism to ensure the redistribution of wealth with growth. Job creation is the only answer and the final option. This will require a quick qualitative shift in the national strategy to make job creation an unequivocal objective of development. This raises the important question of where to find new sources of job creation at a time when the traditional sources – agriculture and government – are no longer sufficient. It is from this perspective that the role of SMEs becomes unquestionably critical. Nevertheless, it is essential to ensure that national policies do not view SMEs as a means of absorbing labour at the bottom of the pyramid and reducing poverty, as when SME development is treated as a social issue it leads to high levels of subsistence enterprise activity with limited potential for economic growth.

It is often argued that SMEs are the backbone of economic activity in developed and developing economies alike. However, the challenge lies in the economic contribution of SMEs, which varies significantly when measured not by the sheer number of enterprises but rather against their contribution to the creation of sustainable jobs and to GDP growth rates. The question then becomes one of transforming the sector from a mere “sponge” for low-productivity activities to a dynamic contributor to modern economic growth, which should be the main objective of any strategy designed to promote the growth and development of the SME sector.

Specifically, the SME sector in Egypt suffers from several concrete constraints that hinder its growth and development and can be summarised as the severe lack of the following crucial factors:

- The skills and systems required to compete effectively in global markets.
- Access to finance.
- Access to information.
- Business development services (BDS).
- Vocational training for labour.

The lack of these factors, together with a weak logistics sector and limited access to markets, distribution channels and supply linkages with larger firms, has created a disabling business environment for SMEs in Egypt. Above all, informality has become a dominant characteristic of the SME landscape. Estimates indicate that the informal sector accounts for more than 30% of the Egyptian economy compared to less than 15% in countries such as China, Singapore and Vietnam (Schneider and Buehn, 2009).

Nonetheless, SMEs' most crucial problem continues to be limited access to the finance required to ensure the growth of the sector. Statistics indicate that in Egypt, even though the SME sector accounts for more than 80% of all economic units, it is able to access less than 10% of the available financing resources. Indeed, some studies reveal that only 5% of small businesses in Egypt have bank loans. Compounding matters, 2009 saw a painful decline in available finance for SMEs in Egypt. This was a direct impact of the recent global financial crisis, whereby banks further reduced their exposure to the SME sector even as other finance providers were unable to step in to fill the gap and equity investors in particular, who barely existed prior to 2009, withdrew even further.

Over the past few years, Egypt has realised the critical importance of developing its SME sector. Accordingly, considerable efforts have been made by different government bodies, civil-society organisations and international donors to level the field for SMEs. However, these initiatives have not yielded the expected results because they have been fragmented and largely uncoordinated due to the absence of a single organisation or body able to take the lead in this field and assume responsibility for coordinating all the efforts in order to maximise output.

The Road Map: First, Think Small

One of the reasons behind the recent waves of political unrest and revolutions washing over the Middle East is believed to be the dramatic increase in the number of unemployed youth over the past twenty years. The real engine of GDP growth – and new jobs – is innovation and SME start-ups. Governments have a crucial role to play in supporting enterprise creation, ensuring a level playing field for smaller businesses and building the

capacity of the SME sector to ensure its growth. It is thus highly recommended both for Egypt and all other developing economies to focus on SMEs and on innovative entrepreneurship programmes. The SME agenda should lie at the heart of all national strategies and activities because only SMEs can make a positive contribution to development as drivers of economic growth and as “civil-society builders.”

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In conclusion, the main recommendations for achieving healthy growth of the Egyptian SME sector can be summarised as follows:

1. A single government or non-governmental body or organisation must be responsible for the overall development and growth of SMEs and innovative entrepreneurship.
2. With regard to SMEs' access to finance, the issue is not necessarily a lack of financing, but rather the mismatch between the available products and the ability of potential entrepreneurs to create convincing and “bankable” business plans and appropriate platforms to use them. Accordingly, it is critical to ensure that SMEs have access to a wide range of financial products, such as private equity funds, venture capital funds, leasing facilities, factoring and cashing, etc., and to improve the financial skills of SME owners and start-ups, as well as their ability to present a convincing business case and properly communicate business performance to financial institutions.
3. Tax policy is one of the main levers that governments can use to stimulate SME growth and entrepreneurship. As such, it should be designed with small firms in mind, taking care to ensure that it promotes transparency and encourages business start-ups, business growth, innovation and business transfer.

4. Innovation and entrepreneurship should be supported and enhanced as they are the only means of creating new sustainable jobs. In Egypt, business education is largely limited to teaching students how to prepare sound business plans that banks will not be willing to finance regardless unless backed by sufficient collateral. The government should thus adopt full-fledged integrated programmes that provide entrepreneurs with the required business skills, practical experience and ongoing coaching and mentoring, before ultimately pointing them towards and helping them to access financial products that match their needs. Additionally, the government should encourage private and public banks to make small capital investments, perhaps through government loan guarantees.

The Egyptian economy is expected to absorb the shocks generated from the recent political transformation by empowering the SME sector

Governments in general, and specifically in Egypt, are the single largest buyer of goods and services. The government procurement market is vast; however, the difficult and complicated pre-qualification and tendering processes used by the government make it impossible for smaller suppliers

without a dedicated tendering team to win government contracts. Accordingly, to support the SME sector the government should decentralise the procurement procedures, introduce e-procurement, ensure that tendering requirements are proportionate to the work undertaken, guard against corruption and, finally, educate suppliers about the tendering process.

Egypt has weathered global financial crisis relatively well in the past. The Egyptian economy is expected to absorb the shocks generated from the recent political transformation by moving on a fast track towards enhancing and empowering the SME sector, with special focus on creating a new generation of innovative entrepreneurs.

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