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Understanding the Entrepreneurship Ecosystem in Tunisia and Egypt

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Article at a glance

- With the exception of information on financial barriers to growth, there is a considerable dearth of theoretical and empirical knowledge of entrepreneurship in Egypt and Tunisia and throughout the MENA region.
- This research effort aims to produce empirical knowledge as well as critique the conceptualizations already developed for entrepreneurship in MENA and the developing world in general.
- Given the structural and institutional constraints in the region, a comprehensive concept of entrepreneurship should tackle the overall ecosystem within which individual entrepreneurs and enterprises operate and examine where they interact with the regulatory, legal, and institutional frameworks.

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This essay will be part of an upcoming report called "Reforming the Entrepreneurship Ecosystem in Post-revolutionary Tunisia and Egypt" to be jointly published in Spring 2014 by CIPE and Stanford University

The report concerns the entrepreneurship ecosystems in Tunisia and Egypt. The entrepreneurship-as-an-ecosystem approach is employed in attempt to answer the broader and more abstract questions of private sector development and capitalist transformation in both countries. The scope of the study comprises the institutional constraints on private entrepreneurship, be they financial or nonfinancial, and the widest variety possible of entrepreneurs and enterprises in the two countries in a way that reflects the reality and complexity of the entrepreneurial socio-economic phenomenon.

The report depends on a sample of around one hundred respondents in each country. The samples are designed to be a microcosm of the entrepreneurial population in Egypt and Tunisia. They represent the various categories and groups of entrepreneurs in accordance with their relative weight as revealed by statistical evidence. The samples are divided vertically on the basis of established-entrepreneurs and would-be- entrepreneurs and on a gender basis and horizontally between the formal and informal sectors and on a regional basis. A questionnaire, focus group discussions and individual interviews are all part of a qualitative study of entrepreneurship that aims to produce a thick and detailed description of the institutional underpinnings of entrepreneurship and a thorough analytical accounts of how different elements of the ecosystem interact with each other. The study follows the logic of qualitative surveys.

1. Introduction

Ongoing upheaval in Egypt and Tunisia since the 2011 revolutions indicates high levels of dissatisfaction with the political order, and expresses a deep desire for a drastic remodeling of the economic system. Well-educated young men and women still find themselves marginalized and excluded from the political and economic order in their countries. Their initial demands for freedom and social justice have hitherto gone unheeded. At the heart of the ongoing political turmoil lies the demand for a sweeping socio-economic reform that may eventually create an economy that offers inclusive-growth, higher levels of productivity and competitiveness, and more job creation. However, unless certain complex and long-term questions are tackled, it is unlikely that political reform will lead to the creation of stable democracies.

Over three decades ago, Egypt and Tunisia were among the first Arab countries to embark on economic liberalization and to open the way for the emergence of a national private sector. The two countries made definite strides towards a developed private sector in aggregate. For instance, the World Bank[1] indicated the private sector's share of non-hydrocarbon GDP to be 70-75 percent for both Egypt and Tunisia and the private sector share in employment to be 60 percent in Egypt and 80 percent in Tunisia.

However, despite its overall sizable share in output and employment, the Egyptian and Tunisian private sectors were by no means dynamic and productive. The broadest base of the private sector in both countries has been made up of a very large number of very small and micro-enterprises that are either family-owned or employ no workers. This broad base of enterprises has often been undercapitalized and under-productive, and operates with limited capacity to grow and access markets. The literature has referred to this as the "missing middle syndrome" where micro-enterprises are denied any real chance of growing into small or medium-sized firms. A thin stratum of large firms on the top of the private sector produces most of the value-added. They usually have strong linkages with the global markets and foreign investment.[2]

High barriers to entry and growth that face the vast majority of entrepreneurs can help explain the poor status of the broadest base of the private sector in the two countries, as well as other MENA economies. Many of these barriers can be traced back to the entrepreneurship ecosystem, which refers to the broad institutional and regulatory framework that governs business entry, exit, and growth. Entrepreneurship as an ecosystem can be employed as an approach to tackle the more abstract question of the failed transition to an all inclusive and dynamic market-based capitalism in the two countries, despite long decades of economic liberalization.

Entrepreneurship is one of the most dynamic approaches to socio-economic transformation and development. It is intimately related to private sector development, micro, small, and medium-sized enterprise policies, job creation, innovation, and competitiveness. However, unlike the study of static policy and of regulatory areas or institutions and structures, analyzing the entrepreneurship ecosystem captures a picture in motion. Tackling the question of entrepreneurship links micro-level analysis that touches upon direct barriers to entry and growth with macro-level analysis that attempts to explain the lack of dynamism, low productivity, undercapitalization, and the weak prospects of growth in the broadest base of the private sector in the region. Moreover, it may provide a way out of the spiral of failed development in which Egypt and Tunisia have been caught for decades.

Why has private entrepreneurship in Egypt and Tunisia remained underdeveloped despite decades of economic liberalization and private sector-friendly incentives and reforms? And how can the entrepreneurship ecosystem in the two countries develop in order to meet the people's high expectations of having a productive and just socio-economic order?

Our study is an attempt to answer the broader and more abstract questions of private sector development and capitalist transformation in both countries. The scope of the study comprises a look at the financial and non-financial institutional constraints on private entrepreneurship and includes the widest variety possible of entrepreneurs and enterprises in the two countries in a way that reflects the reality and complexity of the entrepreneurial socio-economic phenomenon. The report depends on a sample of approximately 100 respondents in each country. The samples are designed to represent a microcosm of the entrepreneurial population in Egypt and Tunisia. They represent the various categories and groups of entrepreneurs in accordance with their relative weight as revealed by statistical evidence. The samples are divided vertically on the basis of established-entrepreneurs and would-be- entrepreneurs and on gender basis and horizontally between the formal and informal sectors and on a regional basis. A questionnaire, focus group discussions, and individual interviews are all part of a qualitative study of entrepreneurship that aims to produce a detailed description of the institutional underpinnings of entrepreneurship and a thorough analytical account of how different elements of the ecosystem interact with each other. The study follows the logic of qualitative surveys.

This essay aims to critically engage with the extant body of literature on private entrepreneurship and its socio-political and institutional determinants and constraints in the MENA region. This review of literature aims to critique the conceptual tools that have been employed in studying the phenomenon of entrepreneurship in MENA in general, and in Egypt and Tunisia in particular. The final goal of the essay is to set an agenda for future research by addressing the lacunae in the present literature while capitalizing on its findings.

2. The State of the Art

2.1 Hammering out a concept of entrepreneurship for MENA

Some scholars in the reviewed literature held that "entrepreneurship in developing countries is the most understudied important global economic phenomenon today".[3] Neither the definitions nor the approaches developed by diverse Western scholarly traditions capture all the dimensions and implications of entrepreneurial activities in the developing world, including in the Middle East and North Africa. As Naude holds "in developing countries the concern is with (entrepreneurship) starting and accelerating growth, and in providing impetus to the structural transformation of economies; in the advanced economies the concern is largely with obtaining new sources of productivity growth".[4] In the Global south, entrepreneurship cannot be set apart from the questions of job creation, poverty alleviation, and growth-enhancement. It is not similar to the policy and academic concerns in the Global north with entrepreneurship as the engine of growth and the source of innovation.

In this vein, The Global Entrepreneurship Monitor (GEM) has been a forceful attempt to study entrepreneurship in a broad variety of countries, including many non-Western developing countries. According to GEM, higher Total Early-stage Entrepreneurial Activity rates (TEA) are inversely related to income so that countries with lower income, thus poorer developing ones, have higher TEA rates than developed countries. In an attempt to remove the possible confusion, GEM distinguishes between two principal components of entrepreneurship based on entrepreneurs' motivation: necessity- versus opportunity-driven entrepreneurship. Indeed necessity-driven entrepreneurship dominates in most MENA countries, including Egypt and Tunisia, even though GEM indicates that it is much higher in the former than the latter. Necessity-driven entrepreneurs most densely cluster in the informal sector and usually run small and micro-enterprises.

The conceptual distinction between necessity- and opportunity-driven entrepreneurship is problematic for many reasons. Asking entrepreneurs about their motivation and ambitions cannot be taken as an absolute in itself. Rather, it reflects environment-related restraints. It would be too simplistic to hold undercapitalization and low-productivity as a choice. Necessity-driven entrepreneurs do not often reflect an intention or motivation on the part of the entrepreneur to remain small and unprofitable or to operate with little to no access to finance or to capital."

Economic opportunity is viewed in the most formal and abstract way in terms of a gap between demand and supply that an entrepreneur can exploit to create profits, rents, and growth for her enterprise. Yet, the concept of opportunity is subject to many social, economic, and political determinants, including educational attainment, access to assets that can be used as capital, and access to finance. Accordingly, the subsistence-driven entrepreneurship that constitutes the biggest portion of entrepreneurial activities in the developing world is not simply the cause of low-productivity and low-growth entrepreneurship. It is also an effect that draws attention to the structural and institutional factors that determine access to opportunity.

Stevenson defines entrepreneurship as a system that "include entrepreneurs (and potential entrepreneurs), institutions and government actions [where] the desired policy outcome is an increased level of entrepreneurial activity….[and] the role of institutions and governments is to foster environments that will produce a continuous supply of new entrepreneurs".[5] Such a definition resets the research agenda for entrepreneurship in developing countries as its focus goes beyond individual entrepreneurs and enterprises into the basic determinants of entrepreneurship as a system and as a broad social phenomenon. In such a setting, the distinction between entrepreneurs on the basis of motivation, growth potential, and innovation is less relevant. Rather, the principal question becomes, under which system can entrepreneurship emerge and grow?

2.2 Property rights and the rule of law

The literature on property rights and the institutional determinants of market-based capitalism and subsequently, entrepreneurship, is relevant and important where it regards the entrepreneurship ecosystem. There is some burgeoning literature on Egypt and Tunisia that depicts the development of their economic institutions during the last two decades and how this influenced the form of capitalism that emerged in the two countries. This literature intersects considerably with many questions regarding access to finance, the rule of law, cronyism and corruption, and the persistent underdevelopment of administrative and juridical structures.

However, the study of the rule of law in Egypt and Tunisia is sparse and offers mainly a formalistic and statistical examination with little in-depth analysis to inform policy and institutional reform. Hence, our study should cover this gap by including the broader representation of private entrepreneurship in the two countries. Obtaining the accounts of would-be entrepreneurs, small and medium-sized enterprise (SMEs) owners, and members of the informal sector regarding specific rule of law issues such as contract enforcement, property registration, and recourse to adjudication should provide us with the different ways of witnessing the problems of the weak rule of law and understanding various responses to them. Moreover, future research should tackle the political roots of the weak rule of law and property rights protection and how the regime change that took place in the two countries of study is likely to impact the drive for institutional reform.

2.3 Financial barriers to growth

How did the literature address the barriers to growth and entry? There is a broad consensus within the literature on MENA that a lack of access to finance is a major barrier to growth for the majority of entrepreneurs throughout the region including in Egypt and Tunisia. The problem does not seem to be in the overall access of the private sector to credit. Rather, it seems to be the uneven distribution of this access, which falls in favor of the larger and more established firms to the exclusion of the broadest base of the private sector of young entrepreneurs, nascent enterprises, and micro, small, and medium-sized enterprises. MENA financial systems are primarily bank-based. The vast majority of entrepreneurs are not bankable and constitute too much of a risk for banks. Additionally, the financial system is not designed in a way to break the vicious circle where the lack of capital only leads to more lack of capital. On the supply side, banks are not equipped sufficiently for project evaluation and risk assessment, so they avoid risk altogether. Banks rather prefer confining their lending to governments or big business.

The literature has attributed the problems of accessing finance to a variety of causes. Some held that the real cause of the problem was the failed development of alternatives to debt financing such as venture capital, secondary stock markets for SMEs, and leasing and mortgage systems. Others underlined that the banking sector is inherently biased against new market entrants and SMEs. However, some literature indicates that it is a manifestation of poor rule of law, weak contract enforcement, and insufficient property rights protection. A fourth scholarly trend held that the real problem was with the state-owned structure of the banking system in the MENA region. Tunisia and Egypt still have banking sectors that are dominated by public banks, as do most countries in the region. These banks were deemed as inefficient, not competitive, and prone to cronyism.

Although the literature has extensively examined the financial barriers to growth, some gaps remain. Little has been written about the informal means of funding through networks of family and friends that do not pass by the formal financial system. Revealing the mechanisms of trust and exchange can be quite useful in informing policy reformers and to involve stakeholders in any future reform. The second gap that was overseen by the literature is the impact of the financial sector reform in MENA region on the SME and young entrepreneurs' access to finance. There is some evidence that suggests that reform has limited further access to finance for the vast majority of private enterprises in the region.

2.4 Non-financial barriers to growth

Little attention was paid to the non-financial barriers that enterprises face, especially nascent enterprises, young entrepreneurs, small and medium-sized firms, and those operating in the informal sector. Other non-financial barriers to growth such as taxation policies and institutions, labor regulations, and access to infrastructure have barely been addressed in any of the literature on entrepreneurship, SME-promotion, or private sector development in MENA. This gap in the literature persists despite the significance of these factors in explaining the scope and pace of development of entrepreneurship in the region. Hence, they should be prioritized in any future research on entrepreneurship.

2.5 The question of informality and entrepreneurship

Some of the reviewed literature focused on private sector development. The concept of private sector in this context often refers to aggregated and abstract macroeconomic indicators such as the private sector share in total GDP, value-added, investment, exports, and employment. Such indicators and measurements are important in describing the overall transformation that took place in countries like Tunisia and Egypt after three or more decades of privatization and trade and capital liberalization.

The problem with the approach outlined above is that it is too static and aggregated. It does not show the dynamics behind the underdevelopment of the private sector and its limited contribution to the growth generation and export base diversification. Adding a study of entrepreneurship provides a very dynamic approach to analyzing private sector development and the ongoing process of transitioning into a market economy in that part of the world.

Another relevant branch of knowledge is on economic informality in the MENA region. Informality is a predominant feature of private entrepreneurship in the vast majority of developing economies in total output, employment, and the number of economic enterprises. Schneider estimates the percentage of the informal activities in Egypt and Tunisia to be 40-60 percent and 25-35 percent respectively.[6]

Informal economic enterprises, usually of very small scale, constitute a sizable percentage of private entities in Egypt and Tunisia. However, despite its overwhelming share in employment generation and business creation, the informal sector is characterized by the literature with low productivity, meager wages, and little growth potential, and thus little contribution in the generation of overall economic welfare. The World Bank[7] notes that the inability of the private sector in the MENA region to globally compete is due to the high level of informality. Operating in the informal sector denies entrepreneurs significant opportunities: "Informality opportunity cost includes limited access to public services, no profit expansion, limited access to financial and business development services and limited possibilities to cooperate with formal sector."[8]

The many challenges in the private informal sector should not be taken as a given or a natural constraint. There are deep institutional, socio-economic, and political restraints that create a status quo where the biggest chunk of the private sector is of a micro-size and operates in the shadows with low-productivity and low potential to grow.

Future research should include a representative sample of informal entrepreneurs and should aim to answer these questions: How do formal institutional and regulatory settings impact informality in the two case studies? How do informal entrepreneurs respond to this impact (informal funding, mentorship, networking, and trust)? What can the government do, if anything, to support such mechanisms and enable informal enterprises to reach their potential? Why has formalization in MENA lagged despite the fact that initiatives have been adopted to formalize the informal sector since the mid-1990s? What are the political underpinnings of the formalization process or of the lack of it?

2.6 Female entrepreneurship

The literature has maintained that gender does have a tremendous impact on entrepreneurship in the MENA region. Female entrepreneurship in MENA in general, including Egypt and Tunisia, has started to receive research attention in the last few years. There is a broad consensus that overall female participation in economic activities is quite low in the MENA region as compared to other parts of the developing world. The Organization for Economic Co-operation and Development (OECD) estimates that "only 32% of women of working age in MENA participate in the labor force as compared to 56% in low and middle income countries and over 61% in OECD countries. The rate of self-employment for women is half that of men."[9]

As a matter of fact, the Global Gender Gap report[10] indicated that the MENA region ranked last in closing the gender gap. The Gender Gap score in MENA was 58 percent as compared to 64 percent for South Asia and Sub-Saharan Africa, and 67 percent for Latin America and Eastern Europe.

The literature has given mixed accounts on the discrimination against female entrepreneurs in MENA. According to the World Bank[11] there are high barriers to entry and growth in the MENA region facing both male and female-owned firms, rather than outright discrimination against female entrepreneurs. Conversely, El-Hamidi and Baslevent[12] held that female entrepreneurs in MENA are indeed discriminated against. However, they traced the high barriers to entry and growth that face female entrepreneurs out of the direct business environment and into the broader regulatory and legal frameworks that impact women's status. For instance, they suggest that inheritance laws in Egypt result in fewer assets available for women to start with, and "thus fewer collateral in face of acquiring credit. Women normally don't hold land, house, or vehicle titles, which is more challenging in rural areas where women's assets are confined to jewelry or furniture, and do not meet the requirement of formal loans of banks." The State of the Field in Youth Economic Opportunities report takes the same position on women's inaccessibility to assets and thus to capital. One interesting point that this report brings up is that the gender gaps in legal rights do not necessarily close with income: "Even women in formal sector employment with high levels of education find themselves vulnerable. Advocacy on this front can affect women in all income strata and across age groups."[13]

The gender dimensions of entrepreneurship are starting to become a focus of studies in MENA. However, our upcoming study aims to add much to the available information about the topic. None of the literature has provided thorough and detailed accounts of how an entrepreneur's gender affects market entry and the potential to grow. Future research should use representative samples of women across all subsections by examining divisions of regional, sectoral, or formal status, for example. This should provide better description and analysis of the different ways through which female entrepreneurs in different regions and sectors experience gender-related obstacles to entry, growth, and exit.

2.7 SMEs and entrepreneurship

Despite the many similarities, the literature holds that there are rather big differences between the two categories of SMEs on the one hand and entrepreneurship on the other. Both SMEs and entrepreneurs share the broader ecosystem. Indeed, "most new firms are small firms, so that a substantial part of the entrepreneurship literature is concerned with the dynamics of SMEs".[14] The same observation is brought forward in the GEM report on Egypt that states: "the vast majority of early-stage enterprises and established businesses are small-sized enterprises: 68%, 60% and 55.9% of nascent, baby and established enterprises, respectively."[15]

Despite their numerical superiority, SMEs suffer from economic deficiencies such as low-productivity, low capitalization rate, and a meager share in total output and value added. Such deficiencies are quite common through the developing economies. Unlike OECD countries, "where small to medium enterprises generate 55% of the GDP, in the poorest countries, GDP is often driven by government and large business; they lack the economic engine that SMEs can provide".[16] This analysis applies to most MENA countries, including Egypt and Tunisia, where large companies that have better access to financial and non-financial resources produce most of the output.

This calls to our attention a phenomenon underlined by the extant body of literature on MENA, which is that of the "missing middle syndrome." There was special reference to this phenomenon in the introductory section of this article. The missing middle syndrome reflects the inability of most private enterprises to grow from the micro-size to occupy the rank of small and medium-sized enterprises. This usually implies a broad variety of constraints and barriers to growth.

Most of the extant literature has produced valuable and dense knowledge about the financial barriers that SMEs face in MENA. El-Kabbani and Kalhoefer[17] hold that "the limited access to external funding, which is mainly represented in debt – especially bank loans – is associated with the unattractiveness of SMEs from the creditor point of view. Bank loans require credit history, collateral, and projections of future cash flows that typically are unavailable for SMEs". Because most small and medium-sized enterprises are located in non-capital-intensive sectors such as commerce and light industries, they often lack assets that can be used as collateral.[18] The authors estimate that 95 percent of Egypt's SMEs do not maintain bank accounts, and thus informal saving mechanisms are their main funding source for start-up and capital.[19] According to the survey they conducted, 100 percent of surveyed micro-enterprises (employing less than five workers) pointed out access to finance as their number one problem compared to 43 percent of small enterprises, 30 percent for medium-sized enterprises, and none in large enterprises.[20]

The literature has shown that most of the policy remedies to the barriers facing SMEs in MENA have been in the area of credit-provision. These remedies attempt to fill the gap left by the financial and banking system by establishing special funds and agencies.

Most of the work on SMEs in MENA has focused on the barriers to growth from purely technical and economic angles. Little attention was paid to the deep political, institutional, and policy roots of the current status of micro, small, and medium-sized enterprises. SMEs stand for almost the totality of the private sector in terms of employment and number of firms. According to Stevenson's estimates,[21] the share of enterprises with fewer than 50 employees accounts for at least 95 percent of private sector enterprises in MENA. According to Central Agency for Public Mobilization and Statistics (CAPMAS) data in 1996, in Egypt one-person establishments constituted slightly more than 50 percent of all enterprises followed by two-person establishments accounting for 26 percent of all private enterprises. "This meant that 76% of all private sector enterprises had fewer than 3 employees. The average size of all Egyptian private sector non-agricultural enterprises in 1996 was 2.9 employees."[22] A World Bank report[23] estimated the share of micro, small and medium-sized firms of total enterprise population in Tunisia to be 97.8 percent. However, they suffer from extremely low-productivity, and limited capitalization and output. Not only has the literature held that the high barriers to entry and growth that face young entrepreneurs and SMEs is related to the poor performance of the overall economies of Egypt and Tunisia, but some also suggested a link between these barriers and the exclusionary and politically unsustainable development model that collapsed in the wake of the 2011 revolts.[24]

The available literature does suffer from limitations. Much of it focuses on financial barriers to entry and growth such as start-up capital and access to credit. Little has been written about the non-financial obstacles that can prove to be as problematic as the financial ones. Hence, our study will focus on typical non-financial barriers such as taxation policies and regimes, labor regulation, education and vocational training, competition, and access to infrastructure. Accordingly, our study should add the examination of non-financial barriers to the study of SMEs.

Beyond firm size, the literature has not addressed the question of regional disparities and their impact on entrepreneurship in MENA. Most studies, reports, and statistics have primarily focused on the capital city (as is the case with Doing Business report by the World Bank). Future research should go beyond the capital city into other urban centers in the provinces to examine whether they face similar or different barriers and whether these barriers are associated with any locational factors.

3. Setting the agenda for future research

The previous sections have provided a brief critical review of the general literature on entrepreneurship in the MENA region. It has outlined the top-level findings as well as the lacunae in that body of literature. This section aims to employ the above critique in order to set the agenda for future research on entrepreneurship in MENA and to guide the intended joint study by CIPE and Stanford.

The study depends on a sample of approximately 100 respondents in each country. The samples are designed to represent a microcosm of entrepreneurial population in Egypt and Tunisia. It represents the various categories and groups of entrepreneurs in accordance with their relative weight as revealed by statistical evidence.

As small as the samples may be, they do not aim to quantitatively describe the principal characteristics of the entrepreneurial phenomenon or at establishing statistical correlations between different phenomena that belong to the universe of study. For this has already been the subject of a rather big number of studies, reports, and indices such as the Global Entrepreneurship Monitor report (GEM), the Global Entrepreneurship and Development Index (GEDI) and the World Bank

Doing Business report. It is already well-established that the entrepreneurship ecosystems in MENA are not conducive to business entry and growth. It would hardly be a contribution to add to the long list of policy and academic material yet another piece that proves the obvious and already proven.

Rather, the study aims to use the survey together with extensive focus group discussions and individual interviews to produce a thick and detailed description of the institutional underpinnings of entrepreneurship on the one hand, and thorough analytical accounts of how different elements of the ecosystem interact with each other.

The study's expected contribution lies in its comprehensiveness and attempt to provide a clear picture of how things are on the ground for average entrepreneurs in Egypt and Tunisia. This perspective is key in understanding the actual barriers in theory and practice and thus in understanding the institutional and policy areas for reform in such political context.

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