

Reforming the Entrepreneurship Ecosystem in Post-Revolutionary Egypt and Tunisia

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Acronyms

API: Agence de Promotion de l'industrie (Tunisia)
APIA: Agence de Promotion de l'investissement Agricole (Tunisia)
BFPME: Banque de Financement des Petites et Moyennes Entreprises (Tunisia)
BTS: Banque Tunisienne de Solidarité (Tunisia)
CAPMAS: Central Agency for Public Mobilization and Statistics (Egypt)
EBI: Egyptian Banking Institute (Egypt)
GEDI: Global Entrepreneurship and Development Index
GEM: Global Entrepreneurship Monitor
ISETs: Instituts Supérieurs des Etudes Technologiques
MENA: Middle East and North Africa
MESMEs: Micro, Small and Medium Enterprises
OECD: Organization for Economic Cooperation and Development
SFD: Social Fund for Development (Egypt)
SME: Small and Medium-sized Enterprises
TEA: Total Early-stage Entrepreneurial Activity
UNDP: The United Nations Development Program
USAID: United States Agency for International Development

Executive Summary

- 1- Despite its overall sizable share in output and employment, the Egyptian and Tunisian private sectors have been 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 enterprises that are either family-owned or employ no workers. This broad base of private sector enterprises has often been undercapitalized, under-productive, and with limited capacity to grow and access markets.
- 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 to approach 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.
- 3- 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 of 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.
- 4- This report wishes to answer two questions: Why has private entrepreneurship in Egypt and Tunisia remained that underdeveloped despite decades of economic liberalization and private sector-friendly incentives and reforms? And how can the entrepreneurship ecosystem in the two countries develop to meet the high expectations of the people of having a productive and just socio-economic order?
 - a. The study dependent on a sample of approximately one hundred respondents for each country. The samples are designed to be a microcosm of the 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. The sample is divided vertically on the basis of enterprise and entrepreneurs' age groups, ownership structure, and gender; and horizontally by sector type and region.
 - b. Questionnaires, focus group discussions and individual interviews were all part of a qualitative study of entrepreneurship aimed at the production of a detailed description of the institutional underpinnings of entrepreneurship and thorough analytical accounts of how different elements of the ecosystem interact with each other. The study follows the logic of qualitative surveys.
- 5- Entrepreneurship is defined as an ecosystem i.e., the environment within which individual entrepreneurs and enterprises operate and interact with the regulatory, legal and institutional frameworks, both formally and informally. The ecosystem is the structure that

impacts the choices of entrepreneurs of entry and exit and their potential to grow. It has three main components:

- a. *Property rights and the rule of law that encompass a wide variety of institutional elements*
These range from property registration, asset retrieval and contract enforcement to bankruptcy, anti-trust and competition protection.
 - b. *The financial subsystem that refers to the formal and informal channels of fund provision*
This dimension includes all the media through which capital is exchanged at a certain cost and is expected to have a big impact on the overall potential for growth.
 - c. *The non-financial factors that impact entrepreneurship.* This category includes taxation rates and regimes; labor regulation; education and vocational training; competition; corruption; and access to infrastructure.
- 6- Overall, formal legal and regulatory structures have been reported by a considerable majority of respondents in Egypt and Tunisia to be either dysfunctional or inaccessible or both. A clear majority of Tunisian and Egyptian entrepreneurs face problems registering their businesses; many - especially in Egypt - reported to be operating informally without any permits, licenses or tax codes. A majority of respondents do not trust formal contract enforcement and report lower frequencies of formal contracts while exacting economic transactions. The same trend applies to the formal legal and regulatory structures that govern market exit: insolvency and bankruptcy. Few reported to have resorted to bankruptcy procedures while the vast majority of those who reported to have exited in the past said that they managed the process informally. Access to institutional credit through banks or special funds remains limited in both Egypt and Tunisia, though more so in Egypt. Equity and non-traditional sources of finance stand for a meager share of total financing for nascent, micro and small enterprises. Still, self-financing through private savings and business profits remains the main source of finance for a majority of entrepreneurs in Egypt and Tunisia.
 - 7- Given the dysfunction and inaccessibility of formal legal and regulatory structures, the broadest base of private sector entrepreneurs in both countries under study operates in a sub-optimal ecosystem. Sub-optimality refers to the final outcome of the weakness of formal structures and insufficiency of alternative means for doing business informally. Sub-optimality is an institutional way of approaching macro-economic phenomena such as low-productivity; lack of competitiveness; and weak growth potential of the private sector in MENA, specifically in Egypt and Tunisia. It also helps in explaining phenomena already underlined by the literature such as the missing middle syndrome, a situation in which enterprises are deprived of growth opportunities, creating an overflow of micro-enterprises.
 - 8- Even though Egypt and Tunisia have much in common with regards to the sub-optimality of their entrepreneurship ecosystems, they are not by any means identical. Rather, there are differences in degree of sub-optimality where Tunisia fares better than Egypt in many respects. Moreover, the institutional sources of sub-optimality tend to differ between the two countries in what can be labeled as the verities of sub-optimality.
 - 9- **Sub-optimal entrepreneurship ecosystems and inaccessible formal structures:**
 - a. **2.1- Business registration: informality is not a choice (1):** The answers given by the majority of Egyptian and Tunisian entrepreneurs indicate high barriers to entry and exit. They indicate also that formal structures in the areas of property rights, business registration, contract enforcement and finance are generally inaccessible for the majority of entrepreneurs in both countries.

- i. Despite a decade of procedure simplification that was internationally praised in both countries, business registration is not easy for the majority of young entrepreneurs, new entrants and nascent enterprises. Only 16 percent of the Egyptian respondents said that the process of business registration was “easy” or “very easy.” Conversely, 48 percent held it to be either “difficult” or “very difficult.” The average time reported in Egypt for registration was 5.02 months. Overall, business registration did not look easier in Tunisia, none of the respondents indicated that the process was “very easy.” Only four percent said that it was “easy.” Conversely, 45 percent held it to be either “difficult” or “very difficult.” The average time reported for registration was 5.56 months.
- ii. However, the registration process seems to have become easier over time. Contrasting the answers by enterprise age in Egypt as well as in Tunisia reveals that business registration took place through a smaller number of agencies and with less time consumed. In the case of Egypt, nascent enterprises –those less than three years old– reported to have dealt with an average of 2.54 governmental agencies as compared to an average of four agencies in the case of young –between 3 and 10 years old– and established enterprises older than 10 years. The time for registration supports the earlier downward trend. Nascent, young and established enterprises reported averages of 4.9, 5.44 and 7 months to get registered, respectively.
- iii. These numbers can be taken as a clear indicator that the process of business registration in Egypt has become relatively easier through time, at least for some entrepreneurs, if not all. Nascent and young enterprises are the ones that were registered between 2003 and 2013, which is the period that corresponds to the administrative, legal and regulatory reforms that were undertaken by the Ahmed Nazif government (2004-2011). However, though things seem to have eased up for some, the registration process remained difficult for a sizable percentage of entrepreneurs. Only in this light can we understand why 31 percent of the nascent and young enterprises reported not having registered and 38 percent having operated in the informal sector.
- iv. The same trend is noticeable in Tunisia. The percentage of entrepreneurs who held the process to be either “difficult” or “very difficult” has declined over time. The percentage was 60 percent for established enterprises; 47 percent for young enterprises; and 44 percent for nascent firm owners/managers. Moreover, the number of agencies indicated by each age group shows a downward trend from an average of four agencies indicated by established-enterprise owners/managers to 3.4 agencies for young and nascent firms. However, despite the relative improvement, a considerable percentage of entrepreneurs still perceive the registration process to be quite hard, complex and expensive.
- v. The overall results significantly contradict the reports and indices developed by the World Bank and other international financial institutions regarding the ease of doing business in Egypt and Tunisia. The disparity can be explained in terms of the sample composition of this study as opposed to that of indices like “the easiness of doing business.” Whereas the main component in this sample is small and micro enterprises in the capital city as well as in other provincial cities, the *World Bank Doing Business* index has focused primarily on medium and large enterprises in predominantly capital cities.
- vi. One of the interesting findings is that a clear majority of respondents in Egypt and Tunisia expressed positive attitudes towards registering their business. When asked to evaluate the impact of business registration on accessibility to finance, business security and access to markets, a clear majority of answers considered the positive impact of registration despite

the reported difficulties and high levels of informality that characterize both economies, especially that of Egypt. Such observations go along with the indicated reasons for not registering that focused on the complexity and high cost together with the fear of being exposed to more corruption upon registration. Hence, it can be said that a majority of entrepreneurs may be willing to register their enterprises, aware of the positive outcome of registration, though laws and regulations - and the way they are applied by the administration - may deter them from doing so.

- b. Contract enforcement, taxation and bankruptcy: informality is not a choice (2):**
Inaccessibility to the formal legal system was clear in the areas of contract enforcement and selection of formal contracts in exacting business transactions. Only 14 percent of Egyptian entrepreneurs and 20 percent of Tunisian entrepreneurs said they “always” use formal contracts in doing business. The largest percentage was reported in the middle. Thirty-four percent and 35 percent of the Egyptians and Tunisians, respectively, said they “sometimes” resort to formal contracts while 34 percent and 21 percent of Egyptians and Tunisians, respectively, stated that they either never or rarely use them. Formal contracts were defined in the survey to include all registered and written transactions in the form of contracts, agreements, checks and bills.
- i.** Alarming enough, in the case of Egypt, younger enterprises seemed less appreciative of formal contracts than older ones. Fifty-nine percent of nascent enterprise owners/managers expressed the belief that formal contracts had a positive impact on their business. The percentage was 79 percent and 86 percent for young and established enterprises, respectively. Moreover, only 32 percent of nascent enterprise owners/managers expressed the conviction that they could defend a contract in Egypt. The percentage was 47 percent and 64 percent of young and established enterprise owners/managers, respectively. The figures indicate a declining trust by new market entrants in the aspect of contract enforcement and its utility altogether.
- ii.** The low frequency of formal contract usage in Egypt and Tunisia was reported by predominantly formal, registered enterprises. This is an indicator of a high ratio of informal transactions where entrepreneurs circumscribe the need for using formal contracts.
- iii.** However, this kind of informality is not by choice as some of the literature has claimed. As a matter of fact, a clear majority of entrepreneur respondents in Egypt and Tunisia (74 percent in both cases) held that formal contracts would have a positive impact on their businesses. What may explain this contradiction is that only 48 percent of Egyptian entrepreneurs and 61 percent of their Tunisian counterparts expressed the belief that formal contracts can be enforced and defended – low percentages that indicate weak rule of law. Hence, entrepreneurs may actually want to use formal contracts, but they cannot afford the risk and cost of weak rule of law. To that effect, one finding from the Egyptian sample indicated respondents who ran registered and formal business (56 percent) reported to be more exposed to corruption and extortion than those operating in the informal sector (45 percent).
- iv.** Market exit that is managed informally and resorts to formal bankruptcy rules is rare. Entrepreneurs in Egypt and Tunisia seem excluded from the formal structures that govern bankruptcy and asset recovery. Only six percent of the Egyptian respondents who reported to have quit business at a previous point said that they resorted to the formal bankruptcy regulation. In the Tunisian sample it was 22 percent. Both rates are low and suggest that 89 percent of Egyptians and 78 percent of Tunisians who quit their businesses exited

informally. The reasons for escaping the formal regulations were common between the two groups: costly and complex regulations and penalization of failure.

- v. The views expressed by the respondents on the tax system in Egypt show that taxation is quite problematic for most entrepreneurs. It is noteworthy that the majority of the respondents own and manage either small or micro-sized enterprises. Almost 55 percent of the respondents “disagree” or “completely disagree” with the statement that tax rates are reasonable and suitable. Fifty-one percent of them “disagree” or “completely disagree” with the statement that tax collection is efficient. Worse still is that 58 percent of the respondents said that they “disagree” or “completely disagree” with the statement that tax collection is transparent enough. Whereas the first result indicates a high level of dissatisfaction with tax policies, the second and third reveals that most entrepreneurs have large issues with tax administration. The significantly high level of dissatisfaction with the tax system can help explain the high levels of informality that characterize the Egyptian economy. Thirty-eight percent of the entrepreneurs who reported not to have registered their firms – those operating informally – attributed their decision to not wanting to confront tax authorities. The high percentage of recorded and registered transactions by all firms included in the sample – registered or not – is another indicator of the unwillingness of transmission.
 - vi. The situation is not much different in Tunisia. Almost 72 percent of the respondents “disagree” or “completely disagree” with the statement that tax rates are reasonable and suitable. Fifty percent of them “disagree” or “completely disagree” with the statement that tax collection is efficient. Worse still is that 62 percent of the respondents said that they “disagree” or “completely disagree” with the statement that tax collection is adequately transparent.
- c. Unfair competition: small capital alienation:**
- i. Unfair competition remains a major perceived barrier to market entry by a majority of Tunisian and Egyptian entrepreneurs. An alarmingly high percentage of respondents expressed their belief that their businesses were vulnerable to unfair practices such as monopoly, price fixing and the non-market control of supplies and inputs. The ratio was 40 percent in the Egyptian sample and 59 percent in Tunisia. Seventy-nine percent of the Egyptians said that the anti-trust laws were weak and 72 percent held that the implementation was the problem. The percentages in Tunisia were as high as 80 percent who held the laws and regulations to be too weak and 90 percent who added to that weak and lax implementation.
 - ii. The views expressed with regards to the exposure to unfair competition is revealing in many senses. On one hand, it confirms the cronyistic structure of the capitalist transformations in Egypt and Tunisia under Mubarak and Ben Ali, respectively. Property rights were distributed unevenly in favor of a few cronies that were more often than not related to incumbent regimes. On the other hand, the responses stand as a clear indication of the perceived weakness of regulatory institutions in both countries despite their formal existence. The state – in both cases – lacked the capacity to regulate the asymmetries of power and information. Last but not least, given the composition of the samples, such answers indicate the extent to which alienated small capital holders and new market entrants are from the markets in which they are supposed to operate.
- d. (In)accessibility to formal or institutional finance:**
- i. The vast majority of respondents reported their primary dependence on self-financing

either through the profits generated by their businesses (73 percent of the respondents in Egypt and 65 percent in Tunisia) or through private savings (66 percent and 56 percent in Egypt and Tunisia, respectively).

- ii. Business profits are not accessible for young entrepreneurs at the start-up phase. Rather, the main sources of finance for young entrepreneurs are private and family savings. In the Egyptian sample, a massive 94 percent of the respondents reported their reliance on private savings at the start-up phase followed by 50 percent and 30 percent who reported family and friends, respectively, as the source of finance. Only 17 percent said that they depended on some sort of bank credit at the early phase of doing business. Over and above, the average share of private savings in the start-up capital reported by respondents was 63 percent as opposed to a mere 10 percent for different types of credit including banks and special funds.
- iii. A very interesting finding was that firm size mattered more than informality with regards to access to finance in Egypt. Almost equal percentages of formal and informal entrepreneurs held restrained access to finance to be a major barrier to growth (57 percent versus 60 percent). Moreover, for both groups, the primary sources of finance were business profits and private savings. Seventy-eight percent of informal entrepreneurs in the sample said that they relied on business profits compared to 70 percent for those operating in the formal sector. Sixteen percent of the formal entrepreneurs reported resorting to banks compared to five percent of their informal counterparts. Even though there is a difference between formal and informal sectors, bank loans retain a meager share of financing formally registered enterprises. Such results clearly suggest that the problem is not with business registration or formality of enterprises but rather with the size of the firm, which almost naturally excludes businesses from the formal banking sector.
- iv. Despite similar overall restraints, access to institutional credit in Tunisia was much better than in Egypt. Since the 1990s, the Tunisian government has attempted to tackle the problem of the access to finance by young entrepreneurs and small and medium-sized enterprises by establishing specialized banks and funds that extend credit without requiring collateral. The two primary examples that were examined in this study were the Tunisian Bank for Solidarity (BTS) and the Bank for Financing Small and Medium Enterprises (BFPME). This seems to have relatively ameliorated the situation compared to Egypt at the start-up phase. Generally, business finance remained heavily dependent on self-financing.
- v. Despite the overall better access to finance by Tunisian entrepreneurs, the survey revealed that the top source of finance at the start-up phase was private savings (39 percent of average reported start-up capital). The second source, however, was bank loans (28 percent of average reported start-up capital), which is an impressive ratio compared to Egypt. Credit from family and friends came in the third and forth positions (23 percent and 8 percent, respectively) of average reported start-up capital.
- vi. However, further examination of the above point revealed that the problem of start-up finance persisted in Tunisia despite the relatively relaxed credit supply, especially when the number of respondents who reported securing bank credit was contrasted with the share of bank credit in total start-up financing. Only 29 percent of the respondents said that they depended on banks and special funds while a massive 60 percent and 43 percent of Tunisian respondents reported to have relied on informal sources of finance: private savings and family credit, respectively.
- vii. The responses given in the survey confirm that alternative and non-traditional forms of

finance remain quite limited in both countries. Despite continuous efforts to raise their shares, the financial systems in Egypt and Tunisia remain by and large bank-based. Only 10 percent of the respondents reported resort to venture capital or stock issuance in Egypt. The situation in Tunisia was not much better. Only 16 percent of the respondents said that they relied on venture capital and only seven percent said so with regards to issuing stocks. Interviewed entrepreneurs in Tunisia had the same reservation as their Egyptian counterparts that non-traditional finance almost exclusively work in non-traditional sectors such as the technology sector. The broader base of the economy is left out.

e. Skills acquisition and entrepreneurship education and training: the predominance of informality

- i. A clear majority of the respondents in Egypt (87 percent) and Tunisia (79 percent) said that their business required some sort of skills. This, of course, goes in harmony with the fact that post-secondary and university graduates constituted the majority of the entrepreneurs in both samples.
- ii. As for the sources through which they acquired these skills, informal ties through family relations or apprenticeship and mentorship were by and large predominant in both cases. In Egypt, family ties came first (reported by 60 percent) followed by apprenticeship (56 percent). It was the reverse in Tunisia where 66 percent reported informal apprenticeship followed by family at 43 percent.
- iii. The percentage of respondents in Tunisia who reported having received technical support from state institutions is significantly higher than that reported by Egyptian entrepreneurs, which was as low as 10 percent. Even though state support remains at the very bottom of the means of skill transferring, preceded by informal apprenticeship and family ties in Tunisia, the relatively higher percentage at 23 percent can be attributed to the broad network of support institutions that the state has created in Tunisia in the last decade. Such institutions include public incubators, business centers and other training facilities. Business and developmental associations came third, mentioned by 21 percent and 30 percent of Egyptians and Tunisians, respectively.

f. Survival in a low-low equilibrium: the meaning of sub-optimality

- i. When asked about the top barriers to growth, respondents from Egypt and Tunisia reported political instability and public disorder (84 percent in the Egypt sample and 54 percent for Tunisia); administrative inefficiency (70 percent for Egypt and 52 percent for Tunisia); and restrained access to finance (63 percent for Egypt and 60 percent for Tunisia). Political instability and public disorder were the first barriers reported by Egyptian entrepreneurs while restrained access to finance was the first for Tunisian respondents.
- ii. Interestingly enough, many of the issues directly related to the entrepreneurship ecosystem – with the exception of finance – seemed not to have been prioritized by the respondent entrepreneurs. Two main results were counterintuitive with regards to corruption and contract enforcement.
- iii. Corruption appears to be overstated as a barrier to growth. Most of the results obtained regarding corruption suggest that corruption is a large problem but not the largest barrier to growth as perceived by the majority of Egyptian and Tunisian respondents in the survey.
- iv. Corruption occupied the fourth position among the top barriers to growth in both surveys. Forty-eight percent of Egyptian respondents and 41 percent of their Tunisian counterparts marked corruption as a barrier to growth. Though sizable, it was preceded by instability and disorder, access to finance and administrative inefficiency – not corruption but rather,

inefficiency.

- v. One counterintuitive finding is that corruption was reported to be a larger problem in the capital city than in the provinces of both Egypt and Tunisia. Corruption was reported to be a barrier to growth throughout all cities in Egypt included in the survey: 32 percent in Cairo; 15 percent in Upper Egypt; and 56 percent in Lower Egypt. However, the highest percentage of respondents reporting to have paid bribes or gifts to state officials was actually in Lower Egypt at 58 percent followed by Cairo at 54 percent and then Upper Egypt at 43 percent. As high as the percentages are, it seems that the weaker state presence in Upper Egypt was translated positively in less exposure to corruption and extortion. Tunisia exhibits similar findings. Corruption came as the lowest barrier to growth by all respondents. Tunis-based entrepreneurs (47 percent) complained more than entrepreneurs from Monastir (37 percent) or Kebili (40 percent). Moreover, Tunis-based entrepreneurs had the highest percentage of reporting having paid bribes and other informal payments at 44 percent. Conversely, those from Kebili had the lowest at 23 percent. This can only be explained in terms of the relative absence of the state.
- vi. Over and above, corruption was placed at the very bottom of the list of barriers to growth experienced by provincial entrepreneurs (38 percent of respondents in Egypt and 26 percent in Tunisia). In both cases, entrepreneurs in the non-capital-city stated that access to infrastructure, skilled-labor finance and markets was more of a barrier than corruption.
- vii. When asked about the required reforms to boost entrepreneurship in the provinces in Egypt and Tunisia, addressing corruption came as the lowest priority in Egypt and second highest priority in Tunisia. In Egypt, public investment in infrastructure, education, decentralization and less regulation were considered higher priorities than fighting corruption. Meanwhile, in Tunisia, public investment in infrastructure, lower tax rates, better political representation and more decentralization came ahead of fighting corruption.
- viii. Like corruption, contract enforcement – or the lack thereof – seemed to be overstated in the literature compared to the answers given by surveyed entrepreneurs. Contract enforcement came at the very end of the list of the barriers to growth in Egypt at 34 percent and came seventh out of eight elements in Tunisia at 41 percent. Again, the number of respondents who marked it as a barrier to growth is sizable, but it does not seem to be a top barrier to them though weak contract enforcement is likely to raise the transaction costs considerably.
- ix. One possible explanation for the relatively low importance given to the question of contract enforcement is the low number of formal and registered contracts in exacting transactions as exhibited above. The low usage of formal contracts was reported by predominantly formal, registered enterprises. This is an indicator of a high ratio of informality of transactions where entrepreneurs circumscribe the need for using formal contracts.
- x. The answers given do not suggest by any means that contract enforcement and corruption are minor or insignificant barriers to growth. Rather, they show that entrepreneurs could survive despite the existence of these two chronic and structural problems. The resultant property rights system is usually a sub-optimal setting where transactions are made in narrow circles of trust – likely in the short-term – where informal mechanisms of enforcement can compensate for the absence of formal state institutions.

10- Regional dimensions of entrepreneurship in Tunisia and Egypt: sustained marginalization

- a. The answers provided by provincial entrepreneurs suggest that the current ecosystem that governs entrepreneurial activities discriminates in favor of the capital city in both Egypt

and Tunisia. Sixty-two percent of provincial entrepreneurs in Egypt expressed the view that the rules, laws and regulations were designed and implemented in favor of those based in the capital city (40 percent of Tunisian respondents). Moreover, 88 percent of Egyptian respondents thought that their chances to grow were greater in the capital in comparison to 53 percent of Tunisians. Sixty-four percent of Egyptians indicated that they would actually move to the capital if given the opportunity compared to 31 percent of Tunisians.

- b. However, the big division in both Tunisia and Egypt does not seem to lie between the capital city and the provinces. Rather, it exists between the two regions of the North and the South. In Egypt, it is Cairo and Lower Egypt on the one hand and the cities in Upper Egypt on the other. In Tunisia, it is the coastal area that includes Le Grand Tunis together with the North West and the South East of the country versus the inland provinces that are landlocked and situated primarily in the Grand Sahara.
- c. According to the answers provided by the respondents, in Egypt, it becomes clear that those owning and managing enterprises in Upper Egypt are operating at a disadvantage in most of the aspects of the entrepreneurship ecosystem. First, the highest percentage of respondents who reported facing barriers to growth was in Upper Egypt at 69 percent followed by Lower Egypt at 53 percent then Cairo at 47 percent. Entrepreneurs in the most marginalized areas suffered the most from barriers to growth. Moreover, Upper Egyptian entrepreneurs recorded the highest percentage with regards to each and every barrier to growth reported.
- d. The situation is not too dissimilar in Tunisia. Like their Egyptian counterparts, entrepreneurs based in all aforementioned regions in Tunisia marked political instability, administrative inefficiency and inaccessibility to finance as the top barriers to growth. However, these barriers were not evenly distributed. Finance was much more restrained in Kebili than among coastal area respondents. Seventy percent of the Kebili-based entrepreneurs reported finance to be their top problem versus 58 percent and 47 percent for Tunis- and Monastir-based respondents, respectively. Conversely, political instability was reported more in Tunis than in the provinces of Monastir and Kebili (64 percent, 53 percent, and 47 percent, respectively).
- e. The answers given by the respondents in the marginalized areas in Egypt and Tunisia clearly suggest that the state is integral to entrepreneurship policy and institutional reform. Additional public investment in infrastructure and human capital were the first two reform demands by Egyptian non-capital-based entrepreneurs (66 percent and 65 percent, respectively). This was followed by the demand for further administrative decentralization (60 percent) and less regulations (57 percent). Additionally, in Tunisia, public investment in infrastructure was the first reform demanded by 66 percent of the respondents followed by lower taxes at 63 percent; better political representation at 61 percent; and more administrative decentralization at 60 percent.
- f. It can be held that in general, the entrepreneurship ecosystem in Egypt and Tunisia is not conducive to the growth of private sector entrepreneurship. The rules, laws and regulations are set and implemented to primarily serve the interests of big capital be it private, state-owned enterprises or foreign capital. Conversely, new entrants and start-ups; micro, small and medium-sized enterprises; and entrepreneurs in the marginalized provinces and regions are usually left out and discriminated against. As a result of this rationale, the transaction costs for operating business is generally higher for the majority of entrepreneurs. Their access to the formal structures and institutions is limited and even nonexistent for some,

which narrows the scope of their business and limits their prospects of growth. The resultant entrepreneurial enterprise is often undercapitalized; small in size; typically informal; and characterized by low productivity, limited competitiveness, and limited capacity to generate jobs.

11- Varieties of entrepreneurship sub-optimality: differences between Tunisia and Egypt

- a. Many of the survey and interview findings indicate that the broadest base of private sector entrepreneurs in Egypt and Tunisia are operating at a sub-optimal level, which significantly undermines their potential for growth. However, that does not imply by any means that Tunisia and Egypt are identical. Despite many institutional and political-economic similarities, the sources and degrees of entrepreneurial sub-optimality are different.
- b. The overall environment in Tunisia has been less hostile towards young entrepreneurs, nascent enterprises and female entrepreneurs as compared to Egypt. The survey suggests that the Tunisian bureaucracy is relatively more efficient and less corrupt than its Egyptian counterpart. Moreover, the Tunisian government under Ben Ali has developed an extensive support structure that targets entrepreneurship and micro and small enterprises. The support structures that were developed since the second half of the 1990s included a range of administrative, financial and non-financial agencies and institutions such as the two special banks: BTS and BFPME and the network of business centers and public incubators.
- c. Even though this support structure has been far from optimal, the survey and personal interviews strongly suggest that it contributed positively in mitigating the biases inherent in the entrepreneurship ecosystem against young entrepreneurs, small capital holders, women and provincial entrepreneurs. One main contribution was that these support structures made finance more accessible at the start-up phase. Hence, Tunisia can qualify into a case of the imperfect correction of biases or a case of half-hearted reforms under Ben Ali.
- d. Conversely, the survey results indicate that Egypt's entrepreneurship ecosystem is much more hostile and discriminatory against young entrepreneurs, nascent and young enterprises, female entrepreneurs and provincial entrepreneurs. Formal structures are quite dysfunctional, corrupt or simply beyond the access of the broadest base of entrepreneurs, significantly more so than in Tunisia. Access to finance is much limited compared to Tunisia, and formal structures play virtually no role in entrepreneurship education or skill formation. Given how much formal structures were biased against entrepreneurship, virtually no support structures similar to those in Tunisia were established in Egypt. Such systems could have mitigated the systemic biases against small capital-holders and young entrepreneurs. Accordingly, Egypt can be typified as a case of sustained anti-entrepreneurship biases.

12- Tunisia: the imperfect correction of biases

a. Tunisia's financial support structures

- i. Almost two thirds (65 percent) of the Tunisian entrepreneurs stated that access to finance was the principal barrier to growth they faced. Historically, access to finance has been one of the main problems that nascent as well as established entrepreneurs faced in Tunisia. The survey tackled the question of finance through two angles: the first is that of the sources of finance reported by entrepreneurs while operating their business while the second is the start-up capital composition at the early stages of starting a business.
- ii. Special banks were established in order to overcome the problems that nascent enterprises and MSME's face upon seeking credit from commercial and investment banks, namely high collateral requirements. The two prime examples in Tunisia are the *Banque de*

Financement des Petites et Moyennes Entreprises (BFPME) and *Banque Tunisienne de Solidarité (BTS)*. Whereas the former specializes in financing small and medium-sized enterprises with a start-up capital that exceeds 100 thousand Dinars and up till the limit of 10 million Dinars, the latter specializes in financing micro-projects with a start-up capital less than 100 thousand Dinars. Both banks are state-owned. The BTS was established in 1997 by a presidential decree. The BFPME was created in 2005. Both institutions had a clear social mission since their establishment. Their primary targets were university graduates who were likely to suffer from Tunisia's extremely high rate of unemployment. Hence, both institutions were actually designed to finance new projects and young entrepreneurs and not just established micro, small and medium firms. According to a manager at the BTS, 85 percent of the projects that are financed by the bank happen to be nascent since the bank's mission is to contribute to job creation.

- iii. The survey offers robust evidence that the financial support structure did contribute to the increase in access to finance for entrepreneurs and the correction of biases against provincial, younger and female entrepreneurs.
- iv. The survey results reveal some considerable changes across time with the entry of special banks into operation. There is a pronounced trend of less dependence on private savings and more dependence on money provided by family, friends and banks/funds. Whereas private savings were reported to have constituted an average of 56 percent of total start-up capital for established firms that were older than 10 years of age, it was 48 percent for young firms and 36 percent for nascent ones. Conversely, the lower dependence on private savings meant a shift beyond self-financing into a variety of formal and informal financing. Young and nascent enterprise-owners/managers – both less than 10 years old – reported much higher percentages of bank credit. This coincides well with the operational expansion of special banks targeting young entrepreneurs, new ventures and small and medium-sized enterprises, namely the BTS and BFPME.
- v. The survey provides some good evidence that some of the new market entrants have access to bank resources at the start-up phase. The survey included ten would-be-entrepreneurs, who reported to be in the process of founding their businesses. Seven out of the 10 reported to have resorted to bank loans at the start-up phase. Money from banks and funds constituted an average of 62 percent of their reported start-up capital. All would-be-entrepreneurs belonged to the younger age cohort (between 21 and 40, inclusively) and all reported to be higher-education graduates.
- vi. Moreover, the answers given by surveyed entrepreneurs show that established-enterprise owners/managers are more likely to apply for bank loans (80 percent) as compared to nascent and young enterprise owners/managers (49 percent and 53 percent, respectively). Even though the reported approval rate is the highest for established enterprises at 82 percent, it does not fall far behind for nascent enterprise owners/managers at 75 percent. This gives some positive traits for the financial support structure in Tunisia.
- vii. Established and young enterprises report higher business profits than nascent ones. Additionally, established enterprises report higher dependence on bank credit than young and nascent ones, perhaps because established enterprises are more eligible to get bank loans than new market entrants. Yet, a considerable percentage of young and nascent enterprise owners/managers reported using bank loans (40 percent and 33 percent, respectively). Such figures refer to the relative availability of credit for new ventures in Tunisia through special banks such as the BTS and the BFPME. Similarly, nascent

enterprise owners/managers reported higher selection of special funds, which indicates that these programs are oriented towards entrepreneurial activities.

- viii. One interesting finding is that both formal and informal sources of finance reported a simultaneous increase over time in Tunisia. This can be at least partly explained in terms of the requirements set by these very banks and funds for self-financing (*auto-financement*) as a precondition for loan provision. Young entrepreneurs often have to rely on “love-money” from family as well as from friends to provide the required premium so as to secure loans. The same family and friend-based networks are for use in providing a rented office or a piece of land at the early stages of the project.
- ix. As the bulk of nascent and young enterprises are owned and managed by younger entrepreneurs who are defined to be below 40 years of age, younger entrepreneurs report less reliance on private savings – the predominant form of self-financing. Conversely, their dependence on family, friends and banks or funds is significantly higher than their older counterparts.
- x. Despite the naturally privileged position of older entrepreneurs and enterprises, the results obtained from the survey indicate that younger entrepreneurs do not fall far behind. Fifty-three percent of the younger entrepreneurs included in the sample indicated that they applied once for a bank loan compared to 63 percent for their older counterparts. The approval rate was higher for younger entrepreneurs at 74 percent as opposed to 60 percent for their older counterparts. Of course, this should be considered in the light of the presence of banks and funds specialized in supporting nascent projects and young entrepreneurs.
- xi. The survey results suggest that ownership structure is another factor that significantly shapes how entrepreneurs respond differently to similar restraints imposed by the ecosystem. Non-family partners and single-ownership entrepreneurs report a significantly higher selection of self-financing – business profits, private saving and the sale of private and family assets – than their family business counterparts. Family business respondents had better access to bank loans as compared to the two other categories. Fifty-six percent of family business-entrepreneurs reported their selection of bank loans in order to finance their business as opposed to 38 and 33 percent for single and non-family partnership entrepreneurs, respectively. It has already been held that family businesses in both Egypt and Tunisia have better access to assets and guarantees that can be used to meet the collateral requirements by the banking sector.
- xii. Upon classifying responses by ownership structure, start-up capital formation shows a very different pattern. Private savings are reported to be the prime source of start-up capital for non-family partnership and single-ownership structures (70 and 38 percent, respectively). The high percentage of private savings reported by non-family partners shows that this is the way to pool resources at the start-up phase among partners. While this may be an indicator of the lack of access – or lack of preference to solicit bank loans for non-family partners – it can be taken as a prerequisite for bank loans for single-ownership entrepreneurs who are required to secure some percentage of self-financing before they can secure loans from special banks free of collateral. Intuitively enough, family business-entrepreneurs reported the highest percentage of resorting to family money at 50 percent. This implies that private savings reported by family business-entrepreneurs refer to individual private savings in distinction from family savings. Interestingly enough, family business entrepreneurs reported the highest access to friends’ money as well compared to the two other subcategories.

- xiii.** The banking sector in Tunisia seems to favor single-owners at the start-up phase. This has to do with the design of pro-entrepreneurship programs that usually target single-owners/managers. This can be explained at the same time by the fact that single entrepreneurs have no option but to resort to banks and special funds at such early phase while family and non-family partners can pool resources through alternative channels.
- xiv.** Additionally, Tunisian support structures seem to have contributed to the correction of discriminatory biases against younger entrepreneurs; nascent enterprises; and female and provincial entrepreneurs. This could be confirmed by contrasting the actual composition of the sample of entrepreneurs and the reported share of each category or subcategory in bank loan reception.
- xv.** The survey shows that access to loans at the start-up phase is rather evenly distributed and almost matches the natural distribution of entrepreneurs in the sample. The share of younger entrepreneurs in loan reception is equal to their share in the sample. Females are slightly overrepresented at 37 percent of loan reception versus 30 percent of the sample. Micro enterprises are slightly overrepresented as well at 79 percent of loan reception versus 73 percent of the sample. Conversely, medium and large enterprises are underrepresented. Whereas their share of the total surveyed enterprises was 10 percent, their share of loans at the start-up phase was only five percent. Moreover, there is no evidence of discrimination along regional lines. The share of provincial entrepreneurs in loans is almost equal to their share of the sample.
- xvi.** The picture depicted above does not change much upon studying the patterns of accessing finance beyond the start-up phase. Female entrepreneurs and micro enterprises remain slightly overrepresented. Medium and large enterprises become overrepresented as well, which is fairly intuitive given the established trend in the survey that larger firms secure more institutional credit. Regionally, Monastir shows some overrepresentation (28 percent of loan reception versus 19 percent of the sample) while Kebili-based entrepreneurs report some underrepresentation at 38 percent of total loans received versus 43 percent of the total sample. Yet, the difference is not that flagrant.
- xvii.** Unlike the case of Egypt, the Tunisian financial subsystem does not show any pronounced or systemic discrimination against certain entrepreneurial subcategories. This, of course, cannot be understood apart from the entrepreneurship-support structure and the network of special banks and funds that extend credit at the start-up phase. These institutions clearly favor young entrepreneurs with higher-education degrees and usually single-ownership structures. There is little regard to region or gender. However, such portrayal of things in Tunisia does not help in answering the earlier question of why two thirds of the entrepreneurs included in the survey reported not to have applied to bank loans when first forming their businesses. This cannot be answered either in terms of cronyism or patronage targeted towards certain entrepreneurs because the average age of surveyed enterprises is three years, which coincides with the Tunisian revolution and thus, the disintegration of the old networks of patronage and corruption related to the Ben Ali regime.
- xviii.** Despite its relative achievements, Tunisia's financial support structure is quite imperfect, and it can hardly help in breaking away from the sub-optimality that marks the overall entrepreneurship ecosystem due to its design and operation. Three principal shortcomings came to the forefront in the personal interviews and focus group discussions conducted with entrepreneurs and bank officials:
 - 1.** The support structures are quite fragmented and disintegrated. There is rather a chasm

between technical and financial knowledge production and processing that is necessary for the efficient and impactful operation of the system. Special banks are theoretically supposed to base their assessment of financing new projects solely upon the proposed idea and project potential for success. They seem to have sufficient information or expertise for that criterion unlike the other structures of support that work intimately and locally with entrepreneurs such as the business centers, incubators and work bureaus. The solution proposed by a BTS official includes more risk and information sharing and integration. Otherwise, as long as the task of the support structures is confined to helping young entrepreneurs get a study written to apply for a loan, the only result is putting the applying entrepreneur on a clashing path with the bank. This is a clear contradiction between the social and economic missions of the structures of support, which leads us to the second point.

2. There has been a clear political agenda under Ben Ali (1987-2011) to find some solutions for the oversupply of higher-education graduates. Within this context, since the late 1990s, the whole support structure of institutions and agencies started to form. The only issue with such an approach to supporting entrepreneurship is that the economic and social motives of action become mixed up and more or less confused. The BTS and BFPME are required to confine their financing on non-commercial projects so as to enable graduates to realize their potential based on what they studied in higher value-added areas in the industrial and service sectors. Moreover, extending credit is conditioned by submitting a certificate of the scientific degree of the applicant. Business centers, incubators and special banks can approve only projects that correspond to the field studied by the applicant. For instance, a computer-science graduate cannot solicit credit for an industrial project. Such measures were laid by the state with the aim of maximizing the social return of public education. However, the main issue with such preconditions is that they do not prioritize innovation and growth potential as main criteria against which a project idea can be assessed.
 3. Given the point above, there is evidence that suggests that financial support structures in Tunisia function, at least partly, as channels for patronage distribution. Interestingly enough, a young entrepreneur from the inland city of Kebili stated that loans from special banks were provided to the Tunisian youth in return for not demanding a job in the public sector. Such a statement is reflective of the moral economy that governs the support structures in Tunisia. It demonstrates the conflicting logic of the economic and social motives of supporting entrepreneurship as a measure to fight unemployment – something close to welfare stipends – and as a measure of boosting investment, innovation and growth. The two may not be in total harmony in practice as many entrepreneurs have held. Hence, it is plausible to hold that entrepreneurship-related funds and preferential credit were used as a form of patronage distribution and development. This may explain the lack accountability and any impact assessment of entrepreneurship financing in the last several years. Moreover, it may explain in part the focus on finance among other start-up relevant issues at the expense of post-start-up issues such as marketing and networking.
- b. Tunisia's support structure: the cases of business centers and public incubators**
- i. Similar to the support structures (*Les structures d'appui*) that the Tunisian state started establishing since the mid-1990s in the field of finance, the state had some initiatives in the fields of entrepreneurship and non-financial support. Reference here is made primarily to two institutions: public incubators (*pépinières*) that started to spring out starting in the mid-1990s and business centers (*Centres d'affaires*) that were established in 2005. Both

institutions have rather similar tasks to perform with slight differences. However, similar to their financial counterparts BTS and BFPME, they were the products of conscious state action under the Ben Ali regime to contain the ever-growing problem of youth unemployment, especially within the ranks of higher-education graduates.

- ii. Incubators have been designed to support entrepreneurs with a broad array of services. Some are soft such as providing coaching and mentorship together with accountant experts and other forms of awareness (*sensibilisation*) and entrepreneurship education. Other services are hard in that they deal with providing access to infrastructure be it in the form of offices (*des locaux/ bureaux*) for new entrants that would relieve them from paying rent at early stages of development or through the provision of phones, Internet and faxes at no cost.
- iii. Business centers were added to the entrepreneurship support structures by 2005. Business centers cover all economic activities. Expanding into all the Tunisian provinces, the plan has been to have a business center in each and every provincial capital. Unlike incubators, business centers do not provide any hard support to the entrepreneurs such as a bureau or access to infrastructures. They are far less integrated into the higher education structure as they exist in separation from higher education facilities. Moreover, unlike incubators, business centers are responsible for serving all age groups, not just undergraduates and newly graduated youth. Business centers provide technical support, education and training to would-be-entrepreneurs. They play a role in providing technical and financial expertise for projects in addition to helping file applications for special banks.
- iv. The support structure that has existed in Tunisia for some time is no doubt exceptional in the Middle East and North Africa. Nothing similar exists in equally dynamic economies such as Egypt where most entrepreneurship support in terms of education, mentorship and coaching are left to informal ties and private efforts by business associations and angel investors. The network of incubators and business centers is quite expansive and has a presence in virtually all large Tunisian urban centers where potential entrepreneurs are likely to live. However, these support structures suffer from some considerable shortcomings that limit their impact in providing actual support for entrepreneurship in Tunisia.
 - 1. To start, officials at both business centers and incubators lack the necessary information to conduct impact assessments. There is virtually no follow-up of entrepreneurs and enterprises after the start-up phase in the case of business centers and after the incubation phase with incubators. The process is quite bureaucratic, and the main criterion against which both institutions are assessed is based on the number of entrepreneurs consulted rather than project success.
 - 2. Another issue that we previously touched upon has to do with the lack of integration in the support structure. Business centers, incubators and work bureaus maintain no shared database of entrepreneurs and projects. Moreover, these agencies that operate in the non-financial side have often little to do with the banks that operate in the financial aspect. They do not share the risk with the banks that decide on extending credit. The primary business of business centers and incubators usually stops after the provision of assistance with the study that is filed for the credit request. Entrepreneurs as well as bankers and officials have all expressed their discontent and discomfort with the uneasy flow of information between all of these structures in a way that precludes the chances of a functional servicing of entrepreneurs at the start-up phase.

3. All in all, support structures – be they financial or non-financial – have been primarily created to shield would-be-entrepreneurs and new market entrants from the rather hostile business environment in Tunisia. Such a strategy may work on a piecemeal basis but it is quite unlikely that it will lead to a major shift for the majority of actors for many reasons. Some reasons have to do with the limited capacity of such structures to service the broadest base of entrepreneurs. Others are related to the overwhelmingly negative or even detrimental impact that the general environment may have on young entrepreneurs and nascent enterprises such as weak rule of law, absent contract enforcement and the inaccessibility of land and finance. Accordingly, such support structures can hardly compensate for systemic reform.
- c. Gender: no sign of systemic discrimination against female entrepreneurs**
- i. A sweeping majority of female respondents (22 out of 30) denied that the registration and licensing of systems in Tunisia discriminated against women, which is the equivalent of 73 percent versus only five interviewed females. This answer indicates that the rules and regulations that are directly related to business registration and licensing are general and gender-neutral but not necessarily gender-sensitive. For instance, whereas the average number of agencies and bodies with which male respondents reported having to deal with to register their business was 3.22, the average number for female respondents was 4.1. This implies more complexity and more red tape to exact the same task of registering or licensing a business. Similarly, regarding the finalization of the registration process, while 11 female respondents reported an average of 10.68 months, their male counterparts reported just six months as an average, which is a significant difference. The difference in gender basis suggests that the way the rules are applied – not the way they are written – is at the core of the issue.
 - ii. As for the access to finance, female entrepreneurs reported to have depended on almost the same sources of finance that their male counterparts reported. The three main sources reported are business profits, private savings and bank loans for both gender groups. Lower numbers of female respondents reported resorting to business profits and private savings at 57 percent and 47 percent, respectively, compared to their male counterparts at 71 percent and 63 percent, respectively. This confirms the point that the literature on female entrepreneurship has traditionally held that females have generally less access to assets and income, which applies to both profits and savings.
 - iii. However, females' share in bank loans does not seem to be lower than that of males because a majority of bank loans in the survey come from special banks that run programs targeting the financing of new ventures and micro and small enterprises. This is a positive indicator of the absence of discrimination against women in practice. One has to bear in mind that these banks usually extend credit without asking for collateral, which may prove to be of greater use for women than men who usually have better access to assets. This point can be further explored if we look at the sources of finance at the start-up phase for both gender groups as reported in the survey.
 - iv. As for finance at the start-up phase, the patterns in both gender groups are close. The highest two sources of start-up capital composition for both gender groups are private savings and family. The third largest component of start-up capital that was reported is institutional credit from banks, associations and funds at 50 percent for female respondents and 35 percent for males. The fact that institutional credit stands for a larger share of start-up capital for females confirms what the survey suggested earlier that females are not

discriminated against upon loan application. Moreover, bank loans were reported to be available for 35 percent of the total female respondents as compared to 25 percent of their male counterparts.

- v. Calculating the number of respondents who reported securing bank credit at the start-up phase shows that bank credit is beyond the reach of the majority of respondents in both gender groups. Only 35 percent of female respondents and 25 percent of their male counterparts had bank credit to finance their start-ups, despite the fact that this credit proved to be the greatest share of the average start-up capital reported. Meanwhile, a massive 59 percent of female respondents and 91 percent of their male counterparts reported to have depended on private savings and family and friends' money. Again, the exclusion of entrepreneurs from access to formal credit is not gender-based as the percentages are quite similar across both groups. Nevertheless, it is noteworthy that only 25 percent of the female respondents reported to have resorted to private savings versus 44 percent of their male counterparts. This may stand as evidence that females have less access to assets than males that can be used to self-finance a start-up.
- vi. As expected, female entrepreneurs turned out to be more vulnerable to extortion and corruption. Thirteen out of thirty female respondents (43 percent) said that they were asked to pay some informal payment, which included bribery and gifts to state officials. This percentage is significantly higher than the ratio of male entrepreneurs that reported similarly, which was 26 percent. Female entrepreneurs voiced more negative views on the issue of corruption than their male counterparts. Twenty female entrepreneurs (67 percent) stated that corruption was a real problem and that more needs to be done toward it versus 45 percent for their male counterparts. The percentages of the male and female respondents who held that corruption was a serious problem and nothing could be done to combat it were very close: 26 percent for males and 20 percent for females.
- vii. Finally, female respondents were asked about the main challenges that they faced in conducting their business. Eighteen out of 30 female respondents (60 percent) held that the main challenge was the general culture of society, which was seen as hostile to female entrepreneurship. The second constraint was family obligations at 53 percent (16 respondent). The third challenge was the access to business networks (47 percent or 14 respondents). Access to finance occupied the penultimate position at 27 percent and the laws and regulations were seen as the least challenging for female entrepreneurs at 17 percent (five respondents).
- viii. The main challenges expressed by Tunisian female entrepreneurs included in the survey have to do with societal factors rather than with the state. General culture, family obligations and business networks all reveal the possible hurdles that women may face upon deciding to become entrepreneurs. However, such obstacles differ completely from state-related challenges that have to do with the setting and implementation of rules, laws and regulations. Moreover, the fact that only a quarter of respondents (27 percent) believe that access to finance is the largest challenge that they face as women indicates, together with earlier answers, that finance is not subject to gender-based segregation. Such a result goes in harmony with the overall idea that Tunisia is the only Arab country that made serious strides toward equality of men and women since the 1950s. Despite the practical and actual challenges that still haunt female entrepreneurship in Tunisia, such early reforms that targeted women status seem to have paid off.

13- Egypt: sustained anti-entrepreneurial biases

- a. Access to finance and its discontents in Egypt**
- i. Restrained access to finance has been reported by the respondents to be the third most challenging barrier to growth. Almost 58 percent of the entrepreneurs stated that access to finance was a principal problem. Indeed, access to finance has for long been one of the main problems that nascent as well as established entrepreneurs faced in Egypt. According to the survey, the three top sources of finance that entrepreneurs reported were business profits at 73 percent; private savings at 66 percent; and credit from family and friends at 35 percent. All three forms are informal and based on self or family financing.
 - ii. The principal institutional channels that should provide debt or equity do not seem to function for the vast majority of entrepreneurs and the broader base of the Egyptian private sector. Bank loans; special funds targeting MSMEs and young entrepreneurs; venture capital; and issuance of stocks came at the end of the list. Only 13 percent reported to have resorted to bank loans followed by six percent for special funds and 12 percent and seven percent for venture capital and stocks, respectively.
 - iii. Thirty-seven percent of the respondents said that they applied for a bank loan. From amongst those who applied for loans, 42 percent reported the actual receipt of credit. For the remainder of entrepreneurs, they expressed various reasons for not soliciting bank loans. The top three factors mentioned were that interest rates were too high at 66 percent; the required collateral and guarantees were too high at 58 percent; and that the procedures were complex, costly and time-consuming at 57 percent. The fourth factor was that the bank viewed the enterprise as too risky to be financed at 49 percent.
 - iv. Thirty-four percent of the respondents reported to have applied for loans from special funds. Seventy-three percent of those who applied reported having received the loans they applied for. Those who received the loans were asked about their experience whether it was satisfactory or not on a scale from 1 to 5 where 1 indicates the least level of satisfaction and 5 indicates the highest. The average answers of 34 respondents – out of a total of 38 who reported to have resorted to this kind of financing – were 3.09 for interest rates; 2.65 for the complexity of procedures and conditions; 2.7 for the exposure to extortion and corruption; and 2.7 for loan maturity. The levels of satisfaction expressed were relatively low.
 - v. Finance at the start-up phase constitutes a very critical link between access to finance and entrepreneurship. A massive 94 percent of the respondents reported to have relied on private savings followed by 50 percent and 30 percent who depended on funds from family and friends, respectively. Banks and associations provided credit for merely 17 percent of the respondents. The situation becomes even graver if the average share of each source of finance is considered as reported by the respondent entrepreneurs. Private savings stood for 63 percent while credit extended by institutions did not exceed five percent of the average start-up capital. Such figures imply that banks hardly extend any credit at the start-up phase. Thus, entrepreneurs are left on their own and to their narrow circles of family and friends to secure their start-up capital.
 - vi. Only 13 (seven percent) of the surveyed entrepreneurs reported resorting to venture capital and issuing stocks. Not surprisingly, the share of non-traditional sources of finance was humble. After almost two decades of trials to develop non-banking means to finance entrepreneurs, little has changed over all. Non-traditional finance remains limited to a few sectors and with little impact on the overall picture in Egypt. Based on the interviews, they rarely direct any investment – or show interest – in working in traditional sectors such as industry, tourism or agriculture though they constitute the largest portion of the economy.

- vii. However, though non-traditional means of finance seem to be limited to a few sectors and an enclave of entrepreneurs, this does not overrule its future potential given the problems with the banking sector. As a matter of fact, there is some evidence that non-traditional finance, especially in the form of venture capital and angel investment, has witnessed some considerable expansion since 2011. Several interviewees, all young entrepreneurs operating in high-technology sectors, reported that some extensive networks of start-ups; venture capital; incubators and accelerators; angel investors; competition rounds; and exhibitions have been developing in the recent years in an unprecedented way. These networks provide the fluid circulation of information as well as financial, social and human capital at the start-up phase.
 - viii. Some evidence suggests that the recent expansion in venture capital has been related to some transnational networks. To start with, the founders of some of the most active venture companies came from a strong background in international finance. There seems to be some conscious copying of successful global experiences. Moreover, there seem to be strong linkages between the recently developed networks of entrepreneurs, incubators and financiers in Egypt as well as in other Arab countries – such as Jordan and the Silicon Valley – with companies owned by Arab expatriates. There is also evidence that these expatriates are trying to copy or at least benefit from the examples set by their Indian counterparts based in the Silicon Valley.
- b. Access to finance and enterprises age groups: has anything changed over time?**
- i. Interestingly enough, the three enterprise-age groups indicate similar trends suggesting that little has changed over almost two decades in Egypt. Private savings remained the predominant source of new businesses followed by “love money” from family and friends. The differences are not significant. Credit furnished by banks or associations was meager for the three groups and it was actually higher for the oldest category of enterprises – eight percent of the total start-up reported by established enterprises – as compared to nascent and young enterprises. All these figures suggest that the financial subsystem has been quite hostile to entrepreneurs and to new market entrants. It suggests as well that most resources spring from personal and family circles at such initial stages. They indicate as well the lack of financial mediators who would provide credit or equity based on new ideas or new ventures.
 - ii. Interestingly, nascent enterprises reported a considerably higher percentage of non-traditional sources of finance mainly venture capital and other forms of investment finance – 13 percent versus one percent for the other two groups. Such reporting indicates the unusual expansion of non-traditional sources of finance in the recent years, which may suggest that some change is underway.
 - iii. The survey shows many intuitive results and some counterintuitive ones as well. It is logical that established enterprises depend more on their business profits than young and nascent enterprises because of their longer presence, stable business operations and low turnover. It makes sense that private savings be reported by a larger number of nascent enterprise owners/managers (76 percent) than by young and established enterprise owners/managers (64 and 58 percent, respectively) because nascent entrepreneurs have a shorter time in business, and thus, are still dependent on their private savings as well as liquidating private and family assets to finance their start-ups. However, the figures indicated by all three groups indicate that self-financing via profits or private savings is crosscutting and that the difference is just in degree. It is easier for nascent enterprises to

- have new partners introduced as a means to finding finances than more established firms.
- iv. However, counter-intuitively, nascent enterprises seem to be doing well in reaching out to debt and equity as compared to older firms. Forty-one percent of the respondents that own or manage nascent enterprises said that they issued stocks compared to 40 and 22 percent for young and established enterprises respectively. In the same vein, the figures of venture capital were quite high for nascent entrepreneurs at 24 percent as compared to young and established enterprises at 17 and 28 percent, respectively.
 - v. As for bank loans and credit furnished by special funds, the figures suggest that established enterprises have a better chance securing debt financing, which is fairly intuitive given the fact that the banking sector is not friendly towards nascent enterprises. Indeed, a significantly lower percentage of nascent enterprise owners/managers reported to have applied for a bank loans at 12 percent as compared to 34 percent for young enterprises and a massive 69 percent for established enterprises. Moreover, loan approval was clearly in favor of established firm owners/managers – a 52 percent approval rate – compared to 40 and 31 percent for nascent and young enterprise owners/managers, respectively.
 - vi. The same trends that apply to bank loans apply to special funds. Only 17 percent of nascent enterprise owners/managers reported to have applied for a special fund versus 28 percent for young enterprises and 50 percent for established enterprises. Moreover, the approval rate was much higher for established enterprises at 72 percent than for nascent and young firms at 43 and 69 percent, respectively. It is interesting that special funds, which are in the Egyptian case usually geared towards financing small firms rather than new entrepreneurial projects, actually segregate against new entrants. This instance suggests that MSME-support programs and funds do not always overlap with supporting entrepreneurship.
 - vii. Given the great overlap between nascent and young enterprise groups and younger entrepreneurs' age group from 20 to 40 years of age, the survey depicts a picture that is not too dissimilar from the one that the classification by enterprise age has drawn earlier. Younger entrepreneurs are less dependent on business profits than their older counterparts. Conversely, they are slightly more dependent on private savings and credit from family and friends. Both features can be explained in terms of the limited period of business operation. Younger entrepreneurs show more reliance on bank loan, venture capital and issuance of stocks than their older counterparts. As for venture capital, the number of younger entrepreneurs who reported resorting to this financial means is almost three times that of the older groups. This should be interpreted in terms of the better acquaintance of younger entrepreneurs with non-traditional mechanisms such as venture capital that was introduced recently into the market, especially in technology sectors.
 - viii. Even though the figures that have to do with bank loans indicate a larger reliance of younger entrepreneurs on bank loans, this does not indicate by any means that they have better access to credit than their older counterparts who are usually owning and operating more established companies with better credit records. As a matter of fact, the numbers of younger entrepreneurs who reported to have applied for loans from banks or associations is significantly lower than those from older groups (29 percent versus 69 percent, respectively). Moreover, the approval rate for younger entrepreneurs was reported to be merely 22 percent as opposed to 31 percent for their older counterparts.
 - ix. The same observation applies to credit from special funds. Only 24 percent of younger entrepreneurs reported to have solicited a loan in comparison to 39 percent for the older groups of entrepreneurs. The approval rates were 53 percent for younger entrepreneurs and

80 percent for the older ones.

c. Size does matter in accessing finance

- i. The results obtained from the survey cannot be separated from the fact that micro and small enterprises constitute around 96 percent of the respondents. Such sample composition reflects the actual structure of the Egyptian private sector in general. Indeed, the Egyptian sample shows that most nascent and young enterprises were micro in size at 61 and 68 percent, respectively, compared to 47 percent for established firms while the rest were small size enterprises. There is ample evidence that the banking sector in Egypt is inaccessible for micro and small enterprises. According to Rocha et al (2011:2), “the share of SMEs in loans is eight percent for the region and 13 percent for non-Gulf Cooperation Council countries.” The share of SMEs in total loans in Egypt was only five percent compared to 24 percent in Morocco; 15 percent in Tunisia; and below average for non-oil economies at 13 percent. In fact, Egypt came after Jordan, Lebanon and Yemen (Rocha et al 2011:22). Egypt is underperforming in an already economically depressed region. The World Bank survey showed that only 10 percent of SME investment expenditure in MENA is financed by a bank loan (Rocha et al 2011:11). Cull et al (2006:3019) indicated that the share of banks in the sources of finance of small firms – employing between 10 and 50 workers – was 20.2 percent in Bangladesh; 14.1 percent in Brazil; 18.2 percent in Croatia; and 24.1 percent in Ecuador.

d. Size matters more than informality when it comes to access to finance

- i. As mentioned earlier, informal entrepreneurs constitute around 31 percent of the sample. Contrasting their answers with their counterparts in the formal sector with regards to access to finance reveals very interesting results. Surprisingly, both groups of respondents reported similar ratios of dissatisfaction with regards to access to finance (58 percent versus 60 percent). This implies that the inaccessibility to finance is not just confined to the informal sector and that it has other reasons that adversely affect both formal and informal private firms in Egypt.
- ii. The largest percentage of respondents of both sectors indicated that their primary source of funding was from profits made by their enterprises. The percentage was a bit higher for the informal sector (31 out of 40 or 78 percent of the respondents) than the formal one (70 percent of the respondents). The second largest source of finance mentioned by the respondents from the two sectors was private savings. The percentages were quite similar for both sectors: informal sector entrepreneurs at 26 out of 40 respondents or 65 percent as compared to the formal at 67 percent. Only 16 percent of formal entrepreneurs and five percent of their informal counterparts reported their attainment of loans and other forms of credit obtained from banks. Even though the percentage of formal sector entrepreneurs who reported to have had access to bank loans is higher than those in the informal sector, it remains rather modest and largely dwarfed by other sources of self-financing.
- iii. The figures suggest that most entrepreneurs – be they in the formal or the informal sector – rely heavily on self-financing through the profits generated by their enterprises and on their private savings. Entrepreneurs in both sectors seem to suffer from major problems in accessing credit from banks. It is quite intriguing that operating in the formal market does not seem to change much of the capacity to access finance.

e. Business ownership structure and access to finance

- i. The survey results reveal that self-financing through the reallocation of business profits is the predominant mode of finance across all three structures of ownership. However, there

are considerable variations. A meager percentage of non-family partnership entrepreneurs have reported their dependence on private savings (eight percent of total respondents) as compared to 67 percent for single-owners and 57 percent for family business entrepreneurs. Non-family partnership entrepreneurs reported a much higher dependence on bank loans (39 percent) and venture capital (47 percent) in financing their business as well as with introducing new partners (16 percent). Interestingly enough, non-family partnership entrepreneurs reported a rather high percentage of resorting to credit from family and friends at 32 percent that is higher than family business at 26 percent and single-owners at seven percent. This point suggests that non-family partnership entrepreneurs have access to both family networks as well as friends to finance their business.

- ii. One remarkable finding is the considerably high share of bank loans in the financing structure of non-family partnership entrepreneurs as compared to family business and single-owner entrepreneurs.
- iii. Given the low percentage of dependence on private savings reported by non-family partnership entrepreneurs, the figures suggest that this very group of entrepreneurs is much more resourceful and less conventional in securing finance for business operations. It even becomes tempting to assume that this indicates more accessibility to formal finance be it traditional through the banking sector or non-traditional through venture capital and angel investors. However, taking a closer look at the responses provided by the entrepreneurs suggests a more complex story.
- iv. The high percentage reported by non-family partnership entrepreneurs of resorting to bank loans shows their dependency rather than their easy access to such resources. The figures given indicate the weight of this particular financial means in the overall sources of finance, yet it indicates nothing about the accessibility of loans. Despite the fact that more entrepreneurs in non-family partnership reported to have depended on bank loans as a source of finance, this category seemed to be the least capable of securing bank loans. Non-family partnership entrepreneurs reported the lowest percentage of soliciting bank loans at 16 percent in contrast to family business entrepreneurs at 60 percent and single-owning entrepreneurs at 33 percent. Moreover, non-family partnership entrepreneurs reported the lowest percentage of those who actually received loans (17 percent) as opposed to 60 percent for family business entrepreneurs and 27 percent for single-owning entrepreneurs.
- v. Family-business entrepreneurs seem to be the best positioned to secure bank loans. This goes in harmony with the financial profiles of the three ownership-structures. Family business respondents reported the highest average of start-up and current capital, the highest turnover and their average firm size was larger than the two other categories. Accordingly, family businesses are the ones with the best capacity to provide collateral as well as guarantors for loans. This may help in understanding why they scored so high when it comes to the actual provision of bank loans compared to the other two categories of non-family business. However, the high reliance on private savings by family-businesses seems to be a matter of preference because family members can more easily and cheaply pool private savings.
- vi. What applied to bank loans proved to apply also to credit from special funds targeting small and micro-firms. Family business- entrepreneurs were at a clear advantage as compared to non-family ownership structures in general. Whereas 55 percent of family-business entrepreneurs reported to have applied for exclusively special funds, 13 percent of single-owning entrepreneurs and non-family partners reported to have done so,

respectively. The same trend is sustained with the loan approval rates reported by entrepreneurs. Whereas the approval rate was 75 percent for single-owner entrepreneurs, it was 65 and 40 percent for family business and non-family partnership entrepreneurs, respectively. It is not yet clear whether this reflects the design of special fund programs which targets single owners or that special funds are the only available option for single-owners due to their incapacity to tap into the resources provided by family or non-family networks that are available for the other two ownership categories.

- vii. These general trends that apply to access to finance in general do apply to the specific issue of start-up capital as the figure below shows. Start-up capital sources vary rather significantly between the three ownership structures of enterprises included in the survey. Whereas private savings are the highest-reported source for single-owners at 80 percent, the percentage goes down to 60 percent for family business and to 42 percent for non-family partnership entrepreneurs. Intuitively enough, money from family sources is the highest for family-businesses and low for single-owners at nine percent of reported start-up capital.
- viii. However, it is substantial with non-family partnership entrepreneurs at 23 percent as well. This suggests that non-family partners usually have access to family networks, and thus, can secure love money as they have access to non-family networks as well. Accordingly, money from friends was the highest for non-family partners at 18 percent as compared to family and single-owner entrepreneurs at eight and six percent, respectively.
- ix. Non-traditional sources of finance, primarily venture capital and angel investors constituted 15 percent of the start-up capital reported by non-family partners, which was considerably higher than their counterparts in the two other categories at one percent. This is a confirmation of the earlier remark that non-family partners have better access to non-family networks meaning that they can secure investments beyond family networks. Last but not least is the percentage of bank loans in start-up capital. It is generally low across the three categories. However, it is the lowest among non-family partnership entrepreneurs because typically, they have no access to collateral at such an early stage. It should be borne in mind that the sample composition indicates that the average age of entrepreneurs is significantly lower for non-family partnership entrepreneurs as compared to family and single-owner entrepreneurs. This may explain their openness to non-traditional financing through venture capital or angel investors in addition to their incapacity to secure bank loans. Conversely, family businesses reported the relatively highest share of bank loans in start-up capital at seven percent.
- x. The report developed a rough map of loan recipients by contrasting the natural distribution of each subcategory with the share of its members in the actual loan reception as reported by the respondent entrepreneurs. Younger entrepreneurs under the age of 40 are clearly underrepresented. Whereas they constitute 60 percent of the sample, their share in bank loans was around 44 percent – a gap of about 16 percent. Females are clearly excluded as well. Their share in the total sample hovers around 16 percent yet only seven percent of bank recipients were females. Ownership structure shows some glaring disparities. Family businesses are overrepresented as their share in surveyed enterprises was 32 percent, yet they stood for 48 percent of total loan recipients. Their overrepresentation comes mainly at the expense of non-family partnership-businesses whose members are 30 percent of the enterprises sample, though their share was as low as 15 percent of loan recipients.
- xi. Small firms employing over six workers were overrepresented. Their share in the sample

was 33 percent, yet their share of approved bank loans was 48 percent. Micro enterprises in contrast were underrepresented at 61 percent of the sample and only 48 percent of loan recipients. Informal enterprises constituted 31 percent of the surveyed firms and their share was as low as 18 percent of total loan recipients.

- xii. What applies to the general access to bank loans does apply to the accessibility to bank loans at the start-up phase. The survey shows the same patterns of exclusion against younger entrepreneurs, females, informal, micro and non-family partnerships. Moreover, it shows that family businesses are more overrepresented in accessing bank/special funds loans at the start-up phase. Whereas their share in the total sample was 32 percent, their share in total loan recipients at the start-up phase was 67 percent. Conversely, single-owners and non-family partnerships were very much underrepresented. Whereas single-owners and non-family partnerships constituted 36 and 30 percent of the total sample, their share in loan reception at the start-up phase was 22 and 11 percent, respectively.

f. Society-inspired discrimination against female entrepreneurs

- i. Seventeen out of the 21 female Egyptian respondents – 81 percent of female entrepreneurs – held that the registration and licensing systems do not discriminate against women. This answer indicates that the rules and regulations that are directly related to business registration and licensing are general and gender-neutral but not necessarily gender-sensitive. Female entrepreneurs may have larger issues dealing with the same registration rules and procedures than their male counterparts.
- ii. Informality was much higher among female than male entrepreneurs. Almost 48 percent of the female-owned enterprises were not registered as opposed only to 27 percent of male-owned/managed enterprises. Of course, the survey conducts no census of firms across Egypt. However, such a figure does go in harmony with the literature on female entrepreneurship and informality, which holds that females are more likely to operate in the informal sector than males.
- iii. The causes of such phenomenon may vary. On the one hand, female entrepreneurs may prefer to operate informally given that their business is often of a smaller size and with a lower potential to grow due to their lack of access to financial, physical and social capital. On the other hand, informality among female entrepreneurs may not be voluntary but rather forced upon them by a hostile registration system. This association between female entrepreneurs and informality needs further investigation.
- iv. Interestingly enough, the female entrepreneurs who reported to have had their businesses registered gave answers that indicate that the process was not more difficult. Whereas the average number of months reported by male entrepreneurs for registration was 7.42, it was only five for females. The average number of governmental agencies that both gender groups reported to have dealt with to get the registration done was almost the same at 4.74 and 4.76 agencies for male and female entrepreneurs, respectively. These figures suggest that female entrepreneurs in Egypt generally face high barriers to entry to the formal market, indicated by the high percentage of informality within their ranks. This point also needs further investigation.
- v. When asked about the expected impact of formal contracts on their businesses, 13 of the female entrepreneurs (62 percent) said that it was positive versus 76 percent of the male respondents. However, that does not imply that females were less inclined to using formal contracts in exacting their transactions. As a matter of fact, female respondents reported slightly higher frequencies of resorting to formal contracts than their male counterparts.

- vi. Though more female than male entrepreneurs reported that they “always” resort to formal contracts, if the total percentage of using formal contracts is calculated, the two gender categories would be near equal in their resort to formal contracts at 52 percent for female versus 53 for male entrepreneurs.
- vii. The higher reported resorting by women to formal contracts may be explained by their search for various means to protect their rights given their general vulnerability. Among female entrepreneurs that provided an answer, only one respondent (13 percent) said that informal agreements are as enforceable as formal contracts as opposed to 65 percent of the male respondents. This may indicate that male entrepreneurs are more capable of enforcing informal transactions and protecting their interests without resorting to formal contracts. Conversely, women seem to lack this capacity, perhaps for reasons that have to do with the general socio-cultural context in Egypt, which suggests that women are less educated, less resourceful and more vulnerable to encroachment on their rights.
- viii. However, it hardly implies that women are actually well protected or even better protected than their male counterparts. As a matter of fact, only seven out of 21 female respondents (33 percent) expressed their belief that formal contracts were enforceable in Egypt as compared to 51 percent of male respondents. This figure shows that women have less access to the legal system, and thus, have lower shares of the rule of law and contract enforcement in Egypt.
- ix. Access to finance provides a very interesting area of contrast between the answers given by female and male entrepreneurs. Almost all of the answers show that it is easier for males to access finance compared to females. This observation is not just limited to the institutional sources of finance such as banks, associations and special funds but also applies to informal sources such as resorting to savings, profits or credit from family and friends.
 1. Female entrepreneurs reported to have depended on almost the same sources of finance that their male entrepreneurs have reported. However, higher percentages of males reported resorting to financing from profits and introducing new partners and credit from family/friends compared to female entrepreneurs. One interesting contrast is the percentage of entrepreneurs that reported using bank loans. Fifteen percent of the male entrepreneurs reported bank loan usage versus only five percent of females at one percent. The figures above show that women are generally less resourceful when it comes to finance and that they often lack access to informal networks as well as institutional credit, which indicates why they mainly rely on private savings. This has to do with the restrictions they suffer with in regards to asset and capital access. This may not be directly related to the sphere of doing business but rather to general norms and laws that regulate women’s status in society.
 2. The survey results show similar sources of finance at the start-up phase as reported by female and male entrepreneurs. There is an overwhelming dependency on private savings by both sexes followed by funds from family. The share of loans from banks or special associations is quite limited for males and negligible for female entrepreneurs.
 3. When asked about the reasons for not resorting to bank loans, the answers given by female entrepreneurs show that they are more vulnerable to the same difficulties reported by their male counterparts. For instance, all female respondents who did not secure loans said that the interest rates were so high, the procedures were complex and costly and that the collateral requirements were too high as opposed to 81, 79 and 81 percent of male respondents, respectively.

- x. Nine female respondents (43 percent) said that they were asked to pay some informal payment in the form of bribery or gifts to state officials. This percentage is high but lower than the ratio of male entrepreneurs that reported the same thing, which was 55 percent. As expected, female entrepreneurs turned out to be more vulnerable to extortion and corrupt practices. The following figure displays the different views expressed by female and male respondents over the issue of corruption.
 - xi. Last but not least, female respondents were asked about the main challenges they faced in doing their business. Sixteen out of 21 female respondents (76 percent) held that their family commitments were a barrier. Thirteen and nine (62 percent and 43 percent, respectively) stated that the general business environment and society's general culture were hostile to female entrepreneurship. Only two respondents (10 percent) held that laws and regulations discriminate against women. The figures are clear indicators of the impact of extra-business factors on female entrepreneurship.
 - xii. The answers provided by Egyptian female entrepreneurs are an excellent example of the difference between a gender-neutral and a gender-sensitive entrepreneurship ecosystem. Whereas formal laws and regulations were the least reported as a special challenge for female entrepreneurs, the overall environment seems quite hostile to women more so than to men. This goes in harmony with the broader literature on female entrepreneurship. The literature holds that the problems often do not lie with the direct rules governing the business ecosystem but rather with the societal and sometimes legal rules and regulations that govern broader social relations. Formal and informal rules deny women equal access to physical, financial, human and social capital and assets. This makes the barriers to entry high for females and forces many of them to operate in the informal sector with a low growth-potential.
- 14- Possible reform areas:** The study does not aim at providing an exhaustive list of detailed reforms that should be introduced so as to render the entrepreneurship ecosystem friendlier or more efficient in Egypt and Tunisia. Rather, it addresses the general framework within which reforms can take place in the post-revolutionary context in both countries. There is already some extensive literature in the form of academic studies, reports, indices and other material that forward technical reforms to treat the many deficiencies of the entrepreneurship ecosystem. This literature has developed since the 1990s a broad variety of institutional and policy reforms in many areas ranging from finance to business registration and contract enforcement among many others.
- 15-** However, the fact that such reforms did not touch the main components of the entrepreneurship ecosystem through decades of economic liberalization indicates that one significant ingredient was missing, which is that of politics. Technical reforms were the only possible way entrepreneurship-related policy and institutional matters could be addressed under the authoritarian regimes of Mubarak and Ben Ali. Technical reforms eventually have distributional consequences, and thus, are implicitly political. Moreover, such reforms have a cost – economic, administrative and social – and thus, their adoption and the way they are implemented is highly inspired if not determined by the different political actors.
- 16-** In pre-revolutionary Egypt and Tunisia, stakeholders were hardly represented and the broad base of private sector entrepreneurs had barely any weight for the regimes to reckon with. Only given the political dimension that was long ignored can one understand why successive rounds of economic liberalization and privatization in Egypt and Tunisia led to

the emergence of an exclusionary model of crony capitalism where the majority of entrepreneurs were denied access to resources – financial as well as non-financial – and thus, were denied access to growth.

- 17-** Entrepreneurship in Egypt and Tunisia faces deeply entrenched institutional problems that extend back to decades of state socialism and crony capitalism under authoritarian regimes. Accordingly, such legacies cannot be undone in little time and changed as part of some brusque measure or move. However, the revolutionary processes that have been going on in Tunisia and Egypt since early 2011 can provide the context for addressing such structural and institutional problems. They can avail the chance for new stakeholders to emerge; sweeping reforms to be made; and old vested interests to be undone. In one sentence, the revolutionary processes make the entrepreneurship ecosystem reform part and parcel of the emergence of the new post-revolutionary political and socio-economic order.
- 18-** Accordingly, no matter how technical entrepreneurship-related reforms turn out to be, they are embedded in broader political and institutional settings. Six main reform-areas appear to be in the forefront for post-revolutionary Tunisia and Egypt:
 - a.** The undoing of old crony networks: much of the hostility of the entrepreneurship ecosystems in Egypt and Tunisia have to do with denied access to financial and non-financial resources to the broader base of private-sector entrepreneurs. This is the other side of the crony character of economic liberalization under the Mubarak and Ben Ali. Cronyism has to be undone so as to liberate enough resources that are to be made available for a broader base of entrepreneurs on transparent and just bases.
 - b.** The state is too big and too important to ignore: the three decades of failed capitalist transition in Tunisia and Egypt clearly demonstrate that market-making is not contingent on getting the state out. It is contingent rather on guaranteeing that functioning institutions are set so as to uphold property rights and regulate the asymmetries of power and information. The state is still very important in both countries. Moreover, the state is still required to play a significant role in both countries in the supply of basic infrastructure; investment in human resources; and narrowing the gaps between regions. State affirmative action is needed as well to remove the discrimination against entrepreneurs on age or gender basis.
 - c.** Deep democratization and better interest representation: Democracy should not be confined to elections and referendums. Rather, it assumes a deeper form of guaranteeing collective action and interest representation in a way that would enable the socially and politically marginalized to express their interests and to become relatively empowered, and thus, enabled to participate meaningfully in the formation of policies and rules that govern their environment.
 - d.** Access to information lies in the very heart of reforming the entrepreneurship ecosystem: The lack of information or the asymmetrical access to information lies in the very heart of the current problems witnessed by entrepreneurs in Tunisia and Egypt. Information is needed at both ends of market contenders and the state. On the one hand, public information must be made equally accessible for all market actors. This requires a variety of legal and institutional reforms that would collect, process and make information available. On the other hand, information regarding entrepreneurs and enterprises must be made available for state agencies.
 - e.** Entrepreneurship support and encouragement should be well-integrated into the overall development strategies of both countries. Entrepreneurship and all the administrative and

legal reforms related to it should cease to be treated only from the social angle of providing jobs for unemployed youth or the distribution of patronage in the form of loans for micro firms or new market entrants. Rather, targeting entrepreneurship should be made part and parcel of the general development strategy by adding a clear economic dimension to the policies and institutional measures that deal with the private sector.

- f. Given the weak formal legal and institutional structures in Tunisia and Egypt, entrepreneurs in both contexts have developed alternative means and channels to survive and grow. Many entrepreneurs, as the survey has revealed, depend on forms of family-or friends-based social capital to access financial and non-financial resources as well as to gain business security and predictability in the face of macroeconomic and political uncertainties. Such forms of social capital should substitute or subvert formal structures and rules as they do now. There should be some synergy of both formal and informal settings in a way that would make informal social capital amassed by entrepreneurs complimentary to formal institutional settings.

Introduction

Any meaningful talk about economic reform in Tunisia and Egypt cannot dismiss the question of entrepreneurship and its ecosystem. 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 and innovation; and competition. However, unlike the static study of certain policy and regulatory areas or institutional settings/structures, analyzing the entrepreneurship ecosystem catches the picture in motion. Tackling entrepreneurship links the micro-level of analysis that touches upon the direct barriers to entry and growth with macro-level analysis that tries to explain the lack of dynamism, low productivity, undercapitalization and the weak prospects of growth of 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 some decades now.

This study aims at giving a thorough account of the entrepreneurship ecosystem in Egypt and Tunisia by exploring its various components and elements. The report serves three principal purposes:

The first is the critical engagement with the extant body of literature on entrepreneurship and other related issues such as private sector development; barriers to entry and growth; and institutional and policy reforms in the two countries as well as the Middle East and North Africa.

The second purpose is to provide a comprehensive and thorough assessment of the main barriers to entry and growth as witnessed and reported by entrepreneurs in both countries. This purpose was served primarily by conducting a comprehensive survey on the views and perceptions of entrepreneurs in Egypt and Tunisia based on their actual experiences. The survey depended on a collection of questionnaires from a sample of more than a hundred entrepreneurs in each of the two countries together with a number of focus group discussions and semi-structured interviews.

The survey was meant to be as comprehensive as possible in two senses: by covering a rather large number of features and elements of the entrepreneurship ecosystem in the questionnaire – the property rights system; rule of law; entry to the formal market; contract enforcement; bankruptcy and exit; access to finance, corruption, labor, education and training; taxation; and access to infrastructure – as well as by targeting a diversified sample of Egyptian and Tunisian entrepreneurs and enterprises that reflect their different characteristics and features. The sample was designed to reflect the actual composition of the enterprise population in both countries in terms of size, age, educational background and gender. Moreover, the sample covered the main geographical regions in each country in a manner that reflects the actual population distribution so as to catch the capital-provinces dynamics. In Egypt, entrepreneurs from six cities – including the capital, Cairo – were included in the sample. Three cities represented Lower Egypt while two represented Upper Egypt. The same was done in Tunisia. Besides the capital city, Le Grand Tunis, a

city was taken to represent the coastal region while another was included to represent the inland provinces.

The third purpose is coming up with policy and institution areas that need reform in the post-revolutionary context based on the views and perceptions expressed by entrepreneurs and other sources. Considering that the revolutionary context in Tunisia and Egypt bears serious chances of structural and wide ranging reform of the entrepreneurship ecosystem, the report acknowledges that reform is not a technical issue. Rather, it is more likely to be the result of lengthy and complex political processes where various interests and stakes are represented. Hence, the report and the research findings are only one input in the complex and multi-faceted process of socio-economic and political change in the two countries of study.

The report aims to contribute to the meager yet growing body of literature on the barriers to entry, exit and growth that entrepreneurs confront in the Middle East and North Africa. It is part of an action-oriented research effort that aims at producing descriptive as well as analytical knowledge that can serve to inform the policy debate and the drive for institutional reform in post-revolutionary Egypt and Tunisia.

The study proceeds in four parts: the first engages with the question of defining entrepreneurship for Egypt and Tunisia. This part provides a critical review of most of the writing on entrepreneurship in the developing world and in the Middle East and North Africa with the aim of molding a concept that best fits the phenomena under study. Part two discusses the main results provided by the questionnaire in Egypt. It covers all components of the entrepreneurship ecosystem and various subgroups of entrepreneurs. Part three does exactly the same with Tunisia. The final part develops some conclusions about the two cases and ends with a series of recommendations that would be hopefully the subject of discussion by two successive roundtables in each of the two countries.

Part One

Defining Entrepreneurship for Egypt and Tunisia

1- Identifying the problem: capitalism without entrepreneurship

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. In the heart of the ongoing political turmoil lies the demand for sweeping socio-economic reform that may eventually create an economy that offers inclusive-growth higher levels of productivity and competition and more jobs. However, unless certain complex and long-term questions are tackled, it is unlikely that political reform will lead to the creation of stable democracies in this part of the world.

Three decades ago, Egypt and Tunisia were among the first Arab countries to embark on economic liberalization and open the way for the emergence of a national private sector. As a matter of fact, the two countries had made definite strides in the development of the role of the private sector in aggregate. For instance, the World Bank (2009:26) indicates that the share of the private sector of non-hydrocarbon GDP is in the 70-75 percent range for Egypt and Tunisia whereas its share in total employment is above 60 and 80 percent, respectively.

In the immediate years preceding the 2011 revolutions, the Egyptian and Tunisian economies recorded what seemed to be sustainable high annual rates of growth that averaged six percent and five percent, respectively¹. The high rates of growth combined with high foreign direct investment and a high export growth were taken as an economic success story. The long years of gradual liberalization and private sector development schemes seemed to finally pay off.

Additionally, the 2010 Index of Economic Freedom noted that most significant gains in economic freedom between 2005 and 2010 were achieved by Egypt among other countries with slight improvements recorded by Tunisia, bearing in mind that Egypt ranked 94th and Tunisia followed, occupying the 95th position in the 2010 Index.

Tunisia recorded a significant success in the area of export expansion and upgrade since the late 1990s. State support combined with incentives for the export of business and foreign direct investment could significantly increase manufactured exports (World Bank 2009b).

¹ According to a World Bank report (2009b:17) Tunisia has enjoyed strong economic growth over the last decade. Real GDP grew by an average of five percent over the 1997-2007 period, a rate that was higher than the 4.3 percent observed for the Middle East and North Africa region but still slightly below the average for middle income countries (5.4 percent) over the period. Tunisia's GDP growth stood at 6.3 percent in 2007 and 5.1 percent in 2008.

The GEM report on Tunisia (2008) caught this export upgrade and placed Tunisia among efficiency-driven economies while Egypt lingered in the lower category of factor-driven economies.

The impressive economic performance in Tunisia and Egypt was viewed as the result of across-the-board reform programs that aimed at encouraging domestic and foreign private investment; market opening; easing of regulation; and establishment of a friendlier environment for the private sector. Over the four years from 2007 (thru 2011) only Egypt has consistently improved its ranking on a year-to-year basis, moving from 165th place in the 2007 *Doing Business* report to 106th place in the 2010 report, and recognized by the World Bank as one of the top reformers among all countries during this period. Tunisia and Turkey have the highest rankings among the MENA – 12 in the 2010 *Doing Business* report (Stevenson 2011:121).

With such promising economic outlooks, why are there still issues? Why have the Egyptian and Tunisian economic development models failed to be sustainable, ending with unprecedented popular revolutions in 2011?

The studies, reports and indices that held Egypt and Tunisia among the top reformers and best performers clearly fail to answer this question. As a matter of fact, most of the literature on private sector development, ease of doing business and economic liberalization and deregulation proved to obscure more than clear the problematic account of capitalist transformation in the two case studies. The “private sector” as a category refers to aggregated and abstract macroeconomic indicators such as the private sector shares in total GDP, value-added, investment, exports and employment, among others. Such indicators and measurements are important in catching the overall transformation that took place in countries like Egypt and Tunisia after three or more decades of privatization, trade, and capital liberalization. However, the concept is too static and abstract. It does not catch the dynamics behind the development – or the lack thereof – of the private sector and how individual entrepreneurs react differently to the environment.

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, under-productive and with limited capacity for growth and accessibility to 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 (Stevenson 2011:81).

There is ample evidence in the literature that decades of economic liberalization did not create a market-based capitalist system in both Tunisia and Egypt. Rather, in the absence of institutional reform and with resilient authoritarianism, liberalization only led to the emergence of some kind of booty/crony capitalism where access to resources was arbitrarily confined to a few politically hand picked cronies. It is well-established that

property rights, contract enforcement and the rule of law have been traditionally weak in Egypt and Tunisia. Access to finance, land and infrastructure has been unequally distributed in favor of some market actors at the expense of others.

Though this body of literature has contributed in explaining the imperfect character of capitalist transformation in Egypt and Tunisia, it does not provide a comprehensive answer to the above question. This literature has proven to be quite elitist, by either analyzing how political power interacted with the economy to generate cronyism and predation or by concentrating on big businessmen and business families. Little attention was paid to the micro-level analysis that is typical of individual entrepreneurs and enterprises operating in the Egyptian and Tunisian economies. Little has been written on the reaction of the broader base of private sector entrepreneurs to the restraints imposed by the formal structures – or lack thereof – and how this impacts their access to formal markets and financial/non-financial resources and their potential for growth.

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 competition. 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.

This report wishes to answer the question of why private entrepreneurship in Egypt and Tunisia has remained relatively underdeveloped despite decades of economic liberalization and private sector-friendly incentives and reforms. It also attempts to explain how the entrepreneurship ecosystem in the two countries developed so as to meet the high expectations of the people – especially the young – that prioritize a productive and just socio-economic order.

2- Defining entrepreneurship for Egypt and Tunisia

One major problem with the extant literature on entrepreneurship is that it is almost exclusively focused on the United States, Canada and the OECD countries i.e. the Northwest or developed capitalist market democracies. Lingelbach et al (2005:7) stated,

“Entrepreneurship in developing countries is the most understudied important global economic phenomenon today.” Neither the definitions nor the approaches developed by diverse Western scholarly traditions catch all the dimensions and implications of entrepreneurial activities in the developing world, and the Middle East and North Africa (MENA) is no exception to this.

This discussion engages with the different definitions of entrepreneurship and the various approaches employed to study the phenomenon. The objective of the discussion is neither academic nor theoretical. Rather, it aims to develop an operational concept of entrepreneurship that best suits the socio-economic and political complexities in Egypt, Tunisia, and MENA. In this process, the main elements of entrepreneurship will be underlined, and the angle through which the phenomenon is tackled will be developed in conversation with the literature.

In this vein, the Global Entrepreneurship Monitor (GEM) is a forceful attempt to study entrepreneurship in a broad variety of countries, including many non-Western developing countries. GEM adopts a very practical and basic definition of entrepreneurs holding them as “active adults in the process of setting up a business.” They will (partly) own or are currently owning and managing an operating young business. This definition coincides with that of those who consider venture creation the most appropriate focus of entrepreneurial research (Reynolds et al: 2005: 209). GEM’s basic tool for cross-country comparison is Total Early-stage Entrepreneurial Activity (TEA). TEA indicates the percentage of adults in each economy engaged in either business start-up – nascent activity – or those operating new businesses up to 3.5 years.

Counter-intuitively, according to GEM, higher TEA rates are inversely related to income where countries with lower income (poorer developing ones) have higher TEA rates than developed countries. Such a conclusion contradicts the well-established conviction that higher entrepreneurial activities are often associated with higher growth and job creation. Conversely, the index has shown it to be highest in poorer countries with low-growth rates, low-productivity and high unemployment. In an attempt to remove the confusion, GEM distinguishes between two principal components of entrepreneurship based on entrepreneurs’ motivation: necessity versus opportunity entrepreneurship.

2.1- Necessity versus opportunity entrepreneurship: Is it relevant at all?

Necessity entrepreneurship is a term developed by Leighton (1989, 1990) and Reynolds et al. (1994) referring to the self-employed that enter the market driven by the lack of income and high unemployment rather than by the pursuit of some market opportunity. Necessity entrepreneurs – also known as shopkeeper or marginal entrepreneurs – are usually less eager to grow and create jobs and are often characterized with low productivity and low capital. Van Stel and Storey called necessity-driven entrepreneurs “refugee entrepreneurs” and elaborated on the shopkeeper effect due to the lack of wage-jobs “coupled with low entry barriers may lead to start-ups that guarantee employment for the business owners but generate no growth” (2004).

Indeed necessity-driven entrepreneurship dominates the scene in most MENA countries –

including Egypt and Tunisia – though GEM indicates that it is much higher in the former than the latter. Necessity-driven entrepreneurs are found operating in the informal sector and belong usually to the rank of small and micro-enterprises (OECD 2013:14). Naude (2008: 28) excludes necessity-driven enterprises altogether from being an entrepreneurial activity for they “do not contribute significantly to economic growth and development.” Also, many people turn to self-employment out of necessity or out of the desire to evade regulations, taxes and other agents’ predatory activities.

GEM is not dismissive of necessity-driven entrepreneurship. It just indicates that its impact on economic growth and job creation is rather modest as it is geared primarily towards subsistence instead of profit making and growth. As Kam et al (2005) held only high growth potential entrepreneurship is found to have a significant impact on economic growth. This finding is consistent with extant findings in the literature that it is fast growing new firms – not new firms in general – that accounted for most of the new job creation. The Global Entrepreneurship Development Index (GEDI) adopts a more conservative definition of entrepreneurship than GEM. However, it reaches the same conclusion indicating that high-productivity entrepreneurship is associated with high-income and vice versa.

2.2- Objections to the dichotomy necessity versus opportunity entrepreneurship

The distinction between necessity and opportunity-driven entrepreneurs in developing economies is much more problematic than it looks for the following reasons:

First, opportunity in the above indices and studies is taken as a given in developing economies. Little attention is paid to the different determinants of economic opportunity such as the institutional and regulatory frameworks within which the market operates.

Second, asking entrepreneurs about their motivation and ambitions cannot be taken as absolute in itself. Rather, it reflects environmental restraints. Necessity-driven entrepreneurship reflects the other side of the coin of informality, which comprises the largest part of private economic activities in most developing countries. It would be too simplistic to hold informality and low-productivity as a choice. They do not often reflect the intention or motivation of entrepreneurs to either grow or make profits or operate with virtually no access to finance or capital. As a matter of fact, many necessity-based entrepreneurs in developing countries escape regulatory regimes by setting up their business in the informal sector.

Third, economic opportunity is viewed in the most formalistic and abstract way in terms of a gap between demand and supply that is caught by the eye of an entrepreneur with the aim of making profits, rents and growth for his/her enterprise. Yet, opportunity is subject to many social, economic and even political determinants. These include educational attainment; access to assets that can be used as capital; and access to finance. Accordingly, subsistence-driven entrepreneurship that indeed constitutes the largest portion of entrepreneurial activities in the developing world is not simply the cause of low-productivity and low-growth entrepreneurship. Rather, it is an effect that draws attention to the structural and institutional factors that determine the presence of opportunity at all.

Fourth, though GEM provides a comprehensive account of entrepreneurship in a large number of countries and encompasses in its analysis various sizes in rural/urban areas and formal/informal sectors, it is quite clear that any meaningful comparison can be made between developing and developed economies using the same concepts. Motivation, which is the main criterion separating necessity-driven from opportunity-driven entrepreneurship, has different connotations in developed economies where a robust institutional, legal and regulatory framework exists and where the playing field is evenly leveled. This is hardly the case in developing economies where entrepreneurs may not be motivated to take risks due to the uncertainties related to the environment – and not the market – and persistence of significant asymmetries of information power.

Fifth, the same limitation has been apparent with using business start-ups as the main indicator for entrepreneurship. As indicated earlier, TEA was found to be higher in developing countries but with lower productivity and less growth prospects. What appears to matter most in developing economies is not market entry per se but rather the entry to the formal market, which entails better access to financial and non-financial resources – technology, markets, information etc. – and thus, higher productivity and growth.

Sixth, stating that necessity-driven entrepreneurship is the reason why entrepreneurship is neither productive nor growth-generating in developing countries is rather tautological. It is similar to explaining underdevelopment in terms of the lack of capital though the latter is just one single manifestation of the former rather than its cause. Instead, the question should be ask why entrepreneurship is driven by necessity and marked by low-productivity. Banerjee and Duflo (2007:165) found that paradoxically enough the poor refrain from taking risks and are reluctant “to commit themselves psychologically to a project of making more money.” Naude (2008:6) comments on this finding by saying those opportunities, which are subject to uncertainty, may be unacceptable (for the poor) as the potential losses may outweigh the potential gains. Thus, manager-owners, family businesses and household enterprises often experience difficulty in innovating and adopting new technology.

Similar to GEM, GEDI and Naude, The World Economic Forum report (2011:9) on entrepreneurship in the Arab world calls for the exclusion of necessity-driven micro-enterprises from the focus of entrepreneurship. They are held to employ only themselves, lack other opportunities and usually do not aspire to grow the business beyond their own subsistence needs. Thus, leaders need to give greater attention to entrepreneurs who are truly innovative – those creating new markets by combining know-how and capital – or who recognize a demand or supply gap in the market and seize the opportunity. These kinds of entrepreneurial activities have positive spillover effects on job growth and the development of the economy.

Such a statement cannot be more self-contradictory. The authors of the report clearly confuse the desire to grow with the ability to do so. They even forward the odd assumption that some people would actually choose to limit their activity to subsistence level and deny themselves the chance of making profits. Amazingly enough, on the following page of the report observes that “more than 80 percent of entrepreneurs in the MENA region have very small-scale operations with enterprise value of less than US\$ 15,000...many microenterprises do not survive the journey towards growth into sustainable small

businesses” (2011: 11). The sentence clearly implies that there are significant restraints on the growth and survival of the broad base of private enterprises that hinder them from growing into small enterprises. Public policy should address these restraints with the aim of lowering the barriers to growth of the largest population of private firms instead of adopting policies that favor those already favored as the report proposes.

The OECD report about new entrepreneurs and high performance enterprises in MENA seems to catch the institutional element at play. The report states, “A small number of well-established enterprises in the region benefit disproportionately from strong market positions. This is the result of regulatory environments that restrict competition and of networks of business, financial and political interests with few incentives to innovate and drive change. In consequence, the total number of enterprises led by economic opportunity and operating formally in higher productivity sectors is smaller than in OECD countries and in dynamic emerging markets” (2013:16).

In conclusion, risk and opportunity in this context is subject to many variables that simply do not appear on the radar of economic analyses such as social marginalization; the exclusiveness of market institutions; the uneven distribution of property rights; and a cronyistic setting where asymmetries of power and information create politically-inspired opportunities rather than market ones. Hence, holding that entrepreneurial opportunity is not given, there is little room to talk about motivation or ambition or individual entrepreneurial ability.

To this effect, Stevenson (2002:48) deconstructs the dichotomy of necessity-and opportunity-driven entrepreneurship. Stevenson argues, “If people are highly motivated to start businesses but have limited capability (a lack of entrepreneurial skills), then even if they have technical skills, the business is unlikely to grow beyond the fledgling stage, unless the environment is very supportive and nurturing. Of course, the optimal situation for a society would be to have high motivation, high opportunity and high skills.”

Hence, entrepreneurship cannot be examined in isolation from the broader context of economic transformation to capitalism in the developing world. Here, entrepreneurship cannot be set apart from larger issues of market-making such as the deepening of private property protection, which entails a functioning rule of law; contract enforcement; property registration; strong financial intermediation; access to information; and competition amongst others.

Entrepreneurship cannot be set apart either from other issues of job creation; poverty alleviation; and growth-enhancement in the developing world. 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. As Naude (2008:2) holds, “in developing countries, the concern is with entrepreneurship starting and accelerating growth and providing impetus to the structural transformation of economies; in the advanced economies, the concern is largely with obtaining new sources of productivity growth, which underlies competitiveness.” As a matter of fact, the introduction of the concept of entrepreneurship to development studies has been to address concerns of poverty alleviation, economic upgrade and fighting unemployment.

Lastly, ruling out necessity-driven entrepreneurship in the name of focusing on high-growth enterprises is throwing the baby with the bathwater. On the policy level, it will tend to reproduce the same biases against small and micro-enterprises, female entrepreneurs and the informal sector. According to Hughes (2000) “Micro, informal (non-registered) and necessity-driven enterprises are essential generators of income and employment, especially for the poorest members of society.” According to Stevenson (2010:175) in his powerful study of entrepreneurship and private sector development in MENA, “even necessity-driven enterprises are a seedbed for experimentation and could lead to the development of higher-opportunity ventures in the future, especially for the better educated entrepreneurs.”

Some scholars have researched and discussed frugal innovation in low technology economies (Zeschky, Widenmayer and Gassmann 2011). This scholarly body confirmed that innovation could indeed happen in response to resource constraints with reference to emerging economies such as China and India (Chistensen 1997; Ray and Ray 2010). The importance of such conceptions is that they try to catch how things are developing on the ground in the wide variety of developing economies. Moreover, they do not confine themselves to high-technology sectors that may have a high growth potential but are usually separated from the traditional sectors that constitute the economy.

Similarly, many scholars consider high growth potential as an integral part of entrepreneurship. These growth-oriented enterprises are the ones that expand and create jobs, and thus, contribute to the growth of the overall economy. Growth-oriented businesses seem to overlap with opportunity-driven entrepreneurs only with a high growth potential. According to an OECD report on high-growth businesses in the MENA region, growth-oriented businesses impact entrepreneurs – the missing middle (gazelles) – are distinguished by their ability to grow economies faster and further than micro-enterprises. They also create more new jobs and add more economic value than long established businesses (2013:54).

The OECD report emphasizes the financial and non-financial barriers that small and micro-business face in the MENA countries and seeks a way out by calling for paying special attention to firms with high-growth potential. However, the report itself admits that it is quite hard to identify developing-country gazelles. It is not clear whether high-growth businesses can be spotted *ex ante* or *ex post*. Focusing on the businesses that are performing well may result in the reproduction of the patterns of marginalization and exclusion against the broadest base of private enterprises in the region, which happen to be small and micro-firms operating in the informal sector. As a matter of fact, the “missing middle” that the report and Stevenson (2011)² highlighted in the region implies that there is a structural and institutional problem that hinders small and micro-firms from ever fulfilling their growth potential and transforming into middle-sized firms. Hence, a sound development strategy should not aim at favoring the “winners” but actually carry small and micro-firms past board policy and institutional tools that may act as barriers to entry into

² According to Stevenson (2011: 81) the private sector in MENA-12 countries is comprised of a very large number of microenterprises – with fewer than five workers – a very small number of small and medium enterprises and a tiny number of large enterprises.

the formal market and to growth of the high-growth yet missing middle.

2.3. – Entrepreneurship as a system

Following the above discussion, there is a question of which definition entrepreneurship is most suited to study the cases of Egypt and Tunisia. The most suitable one is that forwarded by Lois Stevenson's (2002:44) adoption of the broader definition of entrepreneurship: It isn't just something that entrepreneurs 'do', it is a social phenomenon that emerges within the context of a broader society and involves many actors.

Hence, this report is inclined to adopt Stevenson's definition of entrepreneurship as a **system that includes existing and potential entrepreneurs; institutions and government actions; and the desired policy outcome as an increased level of entrepreneurial activity. The role of institutions and governments is to foster environments that will produce a continuous supply of new entrepreneurs** (Stevenson, 2002:45).

Approaching entrepreneurship as a system introduces the literature on institutionalism to that on entrepreneurship where institutions are the rules, be they formal or informal, according to which economic transactions are exacted (North 1981, 1990; Williamson 1990). In that sense, institutions are not confined to formal state or state-related rules, but rather transcend formal laws and regulations into the actual practice and implementation of them that shape and structure incentives, opportunities and risks for entrepreneurs. However, entrepreneurship as a system does not imply some structural approach that simply dismisses or ignores individuals and groups as economic agents that are rendered totally helpless vis-à-vis rigid structures. Rather, the way the economic agents i.e. entrepreneurs react to and interact with the rules that permeate their activities is part and parcel of the ecosystem, dynamically defined.

Such a definition resets the research agenda for entrepreneurship in developing countries, including the two case studies of this report: Egypt and Tunisia. The focus goes beyond individual entrepreneurs and enterprises and into the basic determinants of entrepreneurship as a system and as a broad social phenomenon. In such a setting, the distinction between entrepreneurs and enterprises on the basis of motivation, growth potential and innovation is deemed almost irrelevant. The principal question becomes why growth-oriented entrepreneurship is not as developed as is expected.

The concept of entrepreneurship this study adopts is old and classical, one coined and developed by the 18th century economist Richard Cantillon who associated entrepreneurship with risk-taking with the aim of making profit in whichever field of economic activity. Cantillon's definition renders the term *entrepreneur* almost equal to that of a businessman who founds or establishes new organizational forms with the aim of undergoing activities. The element of risk-taking has to do with uncertain rewards. Such a definition intersects also with the classical economic definition of entrepreneurship as a factor of production along side land, capital and labor for which he/she coordinates the way these factors are brought together.

All those who are self-employed and operate in the private sector in developing economies face uncertain rewards regardless of their productivity, growth potential or innovation. De Soto was among the first to employ this early and basic definition of entrepreneurship in his study of the phenomenon in the Global South. De Soto simply equated self-employment and private sector activity – be it in the formal or informal sectors – regardless of the size of the enterprise with entrepreneurship. His definition focuses on trying to explain why such entrepreneurship is of low-productivity and fails to create jobs beyond the family of the entrepreneur. Such a definition is far from Schumpeter’s well-known and widely celebrated concept of entrepreneurship, which strictly relates to innovation and cycles of growth in a capitalist economy.

2.4 - Entrepreneurship ecosystem and its institutional bases

Entrepreneurship has been studied by a great many approaches that range from psychology, sociology and anthropology to economics and political science. While some scholars tend to focus on the individual characteristics of entrepreneurs – be they psychological traits such as risk-taking, innovation and independence – others have viewed entrepreneurship as a process. By process, they underline the dynamics through which enterprises form, grow and die and their main outcomes: economic growth, innovation and job creation. A third group went beyond entrepreneurs and enterprises into what can be called “entrepreneurship ecosystem,” which refers to the institutional environment within which the process of business creation, growth and market entry and exit take place. The entrepreneurship ecosystem concept is the approach this study adopts in studying this complex, socio-economic phenomenon in Egypt and Tunisia. The question is how can we define entrepreneurship ecosystem for this study.

The term “entrepreneurship ecosystem” was defined by Nadgrodkiewicz (2013:3) as “an environment where businesses can operate on a level playing field, where their rights are protected, and the same rules apply to all” (2013:3). Lowrey (2003) defines entrepreneurship as an economic system that consists of entrepreneurs, legal and institutional arrangements and governments. Governments stand as agents who can adjust the legal and institutional arrangements to promote individual entrepreneurs, and thus, generate growth and economic development.

Others have given a more complex and detailed definition of *entrepreneurship*. The OECD (2012:12) holds the ecosystem to have four elements: personal enablers; financial enablers; business enablers; and environmental enablers.

Personal enablers refer to the individual development of entrepreneurs through the provision of sufficient expertise, knowledge and mentorship through the formal educational system or other informal channels. The second element of financial enablers indicates the presence – or absence – of sources of funding whereas the third factor has to do with professional and technical support given to businesses in areas such as networking, media coverage, and accounting, among others. Finally, the fourth component is environmental enablers that include the regulatory framework, infrastructure and culture.

The OECD reports conclude that “when studying the MENA region’s entrepreneurial

ecosystem, it quickly becomes obvious that some elements of the ecosystem are undeveloped – such as the regulatory framework and equity investors – while other elements – such as advisory – have benefited from various initiatives. The result is an out-of-balance ecosystem.”

Table (1.1): Entrepreneurship ecosystem: definition and components

Our study will define the entrepreneurship ecosystem defined as the environment within which individual entrepreneurs and enterprises operate and where they interact with the regulatory, legal and institutional frameworks both formally as well as in practice. The ecosystem is the structure that impacts the choices of entrepreneurs of entry and exit. The entrepreneurship ecosystem has three main components:

The first component is property rights and the rule of law. It encompasses a wide variety of institutional elements ranging from property registration, asset retrieval and contract enforcement to bankruptcy, anti-trust and competition protection. This domain refers to the basic institutional and regulatory protection to individual entrepreneurs in their economic transactions. It is expected to heavily influence the entrepreneurs’ incentive to enter the market and their assessment of uncertainty and risk, and thus, their perception of market opportunities and potential for growth.

The second element of the ecosystem is the financial subsystem that refers to the formal and informal channels of fund provision. This dimension includes all the media through which capital is exchanged at a certain cost and is expected to have a big impact on the overall potential for growth.

The third and final element is a residual category of all the non-financial factors that impact entrepreneurship. This category includes taxation rates and regimes; labor regulation; education and vocational training; competition; corruption; and access to infrastructure.

3- Sample composition and methodology

This study aims to approach entrepreneurship as a system in order to explore the broader and more abstract questions of private sector development and capitalist transformation in MENA. The primary goal is the production of a qualitative study about the entrepreneurship ecosystem in Egypt and Tunisia. The scope of the study is comprehensive in two senses: one, it comprises the institutional constraints on private entrepreneurship – be they financial or non-financial – and two, it studies 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.

In this regard, the study depends on a sample of approximately one hundred respondents in each country. The sample has been designed to stand as some microcosm of the entrepreneurial populations 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 relatively small as the sample is, it does not aim at quantitatively describing the

principal characteristics of the entrepreneurial phenomenon or at establishing statistical correlations between different phenomena that belong to the universe of study. This has already been the subject of a rather large 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's *Doing Business* report to name a few. It is widely known that the entrepreneurship ecosystems in MENA are not conducive to business entry and growth. Thus, this report does not aim to prove this assertion.

Instead, this qualitative study aims to produce thick and detailed description of the institutional underpinnings of entrepreneurship through thorough analytical accounts of how different elements of the ecosystem interact with each other. The study implements questionnaires, focus group discussions and individual interviews and follows the logic of qualitative surveys. The sample aims at the exploration of the variety of components of the phenomenon under study. This calls for the generation of detailed and rich descriptions of how different kinds of entrepreneurs interact differently with the entrepreneurship ecosystem based on gender, region, enterprise age, formality and size. The questionnaire is an extension of personal interviews for a larger number of respondents. The principal objective is to raise questions and attain answers from respondents that represent typical entrepreneurs corresponding to the various categories of examination that reveal their experience with the ecosystem – their feedback on the restraints and opportunities they face and their accounts of how things are done.

3.1-The survey and its description

The study depends on a randomly stratified sample of a total of 231 entrepreneurs from Egypt (131) and Tunisia (100). The survey was collected in Egypt and Tunisia between June and September 2013. The sample was designed to reflect the actual composition of the entrepreneurs' population in Egypt and Tunisia in terms of the proportional representation of enterprise size, legal status and regional and gender distribution. The sample was predominantly made up of small and micro-sized enterprises. The criterion used was the number of non-family workers. Micro enterprises were defined as the ones that hire less than six workers while small ones would hire between six and 50. Small and micro enterprises constituted almost 99 percent of the total enterprise population in Egypt and Tunisia.

The sample was distributed geographically so as to represent the three main regions of Egypt and Tunisia: in Egypt four governorates from Lower Egypt (Kafr Esheikh, Port Said, Gharbiya and Northern Sinai) with the total share of 42 percent, Cairo with 31 percent and two governorates from the Upper Egypt (Beni Suef and Sohag) with a share of 27 percent of total sample. The sample included one or two cities from each region and the focus remained solely on urban entrepreneurship.

The survey was based on a questionnaire of five-pages of multiple-choice questions. In the case of Egypt, the bulk of respondents in Cairo were approached through the networks of the Center for International Private Enterprise (CIPE). The study relied on local networks in two districts in Cairo well known for the presence of unregistered workshops: Imbaba and El-Zabaleen. The Federation of Economic Development Associations (FEDA), a local

partner of CIPE, collected the surveys in the provinces. The questionnaires were completed through personal interviews with entrepreneurs either individually or in groups. The survey was complemented with a number of personal interviews with entrepreneurs operating registered as well as unregistered enterprises. The author conducted eleven interviews with male and female entrepreneurs. The interviews often ranged from an hour to two and assumed a semi-structured character and covered a variety of issues including those of registration; resort to formal contracts while conducting business; encounters with the administration; and past experiences about the barriers to entry and growth.

As for Tunisia, the study was dependent on the local networks provided by the Institut Arabe des Chefs d'Entreprises (IACE) in Tunis, Kebili and Monastir. The author of this report collected 53 percent of the questionnaires in person while the IACE staff collected the residual. In parallel with the questionnaire distribution, the author of the report had the opportunity to conduct four focus group discussions in Kebili, Monastir and Tunis and over 15 personal interviews with officials and entrepreneurs. The IACE depended on its part on local business centers (Centres d'Affaires) for the direct reaching out to entrepreneurs. This has been the case with the business centers of Manouba, Aryana (both located in Le Grand Tunis), Kebili and Monastir.

3.2- Questionnaire

The survey was based on a questionnaire of a total of 182 questions. The first section asked respondents to answer questions regarding their background. All of the proceeding questions were multiple-choice, and respondents were required to select either *yes* or *no*.

The questionnaire covered ten research areas:

- 1) The first was that of background information about the respondents and their enterprises. This section included the name, age, gender, educational attainment and professional background of the respondent together with the size, age, ownership structure and basic financial information about his/her enterprise.
- 2) The second area of investigation was that of registration and informality. Surveyed entrepreneurs were asked to provide information about the legal status of their enterprises. They were also asked for reasons why they did or did not register their enterprises in addition to registration challenges.
- 3) The third section dealt with contracts. Respondents were asked to provide answers regarding the frequency of resorting to formal contracts and how they found the process of contract enforcement.
- 4) The fourth area of research was on competition and whether respondents reported unfair competition practices and how these practices impacted their business.
- 5) The fifth section was about market exit and bankruptcy and whether respondents used to resort to legal bankruptcy regulations.
- 6) The sixth covered labor and taxation policies and regulations and how they impacted the respondents' business operations.
- 7) The seventh section tackled the question of access to finance. Respondents were asked about the kind of finance they depended on at their initial business phases and their current sources of finance.

8) The eighth area of research was that of entrepreneurship education and skills acquisition. Surveyed entrepreneurs were asked about the skills they needed most in conducting their business and the sources through which they achieved them.

9) The ninth section was dedicated to female entrepreneur respondents.

10) The final section was confined to respondents from outside the capital cities of Cairo and Tunis. These two final sections addressed the special barriers to entry and growth that were expected to face female and provincial entrepreneurs.

3.3- Definitions

Entrepreneurs: business people who own and manage their enterprises, be they formal or informal. The sample filtered out single entrepreneurs who do not hire additional employees. Additionally, non-family worker involvement was a requirement.

Entrepreneurs' age: The sample focused primarily on the representation of young entrepreneurs in the age of work in both countries. In the Egyptian sample, entrepreneurs between 21 and 50 constituted 72 percent of the total number of respondents while in the Tunisian sample, they stood for 86 percent of the total. As a matter of fact, such distribution is not that far from the estimates forwarded by GEM reports in 2008 where entrepreneurs in the age bracket 18-54 stood for 80 percent of total Egyptian entrepreneurs and 91 percent for their Tunisian counterparts.

Educational attainment: Unlike other categories, the sample did not aim at reflecting on the actual composition of educational attainment in the entrepreneurial population in Egypt and Tunisia. Rather, there was an overrepresentation of higher-education graduates in both samples. By higher education, the survey implies university as well as other higher education institutes. This overrepresentation of educated entrepreneurs and potential entrepreneurs involved focusing on the entrepreneurs, and thus, enterprises with the highest growth potential. Broad literature on entrepreneurship has indicated that the more educated entrepreneurs are, the higher the potential of growth and innovation there is. According to GEM reports on Egypt and Tunisia in 2008, entrepreneurs with no formal education constituted 33 percent and 27 percent of the total population of entrepreneurs in Egypt and Tunisia, respectively. A majority owned micro-sized firms that operated in the informal sector. Those with a post-secondary degree constituted 15.7 percent and 35.7 percent of entrepreneurs in Egypt and Tunisia, respectively. In the sample, higher-education graduates were allotted a high percentage at 51 percent in Egypt and 79 percent in Tunisia.

Firm size: The sample was designed to reflect the weight of each category of firms in the actual firm population in the two economies. The vast majority of respondents were the owner-managers of micro, small, and medium-sized enterprises. The World Bank – along with other statistical sources – hold these firm categories to constitute approximately 98 percent of the firm population in both Egypt and Tunisia. The criterion used to classify firms by size has been defined in terms of the number of workers rather than in capital. Using the number of workers instead of capital – or turnover – has to do with several factors. First, many entrepreneurs show reluctance in giving accurate financial figures while they are not as sensitive with the number of people they hire. Second, Egypt and Tunisia have different and often contradictory legally financial criteria for firm size. Hence,

by establishing the number of workers as a criterion, micro firms were defined as firms with less than six workers, small firms with six to 50 workers, medium-sized firms between 51 and 100 and large firms with a labor force that exceeds a hundred.

In the Egyptian sample, micro-firms constituted 61 percent of the total firms, which is the exact percentage that GEM report on Egypt in 2008 gave to this very cohort of firms. Small firms stood for 35 percent while medium-sized and large ones constituted together around 4.5 percent of the total. It is noteworthy that the sample filtered out micro-enterprises that employed no workers at all though only had the owner as the sole employee. This category of single-owner enterprises was estimated to constitute approximately 16 to 24 percent of the total population of firms according to GEM report on Egypt in 2008. All in all, micro, small and medium-sized enterprises represent 96.5 percent of the total firms included in the survey.

As for the Tunisian sample, micro, small and medium-sized enterprises constituted together around 97 percent of the total number of surveyed firms. Micro-firms employing less than six workers totaled 85 percent, small ones totaled 12 percent and medium-sized and large firms for the residual at three percent. The extremely small share of medium-sized enterprises in both case studies does demonstrate the long-emphasized observation by the literature of the missing-middle syndrome.

It is noteworthy that there is sizable evidence availed mainly by GEM and other stripes of the literature that the sweeping majority of entrepreneurs belong to the category of micro and small firms.

Regions: Regions are represented in the sample in a way that reflects their relative weight in the population of each country. The sample includes one or two cities from each region in the country. The sample focuses solely on urban entrepreneurship. Three main regions were differentiated in each country. The plan is to study three cities, one from each region. In Egypt, Cairo – the capital region – received a representation of approximately 17 percent of the sample. Three cities were chosen to represent Lower Egypt – Kafr Esheikh, Port Said and Northern Sinai – with the total share of 48 percent of the sample, and two governorates from Upper Egypt – Beni Suef and Sohag – with a total share of 35 percent.

For Tunisia, the survey includes respondents from three cities that were held to represent the principal regional divide in Tunisia, which is that between the coast and the inland provinces besides the capital city. Le Grand Tunis had a share of 37 percent, which is close to the share of its four composing provinces³ in the total population of Tunisia. Another coastal city was chosen to represent the rest of the region aside from the capital. This city was Monastir, which lies to the south of Tunis and had a representation of 19 percent of the sample. Together, Tunis and Monastir held the share of 57 percent, which is roughly equivalent to the share of the Tunisian population that lived off the Mediterranean shores. Kebili, the capital of an inland province had the share of 43 percent of the sample, which is

³ Tunisia is made up administratively of 23 provinces or states (Arabic: *Welayat*). Tunisia is a unitary state, and thus, constituent *states* usually refer to governorates – administrative rather than political units. We will use the word *province* instead of *state* to avoid the confusion with the Tunisian state.

roughly equivalent to the percentage of Tunisians who lived in the inland provinces.

Informal enterprises: Enterprises that operate without industrial or commercial registry or a tax card. The survey has adopted a rather formalistic definition of formality by focusing almost solely on the business registration. Accordingly, *informal* is equated with non-registered business. The sample has filtered out single entrepreneurs who own and manage business without hiring any nonfamily workers. Hence, *informal enterprises* in this study refer to non-registered economic entities that employ nonfamily workers. This is the only stripe of economic informality that is included in the study. Broader definitions of informality that include non-registered transactions and informal labor are not touched upon directly in the sample selection.

Informal economic units that employ nonfamily workers exist in Egypt more than in Tunisia where the state has more capacity to regulate the economy (World Bank governance matters index: regulatory capacities). Around 20 percent of the Egyptian sample has been made up of such entrepreneurs that own and manage non-registered sweatshops, yards, workshops and small factories. In Tunisia, only ten of the entrepreneurs belong to this category of non-registered businesses that hire workers. However, the majority of those who were not registered were comprised mostly of potential entrepreneurs that were in the process of registering their businesses rather than informal ones.

Female entrepreneurs: The sample includes a number of female entrepreneurs that is roughly equivalent to the overall rate of female participation in entrepreneurial activities according to GEM. In Egypt, GEM estimated the percentage of female entrepreneurs to be less than 20 percent. 15% of the total sample included female respondents. GEM's estimate was much higher for Tunisia. Female entrepreneurs were seen to constitute around 27 percent of total entrepreneurs. The Tunisian sample included around 30 percent female respondents. Due to the lack of precise information about the female share of entrepreneurial activities across different regions, firm sizes and sectors, the sample composition will hold equal distribution of females across regions. However, gender representation may indeed vary, as the representation of female entrepreneurs is likely to be higher in the capital than in the provinces.

Part Two

Entrepreneurship Ecosystem in Egypt: Barriers and Reforms

1- Sample composition and description

The sample is made up of 131 respondents whose questionnaires were collected in June and September 2013 in Egypt. The sample has 21 female respondents (16 percent). It is distributed between the three main regions in Egypt: four governorates from Lower Egypt (Kafr Esheikh, Gharbiya Port Said and Northern Sinai) with the total share of 42 percent, Cairo with 31 percent and two governorates from the Upper Egypt (Beni Suef and Sohag) with a share of 27 percent of total respondents. The formal sector (defined as legally registered companies) stands for 69 percent of the total sample whereas the informal sector stands for 31 percent. The following table gives a general view of the sample composition:

Table (2.1): Data description in the Egypt (Percentage reported by respondents)

Region		Entrepreneur age		Female entrepreneurs	Educational attainment	
		21-40	Over 41		School education	Higher-education
Lower Egypt	42	40	60	13	55	37
Upper Egypt	27	49	51	3	47	37
Cairo	31	90	10	32	93	7
Total/Average	100	60	40	16	65	27

Of the entrepreneur age groups covered in the sample, almost 80 percent of respondents were found to be between 21 and 50. The entrepreneurs included in the sample show varying levels of educational attainment as indicated below.

Table (2.2): Entrepreneurs' educational attainment (percentage of respondents)

No formal education	Primary/Preparatory	High school	Higher education
6	8	20	64

As for the enterprises included in the sample, the average firm age hovers around 7.38 years based on answers provided by 122 respondents of the total 131. The surveyed enterprises can be classified into three age groups as indicated below:

Table (2.3): Enterprise age (percentage indicated by respondents)

Nascent enterprises (zero to 3 years inclusive)	31
Young enterprises (Over 3-10 years inclusive)	36
Established enterprises (Over 10 years old).	27
No answer	6

Nascent enterprises were found to be owned and managed by younger and more educated entrepreneurs. Seventy-eight percent of them belong to the age bracket of 21 to 40 compared to 60 and 53 percent for young and established enterprises respectively. This is fairly intuitive as younger entrepreneurs undertake usually nascent ventures. However, the percentages of the three firm-age subcategories suggest that the overall population of enterprises, as well as entrepreneurs, included in the sample is quite young, generally. Nascent enterprises are managed and owned by the highest percentage of higher-education graduates (80 percent) as compared to young and established enterprises (62 and 58 percent respectively). Most nascent enterprises belong to the non-family partnership enterprises (59 percent). Conversely, the dominant form of ownership in young enterprises was single-owners (49 percent) and the dominant structure in established enterprises was family business (58 percent).

As for firm size, most nascent and young enterprises were of the micro size (61 and 68 percent, respectively compared to 47 percent for established firms). Forty-seven percent of the established firms included in the sample were small (employing between 6 and 50 workers) compared to only 32 and 28 percent for nascent and young enterprises respectively. Six percent of the established enterprises were large, employing over a hundred workers while the percentage was zero for the two other firm age categories. In the same vein, informality (non-registered enterprises) was concentrated in nascent and young firms (31 and 38 percent respectively) while its share of established firms was as low as 17 percent. Informality is tied to firm size, as enterprises tend to become relatively larger and more formal through time; informal and micro ones are often nascent or young.

The sample indicates various ownership structures as indicated in the table below:

Table (2.4): Ownership structure (percentage reported by respondents)

Single Ownership	36
Family ownership	32
Non-family partners	30
No answer	2

Family business and non-family partnerships in the sample tend to be larger in terms of the number of workers as well as capital and turnover than single-owned and run enterprises. The majority of single-owned and managed enterprises were of the micro-size (74 percent of the total single firms) while the percentage was less for family businesses (64 percent) and non-family partnerships (50 percent). The same applies to the financial indicators reported by the survey respondents. The average start-up capital for single-owned firms was L.E. 178,138 versus L.E.814, 482 and L.E. 378,646 for family business and non-family partnerships respectively. The current capital reported confirms this pattern. Family business recorded the largest average (L.E. 1,652,746) followed by non-family partnerships (L.E.751, 681) and then single-owned firms (L.E. 311,709). The annual turnover reported conforms to the same pattern⁴.

The highest percentage of informal enterprises (non-registered ones) in the sample was found amongst the ranks of single-owned firms (43 percent as opposed to 31 percent and 18 percent for family business and non-family partnerships). There may not be a direct causal link between single-owned enterprises and informality. Yet, there may be some intermediate variables that explain the overrepresentation of informal entities in this ownership category such as small firm size and subsequently the low potential of accessing finance, markets and information. The sample indicates also that the average age of surveyed entrepreneurs is much lower in non-family partnerships as compared to family business and single-owned enterprises. Eighty-seven percent of the entrepreneurs that owned and managed non-family partnerships were in the age bracket of 21 to 40 years old as compared to 52 percent with single-owned enterprises and 45 percent with family businesses.

Last is firm size: 61 percent of the firms can be classified as micro-firms hiring less than six workers, 33 percent were small hiring between six and 50 workers. Conversely,

⁴ A plausible explanation for the association between larger firm size and non-single ownership can be that family business and non-family partnerships have better access to resources at virtually all business stages. They have better access to finance for their capacity to secure collateral for loans or to accumulate private savings. They have better access to networks as well in order to obtain skills, market shares and information. In one sentence, non-single owned enterprises have often a larger potential from the outset as compared to single-owned ones.

medium-sized firms stood for less than two percent of the sample and large firms hiring more than 100 workers constituted two percent of the sample. The high representation of micro-firms in the Egyptian sample is representative of the actual population of enterprises. However, the sample only included micro-firms that employed non-family workers. Hence single-owned micro-enterprises that are usually made up of only one person together with exclusively family-based micro-enterprises were excluded. The rationale behind the removal of these kinds of micro-firms is to weed out subsistence or necessity-driven activities that are usually performed by the poor or the unemployed as a means for gaining a living. The average annual turnover reported by the micro-firm entrepreneurs in the sample was L.E. 181,502 (roughly equal to 45,882 dollars) and their average reported current capital was L.E. 321,179 (roughly equal to 25,929 dollars). The turnover is significantly higher than the annual per capita income in Egypt (for 2012), which was 3186 dollars according to the World Bank. Moreover, the average capital reported indicates that these entrepreneurs are small capital-holders and thus are not typically subsistence entrepreneurs whose capital is often confined to the merchandise or the simple tools with which they own and operate.

The entrepreneurs included in the survey can be classified into two broad age subcategories: the first is that of younger entrepreneurs who are less than 40 years old (inclusive) and the second is that of older entrepreneurs who are over 40. Within the first group, entrepreneurs between 21 and 30 constitute around 60 percent followed by those between 31 and 40 (38 percent). Both can be considered to belong to the “not so young” age cohorts⁵. Overall, younger entrepreneurs stand for almost 61 percent of the sample revealing the young nature of Egyptian entrepreneurship. Those who are over 40 stand for 39 percent of the total sample. The subgroup of entrepreneurs between 41 and 50 stand for 51 percent of the older entrepreneurs’ group followed by 29 percent and 19 percent for those between 51 and 60 and those over 60, respectively.

Younger entrepreneurs are better educated than their older counterparts. Seventy-one percent of the younger ones have some high-education degree versus only 51 percent amongst the older entrepreneurs. Career paths of both groups are markedly different. Among the younger entrepreneurs the majority were wage-employees before becoming entrepreneurs (31 percent), 24 percent were students and 26 percent were originally self-employed before starting their ventures. Among the older entrepreneurs, none reported to have been students. The majority was self-employed (42 percent) followed by wage-employees as well (31 percent) and working in a family-business (16 percent). Six percent of the younger entrepreneurs and 12 percent of their older entrepreneurs reported to have

⁵ Campante et al. (2011:179) argue that contrary to the “youth hypothesis” that was used to refer to the demographic explosion of those who are under 15 in the Arab world to explain the political and economic underpinnings of the recent revolutions, the age cohorts that appear statistically to be most significant economically as well as politically are those “not so young” aging between 25 and 39. According to the Campante et al. the countries that were affected by significant uprisings during the Arab Spring were also places where the share of population aged 25-39 had increased considerably from 1980 to 2010 amid a labor market climate featuring high unemployment rates. Thus, it seems that the demographic shift in this “not-so-young” age cohort might actually be more relevant for the recent Arab experience.

been unemployed⁶.

As for the enterprise profiles that entrepreneurs of both groups own and manage, most enterprises owned/managed by older entrepreneurs are either single-owned (45 percent) or family business (42 percent). Among the younger entrepreneurs' group, most enterprises have the ownership structure of non-family partnerships (41 percent) followed by single- and family-ownership (30 and 26 percent, respectively). As for firm-size, younger entrepreneurs had a larger share of micro-enterprises (68 percent) opposed to 49 percent for their older counterparts. Six percent of older entrepreneurs reported to own/manage large firms (employing more than a hundred workers) while zero younger entrepreneurs reported that. Given the size differences, informality was reported to be much higher among younger entrepreneurs (40 percent said that they were operating non-registered businesses) than older entrepreneurs among whom only 16 percent were running non-registered enterprises.

This section will explore the entrepreneurship ecosystem in Egypt and the barriers to entry and growth as expressed by the respondents.

2- Property rights and the rule of law

The first component of the entrepreneurship ecosystem is property rights and the rule of law. It encompasses a wide variety of institutional elements ranging from business and property registration; asset retrieval and contract enforcement to bankruptcy; and anti-trust and competition protection. This domain refers to the basic institutional and regulatory protection to individual entrepreneurs in their economic transactions. It is expected to heavily influence the entrepreneurs' incentives to enter the market and their assessment of uncertainty and risk, and thus, their perception of market opportunities and growth potential.

2.1- Business registration and the barriers to entry in Egypt

The barriers to entry in this context refer to the administrative, regulatory and legal factors that hinder the formal registration of economic enterprises. Barriers to entry include the requirements to register a business at relevant government agencies, for example: the ministry of investment; the ministry of industry and trade; tax authority; and social security authorities among others. As in many developing economies, there is always the option for entrepreneurs to operate in the informal sector while bearing the cost of doing so that may take the form of the foregone chances to grow, restrained access to finance and to larger markets together with being more vulnerable to extortion and harassment. Hence, barriers to entry refer primarily to the factors that impede the entry to the formal economy by being

⁶ The low percentage of the unemployed in both categories suggests that the choice of working in the private sector has been taken independent of the direct pursuit of work and income due to unemployment or what some trends of the literature call necessity-driven unemployment. As in the case of Tunisia these numbers dispel the old standing conviction that people in Egypt and in MENA in general are often predisposed against private entrepreneurship and that their preference has been usually some form of public sector employment.

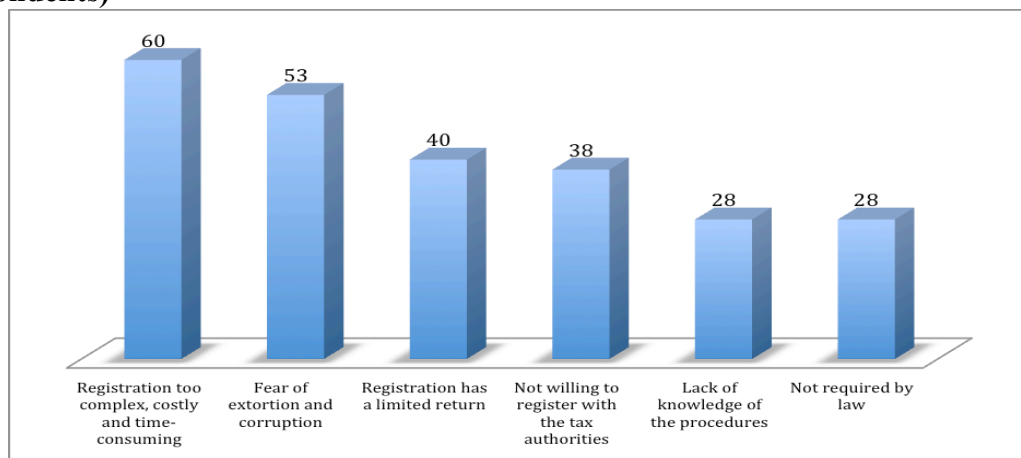
registered and licensed to operate by the government.

The survey has adopted a rather formalistic definition of entry by focusing almost solely on the regulations, laws and procedures and the way they are observed by the government. There may be other substantive barriers to entry such as monopolistic or oligopolistic practices or the undersupply of property rights in favor of a few cronies. These factors are treated in other sections of the study as restraints on free market competition.

According to the survey, 40 respondents – 31 percent of total sample – reported that they were operating informally without registering their economic activities and with no tax or fiscal code. When asked why they did not register their enterprises, 60 percent indicated that the registration process was too complex, costly and time-consuming; 53 percent stated that registering their businesses would make them more exposed to extortion and paying bribes; 40 percent said that business registration has a limited return; 38 percent reported their unwillingness to deal with tax authorities upon registering; and 28 percent indicated their lack of knowledge of the required procedures for business registration. The following figure depicts the main reasons for not registering as indicated by respondents:

When asked about the reforms that would make them more inclined to register, 60 percent said that they would register if the procedures and required documents were simplified and reduced in number; 53 percent demanded cutting the fees and costs of registering; and 55 percent stated that they would register if their exposure to extortion and bribery while registering decreased.

Figure (2.1): Reasons for not registering as indicated by entrepreneurs (Percentage of respondents)⁷



⁷ The case of “registration not required by law” refers to economic activities that can be exercised by entrepreneurs without the legal obligation of registering. A wide array of services can be delivered informally in Egypt without the formal requirement of a permit or a license or any other form of registration. For instance, house cleaning, delivery of cooked food, car washing and car parking among many others do not require any permit – unlike street vending, for example. Another example that the author came across while conducting interviews with people in the informal sector involves an entrepreneur who owned three taxis and had no company register despite the fact that he was acting as one by hiring three drivers and collecting the revenue on daily basis. He was instead just registered as a car or a taxi owner.

For those who reported the registration of their enterprises, 84 of the respondents indicated the average number of agencies they had to deal with to secure all the required permits and licenses was 4.74 governmental bodies. The average time reported by 87 respondents to get their enterprises officially established was 5.02 months. As for the process itself, only 16 percent of the respondents indicated that the process was either “easy” or “very easy” while 18 percent said that it was “ordinary”. Conversely, 20 percent and 37 percent of the respondents reported the process to have been either “difficult” or “very difficult,” respectively. Approximately nine percent provided no answer.

Among those who chose “difficult” or “very difficult” (52 respondents), 67 percent said that the issue lay with the laws and regulations while 85 percent said that the source of difficulty was the government bureaucracy. Fifty percent mentioned other sources of the issue, among which the most frequent was corruption and negligence. One respondent said that the issue was with the cost rather than the complexity of the procedures.

One of the interesting findings is that a clear majority of respondents expressed positive attitudes towards registering their business. When asked to evaluate the impact of officially registering their businesses on access to finance, business security and access to markets the following answers were given:

Table (2.5): The impact of formal business registration as indicated by entrepreneurs (percentage of respondents)

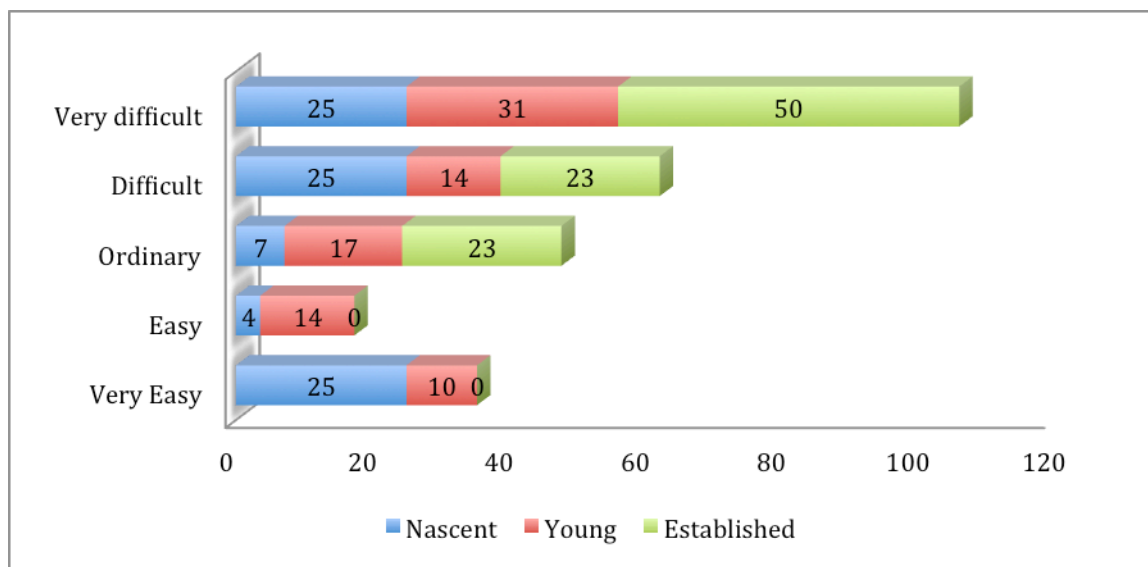
The impact of registering	Very Important	Somehow important	Not that important	Not important at all
Access to finance	70 percent	14 percent	15 percent	23 percent
Business security	67 percent	16 percent	20 percent	18 percent
Access to markets	74 percent	18 percent	16 percent	16 percent

A clear majority of answers seems to consider the positive impact of registration despite the reported difficulties and the rather high levels of informality that characterize the Egyptian economy. Such observations go along with the earlier indicated reasons for not registering that focused on the complexity and high cost together with the fear of being exposed to more corruption upon registration. Hence, it is safe to state that a majority of entrepreneurs may be willing to register their enterprises and may be quite aware of the positive outcome of registration but the laws and regulations and the way they are applied by the administration may deter them from doing so.

Contrasting the answers given by entrepreneurs according to their enterprise age can be very informative in showing how the registration process has developed over time. By classifying the sample of entrepreneurs by the age of the enterprises they own and manage, it becomes clear that a larger number of nascent and young enterprise-owners/managers report the registration process to have been easy as compared to those running established

enterprises older than ten years. A considerable 29 and 24 percent of nascent and young enterprises reported the process to be either “easy” or “very easy” while zero said so in the third category of entrepreneurs. Yet, another considerable percentage of nascent and young-enterprise owners/managers held the process to be either “difficult” or “very difficult” (50 and 45 percent, respectively) as opposed to a massive 73 percent of established firm entrepreneurs.

Figure (2.2): The difficulty of business registration by enterprise age as indicated by entrepreneurs (percentage of respondents)



The average number of agencies that each enterprise age group reported shows that the average is significantly lower for nascent firms (2.54 agencies) compared to young and established enterprises – four agencies for each. However, it should be taken into consideration that seven entrepreneurs running nascent enterprises reported that they hired lawyers/legal accountants to get the registration process done, which includes the agency they dealt with as one even though that does not indicate by any means the actual number of governmental agencies one has to deal with to get a business registered. However, hiring lawyers to go through the process is an indicator that the process is not easily accessible for entrepreneurs, indicating that the cost for hiring a lawyer/legal accountant is not particularly high.

The number of months reported by each enterprise age group confirms the earlier trend. Nascent enterprise owners/managers reported an average of 4.9 months to get their businesses registered. Young enterprise owners/managers reported an average of 5.44 months whereas established firm entrepreneurs reported a higher average of seven months. The figures suggest that the process has become progressively shorter on average for enterprises registering in the last three years compared to those in the last ten years and both compared to enterprises that are more than ten years old.

Given the high presence of young entrepreneurs among the ranks of owners and managers of nascent and young enterprises, it would be interesting to test whether there were any

generational changes in the perceptions and views of Egyptian entrepreneurs. The sample of entrepreneurs can be divided into two large groups on basis of age: the first is that of younger entrepreneurs between 20 and 40 years old while the second is of older entrepreneurs from 41 to over 60 years. Younger entrepreneurs report more positive views about the difficulty of the process of business registration. Approximately 28 percent of them said it was either “easy” or “very easy” in contrast to only two percent of the older entrepreneurs’ group. Fewer young entrepreneurs held the process to be either “difficult” or “very difficult” (44 percent) as compared to their older counterparts (70 percent). This indicates that the process of registration has become easier cross generationally. However, it should be taken into consideration that such positive views of the registration process are calculated from among the group of entrepreneurs who reported their businesses to have been registered. Conversely, a massive forty percent of younger entrepreneurs – from less than 20 to 40 years old – reported to have been operating in the informal sector with no business registration, in contrast to only 16 percent of their older counterparts. This shows that the process of registration has indeed become easier over time but for a segment of younger entrepreneurs and not to the general population.

These numbers can be taken as a clear indicator that the process of business registration has become relatively easier through time, at least for some entrepreneurs, if not, for all of them. Nascent and young enterprises are the ones that were registered between 2003 and 2013, which is the period that corresponds to the administrative, legal and regulatory reforms that were undertaken by the Nazif government (2004-2011). However, even though things seem to have eased up for some, the registration process remained difficult for a sizable percentage of entrepreneurs. Only in this light can we understand why 31 and 38 percent of the nascent and young enterprises reported that they did not register, suggesting that they operated their firms under the informal sector.

2.1.2 - Informality and entrepreneurship in Egypt

Enterprise informality is closely related to the process of business registration and licensing. There is some consensus in the literature that high barriers to entry lead to high levels of informality⁸. High levels of informality indicate generally weak rule of law and limited property rights protection.

As indicated earlier, 40 respondents (31 percent) reported to be operating non-registered businesses. By contrasting the profiles of formal and informal enterprises, many of the assumptions forwarded by the literature are proven⁹. Entrepreneurs operating in the

⁸ See for instance, Klapper, Amit and Guillen 2010; Johnson, Kaufmann and Zoido-Lobaton 1998, 1999; Friedman et al. 2000; Van Stel, Storey, Thurik 2007

⁹ The literature on Egypt has stressed the “high cost of formalization of small ventures that raises the barriers to entry into the formal sector together with the high operating costs — time consuming, burdensome and complex tax, unaffordable labor regulations, cumbersome property registration [and] formal loan applications” (Attia 2007:21). Al-Yahya and Airey (2008:15) reiterated “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 percent of micro-enterprises and SMEs operate in the informal market.” El Mahdi (2006:14) holds informality as “a case of no-acceptance of the ongoing complicated laws of becoming formal — licensing, registering the enterprises, social security, and

informal sector are generally younger than those in the formal sector. Almost 78 percent of informal entrepreneurs (31 out of 40 respondents) belong to the 21-40 age group whereas those operating in the formal market (52 percent) belong to same age group (21-40). Forty-seven percent are over 40. The contrast is as clear when it comes to educational attainment. For the informal sector, nine out of 40 (23 percent) reported that they had not received any formal education or had just received primary or preparatory education while 11 and 20 (28 percent and 50 percent, respectively) reported to have gone to high school or university. Conversely, those operating in the formal market generally reported higher levels of education: 70 percent were higher education graduates and 16 percent were graduates of high school.

The fact that those operating in the informal sector are often of a younger age and with lower educational attainment is evidence of the barriers to entry that these specific cohorts face. Thus, they are often forced to work in the informal sector. However, the percentage of informal entrepreneurs that reported to have received some higher education degree (50 percent) is quite substantial and shows that informality has become the refuge even for educated youth.

As expected, informal enterprises included in the sample were significantly smaller in size than formal ones, be it in terms of the number of hired workers or in terms of assets and turnover¹⁰. Within the sample, 36 out of 40 respondents (90 percent) of the informal enterprises included in the survey were owning/managing micro firms – hiring less than six workers – and the residual (10 percent) constituted small hiring between six and 50 workers. The calculated average of their reported assets and capital in current prices was L.E. 276,147 with the average annual turnover at L.E. 100, 204. Conversely, firm size tended to increase within the formal sector. Micro-firms constituted 48 percent; small and medium firms stood for 46 percent; and large firms hiring more than a hundred workers was at almost three percent of the total sample of formal enterprises. The same observation applies to total reported assets and annual turnover. The calculated average of assets and capital in current prices was L.E. 2,283,688 – approximately eight times the reported assets of the informal sector – while the average for annual turnover was L.E. 751,681 – approximately 7.5 times the figure reported by the informal entrepreneurs.

The above observations are in perfect conformity with the extant literature on the informal sector in Egypt as well as in the developing world in general. Informal activities are usually based in service and commercial sectors and require few assets. Moreover, they are usually micro enterprises with a limited number of workers involved, often relying on family members¹¹.

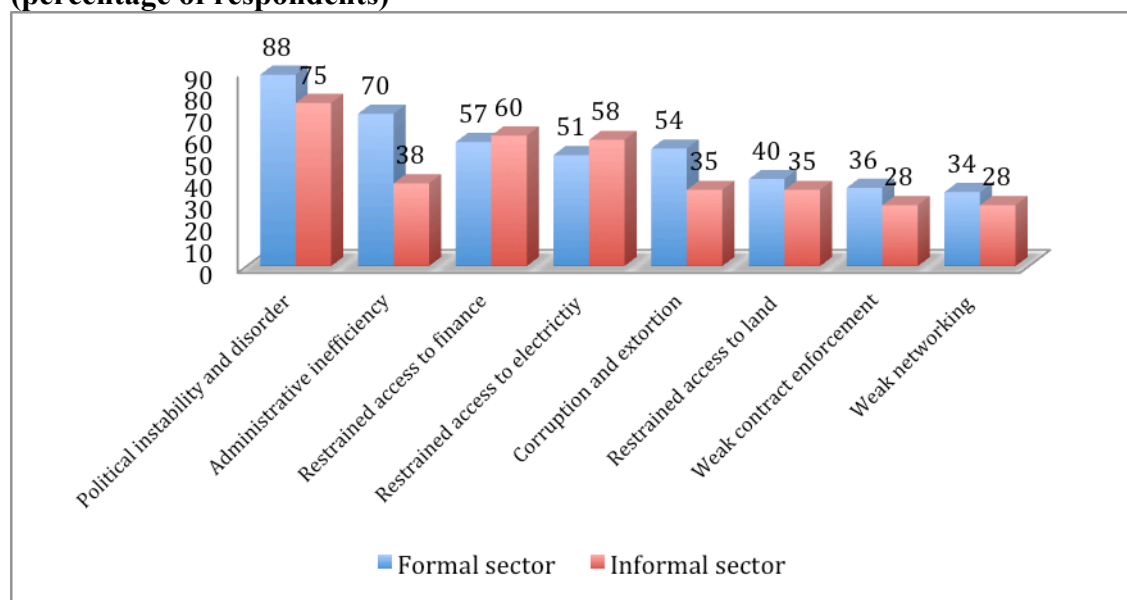
taxes amongst others – and therefore non-conforming by them, and simultaneously forgoing the chance of being able to use any benefits attached to formality.”

¹⁰ El Mahdi (2006:14) estimated that 81 percent of small and micro enterprises – less than 50 workers – are informal, given that they stand for more than 90 percent of all private sector enterprises.

¹¹ Schneider (2007:515) estimates the share of the informal sector in Egypt to be 40-60 percent. The same applies to the share of the informal sector in total employment. Of course, a great part of informality has to do with transactions rather than informal enterprises. However, informality as a socio-economic phenomenon is too big to ignore. The World Bank estimates that only about 10 percent of the total employment in Egypt is in

Some interesting results are obtained from contrasting the answers given by informal and formal entrepreneurs with regards to the principal barriers to growth that they experienced. Surprisingly, the figure below shows that the entrepreneurs in both sectors report similar obstacles. However, it seems that the formal sector respondents suffer more than their informal counterparts when it comes to the administrative inefficiency, political instability and exposure to extortion and corruption. This may sound counterintuitive, but it is actually not. Formal enterprises often deal more with government bodies than informal ones and this makes them more vulnerable to these problems. In fact, avoidance of these problems has been reported as a reason behind not registering in the first place.

Figure (2.3): Barriers to growth as indicated by informal and formal entrepreneurs (percentage of respondents)



Formal-sector entrepreneurs reported a higher level of discontent with administrative inefficiency as compared to their informal counterparts. This is fairly intuitive given that formal enterprises deal more often with government agencies unlike those in the informal sector. The same applies to the inaccessibility to land, which was reported at a much higher rate by formal-sector entrepreneurs than informal ones. This is likely the result of the fact that formal enterprises have more capital, and thus, need land to operate while informal enterprises are of smaller size and are significantly less capital and assets.

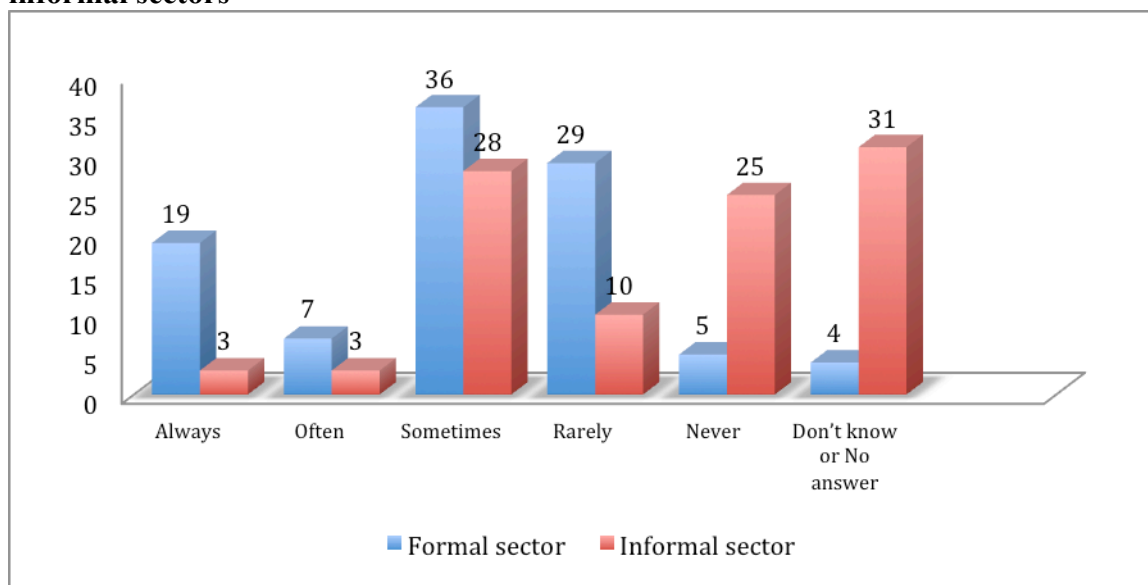
Contract enforcement came at the bottom of concerns expressed by both groups of entrepreneurs. However, contrasting the resort to formal contracts between the two sectors can be quite revealing in many ways. The figure below displays the frequency reported by

the formal private sector. The rest is distributed between the informal sector – over one third – and the agricultural sector – over a quarter (World Bank 2009:232). “Over 70 percent of all private sector wage workers are employed as informal workers” (World Bank 2009:233)¹¹.

respondents from the informal and formal sectors of resorting to formal contracts that may comprise many forms of official agreements such as bills and checks. As expected, formal sector-entrepreneurs often use more formal contracts in exacting their transactions compared to their counterparts in the informal sector. Eleven out of 40 informal entrepreneurs (28 percent) reported that they “sometimes” use formal contracts as opposed to 10 and 9 respondents (25 and 23 percent) who stated they “rarely” or “never” use them, respectively. As for the formal sector, one interesting observation is the low frequency of using formal contracts reported by formal sector: entrepreneurs. Only 19 percent of the formal sector-respondents indicated that they “always” use formal contracts as opposed to 36 percent and 29 percent who indicated that they do so “sometimes” and “rarely,” respectively.

The fact that many registered enterprises do not use formal contracts reveals that a great part of their transactions take place in the informal market despite their formal status. This supports Hernando De Soto’s observation of the formal and informal sectors as a continuum rather than two separate systems or spheres. Ashraf Al-Arabi – Egypt’s former head of the Tax Authority – did mention in the personal interview that many officially registered companies use informal outlets and subcontractors as a means to evade taxes. This is not to mention the high frequency of informal labor utilized by formally registered firms.

Figure (2.4): The frequency of resorting to formal contracts in the formal and informal sectors



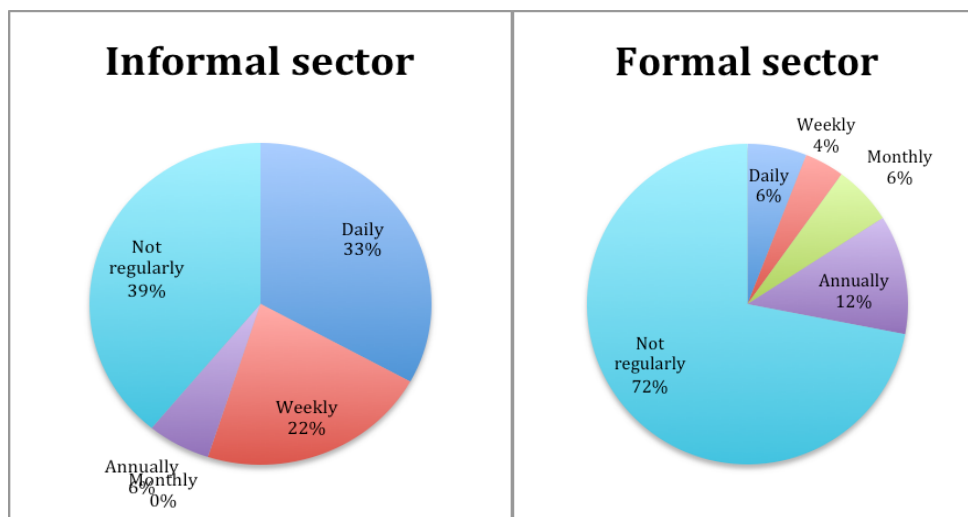
2.1.3- Informality and corruption

Another interesting contrast between the formal and informal sectors is their exposure to corruption and extortion. Fifty-six percent of the formal sector entrepreneurs stated that they were asked to pay bribes while only 45 percent (18 out of 40) of the informal sector entrepreneurs mentioned that. This observation is harmonious with the earlier remark that showed that the formal sector was more exposed to corruption than the informal one. Many

explanations can be brought up for this observation. To start with, informal sector enterprises are much smaller in size, turnover and capital and this may explain why they may not be as tempting as the bigger and wealthier companies in the formal sector. Another explanation is that most informal enterprises operate in small markets and have limited transactions, and thus, they are less vulnerable to dealing with the government as compared to formal ones that have to obtain and renew permits, licenses and whatnot. All in all, the responses obtained from entrepreneurs of both sectors suggest that extortion and bribery are big problems for all entrepreneurs¹².

Exposure to extortion may be crosscutting between formal and informal sectors of the Egyptian economy. However, the structure of informal payment does vary between the two sectors. The two pie charts below show the frequency of paying bribes as reported by respondents from the formal and informal sectors in Egypt. As expected, informal sector entrepreneurs pay bribes on daily and weekly basis whereas entrepreneurs in the formal sector tend to pay higher percentages on a monthly and annual basis. This can be explained in terms of the structure of transactions in each sector. In the informal sector, transactions are of a short-term nature and so is informal payment and the opposite is true with the formal sector. However, despite the reported figures that show that formal sector entrepreneurs are more exposed to extortion than their informal counterparts, it seems that informal ones have to pay bribes more regularly to keep their work going. This is shown in the figure below where formal sector entrepreneurs report more irregular instances of paying bribes compared to their informal counterparts.

Figure (2.5): The structure of informal payment in the formal and informal sectors (percentage of respondents)



¹² This observation resonates with Schneider's conclusions about informality and corruption. Schneider (2006:528) holds a strong relation between high levels of corruption and a higher presence of a shadow economy. Corruption can be a result of the weak institutional and regulatory frameworks that govern business activities in many developing countries, including Egypt. It may constitute itself a barrier to entry through raising the unofficial costs of registration and formalization.

2.2- Contract enforcement

Besides business registration, contract enforcement is one main pillar of the rule of law and property rights protection in any ecosystem. When asked whether formal contracts have a potentially positive impact on their business, 74 percent of the respondents answered in the affirmative. By formal contracts, the survey referred to all formal and registered agreements that may take the form of a contract, bill, check or any other form of registered and written transaction.

Though a high percentage of entrepreneurs expressed their favorable view for exacting formal transactions, a significantly lower percentage reported their opting for formal contracts. Only 14 percent of the respondents actually stated that they “always” use formal contracts in doing their business. Five percent said that they “often” do that. Conversely, 34 percent reported that they “sometimes” use formal contracts in comparison to 23 percent who “rarely” do that and 11 percent who never resort to them. The figures are quite revealing. They provide live evidence for the high percentage of informal transactions that are made through various means other than official, registered and written contract forms. The figure below depicts the ratios in a pie chart.

Figure (2.6): The frequency of resorting to formal contracts as reported by respondents



What may help explain the rather low frequency of using formal contracts in Egypt? The survey may provide an answer. Only 48 percent of the respondents expressed their belief that formal contracts are enforceable and can be defended in Egypt. This can be considered as a low percentage and a clear sign of the poor status of the rule of law where entrepreneurs may have contracts that do not practically provide them with enough protection. From among those who expressed the view that formal contracts are not enforceable in Egypt (52 percent of the respondents), 66 percent said that the legal procedures were too complex, costly and time-consuming. Similarly, 59 percent held that the problem was with the laws and regulations that they deemed deficient while 32 percent

expressed their distrust in the judiciary.

Around 34 percent of the respondents stated that contract enforcement was the principal barrier to growth that they faced. The problem of contract enforcement occupied the seventh and penultimate position on the long list of barriers to growth in Egypt. However, this should not be interpreted as a sign of satisfaction with the way contracts are enforced¹³. The low rank given by entrepreneurs to contract enforcement, as a barrier to growth, does not suggest either that it is no priority for them in Egypt. It rather indicates that many Egyptian entrepreneurs could survive weak contract enforcement and the poor status of the rule of law in general by bypassing the system altogether. This was clearly shown in the rather low frequency of resorting to formal contracts together with the generally high levels of informality in the Egyptian economy.

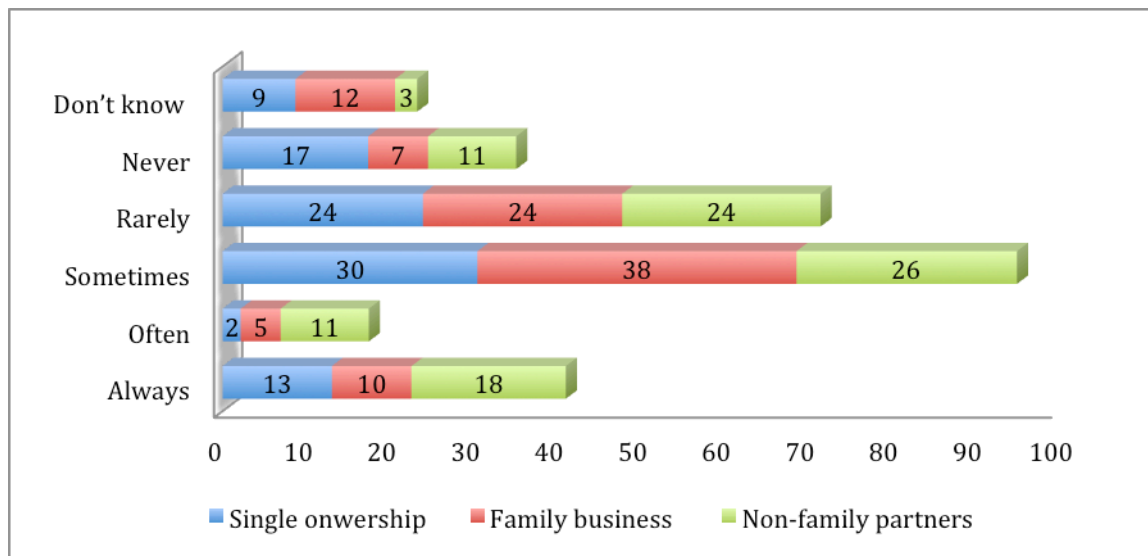
However, this does not mean at all that weak contract enforcement has no detrimental impact on the prospects of business growth and expansion and on its chances of accessing finance, capital and markets. As a matter of fact, it is quite plausible to link the weak status of contract enforcement and the inclination among entrepreneurs to avoid resorting to them with the stifled growth of micro and small enterprises that constitute the majority of privately owned firms. In the absence of robust structures that could enforce contracts between parties, the transaction cost is likely to be quite high due to the high risk attached to the contract. In such an ecosystem, transactions remain confined to narrow circles of trust or remain short-term with small values and operational only in cash. These are all characteristics of a micro-and small-sized – often-informal – private sector that has little opportunity for growth.

2.2.1- Contract enforcement and ownership structure

Though resorting to formal contracts is relatively low across the board in Egypt, it is interesting to contrast this aspect according to the ownership structure. As expected, non-family partnership entrepreneurs reported more resort to formal contracts in exacting their transactions than family-business and single-owner entrepreneurs. The figure below depicts the percentage reported by each group and the frequency of resorting to formal contracts of different kinds. Non-family partnership entrepreneurs report a significantly higher, albeit low in absolute terms, frequency of “always” or “often” resorting to formal contracts than the two other categories. This may be explained in terms of the need of this type of entrepreneurs to do business outside of closed family circles that are usually of high informal trust. At the same time the business operated by non-family partners is usually larger than that of single-owner entrepreneurs who can confine their business to a closed circle of trust-worthy associates or to short-term transactions. One must consider as well that single-owners report the lowest resort to formal contracts due to the disproportionately high representation of informal businesses in that category.

¹³ According to a USAID report (2008:20) “The time to enforce a contract is also exceptionally high — nearly three years (1,010 days) — relative to the time required in Jordan (689 days) and Turkey (420 days).” The report concluded, “Slow contract enforcement decreases confidence in the rule of law.”

Figure (2.7): The frequency of resorting to formal contracts by ownership structure as reported by entrepreneurs (percentage of respondents)

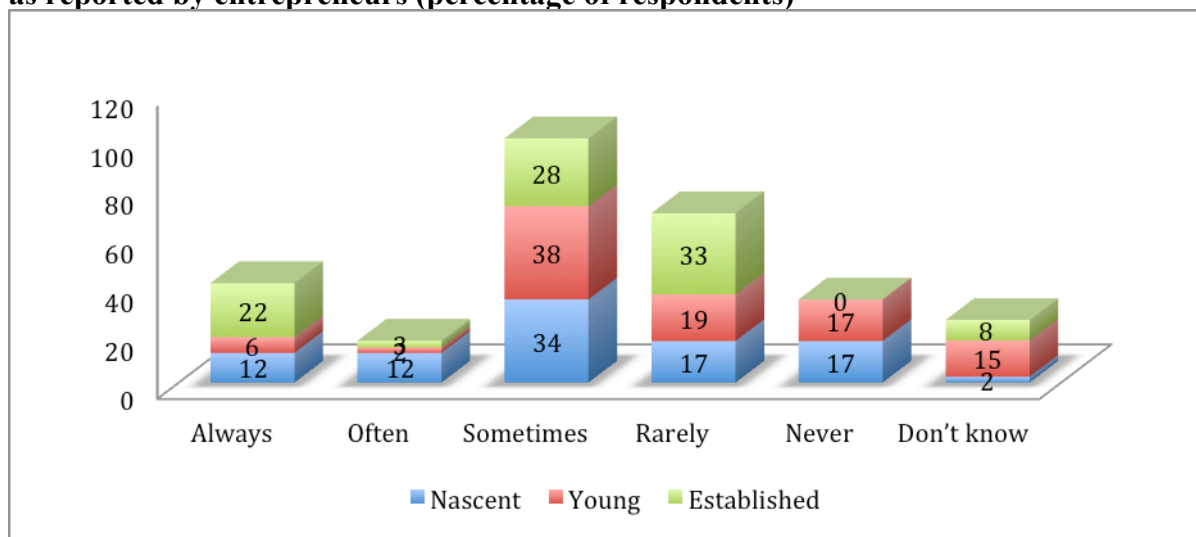


Hence, non-family partnership entrepreneurs have to rely on formal contracts to conduct their business than other ownership structures. However, this need does not mean that they are satisfied with the system of contract enforcement by any means. As a matter of fact, it seems that the more entrepreneurs resort to formal contracts as they become more inclined to express dissatisfaction with this the legal system. Whereas 72 percent of single-ownership entrepreneurs and 79 percent of family-business entrepreneurs expressed the belief that resorting to formal contracts has a positive impact on their business, only 66 percent of non-family partnership entrepreneurs held that belief. Of course, these figures represent the perceptions and convictions of different entrepreneurial categories. They do not necessarily reflect their actual experience. As earlier data has shown, many entrepreneurs may hold that formal contracts are good for their business, but in action they seldom resort to them due to many reasons related to their inflexibility, cost and fear of extortion.

However, the earlier trend is present in experience as well. Only 34 percent of non-family partnership entrepreneurs said that one could defend a contract in Egypt, which can be considered a significantly lower percentage than the overall average of the sample (48 percent). The figures for family-business and single-owner entrepreneurs were slightly above the average at 55 and 52 percent, respectively.

2.2.2- Contract enforcement and enterprise age

Figure (2.8): The frequency of resorting to formal contracts by enterprise age group as reported by entrepreneurs (percentage of respondents)



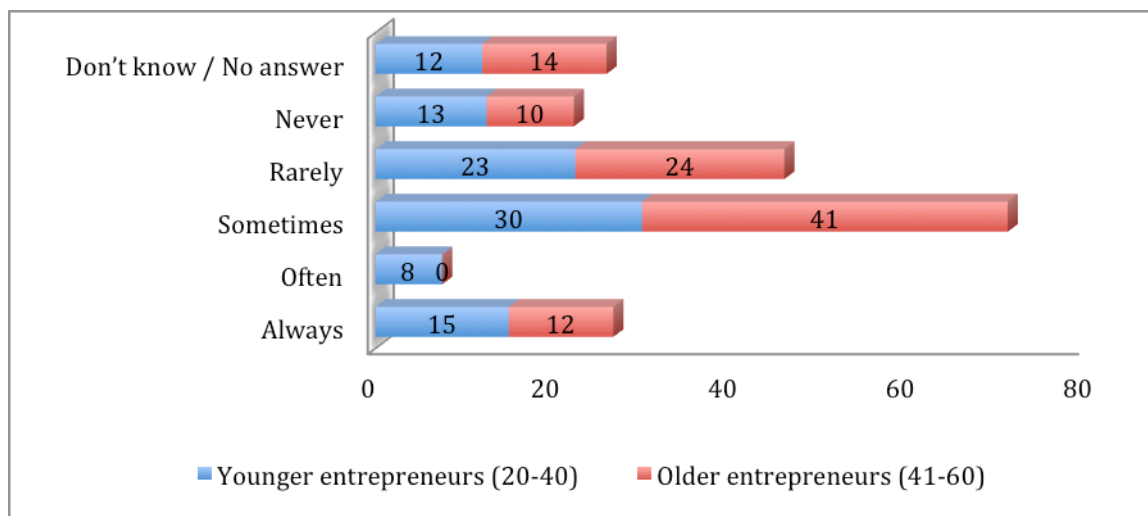
Does the resort to formal contracts differ across enterprise and entrepreneurs' generations? Is the Egyptian economy heading towards more formality in economic transactions? Interestingly enough, the answers provided by surveyed entrepreneurs suggest that the resort to formal contracts is evenly distributed between different firm generations. Fifty-eight percent of nascent enterprise owners/managers indicated that they use formal contracts in one way or the other. It was 53 percent for established enterprises and 47 percent for young enterprises. The figures of those who reported to have "never" or "rarely" used formal contracts were 34, 36 and 33 percent for nascent, young and established enterprises, respectively. In general, the figures indicated that formal contracts are a bit higher than half of the total sample of entrepreneurs while those who "always" or "often" use formal contracts are general below one quarter of the entrepreneurs of the three firm age categories.

All these results indicate that the tendency towards informality among Egyptian enterprises and entrepreneurs is constant. As a matter of fact, younger enterprises seem less appreciative of formal contracts than older ones. Fifty-nine percent of nascent enterprise owners/managers expressed the belief that formal contracts have a positive impact on their business. The percentage was 79 and 86 percent for young and established enterprises, respectively. Moreover, only 32 percent of nascent enterprise owners/managers expressed the conviction that they can defend a contract in Egypt. The percentage was 47 and 64 percent for young and established enterprise owners/managers, respectively. The figures indicate a declining trust by new market entrants in terms of contract enforcement and its value altogether.

A closer look can be obtained by contrasting the views provided by different age groups of entrepreneurs. Younger entrepreneurs – those less than 40 years old – reported a higher frequency of resorting to formal contract while exacting their transactions. Around 23

percent of them reported to have “always” or “often” used formal contracts as opposed only to 12 percent amongst their older counterparts – those over 41 years old. However, when all three categories of “always,” “often” and “sometimes” are added together to indicate the overall frequency of resorting to formal contracts, the figure would amount to 53 percent for both groups. Similarly, the numbers of entrepreneurs belonging to both groups who have reported to have “never” or “rarely” resorted to formal contacts is quite close at 33 and 35 percent for younger and older entrepreneurs, respectively.

Figure (2.9): The frequency of resorting to formal contracts by entrepreneurs’ age group as reported by entrepreneurs (percentage of respondents)



Like the results obtained on enterprise age, Egyptian entrepreneurs show some constancy in their resort to formal contracts while conducting business. The percentage of those who “always” or “often” use them is below a quarter and of those who report any frequency of resorting to formal contracts is a bit above 50 percent in both age groups. Moreover, younger entrepreneurs actually reported less confidence in the formal system of contract enforcement than their older counterparts. Only 70 percent of the younger entrepreneurs expressed the belief that formal contracts can be beneficial for their business as opposed to 80 percent of the older age group. Additionally, only 43 percent of the younger ones believed that contracts are defendable in Egypt in contrast to 57 percent of their older counterparts.

2.3- Competition

Unfair competition can be a key barrier to entry as well as to growth. It may be a sign of the uneven distribution of property rights as well where certain market actors predate on the property rights of others, be they competitors, consumers or suppliers. Weak competition protection and monopolistic or oligopolistic practices also indicate a weak regulatory capacity by the state.

Forty percent of the respondents said that they face unfair competition, such as price fixing; monopolistic practices; and the control of supplies and inputs needed for production.

Moreover, 56 percent of those who expressed this view held that these practices had a negative impact on their growth opportunities. The figures are relatively high and indicate that the markets in Egypt suffer from various practices that limit free competition, and thus, curtail the chances of many entrepreneurs to grow and access markets.

When asked about the reasons behind such unfair competition, 79 percent of the respondents “completely agreed” with the statement that laws and regulations in the field of competition were deficient and suffered from major flaws. However, another significant percentage (71 percent) stated that the problem was more with the implementation and enforceability of laws and regulations than with the laws themselves. Seventy-three percent of the respondents “completely agreed” that state officials are biased to certain firms and businessmen. The general views tend to hold that the laws are either too weak or are not enforced and that the state is biased to certain economic actors at the expense of others. The table below depicts the answers.

Table (2.6) Views on the factors contributing to unfair competition

	Completely agree	Agree	Disagree	Completely disagree	Do not know
Laws and regulations are deficient and suffer from major flaws	79 percent	44 percent	4 percent	2 percent	8 percent
State officials are biased to certain businessmen	73 percent	35 percent	4 percent	12 percent	13 percent
Laws and regulations are good but the problem is with their application and enforcement	71 percent	38 percent	10 percent	2 percent	10 percent

The answers are quite revealing for they show that free competition is a main concern for a large percentage of entrepreneurs in Egypt. It is noteworthy that such views were expressed by a majority of micro and small enterprises that usually operate in small segments of the market and seem to suffer from price fixing and the monopolistic control of the factors of production as well as of the product markets.

The views expressed by the entrepreneurs resonate with earlier studies on competition in the Egyptian market. Egyptian economic sectors are either overregulated in favor of state-owned monopolies that simply shun private actors from competition or are unregulated in a

way that makes some actors exploit the asymmetries of power and information to predate on their competitors¹⁴.

2.4- Barriers to exit (bankruptcy and asset recovery)

Entrepreneurship is risky by definition and a considerable ratio of market entrants fail to survive and they are often forced to terminate their activity. Hence, the way bankruptcy and asset recovery are organized in practice is of extreme importance for the overall entrepreneurship ecosystem. Bankruptcy and asset recovery are intimately related to the areas of contract enforcement, the rule of law and property rights protection. Moreover, they are closely tied to the question of the access to finance and the risk that creditors have to bear to extend money to entrepreneurs.

Twenty-seven percent (35 respondents) of the total number of respondents reported that they started and terminated some kind of economic enterprise, pulling out of the market. However, only six percent from this category reported to have resorted to formal bankruptcy regulations as organized by the law. For the rest who did not resort to the bankruptcy law (89 percent), 37 percent said that the problem was that the law criminalizes insolvency and penalizes failure and 66 percent expressed the views that bankruptcy regulations were too expensive, complex and time-consuming. Meanwhile, 60 percent of the respondents held that the formal bankruptcy procedures made the restart of a new economic activity very difficult.

The above figures suggest that market exit is informally managed in Egypt. Entrepreneurs seldom resort to the extant law and regulations, and they do not often resort to state agencies with regards to asset recovery. This may definitely help in explaining the reported restraints on the access to credit as many institutions shy away from extending credit to enterprises knowing the mild chances of asset recovery upon business failure. This may explain as well the reported discontent by entrepreneurs due to the high collateral and guarantee requirements by banks, funds and associations. Moreover, the fact that bankruptcy and asset recovery often happen informally with no state intervention and outside of the law may suggest that entrepreneurs conduct their business within narrow circles of trustworthy people in the same vicinity or on a family-basis.

The figures indicated in the survey are in harmony with earlier studies and reports on the issue of bankruptcy and asset recovery in Egypt. According to GEM (2008: 21; 2010:34), Egypt shows low discontinuance rates. Only 3.8 percent of the Egyptian adult population that owned an enterprise was no longer active, of which 1.3 percent quit their work and 2.5

¹⁴ The results given by the survey are in harmony with earlier reports and studies. They hold monopolistic and oligopolistic practices as deeply enmeshed in authoritarian regime dynamics and the overall quality of governance. The GEDI report (2012:21) emphasized the general weakness of competition in the Middle East. Along the same lines, the GEM report on Egypt (2010:47) held the view that the anti-trust legislation – which breaks up existing monopolies and prevents the formation of new monopolies in order to increase competition and societal welfare – is ineffective and not well enforced in Egypt, thus, creating entry barriers to the new and growing firms which are unfairly blocked by the established firms. They also believe that new and growing firms in Egypt cannot easily enter new markets and that the cost of market entry is high.

reported closure. The low figures of enterprise churning indicate low entrepreneurial dynamism and less efficiency. The World Bank (2009:120) reported “the process of entry and exit of firms in MENA countries is less dynamic than in the transition countries of Eastern Europe.” However, the low rate of reported exit may not reflect the actual number of those who go out of business without going through the bankruptcy and foreclosure procedures, especially that less than 10 percent in the survey reported their resort to formal bankruptcy regulations, which suggests that the vast majority of entrepreneurs who exit the market do it informally.

Egyptian entrepreneurs shy away from opting to formal bankruptcy regulations due to their high cost and time-consumption. A World Bank report (2007: 43) holds that closing a business is more difficult in the Middle East than in many other regions, and the rate of recovery is lower. On average it takes three years to close a business, and the recovery rate on initial capital is 30 percent, compared to 75 percent asset recovery and 1.5 years in OECD countries; 30 percent and 2.5 years in Latin America; and 20 percent and four years in South Asia.

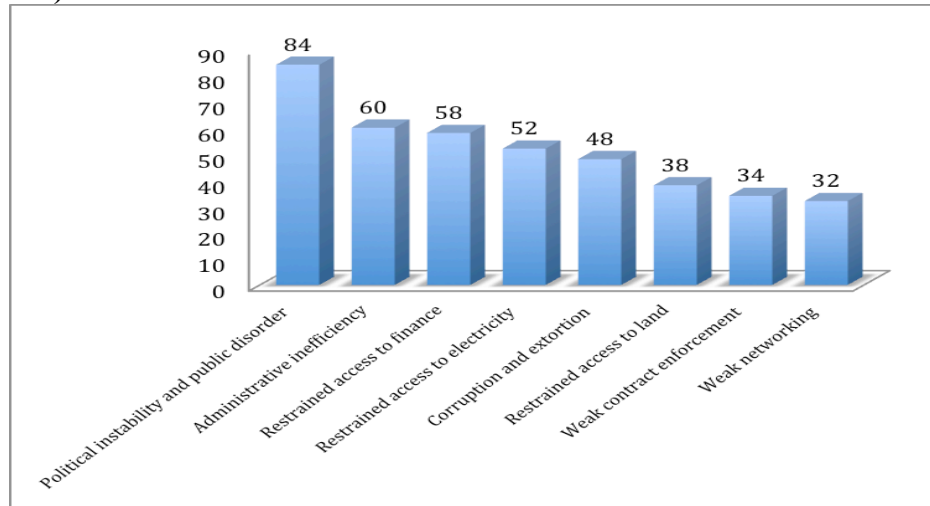
Little reform has happened in the bankruptcy system in Egypt (World Bank 2008, 2009; USAID 2008 and Stevenson 2011). The law focuses on personal bankruptcy, as opposed to corporate bankruptcy. Moreover, the rules rely on liquidation and fail to provide any regulation for reorganization, and the process is multi-layered, complex, and time-consuming. The court plays a very active role in supervising and approving all aspects of the process, leading to further delays. The eventual outcome, which is the sale of the debtor’s assets via public auction, results in very low proceeds. Internationally, Egypt compares unfavorably in terms of the time it takes at more than six years, the cost at more than 25 percent of the estate, and the recovery rate at less than 20 percent. Altogether, Egypt is ranked 106th globally in these dimensions (World Bank 2008:xxix). The report concludes with the need for changing “the entire system of bankruptcy rules.”

3-Financial subsystem: barriers to growth and entrepreneurship in Egypt

In the introductory section, three main components of the entrepreneurship ecosystem were outlined. The first component is the property rights regime with all of its legal, regulatory and institutional underpinnings. The second is the financial subsystem. And the third component is a residual category of all the non-financial factors that impact entrepreneurship. The evaluation of the financial and non-financial components of the entrepreneurship ecosystem is tackled in the survey by asking the respondents about the principal barriers to growth they experienced.

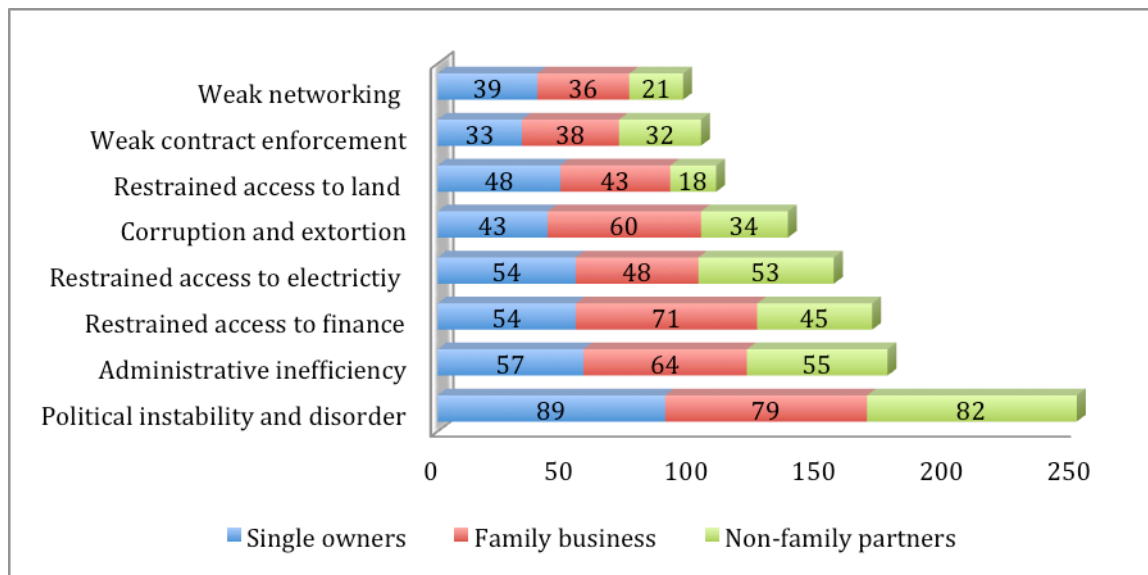
Eight-four percent of the respondents mentioned that political instability and public disorder are the main barriers to economic growth. There are good reasons to think of this answer in the context of the ongoing turmoil in Egypt since the breakout of the January revolution in 2011. Next to this factor, 60 percent underlined administrative inefficiency and the weak capacity to get things done. Restrained access to finance and to electricity came third and fourth, scoring 58 percent and 53 percent, respectively. Corruption came in fifth position indicated by 48 percent of the respondents.

Figure (2.10): Barriers to growth as indicated by entrepreneurs (percentage of respondents)



Corruption is not evenly distributed among all groups of entrepreneurs. Contrasting the answers given by owners/managers of micro-enterprises who own less than six workers with those of small enterprises employing between 6 and 50 workers, it shows that the latter (58 percent) reported to be more exposed to corruption than the former (48 percent). Even though the numbers are significant in both categories, the difference is rather substantial and it suggests some Russian trait in the Egyptian entrepreneurship story where relatively larger firms are more exposed to extortion and predation than smaller ones. Such a finding can be quite serious for it may provide an incentive for many entrepreneurs not to scale up and to keep their businesses small so not to be visible for state-predators. Moreover, if such a finding is contrasted with earlier findings that indicated that informal enterprises are less exposed to corruption and extortion compared to formal ones, this finding becomes confirmed. Remaining small and informal may indeed seem like a good strategy for many entrepreneurs. This may also explain the missing middle syndrome where micro and small firms never get to grow past their original size.

Figure (2.11): Barriers to growth by ownership structure as indicated by entrepreneurs (percentage of respondents)



Contrasting respondent entrepreneurs by their enterprise ownership structure provides some useful and interesting insights. Whereas all kinds of entrepreneurs hold that political instability and disorder was the top barrier to growth that they witnessed, family-businesses were the least affected. This can be attributed to the family safety net that is not available for non-family partnerships or single-owned enterprises.

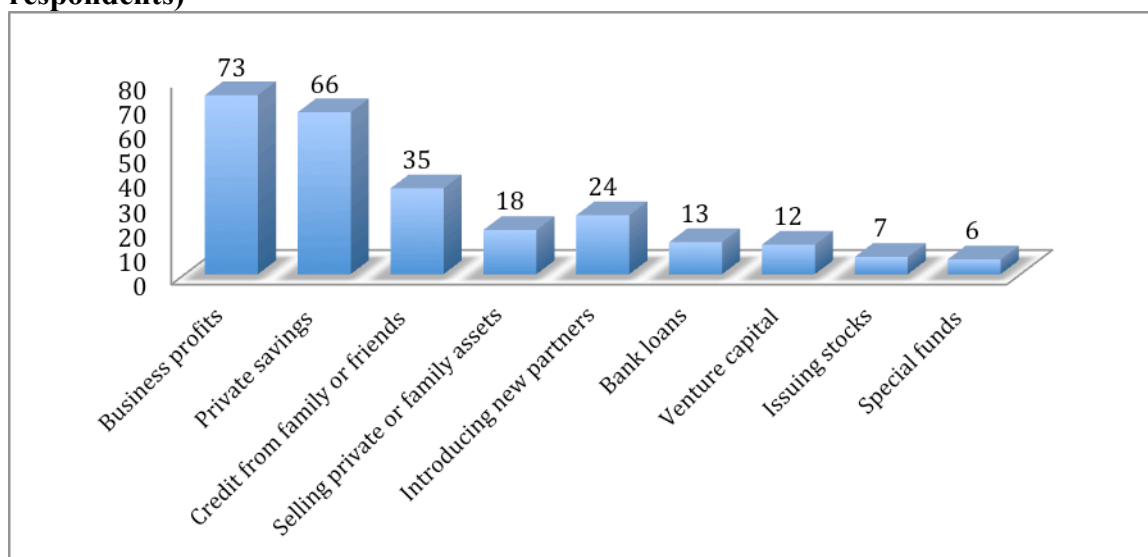
Conversely, family-business entrepreneurs had the highest percentage of respondents who chose administrative efficiency at 64 percent compared to single-owners at 54 percent and non-family partners at 45 percent. This can be explained in the light of the higher presence of formal (registered) firms in that ownership category, which forces them to deal more often with the bureaucracy.

Another interesting finding as well is that access to finance was the largest problem for family-business entrepreneurs (71 percent) as compared to the two other categories, especially non-family partnership entrepreneurs (45 percent). Family-businesses may have more access to family networks than to formal institutions. Finally, the answers given about weak networking as an obstacle to growth is revealing. Only 21 percent of the non-family partnership entrepreneurs held it to be a problem in contrast to 39 and 36 percent for single-owners and family businesses, respectively. This may be explained in terms of the better access non-family partners have to wider networks that are not confined to family circles. Single-owners should be the ones that feel the problem the most for they typically lack the access to family as well as non-family networks.

3.1- Access to finance and its discontents in Egypt

Restrained access to finance has been reported by the respondents to be the third top barrier to growth that they experienced. Almost 58 percent of the entrepreneurs stated that access to finance was a principal problem. Indeed, access to finance has for long been one of the main problems that nascent as well as established entrepreneurs faced in Egypt. According to the survey, the top three sources of finance that entrepreneurs reported were business profits (73 percent), private savings (66 percent) and credit from family and friends (35 percent). All three forms are informal and based on self or family financing. The figure below depicts various sources of finance as reported by entrepreneurs. Bank loans; special funds targeting MSMEs and young entrepreneurs; venture capital; and issuance of stocks came at the end of the list. Only 13 percent reported to have resorted to bank loans followed by 6 percent for special funds; 12 percent for venture capital; and 7 percent for stocks.

Figure (2.12): Sources of finance as reported by respondents (percentage of respondents)



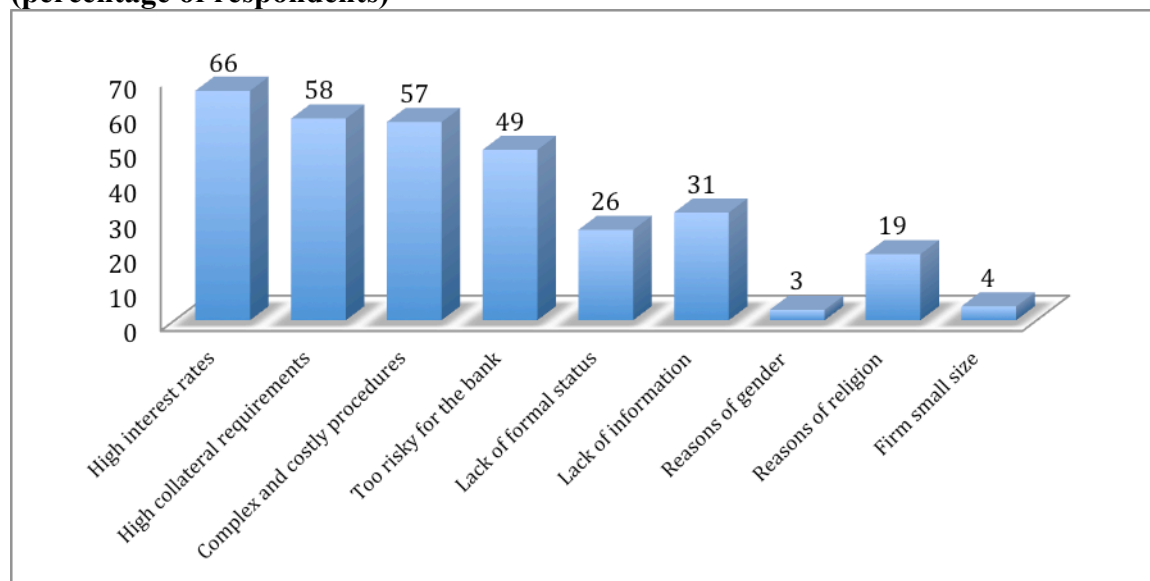
The above chart exhibits clearly that most entrepreneurs depend on some sort of self-financing, mainly on the profits generated by the business itself together with their private savings. The principal institutional channels that should provide debt or equity do not seem to function to the vast majority of entrepreneurs and the broader base of the Egyptian private sector.

Thirty-seven percent of the respondents said that they applied for a bank loan. Among those who applied for loans, 42 percent reported the actual receipt of credit. For the remainder of entrepreneurs, they expressed various reasons for not soliciting bank loans: the interest rates were too high (66 percent); the required collateral and guarantees were too high (58 percent); and the procedures were complex, costly and time-consuming (57 percent). The fourth factor was that the bank viewed the enterprise as too risky to be financed (49 percent). This is quite relevant for nascent entrepreneurs; micro and small

enterprises; and of course, informal activities.

A question was included in the survey about the entrepreneurs' experience with special funds such the Social Development Fund and other programs specialized in financing SMEs and new market entrants. Thirty-four percent of the respondents reported to have applied for loans from special funds. Seventy-three percent of those who applied reported having received the loans they applied for. Those who received the loans were asked about their experience whether it was satisfactory or not on a scale from 1 to 5 where 1 indicated the least level of satisfaction and 5 indicated the highest. The average answers of 34 respondents out of a total of 38 who reported to have resorted to this kind of financing were 3.09 for interest rates; 2.65 for the complexity of procedures and conditions; 2.7 for the exposure to extortion and corruption; and 2.7 for loan maturity. The levels of satisfaction expressed were relatively low¹⁵.

Figure (2.13): Reasons for not securing bank loans as reported by respondents (percentage of respondents)



Finance at the start-up phase constitutes a very critical link between access to finance and entrepreneurship. A massive 94 percent of the respondents reported to have relied on private savings followed by 50 percent and 30 percent who depended on funds from family and friends, respectively. Banks and associations provided credit for merely 17 percent of

¹⁵ Special funds and programs were established in order to overcome the problems that nascent enterprises and MSMEs face upon seeking credit from banks. However, the creation of parallel channels to meet the credit demands of the vast majority of entrepreneurs and enterprises does not seem to have worked out well. Some scholars have estimated that only 10 percent of the credit demands of MSMEs are being met by the financial system in Egypt (Roll 2013:556). The extremely high dependence on private savings, family financing and profits as reported by the respondents support that evidence. The former Central Bank governor agreed with the importance of mainstreaming credit supply for the broader base of private enterprises, which implies the need for large reforms in the banking sector.

the respondents. The situation becomes even graver if the average share of each source of finance is considered as reported by the respondent entrepreneurs. Private savings stood for 63 percent while credit extended by institutions did not exceed five percent of the average start-up capital. Such figures imply that banks hardly extend any credit at the start-up phase. Thus, entrepreneurs are left to themselves and to their narrow circles of family and friends to secure their start-up capital.

Table (2.7) Sources of finance at the start-up phase as reported by entrepreneurs (percentage of respondents)

Source of finance	Average percentage reported by respondents	Percentage of respondents using each source of finance
Private savings	63 percent	94 percent
Funds from family	17 percent	50 percent
Funds from friends	10 percent	30 percent
Credit from banks or associations	5 percent	17 percent
Other	5 percent	7 percent

3.1.1- What about non-traditional sources of finance?

Only 13 and seven percent of the surveyed entrepreneurs reported resort to venture capital and issuance of stocks, respectively. Not surprisingly, the share of non-traditional sources of finance was humble. After almost two decades of trials to develop non-banking means to finance entrepreneurs, little has changed overall. Non-traditional finance remains limited to a few sectors and with little impact on the overall picture in Egypt.

Based on the interviews the author conducted on the field in Egypt, several young entrepreneurs expressed reservations on how venture capital or angel investors work in Egypt, as the two main examples of non-traditional sources of finance. Dalia El-Said – an officer in a start-up supporting company – said that most non-traditional sources of finance are confined to high-tech sectors. They rarely direct any investment – or show interest – in working in traditional sectors such as industry, tourism or agriculture even though they constitute the largest portion of the economy. Abdelrahman Wahba – a young entrepreneur who started his own company in 2010 – confirmed Dalia’s point. He added that the concept of *angel investing* is new beyond the comprehension for many people and that such opportunities are quite limited.

Another entrepreneur, Mai Medhat, who established a company two years ago with two partners in the high-tech sector also, stated that they had to depend on their personal savings to start their business. They are considering seeking an angel investor in the future. Mai said that sometimes investors won’t finance an enterprise unless it has proven to be functional and that is why Mai and her partners were investing their own money first in the hopes of attracting funds after they create a solid client base.

However, though non-traditional means of finance seem to be limited to a few sectors and an enclave of entrepreneurs, this does not by any means overrule its future potential given the problems with the banking sector. As a matter of fact, there is some evidence that non-traditional finance, especially in the form of venture capital and angel investment, has witnessed some considerable expansion since 2011. Several interviewees – all young entrepreneurs operating in high-technology sectors – reported that some extensive networks of start-ups, venture capital, incubators and accelerators, angel investors, competition rounds and exhibitions have been developing in the recent years in an unprecedented way. These networks provide the fluid circulation of informal as well as financial, social and human capital at the start-up phase. Some of these networks are organic, based on young university-graduates – primarily engineering and computer science – while others have assumed a more institutionalized character through venture capital firms, incubators and exhibitions. Even though it is a bit too early to pass any judgment about the impact of such recent expansion, it should not be the case.

At the heart of the unfolding story is a venture capital firm called Sawari Ventures, which was established in 2010. Sawari Ventures is an international venture capital firm that invests in start-ups in the Middle East and North Africa. In September 2011, Sawari established an incubator called Flat6labs, which has become the “center of this bubble” according to one interviewee. Moataz Soliman – a young entrepreneur who established his company in 2012 – said that Flat6labs provided him with a wide-range of services beyond the credit forwarded by Sawari Venture – all deemed crucial at the start-up phase. These services included assistance with registration, mentorship and training in finances and industry-specific issues. IT industry developers conducted the training sessions, passing their experience in the field.

Some evidence suggests that the recent expansion in venture capital has been related to some transnational networks. To start, the founders of Sawari Ventures itself came from a strong background in international finance. There seems to be some conscious copying of successful global experiences. Moreover, there seems to be strong linkages between the recently-developed networks of entrepreneurs, incubators and financiers in Egypt as well as in other Arab countries – such as Jordan and the Silicon Valley – with companies owned by Arab expatriates. Sawari Ventures and its incubator Flat6labs provided the networking for start-ups to access finance and training outside of the immediate Egyptian market. There is evidence that these expatriates are trying to copy – or at least benefit – from the examples set by their Indian counterparts based in Silicon Valley.

One interesting thing is that this expansion in venture capital-related networks occurred following the revolution. Given the synchronization – or coincidence as some would claim – some of the respondents found some association between the two while others did not. Moataz found no link whatsoever. He expressed the belief that this was a rather incremental change that started some years before the revolution and was not confined by any means to Egypt.

Conversely, Ossama Hassanein – an Egyptian entrepreneur based in the Silicon Valley and the owner of an active company in the field of angel investment – found some association between the virtual absence of state institutions in Egypt following the revolution and the

expansion of private initiatives. The state has been an active actor in the support of the technology industry since the early 2000s. This has taken many forms ranging from the investment in infrastructure to the encouragement of multinationals to invest in Egypt's burgeoning sector and the great expansion in communications and computer science departments and faculties in Egyptian universities. Hassanein held that the extensive involvement of the state was a disincentive for private initiatives. However, following the revolution, there was need for non-state efforts and there were resources for that.

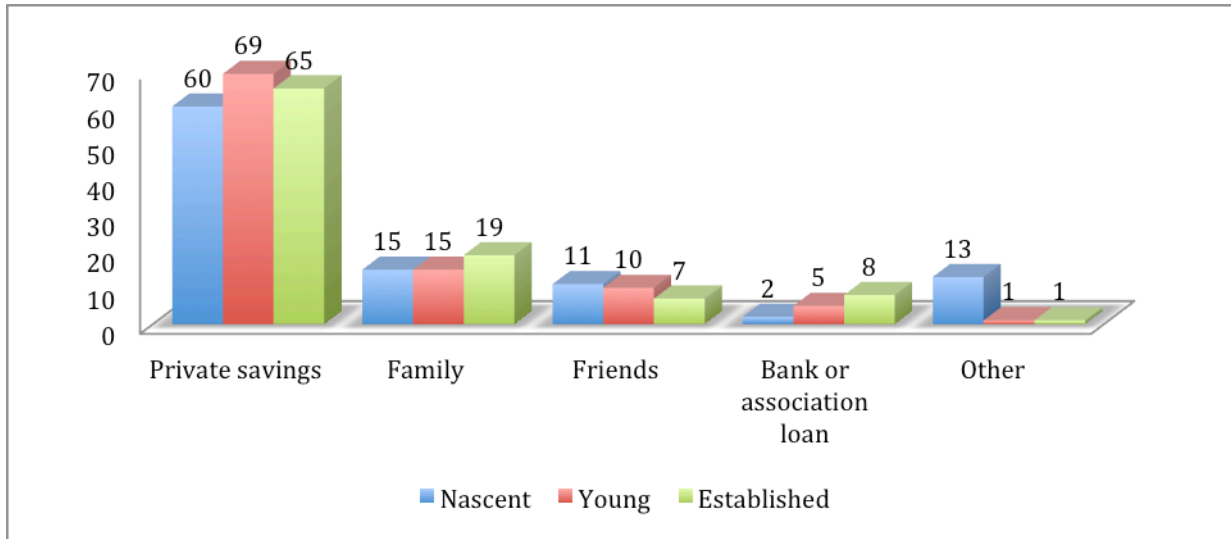
Why did this recent expansion in venture capital and angel investment happen? Answering this question is beyond the direct scope of this report. However, it is worth investigating separately together with a number of other questions related to non-traditional means of finance and the networks that are attached to them: How is such a recent expansion related to the incremental investment by the state and private sector in the technologies industry since the late 1990s? And how can such seemingly successful a case be expanded to other non-high technology sectors that represent the mainstream economic activities in a factor-driven economy like that of Egypt?

3.1.2- Access to finance and enterprises age groups: Has anything changed?

The figure below depicts a picture of the sources of start-up capital in time by examining the three subcategories: nascent enterprises – those less than three of age, young enterprises – those between three and ten, and established firms – those more than ten years of age. Entrepreneurs were asked to report the sources of their start-up capital at the time they initiated their business. Interestingly enough, the three enterprise-age groups indicated similar trends suggesting that little has changed over almost two decades in Egypt. Private savings remained the predominant source of new businesses followed by love money from family and friends. The differences are not significant. Credit furnished by banks or associations was meager for the three groups and it was actually higher for the oldest category of enterprises – eight percent of the total start-up reported by established enterprises – as compared to nascent and young enterprises.

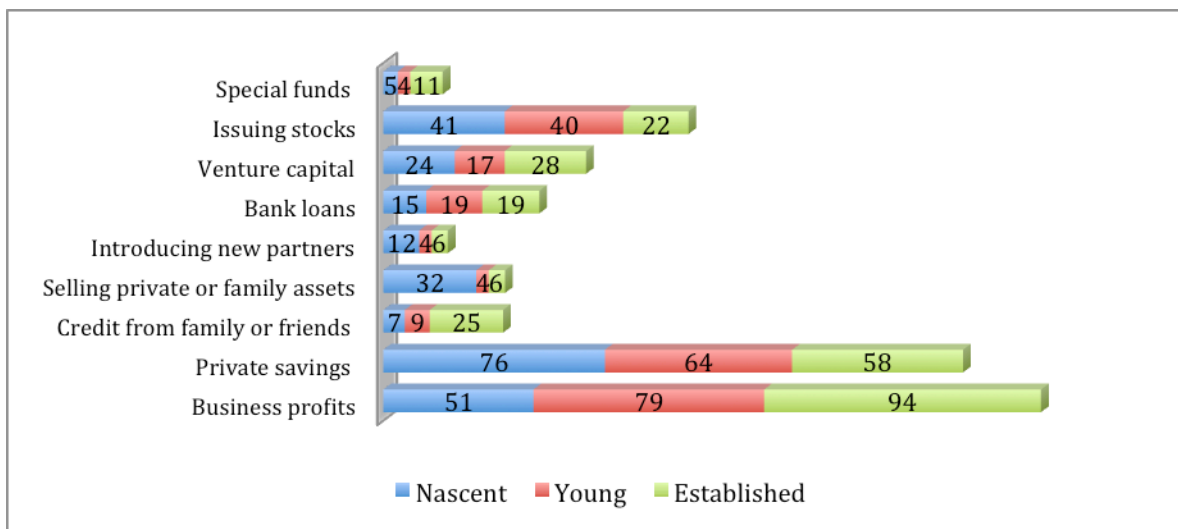
All these figures suggest that the financial subsystem has been quite hostile to entrepreneurs and new market entrants. It also suggests that most resources spring from personal and family circles at initial stages. They indicate the lack of financial mediators who would provide credit or equity based on new ideas or new ventures.

Figure (2.14): Sources of finance at the start-up phase by enterprise age group as reported by entrepreneurs (percentage of respondents)



Interestingly, nascent enterprises reported a considerably higher percentage of non-traditional sources of finance, mainly from venture capital and other forms of investment finance – 13 percent versus one percent for the other two groups. Such reporting indicates the unusual expansion of non-traditional sources of finance in the recent years, which may suggest that some change is underway. This will be discussed at more length in the coming sections.

Figure (2.15): Sources of finance by enterprise age as indicated by entrepreneurs (percentage of respondents)



The figure above shows many intuitive results and some counterintuitive ones as well. It is logical that established enterprises depend more on their business profits than young and nascent enterprises because of their longer presence, and thus, more stable business

operations and turnover. It makes sense, too, that private savings be reported by a larger number of nascent enterprise owners/managers (76 percent) than young and established enterprise owners/managers (64 and 58, respectively). This is true because nascent entrepreneurs have a shorter time in business, and thus, are still dependent on their private savings as well as liquidation of private and family assets to finance their start-ups. However, the figures indicated by all three groups indicate that self-financing via profits or private savings is crosscutting and that the difference is just in degree. It is easier for nascent enterprises to have new partners introduced as a means to finding finances than more established firms.

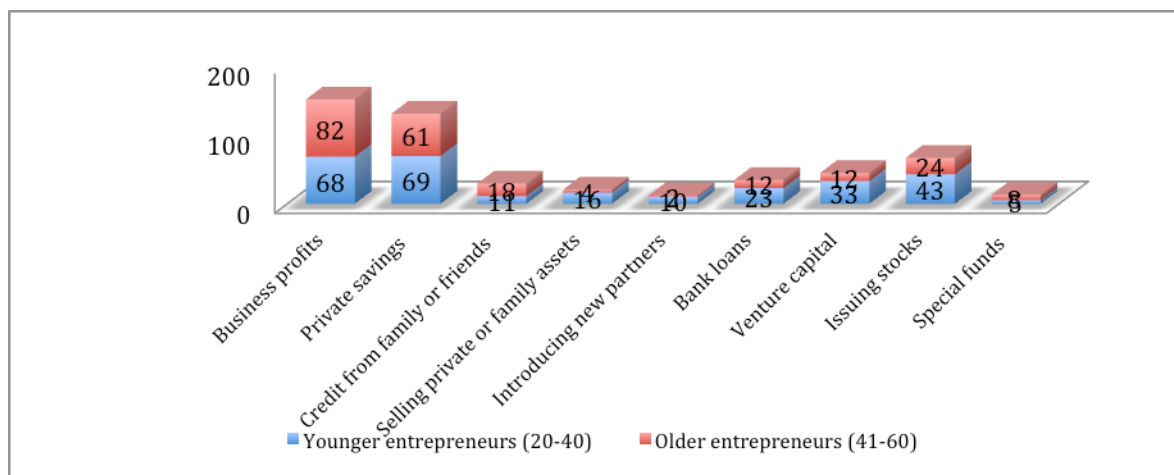
Still, nascent enterprises seem to be doing well in reaching out to debt and equity as compared to older firms. Forty-one percent of the respondents that own or manage nascent enterprises said that they issued stocks compared to 40 and 22 percent for young and established enterprises, respectively. In the same vein, the figures of venture capital were quite high for nascent entrepreneurs at 24 percent as compared to young and established enterprises at 17 and 28 percent, respectively. This shows that nascent entrepreneurs – where there is an overrepresentation of young people – are well acquainted with non-traditional forms of financing such as stocks and venture capital. It shows that established firms can tap into these sources of finance as well. It is likely that the figures reported have to do with the relative development of these non-traditional financial channels in recent years.

As for bank loans and credit furnished by special funds, the figures suggest that established enterprises have a better chance securing debt-financing, which is fairly intuitive given the fact that the banking sector is not friendly towards new ventures or nascent enterprises. Indeed, a significantly lower percentage of nascent enterprise owners/managers reported to have applied for a bank loans at 12 percent as compared to 34 percent for young enterprises and 69 percent for established enterprises. Moreover, loan approval was clearly in favor of established firm owners/managers – a 52 percent approval rate – as compared to 40 and 31 percent for nascent and young enterprise owners/managers, respectively.

The same trends that apply to bank loans apply to special funds. Only 17 percent of nascent enterprise owners/managers reported to have applied for special funds versus 28 percent for young enterprises and 50 percent for established enterprises. Moreover, the approval rate was much higher for established enterprises at 72 percent than for nascent and young firms at 43 and 69 percent, respectively. Special funds – which are in the Egyptian case usually geared towards financing small firms rather than new entrepreneurial projects – actually discriminate against new entrants. This instance suggests that MSME support programs and funds do not always overlap with supporting entrepreneurship.

Given the great overlap between entrepreneurship age groups, it would be useful to contrast the answers given by entrepreneurs based on their age groups.

Figure (2.16): Sources of finance by entrepreneurs' age group as indicated by entrepreneurs (percentage of respondents)



The figure above depicts a picture that is not too dissimilar from the one that the classification by enterprise age has drawn earlier. Younger entrepreneurs are less dependent on business profits than their older counterparts. Conversely, they are slightly more dependent on private savings and credit from family and friends. Both features can be explained in terms of the limited period of business operation. Younger entrepreneurs show more reliance on bank loans, venture capital and stock issuance than their older counterparts. As for venture capital, the number of younger entrepreneurs who reported resorting to this financial means is almost three times that of the older groups, and this should be interpreted in terms of the better acquaintance of younger entrepreneurs with non-traditional mechanisms such as venture capital that was introduced recently into the market, especially in the technology sector.

Though the figures indicate younger entrepreneurs have a much larger reliance on bank loans, this does not indicate by any means that they have better access to credit than their older counterparts who are usually owning and operating more established companies with better credit records. As a matter of fact, the numbers of younger entrepreneurs who reported to have applied for loans from banks or associations is significantly lower than those from older groups – 29 percent versus 69 percent, respectively. Moreover, the approval rate for younger entrepreneurs was reported to be merely 22 percent as opposed to 31 percent for their older counterparts.

The same observation applies to credit from special funds. Only 24 percent of younger entrepreneurs reported to have solicited a loan in comparison to 39 percent for the older groups of entrepreneurs. The approval rates were 53 percent for younger entrepreneurs and 80 percent for the older ones.

3.2- Size does matter in accessing finance

The results obtained from the survey cannot be separated from the fact that micro and small enterprises constitute approximately 96 percent of the respondents. Such sample composition reflects the actual structure of the Egyptian private sector, generally¹⁶.

The problems that face MSMEs often overlap with those that confront entrepreneurship. Though there are differences between the two terms with clear implications for policy-design and tools, both MSMEs and entrepreneurship share the broader ecosystem. Most new firms are small firms, which accounts for the substantial amount of entrepreneurship literature is concerned with the dynamics of SMEs (Naude 2008:3)¹⁷. Indeed, the Egyptian sample shows that most nascent and young enterprises – those less than five years of age – were of micro size – 61 and 68 percent, respectively, compared to 47 percent for established firms – while the rest were small.

The literature holds the banking system to discriminate against nascent entrepreneurs and small and medium enterprises under which most young entrepreneurs and nascent enterprises fall. Though this sounds like a generic problem¹⁸, there is ample evidence that the banking sector in Egypt is specifically inaccessible for micro and small enterprises. According to Rocha et al (2011:2), “the share of SMEs in loans is eight percent for the region and 13 percent for non-Gulf Cooperation Council countries¹⁹.” The share of SMEs in total loans in Egypt was only five percent compared to 24 percent in Morocco; 15 percent in Tunisia; and below the average of the non-oil economies at 13 percent. In fact, Egypt came after Jordan, Lebanon and Yemen (Rocha et al 2011:22). Egypt is underperforming in an already underperforming region. The World Bank survey exhibited that only 10 percent of SME investment expenditure in MENA is financed by a bank loan (Rocha et al 2011:11). Cull et al (2006:3019) indicated that the share of banks in the sources of finance of small firms employing between 10 and 50 workers was 20.2 percent in Bangladesh; 14.1 percent in Brazil; 18.2 percent in Croatia; and 24.1 percent in Ecuador.

The GEM report on Egypt (2010:15) maintained the main challenge facing nascent and young entrepreneurs together with established business owners to be “the difficulty of meeting criteria of selection for loans, followed by the bureaucratic procedures that they have to go through in order to apply for the loan ... a major challenge that faces nascent

¹⁶ The share of enterprises with fewer than 50 employees accounts for at least 95 percent of private sector enterprises in MENA. In Egypt, the number of SMEs is 2.34 million firms with a total of 4.3 millions if the informal sector is included (Stevenson 2010:81).

¹⁷ The same observation is forwarded by the GEM report on Egypt (2010): The vast majority of early-stage enterprises and established businesses are small-sized enterprises. 68 percent, 60 percent and 55.9 percent of nascent, baby and established enterprises, respectively, have 1-5 jobs, and a very low percentage has more than 20 jobs.

¹⁸ According to a World Bank working paper (January 2011) the ratio of median of SME loans to GDP was 15.3 percent in high income countries followed by seven percent for Europe and Central Asia, 6.4 percent for East Asia, 5.5 percent for MENA, 3.9 percent for Latin America and 4.3 and 2.6 percent for South Asia and Sub-Saharan Africa respectively.

¹⁹ The definition of SMEs in Rocha et al study is the same definition this report adopts. SMEs are defined in terms of the number of workers and they include all enterprises employing less than a hundred workers.

entrepreneurs is that the repayment amount is too high.”

The issue does not seem to involve overall access of the private sector to credit. Rather, it seems the issue is attributed to the uneven distribution of this access, which falls in favor of the larger and more established firms at the exclusion of the broadest base of private MSMEs²⁰.

MSMEs and nascent and young enterprises seem to be caught in a spiral. Low levels of capitalization and the little information available about their operations make it quite risky for banks to finance them without demanding big collaterals and guarantees. However, since most small and medium enterprises are located in non-capital-intensive sectors, they often lack assets that can be used as collateral²¹.

Upon interviewing Farouk El-Okda, Egypt’s former Central Bank, El-Okda admitted that access to finance was one big problem that the banking sector faced. El-Okda – during whose tenure the Egyptian financial sector underwent two lengthy rounds of reform in 2004 and 2008 – stated that the priority was first given to the overall health of the banking sector. During the first round of reforms (2004-2008), the reform plan focused on complying with the Basel II criteria. The priority was given to consolidating and recapitalizing banks; treating the problem of nonperforming loans; and the setting and observance of sound prudential regulations. According to EL-Okda, back at that time, a few people were thinking of corporate governance or the access to finance.

Once the first round of reforms was concluded successfully, the second round followed starting in 2008. That round aimed at tackling the problems of access to finance experienced by the broader base of the private sector, especially SMEs. The second round aimed at making SMEs bankable, providing micro finance and introducing corporate governance to the banking sector. El-Okda acknowledged the problems of the inaccessibility to finance and stated that among the targets of the second round of reforms was the raising of the share of SMEs in total bank loans in the future. He held Malaysia as a good example for extending credit to the broad base of SMEs. However, the second round of reform was halted by the political turmoil that followed the January revolution in 2011.

According to the survey, most of the problems related to access to finance had to do with the lack of information by both banks and entrepreneurs. Among those who failed to secure loans from banks, 31 percent said that their lack of knowledge of the procedures and conditions was the reason for not soliciting credit. The former governor of the Egyptian Central Bank held that the lack of information was a major problem that faced bankers as

²⁰ According to the World Bank (2009:111): MENA has a deeper banking sector than most other emerging markets, but it has a small client base. As a matter of fact, Egypt is above the MENA average. Domestic credit to the private sector and domestic credit provided by the banking sector as percentages of the GDP are around 50 percent and 75 percent, respectively, in Egypt, compared to an average of 60 percent and 75 percent, respectively, for middle-income countries (Stevenson 2011:120).

²¹ El-Kabbani and Kalhoefer 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 (2011:5) as shown in the survey.

well. El-Okda stressed the need for training both the creditors as well as the debtors with the aim of making a company bankable. He added that the second phase of the financial sector reform program (2008-2012) was aiming at tackling the problem of access to finance through three measures: the creation of a database of SMEs so as to provide an overall and comprehensive survey of all SMEs. The database was actually developed by the Central Bank in cooperation with the Faculty of Economics and Political Science; the Egyptian Banking Institute (EBI); and the Central Agency for Public Mobilization and Statistics (CAPMAS). The second measure was the establishment of the first credit bureau – a privately-owned agency – so as to provide banks with information about the financial status of SMEs applying for credit. The third measure – that is yet to be taken – was the creation of a Credit Guarantee under the supervision of the Central Bank. The guarantee was supposed to provide a system of classification for SMEs using a scoring system to provide funds to guarantee a certain percentage of the loans taken by SMEs.

3.3- Size matters more than informality when it comes to access to finance

As mentioned earlier, informal entrepreneurs constitute approximately 31 percent of the sample. Contrasting their answers with their counterparts in the formal sector with regards to access to finance reveals very interesting results. Surprisingly, both groups of respondents reported similar ratios of dissatisfaction with regards to access to finance (58 percent versus 60 percent), which implies that the inaccessibility to finance is not just confined to the informal sector and that it has other reasons that adversely affect both formal and informal private firms in Egypt.

The largest percentage of respondents of both sectors indicated that their primary source of funding was the very profits made by their enterprises. The percentage was a bit higher for the informal sector at 78 percent of the respondents versus the formal sector at 70 percent. The second largest source of finance mentioned by the respondents from the two sectors was private savings. The percentages were quite similar for both sectors: 65 percent of informal sector entrepreneurs and 67 percent for entrepreneurs in the formal sector. Only 16 percent of formal entrepreneurs and five percent of their informal counterparts reported their obtainment of loans and other forms of bank credit. Though the percentage of formal sector entrepreneurs who reported to have had access to bank loans is higher than those in the informal sector, it remains rather modest and largely dwarfed by other sources of self-financing.

The figures suggest that most entrepreneurs – be they in the formal or the informal sector – rely heavily on self-financing through the profits generated by their enterprises and on their private savings. Entrepreneurs in both sectors seem to suffer from major problems in accessing credit from banks. It is quite intriguing that operating in the formal market does not seem to change much of the capacity to access finance.

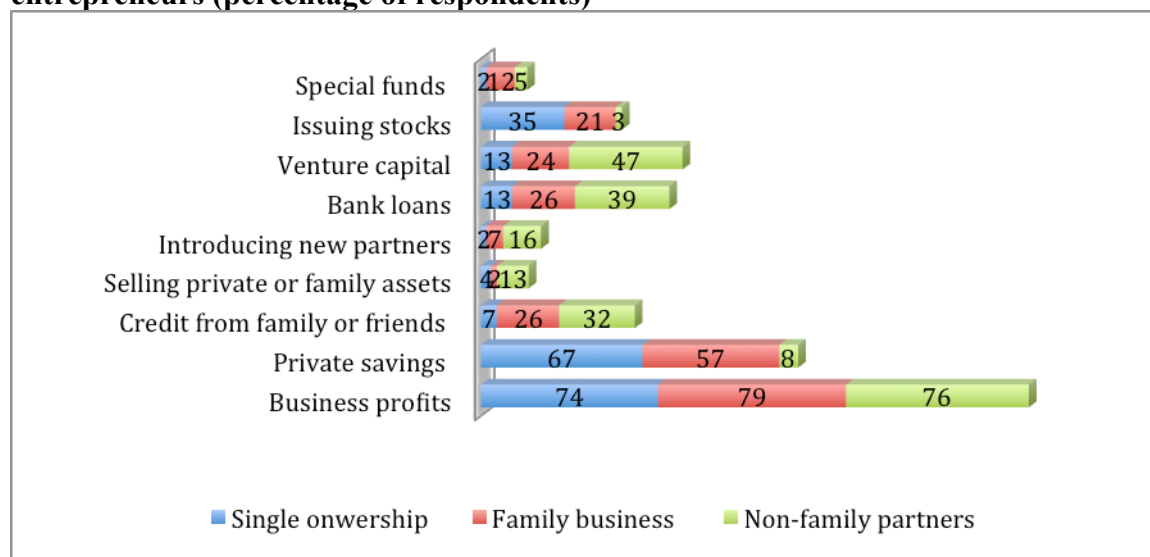
3.4- Business ownership structure and access to finance

Though the overall financial subsystem proved to be a restraint to the majority of survey respondents, the population of entrepreneurs is anything but homogenous. In addition to enterprise size, age and formal status, ownership structure can inform us considerably

about how different groups of entrepreneurs react differently to the system restraints.

The figure below reveals that self-financing through the reallocation of business profits is the dominant mode of finance across all three structures of ownership. However, there are considerable variations. A meager percentage of non-family partnership entrepreneurs have reported their dependence on private savings at eight percent of total respondents compared to 67 percent for single-owners and 57 percent for family business entrepreneurs. Non-family partnership entrepreneurs reported a much higher dependence on bank loans (39 percent) and venture capital (47 percent) in financing their business as well as the introduction of new partners (16 percent). Interestingly enough, non-family partnership entrepreneurs reported a rather high percentage (32 percent) of resorting to credit from family and friends that is higher than family business (26 percent) and single-owners (7 percent). This point suggests that non-family partnership entrepreneurs have access to both family networks as well as friends to finance their business.

Figure (2.17): Sources of finance according to ownership structure as reported by entrepreneurs (percentage of respondents)



One remarkable finding is the considerably high utilization of bank loans and venture capital by non-family partnership entrepreneurs as compared to family business and single-owner entrepreneurs. Given the low percentage of dependence on private savings reported by non-family partnership entrepreneurs, the figures suggest that this very group of entrepreneurs is much more resourceful and less conventional in securing finance for business operations. It becomes tempting to assume that this indicates more accessibility to formal finance be it traditional through the banking sector or non-traditional through venture capital and angel investors. However, responses provided by the entrepreneurs suggests a more complex story.

The high percentage reported by non-family partnership entrepreneurs of resorting to bank loans shows their dependency rather than their accessibility to such resources. The figures given indicate the weight of this financial means in the overall sources of finance, yet it indicates nothing about the accessibility of loans. Despite the fact that more entrepreneurs

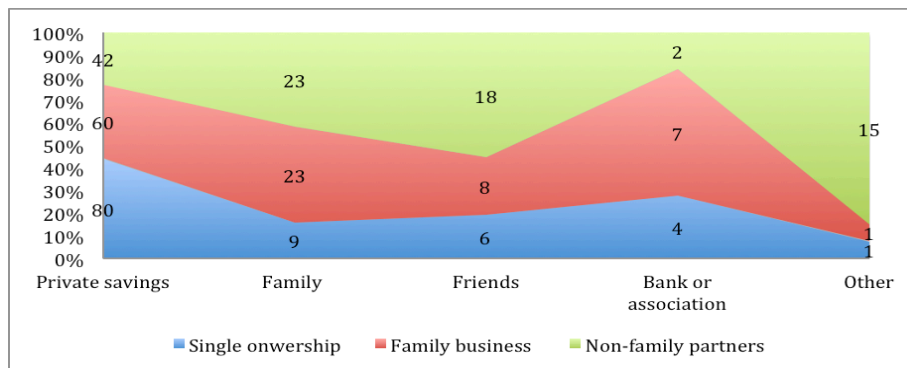
in non-family partnership reported to have depended on bank loans as a source of finance, this category seemed to be the least capable of securing bank loans. Non-family partnership entrepreneurs reported the lowest percentage of soliciting bank loans at 16 percent in contrast to family business entrepreneurs at 60 percent and single-owning entrepreneurs at 33 percent. Moreover, non-family partnership entrepreneurs reported the lowest percentage of those who actually received loans at 17 percent as opposed to 60 percent for family business entrepreneurs and 27 percent for single-owning entrepreneurs.

Family-business entrepreneurs are best positioned to secure bank loans. This goes in accordance with the financial profiles of the three ownership-structures. Family business respondents reported the highest average of start-up and current capital; the highest turnover; and the largest firm size average among the categories. Accordingly, family businesses are the ones with the best capacity to provide collateral as well as guarantors for loans. This may help in understanding why they scored so high in the actual provision of bank loans compared to the other two categories of non-family business. However, the high reliance on private savings by family-businesses seems to be a matter of preference because family members can easily and more cheaply pool private savings.

What applied to bank loans proved to also apply to credit from special funds that target small and micro firms. Family business entrepreneurs were at a clear advantage as compared to non-family ownership structures in general. Whereas 55 percent of family-business entrepreneurs reported to have applied for special funds, only 13 percent of single-owning entrepreneurs and non-family partners reported to have done so, respectively. The same trend is sustained with the loan approval rates reported by entrepreneurs. Whereas the approval rate was 75 percent for single-owner entrepreneurs, it was 65 and 40 percent for family business and non-family partnership entrepreneurs, respectively. It is not yet clear whether this reflects the design of special fund programs which targets single owners or that special funds are the only available option for single-owners due to their incapacity to tap into the resources provided by family or non-family networks that are available for the other two ownership categories.

These general trends that apply to access to finance in general do apply to the specific issue of start-up capital as the figure below shows.

Figure (2.18): Start-up capital sources by ownership structure as indicated by entrepreneurs (percentage of respondents)



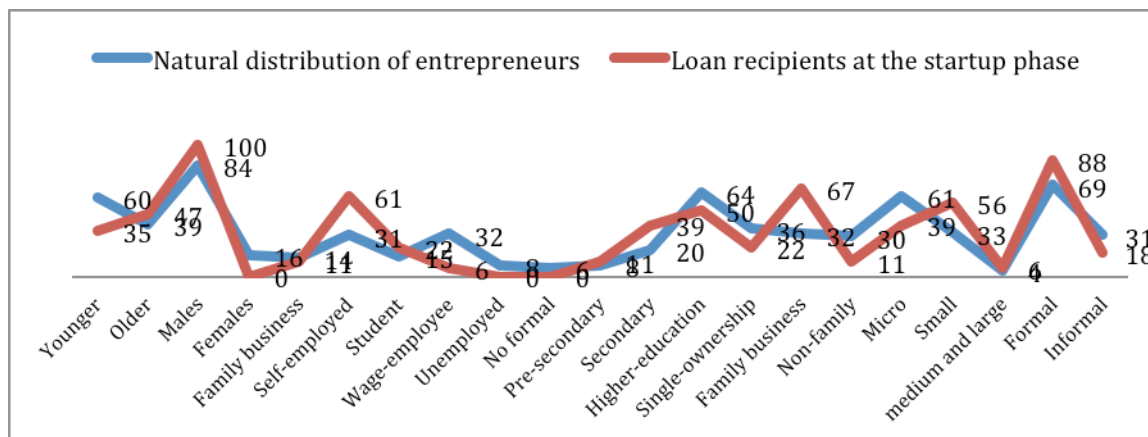
Start-up capital sources vary rather significantly between the three ownership structures of enterprises included in the survey. Whereas private savings are the highest-reported source for single-owners at 80 percent, the percentage goes down to 60 percent for family business and to 42 percent for non-family partnership entrepreneurs. Intuitively enough, money from family sources is the highest for family-businesses and low for single-owners at nine percent of reported start-up capital. However it is substantial with non-family partnership entrepreneurs as well at 23 percent. This suggests that non-family partners usually have access to family networks, and thus, can secure love money as they have access to non-family networks as well. Accordingly, money from friends was the highest for non-family partners at 18 percent as compared to family and single-owner entrepreneurs at eight and six percent, respectively.

Non-traditional sources of finance – primarily venture capital and angel investors – constitute 15 percent of the start-up capital reported by non-family partners, which is considerably higher than their counterparts in the two other categories of family- and single-owned enterprises. This is a confirmation of the earlier remark that non-family partners have better access to non-family networks, and thus, can secure investments beyond family networks. Last is the percentage of bank loans in start-up capital. It is generally low across the three categories. However, it is the lowest among non-family partnership entrepreneurs typically because they have no access to collateral at such an early stage of development. It should be noted that the sample composition indicates that the average age of entrepreneurs is significantly lower for non-family partnership entrepreneurs compared to family and single-owner entrepreneurs, and this may explain their openness to non-traditional financing through venture capital or angel investors, which might explain their incapacity to secure bank loans. Conversely, family businesses reported the relatively highest share of bank loans in start-up capital at 7 percent.

The figure below provides a rough map of loan recipients by contrasting the natural distribution of each subcategory with the share of its members in the actual loan reception as reported by the respondent entrepreneurs. The natural distribution is represented in blue while loan recipient distribution is in red. The gap between the two lines shows whether or not the subcategory was overrepresented or underrepresented in the access to bank loans. Younger entrepreneurs – those below the age of 40 – were clearly underrepresented. Though they constitute 60 percent of the sample, their share in bank loans was around 44 percent – a gap of about 16 percent. Females are clearly excluded as well. Their share in the total sample hovers around 16 percent yet only seven percent of bank recipients were females. Ownership structure exhibits some glaring disparities. Family businesses were overrepresented as their share in surveyed enterprises was 32 percent, yet they stood for 48 percent of total loan recipients. Their overrepresentation comes mainly at the expense of non-family partnership-businesses whose members constitute 30 percent of the enterprises sample, though their share of loan recipients was as low as 15 percent.

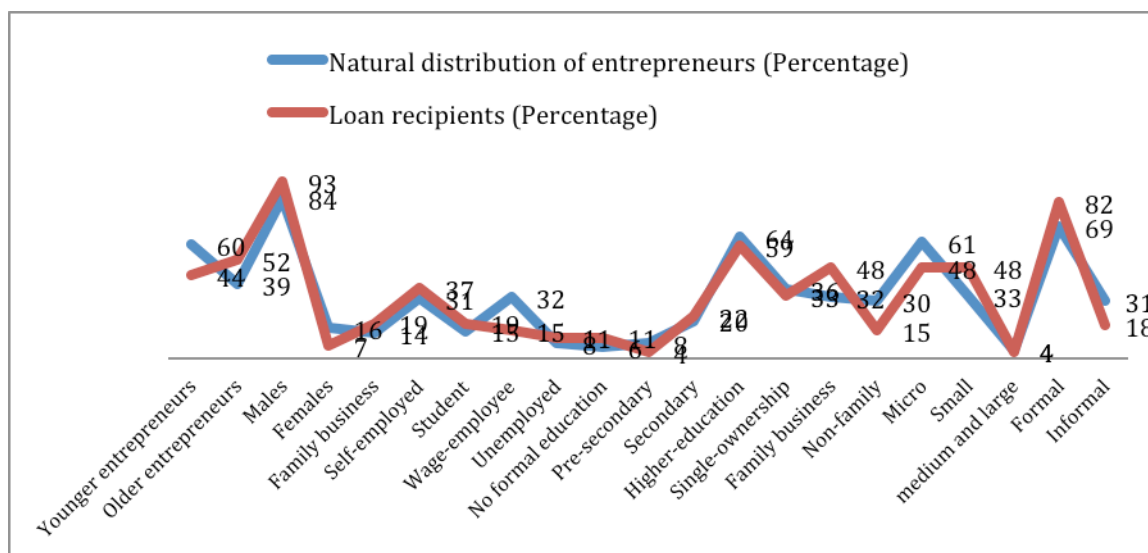
Small firms were overrepresented. Their share in the sample was 33 percent, yet their share in approved bank loans was 48 percent. Micro enterprises, in contrast, were underrepresented at 61 percent of the sample and only 48 percent of loan recipients. Informal enterprises constituted 31 percent of the surveyed firms and their share was as low as 18 percent of total loan recipients.

Figure (2.19): A map of bank loan recipients as indicated by entrepreneurs (percentage of respondents)



What applies to the general access to bank loans applies to access to bank loans at the start-up phase. The figure below shows the same patterns of exclusion against younger entrepreneurs, females, informal, micro and non-family partnerships. Moreover, it shows that family businesses are even more overrepresented in accessing bank/special funds loans at the start-up phase. Whereas their share in the total sample was 32 percent, their share in total loan recipients at the start-up phase was 67 percent. Conversely, single-owners and non-family partnerships were largely underrepresented. Whereas single-owners and non-family partnerships constituted 36 and 30 percent of the total sample, their share in loan reception at the start-up phase was 22 and 11 percent.

Figure (2.20): A map of bank and special funds loan recipients at the start-up phase as indicated by entrepreneurs (percentage of respondents)



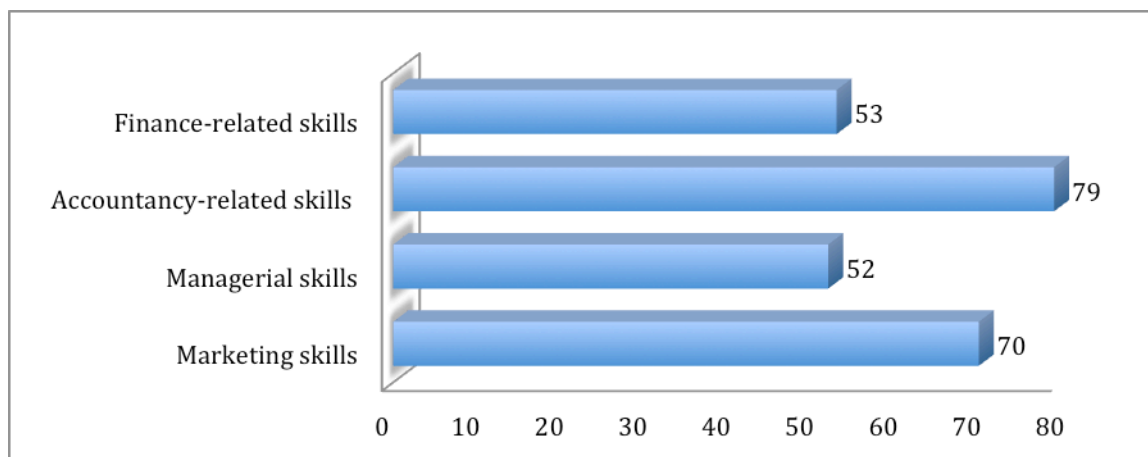
4- Non-financial components of the entrepreneurship ecosystem

This section will tackle the issues of education and training, labor and taxation as the most significant non-financial components of the entrepreneurship ecosystem. The survey did not ask the respondents to report their impression or evaluation of the overall system. Rather, the focus has been on the direct experience lived by the respondent entrepreneurs.

4.1- Entrepreneurship education and training

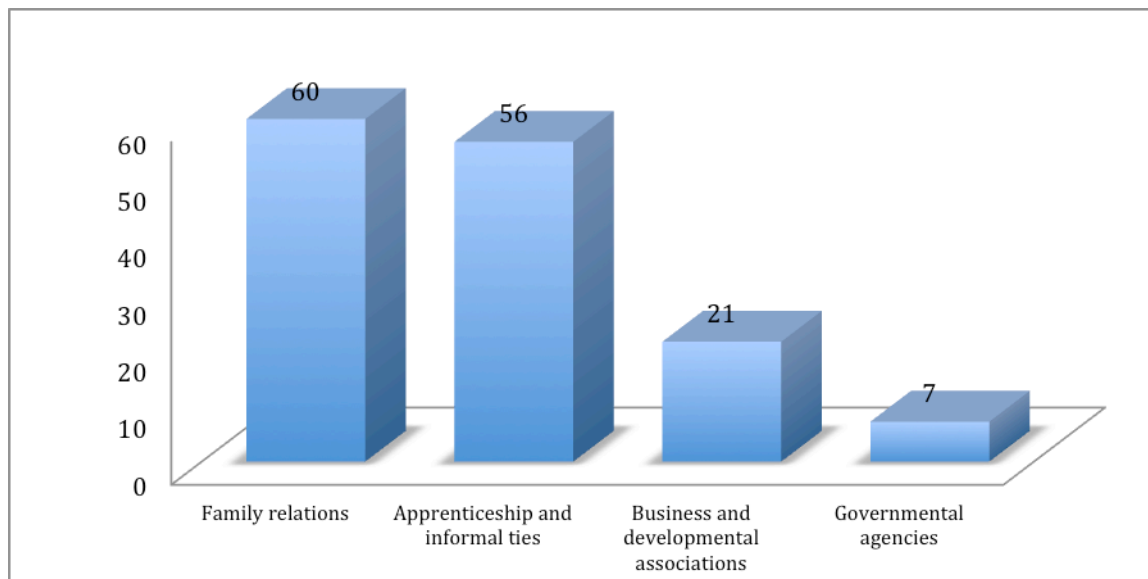
The entrepreneurs were asked about whether their business needed certain skills and if so, where they acquired them. The aim of raising this question was to explore the issue of entrepreneurship education and whether the education and training systems in Egypt were relevant to entrepreneurship. Eighty-seven percent of the respondents said that running their business required some skills. The figure below shows that a significant majority of the respondents said that their business required some kind of skills. Seventy-nine percent mentioned the need for accountancy-related skills, followed by 70 percent for marketing skills.

Figure (2.21): Skills required for running an enterprise (percentage of respondents)



The answers given above indicate that entrepreneurs do require some skills in order to operate their businesses. Where do they usually obtain these skills? The figure below shows the main sources of skill-acquisition as reported by the respondents. Sixty percent said that the main source was their family relations. This is important given the size of family businesses in the population of private enterprises in Egypt. The second source was as informal as the first: apprenticeship and informal ties at 56 percent of respondents. Governmental agencies – including training and education facilities – were reported to have helped only seven percent of the respondents while business and developmental associations were mentioned by 21 percent.

Figure (2.22): Sources of skill attainment as expressed by entrepreneurs (percentage of respondents)



The fact that the skills deemed necessary by entrepreneurs are usually obtained via informal means based on apprenticeship or family ties reveals the deficiency in institutional training and education systems in Egypt²².

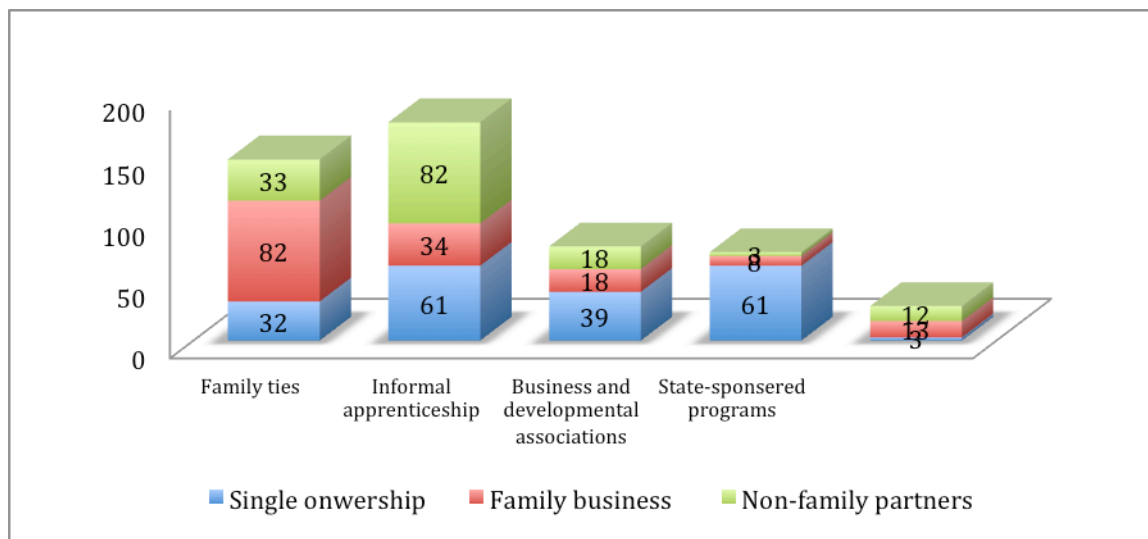
Informal channels of entrepreneurial skill transfer and acquisition seem to play a significant role in Egypt across sectors, firm size and ownership categories. An interesting example would be the contrast of the experiences of entrepreneurs in the formal and informal sectors as indicated in the survey. As expected, those operating in the informal sector reported less need for skills to run their business as only 78 percent claimed that they needed special skills for that compared to 91 percent in the formal sector. This is related to the characteristics of the informal sector where enterprises are usually smaller in size with less capital and workers involved and usually in low-technology sectors that are directly tied to their immediate local environments. However, despite this difference, the means of skill acquisition look very similar. Family ties were reported to be the prior channel of skill passing at 59 percent in the formal sector and 48 percent in the informal sector. The second

²² GEM report on Egypt (2010:16) examined how the educational system is related to innovation and other entrepreneurial skills. The report conveyed the experts' opinion that the education system with respect to entrepreneurship is very poor and this is reflected in Egypt being ranked last among the other GEM countries on the Education and Training. National experts as one of the top constraining factors perceived the education system, at all levels, in Egypt. They negated the effect of primary and secondary schools on encouraging creativity, self-sufficiency and personal initiative (1.28), believing that education at this level does not provide adequate instruction in market economic principles (1.29) nor adequate attention to entrepreneurship and new firm creation. This view also extends at the university/college level, where they felt that students were not exposed to/provided with the necessary preparations to start a business. Nevertheless, they looked at the vocational training with relatively less negativity and felt that to some extent it could provide adequate preparation for starting up and growing new firms (2.33) (GEM 2010:42).

source was informal apprenticeship and mentorship at 59 and 38 percent for formal and informal-sector entrepreneurs, respectively. Respondents reported business and developmental associations at almost equal percentages at 19 and 20 percent for formal and informal-sector entrepreneurs, respectively. Meanwhile, state-supported institutions were reported by just eight percent in the formal sector and three percent in the informal sector.

Classifying respondents by the ownership structure of the firms they own and manage reveals interesting variations amongst them and informs us on how skills transfer and acquisition is actually accomplished in Egypt. The figure below reveals that family ties are the most important within family business at 82 percent of the respondents. Conversely, single-ownership enterprises and non-family partnerships are more dependent on informal apprenticeship and mentorship channels than their family business counterparts. However, family ties remain quite important for non-family business as well as almost one third of the entrepreneurs of the two other categories held them to be the source of skill acquisition. Another interesting observation is that the primary beneficiaries of private or state-sponsored training programs are single-owners of enterprises as compared to family businesses and non-family partnerships. It is not yet clear whether this is the case because single-owners of enterprises lack the networks that other multiple-owners have either through partners or family members or because programs are designed in a way that best fits single-owners.

Figure (2.23): Sources of skill attainment as expressed by entrepreneurs according to ownership structure (percentage of respondents)

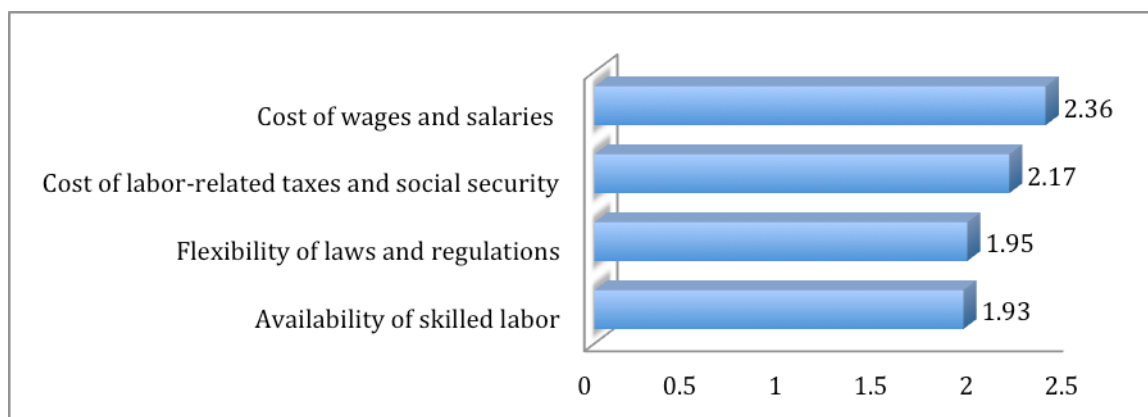


4.2- Labor regulations and quality

Another important issue for entrepreneurs is the labor system, which includes the laws and regulations governing labor. Respondents were asked to express their degree of satisfaction with four labor-related issues on a scale from 1 to 5 where 1 indicated the least level of satisfaction. The availability of skilled labor received the lowest score (1.93 out of 5) followed by the flexibility of labor laws and regulations (1.96 out of 5). The laws and

regulations were reported to be inflexible, which echoes a great many reports and studies on Egypt.

Figure (2.24): Scores indicating the degree of satisfaction with labor in Egypt (the score is out of five, which indicates the maximum degree of satisfaction)



The shortage of skilled labor is a major restraint on the prospects of economic development altogether in Egypt. This point is intimately related to the general educational and training systems, which can be held as major barriers to growth. The educational system supplies poor quality entrepreneurs as well as unskilled labor. The type of education is a critical issue for improving the knowledge and skills, quality and capacity of SME owners and new entrepreneurs in addition to ensuring that they have access to appropriately skilled labor to meet the demands of a modern economy.

4.3- Taxation regime

The views expressed by the respondents on the tax system in Egypt show that taxation is quite problematic for most entrepreneurs. It is noteworthy that the majority of the respondents own and manage either small-or micro-sized enterprises. Almost 55 percent of the respondents “disagree” or “completely disagree” with the statement that tax rates are reasonable and suitable. Fifty-one percent of them “disagree” or “completely disagree” with the statement that tax collection is efficient. Worse still is that 58 percent of the respondents said that they “disagree” or “completely disagree” with the statement that tax collection is adequately transparent. The first result indicates a high level of dissatisfaction with tax policies. The second and third results reveal that most entrepreneurs have big problem with tax administration.

Table (2.8): Views expressed by entrepreneurs on the tax system in Egypt (percentage of respondents)

	Completely Agree (Percent)	Agree (Percent)	Disagree (Percent)	Completely Disagree (Percent)	Don't know or No answer (Percent)	Total (Percent)
Tax rates are reasonable and suitable	1	13	31	34	21	100
Tax collection is efficient	8	15	26	27	24	100
Tax collection is transparent enough	2	11	29	31	27	100

The significantly high level of dissatisfaction with the tax system can help explain the high levels of informality that characterize the Egyptian economy. Thirty-eight percent of the entrepreneurs who reported not to have registered their firms – those operating informally – attributed their decision to not wanting to deal with the tax authorities. The high percentage of recorded and registered transactions by all firms included in the sample – be they registered or not – is another indicator of the unwillingness of transmitting any information to the state due to the lack of trust. A good example of this high uncertainty upon dealing with the government is what the author came by when conducting interviews with non-registered entrepreneurs owning/managing workshops in a Cairo shantytown. Two entrepreneurs informed the author of this report that though it is relatively easy to register their workshops as companies, they would never do that because this will provide information about their financial position to the government. The government targeted a neighbor of theirs who registered his workshop as a company and then got a letter from the tax authorities requiring him to pay the worth of 10 years worth of tax arrears due for the years he had been operating before registering the workshop.

Such views expressed by the respondent entrepreneurs come after big reforms were introduced to the two areas of tax policy-making and tax administration between 2004 and 2008. Ashraf Al-Arabi, the former head of the tax authority (2007-2010), said that the reform program aimed primarily at simplifying the laws that were governing taxes in Egypt. According to him, the laws were too old and too complex for ordinary investors to read and understand. Both areas of tax policy and tax administration were targeted with reform. The rates were reduced and the system was simplified with the aim of broadening the tax base. The Tax Authority was then computerized for the first time, according to Al-Arabi.

However, Al-Arabi admits that these reforms were primarily targeted towards large and medium-sized enterprises rather than small and micro ones that happened to constitute the vast majority of private entities in Egypt. According to Al-Arabi, the reform team had little human and administrative capacity to target everyone with reforms.

“In the first two years of the reform process, we did not care much about small, medium or micro enterprises,” said Al-Arabi. The focus was on making sure that the amended tax law and regulations were generating enough money and that it was accepted by the taxpayer society and that it was less disposed to tax evasion. The tax authority focus during the first two years (2006-2008) was on large taxpayers, applying the theory of 80 – 20, where 80 percent of the revenue comes from 20 percent of taxpayers. Al-Arabi held that large taxpayers – unlike small and micro enterprises – were usually well educated with better experience in dealing with the tax authorities. They had no staff to deal with the wider base of enterprises, which were too small to generate considerable amounts of revenues for the state.

Small and micro enterprises are required to pay their taxes through a special system based on a presumptive tax. Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from application of the indirect method²³. This is mainly due to the lack of information regarding their annual turnover and the high cost of gathering and processing this kind of information compared to the potential revenue from this category of firms. However, it increases the discretion given to the administration and makes engaging with tax authorities a major issue for small and micro enterprises. One has to recall that almost 40 percent of the respondents who reported their business as registered said that this was due to their unwillingness to deal with the tax authorities.

5- Female entrepreneurship in Egypt

Female entrepreneurs constitute 16 percent of the total number of respondents in the survey (21 of the total number of respondents). Eleven out of 14 reported operating in the formal sector (52%), versus 10 in the informal sector. The female and male respondents share a similar regional distribution across Egypt. Their profiles differ a bit when it comes to firm size. Sixteen of the female-owned and run enterprises (76 percent) were micro firms – those firms hiring less than six workers – and three (14 percent) were small (those firms hiring between six to 50 workers²⁴ while bigger firms – those hiring more than 50 – stood

²³ Tax Law Design and Drafting (volume 1; International Monetary Fund: 1996; Victor Thuronyi, ed.) Chapter 12, Presumptive Taxation

²⁴ Given the many barriers to entry and to growth that female entrepreneurs face in Egypt, there is an overrepresentation of women in micro-and small-sized firms, primarily those who operate in the informal sector. El-Hamidi et al (2010:2) found that the majority of women-owned businesses employ less than three workers; operate mainly in trade – a reflection of their lack of capital; and achieve their primary source of start-up capital from their own savings where only four percent came from loans (both formal and informal). El Mahdi (2006:19) confirms this trend for Egyptian women. Women entrepreneurs are concentrated in the one-person sized category. Women are faced with additional and specific difficulties compared to their male

for two out of the 21 respondents (10 percent). Conversely, male entrepreneurs generally reported larger firm sizes. Firms hiring more than 50 workers constituted around 36 percent of the total firms owned and managed by male entrepreneurs – 40 respondents out of 110 male entrepreneurs – while 58 percent were micro firms. This difference in firm size confirms a general remark that female entrepreneurs have less access to resources in general, and thus, end up running smaller units compared to men.

This section will contrast the answers given by female and male respondents as a means for discerning how each category deals with the same aspects of the entrepreneurship ecosystem. The section will focus on the female reported interaction with business registration, contract enforcement, access to finance and corruption.

5.1- Business registration is harder for female entrepreneurs

It is noteworthy that 17 of the 21 female respondents (81 percent of female entrepreneurs) held that the registration and licensing systems do not discriminate against women. This answer indicates that the rules and regulations that are directly related to business registration and licensing are general and gender-neutral but not necessarily gender-sensitive. Female entrepreneurs may have larger problems dealing with the same registration rules and procedures than their male counterparts.

To start, the informality was much higher among female than male entrepreneurs. Almost 48 percent of the female-owned enterprises were not registered as opposed only to 27 percent of male-owned/managed enterprises. Of course, the survey is no census of firms across Egypt. However, such a figure does go in harmony with the literature on female entrepreneurship and informality, which holds that females are more likely to operate in the informal sector than males (EL-Mahdi 2006). The causes of such phenomenon may vary. On one hand, female entrepreneurs may prefer to operate informally given that their businesses are often of a smaller size and with a lower potential to grow due to their lack of access to financial, physical and social capital. On the other hand, informality among female entrepreneurs may be not be voluntary but rather forced upon them by a hostile registration system. This association between female entrepreneurs and informality needs further investigation.

Interestingly enough, the female entrepreneurs who reported to have had their businesses registered gave answers that indicate that the process was not especially harder for them. For instance, whereas the average number of months reported by male entrepreneurs for registration was 7.42, it was only five for females. The average number of governmental agencies that both gender groups reported to have dealt with to get the registration done was almost the same at 4.74 and 4.76 agencies for male and female entrepreneurs, respectively. These figures suggest that female entrepreneurs in Egypt generally face high barriers to entry to the formal market, indicated by the high percentage of informality within their ranks. However, for those who could make it to the registration process, the procedures and rules were not harder for them than their male counterparts. This can be

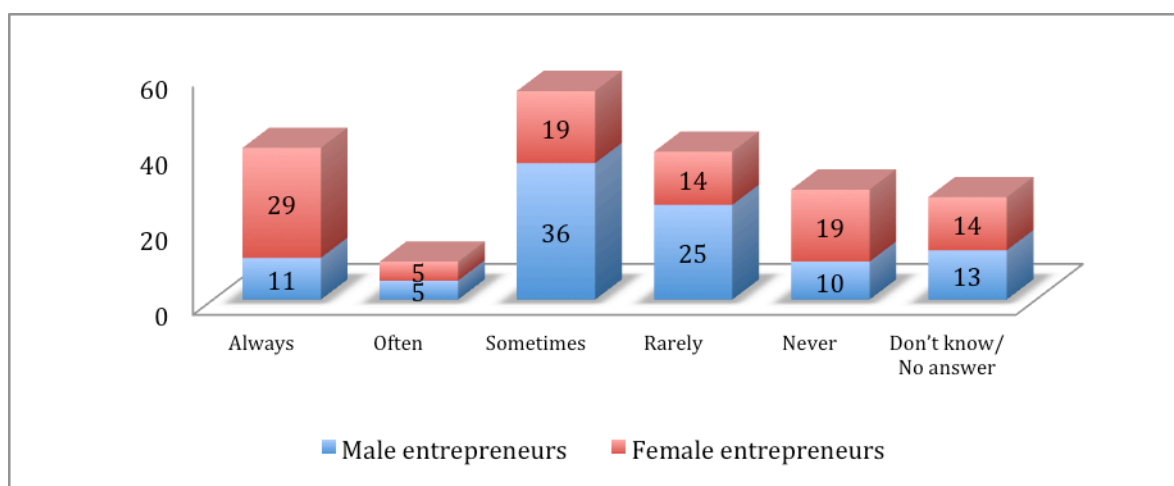
counterparts. Women work more hours, earn less, and generally have less education than their male counterparts. They have less access to training, credit, and markets.

explained in many different ways related to firm-size, start-up capital or the educational background of female entrepreneurs. This point also needs further investigation.

5.2- Contract enforcement and female entrepreneurship

When asked about the expected impact of formal contracts on their businesses, 13 of the female entrepreneurs (62 percent) said that it was positive versus 76 percent of the male respondents. However, that does not mean that females were less inclined to using formal contracts in exacting their transactions. As a matter of fact, female respondents reported slightly higher frequencies of resorting to formal contracts than their male counterparts as indicated in the figure below.

Figure (2.25): The frequency of resorting to formal contracts as expressed by female and male entrepreneurs (percentage of respondents)



Though more female entrepreneurs reported that they “always” resort to formal contracts, when the total percentage of using formal contracts was calculated, the two gender categories would be almost equal in their resort to formal contracts at 52 percent for female versus 53 for male entrepreneurs.

Women’s reported higher resort to formal contracts may be explained by their seeking of various means to protect their rights given their general vulnerability. Among female entrepreneurs that provided an answer, only one respondent (13 percent) said that informal agreements were as enforceable as formal contracts as opposed to 65 percent of the male respondents. This may indicate that male entrepreneurs are more capable of enforcing informal transactions and protecting their interests without resorting to formal contracts. Conversely, women seem to lack in this capacity, likely for reasons that have to do with the general socio-cultural context in Egypt, which suggests women are less educated, less resourceful and more vulnerable to encroachment of their rights.

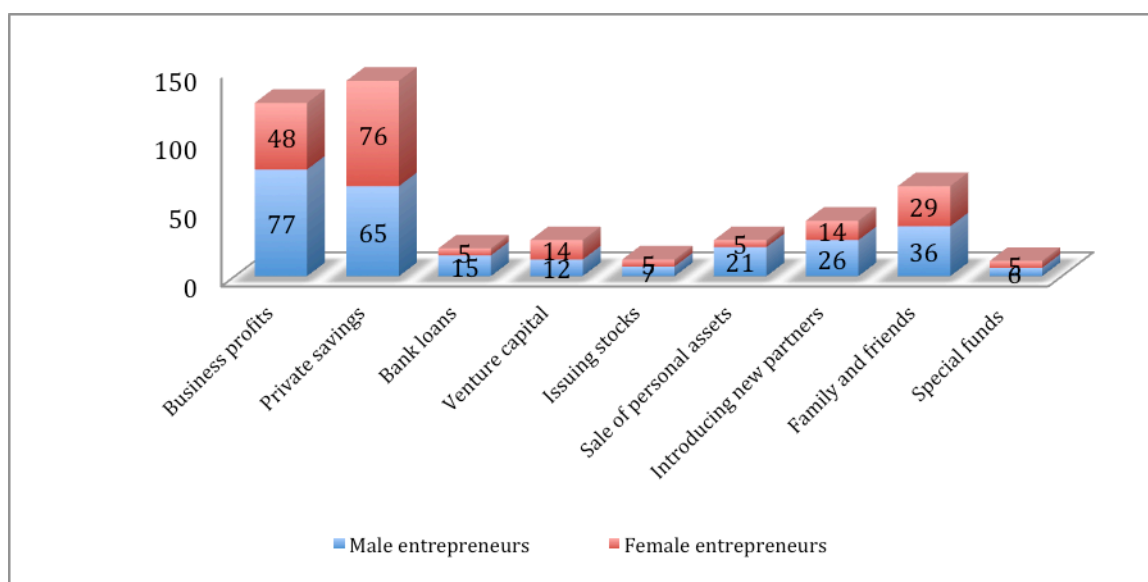
However, this hardly implies that women are actually well protected or even better protected than their male counterparts. As a matter of fact, only seven out of 21 female respondents (33 percent) expressed their belief that formal contracts were enforceable in

Egypt as compared to 51 percent of male respondents. This figure shows that women have less access to the legal system, and thus, have lower shares of the rule of law and contract enforceability in Egypt.

5.3- Access to finance is harder for female entrepreneurs

Access to finance provides a very interesting area of contrast between the answers given by female and male entrepreneurs. Almost all of the answers show that it is easier for males to access finance compared to females. This observation is not just limited to the institutional sources of finance such as banks, associations and special funds, but it also applies to informal sources such as resorting to savings, profits or credit from family and friends.

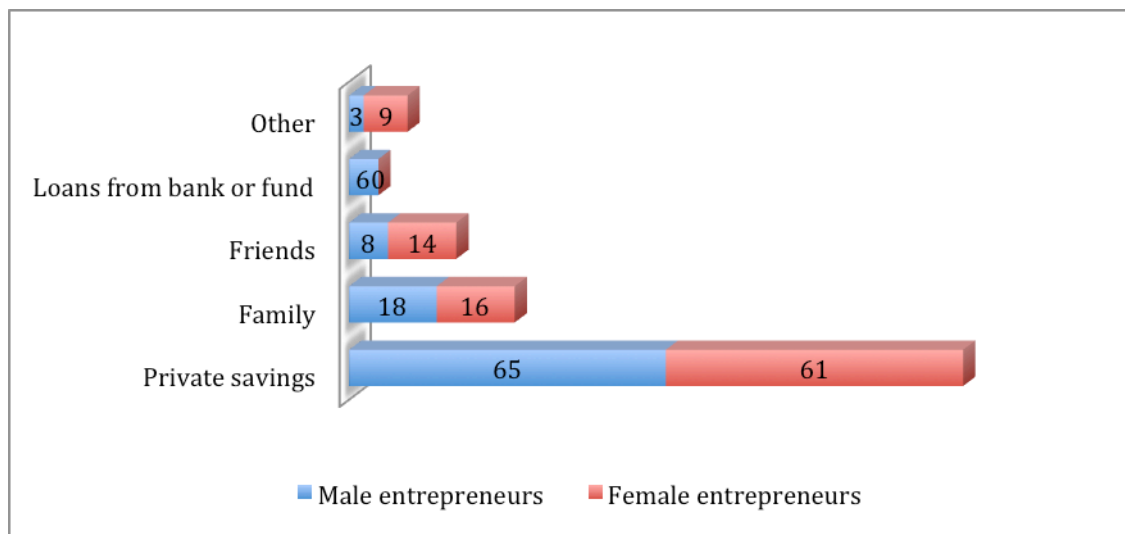
Figure (2.26): Sources of finance as reported by female and male entrepreneurs (percentage of respondents)



Female entrepreneurs reported to be dependent on almost the same sources of finance that their male entrepreneurs have reported. However, higher percentages of males reported their resort to financing from profits; introducing new partners; and credit from family and friends compared to female entrepreneurs. One interesting contrast is the percentage of entrepreneurs that reported using bank loans. Fifteen percent of the male entrepreneurs reported using bank loans versus only five percent of females (one respondent). The figures above show that women are generally less resourceful when it comes to finance and that they often lack access to informal networks as well as institutional credit, which suggests why they mainly rely on private savings. This has to do with the restrictions they suffer with when accessing assets and capital that may not be directly related to the sphere of business operation but rather to general norms and laws that regulate women's status in society²⁵.

²⁵ EL-Hamidi and Baslevent (2010:5) held women's low participation in the labor market as reflecting "the existence of deeply-rooted gendered social norms that transcends economic development.... Women-led

Figure (2.27): Sources of finance at the start-up phase as reported by female and male entrepreneurs (percentage of total finance)



The figure above shows similar sources of finance at the start-up phase as reported by female and male entrepreneurs. There is an overwhelming dependency on private savings by both sexes followed by a dependency on funds from family. The share of loans from banks or special associations is quite limited for males and negligible for female entrepreneurs.

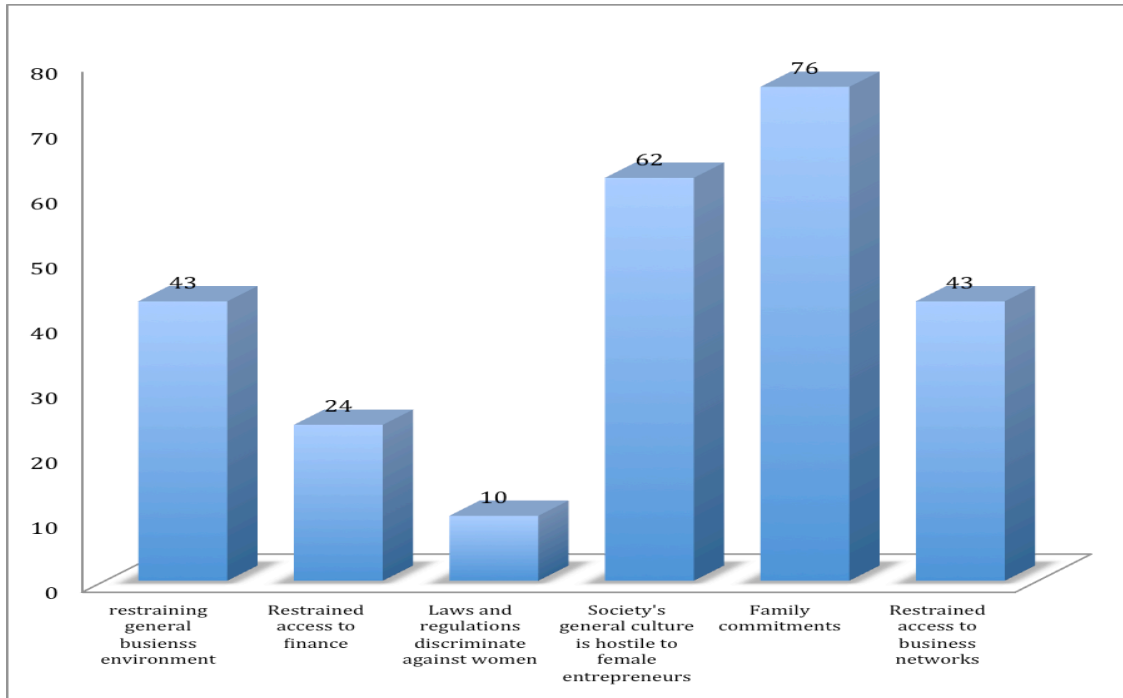
5.4- Exposure to corruption and female entrepreneurship

Nine female respondents (43 percent) said that they were asked to pay some informal payment in the form of bribery or gifts to state officials. This percentage is high but lower than the ratio of male entrepreneurs that reported the same, which was 55 percent. As expected, female entrepreneurs turned out to be more vulnerable to extortion and corrupt practices. The following figure displays the different views expressed by female and male respondents over the issue of corruption.

Last, female respondents were asked about the main challenges they face in doing their business. Sixteen out of 21 female respondents (76 percent) held that their family commitments were a barrier. Thirteen female respondents (62 percent) stated that the general business environment was hostile to female entrepreneurship compared to nine (43 percent) that stated society's general culture was hostile. Only two (10 percent) held that laws and regulations discriminate against women. The figures are clear indicators of the impact of extra-business factors on female entrepreneurship.

micro-and small enterprises were found to be operating at a disadvantage. They start at 'a considerably lower level of capitalization; are highly concentrated in trade sectors (where barriers to entry are lower); more likely to have only one worker; and less likely to be exporting. In addition, they have less access to formal education, business management, and finance.'

Figure (2.28): Main challenges that face female entrepreneurs (percentage of respondents)



The answers provided by Egyptian female entrepreneurs are an excellent example of the difference between a gender-neutral and a gender-sensitive entrepreneurship ecosystem. Whereas formal laws and regulations was the least reported special challenge for female entrepreneurs, the overall environment seems quite hostile to women more so than to men. This goes in harmony with the broader literature on female entrepreneurship. The literature holds that the issues often do not lie with the direct rules governing the business ecosystem but rather with the societal and sometimes legal rules and regulations that govern broader social relations. Formal and informal rules deny women equal access to physical, financial, human and social capital and assets. This makes the barriers to entry high for females, forcing many of them to operate in the informal sector with low growth-potential.

6- Regional dimensions of entrepreneurship in Egypt

6.1-Contrasting entrepreneur and enterprise profiles

The survey covers entrepreneurs from several regions and cities in Egypt. The focus remains urban across all of the surveyed regions. The survey includes respondents from seven cities that were held to represent the three main regional units in Egypt: The North, the South and Greater Cairo, the capital city. Cairo's share constitutes approximately 31 percent of the total sample, which is a bit over its share in total Egyptian population. The North or Lower Egypt was represented by respondents from four cities: Kafr-Es Sheikh to the northwest of the Nile Delta; Port Said to the Northeast of the Delta and on the northern turf of the Suez Canal; Tanta in the center of the Delta; and Al-Arish, the capital of Northern Sinai. Altogether, they constitute approximately 42 percent of the sample, which is

equivalent to the share of the North in Egypt's population. The South (Upper Egypt) was represented by two cities – Beni-Suef and Sohag – with a total share of 27 percent of the sample.

Entrepreneurs' ages are reported to be much higher in the provinces of Lower Egypt (The North) and Upper Egypt (The South) as compared to Cairo. The majority of entrepreneurs in Cairo (90 percent) were in the age bracket 21-40 compared to only 49 percent and 40 percent in Lower and Upper Egypt, respectively. Entrepreneurs over 41 constituted the majority in the provinces. Though the sample is by no means a census of entrepreneurs or enterprises, the representation of age groups may be revealing. Opportunities are more abundant in Cairo for young entrepreneurs and the environment – as restrained as it is – is more dynamic than in the provinces.

The same observation applies to the representation of female entrepreneurs who stood for 32 percent in Cairo; 13 percent in Lower Egypt; and a mere three percent in Upper Egypt. This is in harmony with the information provided by GEM (2010), which shows that most opportunities for females exist in the capital cities rather than in the provinces. The figure reported for education reflects the same trends in favor of the capital city. Higher-education graduates constitute the vast majority of the Cairo-based respondents (93 percent) compared to Lower Egypt (55 percent) and Upper Egypt (47 percent). Those with only a school degree – primary, preparatory and high school – constituted seven percent; 37 percent; and 37 percent in Lower Egypt; Upper Egypt; and Cairo, respectively.

As for firm sizes reported by the respondents, micro-firms employing less than six workers constituted the majority of firms in all three regions, followed by small firms. Medium-sized firms employing between 51 to 100 workers were almost negligible in all three regions, which indicates the missing middle syndrome already underlined by the literature. Last but not least, as expected, large firms that employed over a hundred workers were primarily based in Cairo, an indicator of how enterprises are more capital-intensive in the capital city as compared to the provinces.

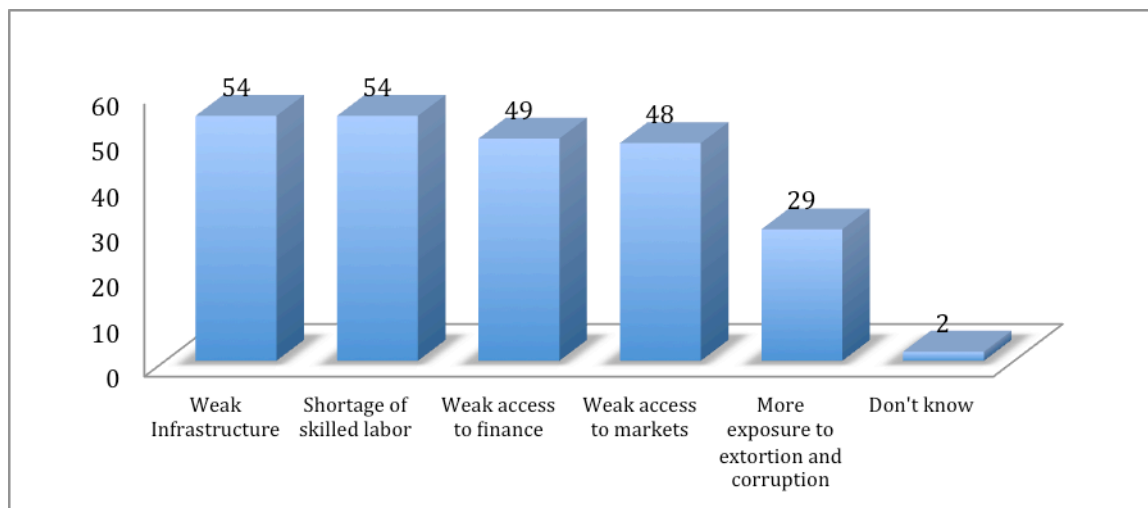
The following section will show the perceptions of the respondents from outside of Cairo regarding the barriers they experience and the reforms that can enable them to improve the status of their businesses.

6.2- Perceptions from the provinces about the barriers to growth

First, approximately 72 percent of the respondents from outside of Cairo expressed the belief that the opportunities for growth would have been much higher had they been situated in the capital city. Similarly, 58 percent of the respondents said that they would move their economic activities to the capital city if they had the chance. Fifty percent of the entrepreneurs agreed with the statement that the institutional, legal and regulatory framework discriminated against different provinces in favor of the capital city.

When asked about the principal barriers to growth they experience, the answers were as follow in the figure below:

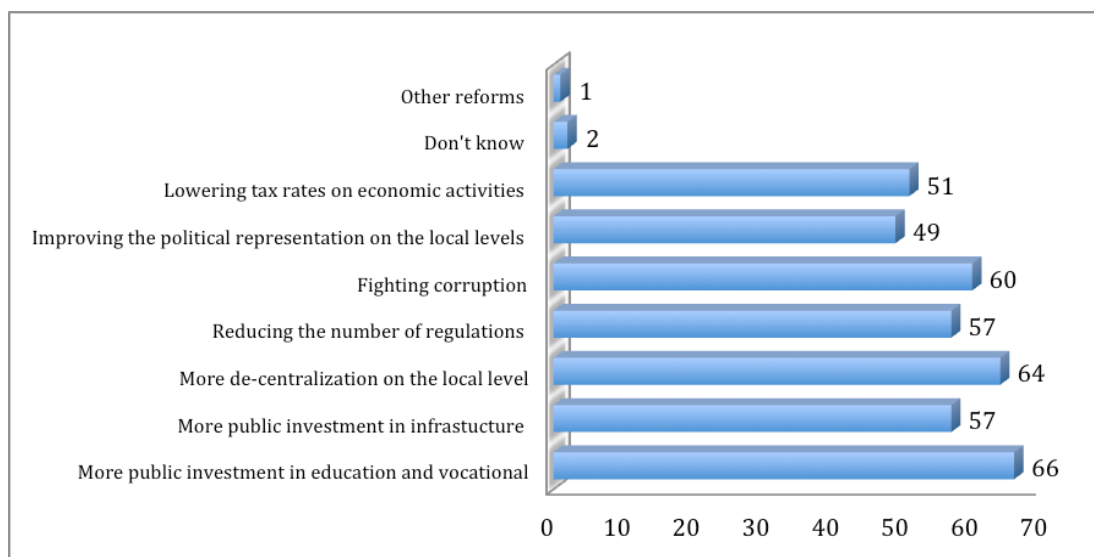
Figure (2.29): Main barriers to growth as reported by entrepreneurs in the regions outside of Cairo (percentage of respondents)



The two barriers that received the highest percentage of responses were weak infrastructure and the shortage of skilled labor (54 percent) followed by weak access to finance (49 percent). These barriers reveal that the weak investment in human and physical capital is among the top factors for the perceived weaknesses of the business environment outside of the capital city. Skilled labor shortages do not only have to do with the poor status of education and training but also with the migration of skilled labor to the capital.

Entrepreneurs from outside of Cairo were asked about the reforms they would deem necessary for the improvement of their chances to grow. The figure below shows the results.

Figure (2.30): Required reforms to improve the opportunities for growth in the regions outside of Cairo (percentage of respondents)



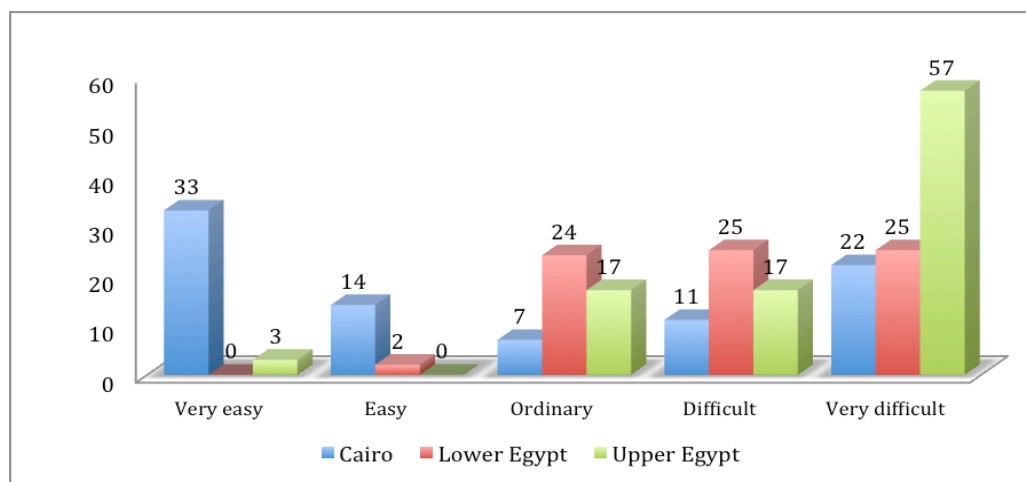
In harmony with the earlier answers, a majority of respondents put public investment in human and physical infrastructure at the very top of the required reforms. Seventy-one percent of the respondents said that more public investment is needed in the fields of education. Sixty-six percent of them named training and training and 57 percent said the same with regards to infrastructure. This shows that state policies and plans are still relevant to narrow the gaps between regions and enhance the growth opportunities for private businesses and entrepreneurs. Interestingly enough, 64 percent of the respondents held that more de-centralization was needed on the local level, and 49 percent of them expressed the conviction that the political representation of the provinces needed to be improved.

6.3- Contrasting the views of entrepreneurs across Egypt's three regions

This section contrasts the answers given by entrepreneurs from the three regions so as to show the difference, if any, between their experiences. The focus will be on the evaluation of the business registration process; the resort to formal contracts and the views around contract enforcement; the barriers to growth; access to finance; and corruption.

The figure below shows the views expressed by respondents in each region with regards to the difficulty of the business registration process. A higher percentage of Cairene entrepreneurs reported the process to be “very easy” compared to the two other regions. That can be taken as an indicator of the uneven process of business distribution on regional basis where those residing in the capital faced significantly less difficulties in getting their business registered compared to their counterparts outside of the capital city. The percentage of those who reported the process to be “ordinary” was the highest in Lower Egypt followed by Upper Egypt and then Cairo. However, the percentages remain limited and less than the quarter of respondents. Along the earlier trends, only 33 percent of Cairene respondents held the process to be either “difficult” or “very difficult” in contrast to a massive 50 percent and 74 percent of the respondents from Lower and Upper Egypt, respectively.

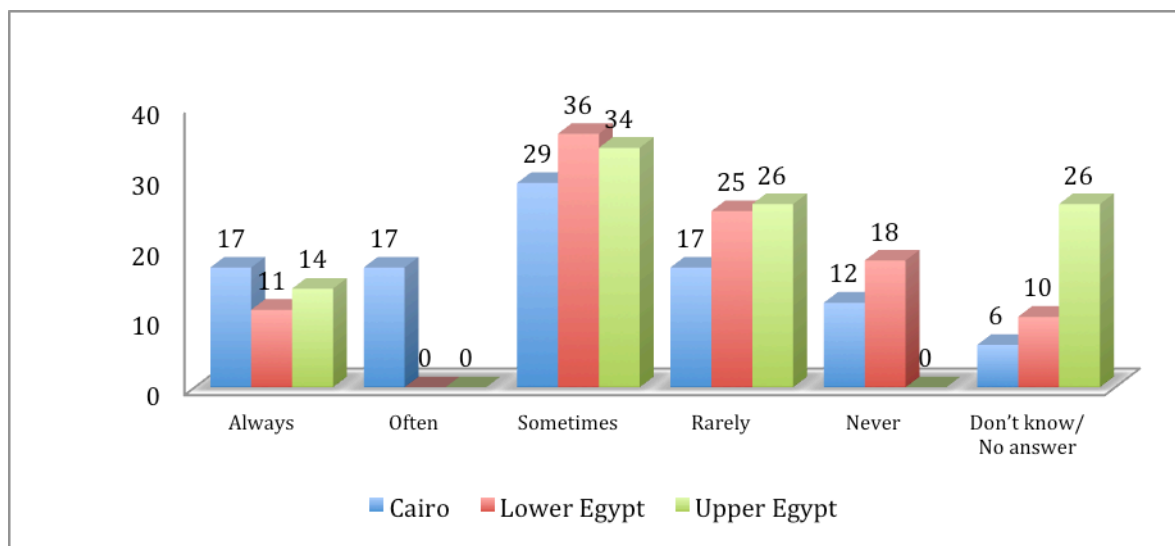
Figure (2.31): Contrasting the views about the easiness of the registration process across regions in Egypt (percentage of respondents)



Business registration is one indicator of the access to the country's formal state structure. The results suggest that some significant regional disparity exists between the three regions. Two dividing lines seem to exist: one between the capital and the provinces on the one hand – where the formal registration system practically favors those residing in Cairo – and the other between Lower Egypt and Cairo together versus Upper Egypt. The answers provided by entrepreneurs suggest that the roots of the problem are traceable to both the laws and regulations and the way the bureaucracy implements them. However, these problems are felt much more in the provinces than in Cairo. Interestingly enough, Egypt has a centralized government and is a unitary state; hence, all regions are subject to the same laws and regulations. The answers nevertheless suggest that the laws and regulations are designed in a way that favors Cairo.

Another indicator of the access to formal structures is the reported frequency of resorting to formal contracts by entrepreneurs across the three regions. The figure below shows that a slightly higher percentage of respondents in Cairo reported that they “always” or “often” use formal contracts in exacting their transactions (34 percent) compared to 11 and 14 percent for Lower and Upper Egypt, respectively. This is an indicator of a higher level of formality in the capital city. However, it also indicates a high level of informality across Egypt in general as formal contracts were confined to one third of Cairo entrepreneurs who are supposed to be the most formal in the economy. The figures for “sometimes” and “rarely” are higher in Lower and Upper Egypt than in Cairo. The figures for “sometimes” and “rarely” are higher in Lower and Upper Egypt than in Cairo.

Figure (2.32): The frequency of resorting to formal contracts as reported by entrepreneurs across Egypt's three regions (percentage of respondents)

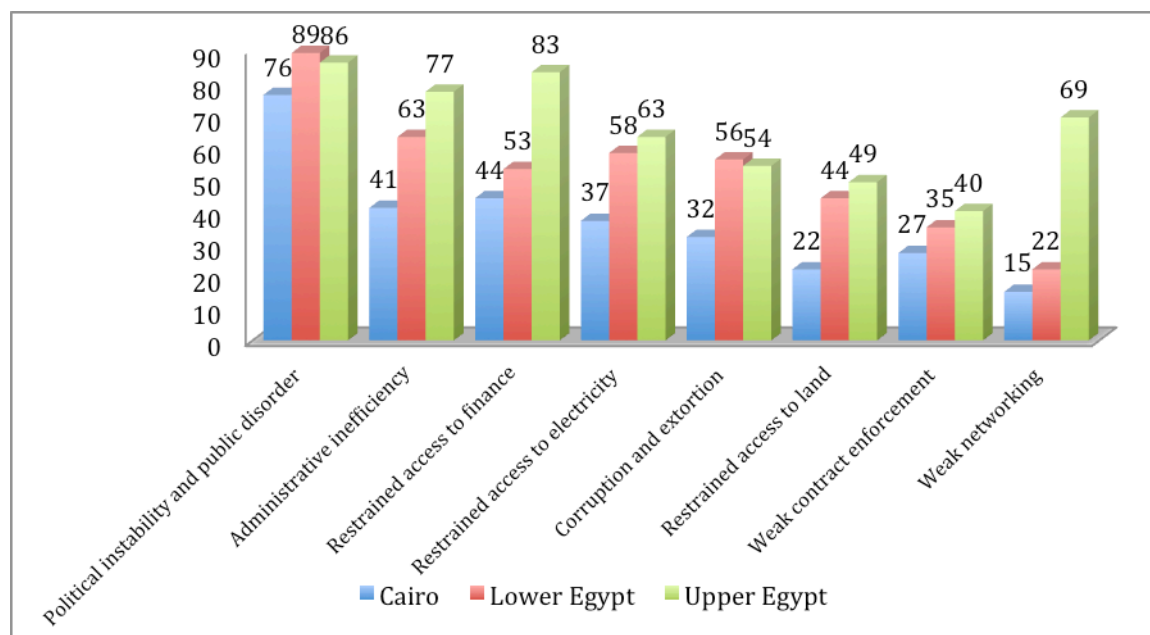


Interestingly enough, a higher percentage of respondents in Lower Egypt (71 percent) and Upper Egypt (91 percent) expressed their belief that formal contracts have a positive impact on their businesses than those from Cairo (63 percent). The percentages seem to be inversely related to the frequency of the actual resort to formal contracts. This may indicate that entrepreneurs in the provincial areas wish to use more formal contracts in their transactions, though they cannot due to the cost and complexity. However, one should

consider that the overall resort to formal contracts in all three regions in Egypt – including Cairo – is rather low, indicating a generally high level of informality that may reach up to 50 or 60 percent of the GDP as calculated by Schneider (2009).

The figure below shows very interesting trends by contrasting the views expressed by entrepreneur respondents from the three regions of Egypt with regards to the barriers to growth that they experience. The very first observation is that the respondents of the three regions have expressed similar concerns in the same arrangement of priorities. The first was political instability and disorder (average 84 percent) followed by administrative inefficiency (average 60 percent) and then access to finance (average 65 percent) and corruption in the fourth place (average 59 percent). The second remark is that the highest percentage of respondents who reported facing barriers to growth was in Upper Egypt (65 percent) followed by Lower Egypt (53 percent) and then Cairo (37 percent). This order makes logical sense as entrepreneurs in the most marginalized areas suffer the most from barriers to growth as compared to the capital city. The close figures between Lower Egypt and Cairo suggest that the real chasm exists between the North and the South and that the most pressing problems of socio-economic marginalization are rather concentrated in Upper Egypt.

Figure (2.33): Barriers to growth as expressed by respondents across Egypt's three regions (percentage of respondents)



Lower and Upper Egyptian entrepreneurs recorded the highest percentages with regards to each barrier to growth reported. The suffering from political instability and public disorder seems to be regionally distributed in an uneven way as shown in the figure above. The discrepancy becomes even bigger when looking at access to electricity. Lower and Upper Egypt reported close figures (58 percent and 63 percent, respectively) that were much higher than those reported by Cairene entrepreneurs (37 percent). This is a clear indicator that power shortages and cuts were unevenly distributed in favor of the capital city. The

same applies to the access to land. Whereas only 22 percent of the respondents from Cairo reported this issue to be a barrier to growth, 44 and 49 percent did so in Lower and Upper Egypt, respectively. These answers are relatively counterintuitive because access to land in the capital city should be more expensive than in the provinces. However, the administrative restrictions may be unevenly distributed and provincial entrepreneurs may be having more problems in accessing capital and assets.

Another revealing regional disparity is that with regards to the capacity to network. Whereas the figures reported by respondents in Cairo and Lower Egypt were close – 15 percent and 22 percent, respectively, a massive 69 percent of Upper Egyptian entrepreneurs held networking to be a barrier to growth. The disparity here is between the North and the South, and it serves as additional proof to how the marginalization of Upper Egypt – in both economic as well as political terms – reduces the opportunities available for the entrepreneurs there. Hence they often lack the networks that may help them in accessing resources such as finance, information, markets and assets.

Weak contract enforcement came near the bottom of the barriers mentioned by the respondents from the three regions. This is a practical reflection of the low frequency of resorting to formal contracts while exacting transactions in general. The figures were 27 percent for Cairo; 35 percent for Lower Egypt; and 40 percent for Upper Egypt. It shows that the inaccessibility to state formal structures such as the judiciary is a common problem that is evenly distributed throughout the region in what can be called equal inaccessibility to the rule of law.

Respondents put corruption as a barrier to growth in the fifth position from the three examined regions with an average of 47 percent. The percentages of respondents from the three regions were higher in Lower and Upper Egypt than in Cairo. However, when asked whether they were required to hand in informal payments such as bribes or gifts to state officials, 54 percent of the respondents from Cairo answered in the affirmative. The figures were 58 percent for Lower Egyptian entrepreneurs and 43 percent for Upper Egyptians. The figures are quite interesting because they indicate that exposure to corruption is relatively higher in Cairo and Lower Egypt than in Upper Egypt. This needs to be explained. There is a probability that it has to do with the presence of state officials, which tends to be higher in the capital city and in the North in contrast to the South. It may also be due to the fact that entrepreneurs in Lower Egypt and Cairo have better access to assets and capital, and thus, are more tempting for state officials to predate.

Part Three Tunisia's Entrepreneurship Ecosystem: Barriers and Reforms

1- Sample composition and description

The Tunisia sample is made up of a hundred respondents whose questionnaires were collected between June and September 2013. Female entrepreneurs stand for 30 of the total number of surveyed entrepreneurs. The sample is regionally distributed between the two main regions in Tunisia, the coast and the inland areas besides the capital: Le Grand Tunis and Monastir have been taken as representatives of the Coastal region while Kebili represents an inland city. The regional distribution is indicated in the following table:

Table (3.1): Sample composition in Tunisia (percentage points)

Region		Entrepreneurs age		Educational attainment	
		21-40	Over 41	School education	Higher-education
Le Grand Tunis	43	78	22	22	78
Monastir	10	100	0	5	95
Kebili	38	88	12	18	72
Total/Average	100	89	11	15	82

The relative weights assigned to each of the urban centers roughly echoes the actual population distribution in Tunisia where almost 60 percent live on the coast while the remaining 40 percent reside in the in-land provinces to the West and South of the country.

The formal sector (defined as legally registered companies) stands for 75 of the total sample whereas those who reported to be operating without registering are 20. (Five respondents did not provide an answer to this question.) As for the age cohorts covered in the sample, 47 respondents were found to be between 21 and 30, 39 respondents belong to the 41-50 intervals. Only two of the respondents reported to be below 20 while eight reported to be over 50. Four respondents gave no answer.

The entrepreneurs included in the sample are predominantly young, well-educated and with a past experience as wage-employees or students. All in all, 79 of the respondents reported some high-education degree (university degrees or their equivalent), followed by 16 who reported to be graduates from high school. Only two had no formal education.

Surveyed entrepreneurs can be divided into two broad age groups: younger entrepreneurs

who are below 40 and older ones who are over 40. The division is inspired by Campante et al (2011) argument about the critical size and role of this “not-so-young” age cohort in the Arab countries, including Tunisia. Younger entrepreneurs included in the survey constituted 87 percent of the sample. Fifty-three percent of them were between 21 and 30 and 45 percent between 31 and 40. Seventy-two percent of the younger entrepreneurs were males (32 percent females). A massive 85 percent of younger entrepreneurs reported to be holding some high-education degree while 15 percent had a secondary-level education.

As for their pre-entrepreneurial careers, 37 percent reported to have been students and 39 percent were wage-employees before becoming entrepreneurs. Only nine percent were self-employed, three percent worked for family business and 15 percent reported to have been unemployed. The high percentage of students reflects the average low age of the surveyed entrepreneurs while the relatively low percentage of those coming from unemployment shows that the vast majority were motivated by factors other than mere job seeking or petty income generation. The fact that young educated entrepreneurs, among whom a sizable percentage were either students or wage-employees would opt for some privately-owned and managed activity dispels the long-standing established conviction in policy and academic circles that the people of the Middle East and North Africa lack the entrepreneurial spirit and that due to decades of state socialism they seek solely public-sector jobs²⁶.

The older entrepreneurs’ category is much more limited in size with only eight entrepreneurs. The majority was between 41 and 50 (88 percent of them). Eighty-eight percent were males. Naturally the average firm age reported was much higher (10.71 years). Education levels reported are relatively lower than their younger counterparts. Only 50 percent reported to have had some higher-education degree while 38 percent had some secondary-education.

As for the enterprises included in the sample, the average firm age hovers around three years. The sample indicates various ownership structures: 62 of the enterprises had a single owner/manager. Nine were family businesses while non-family partners owned 15 percent of the surveyed enterprises

The sample has a big representation of micro firms employing less than 6 non-family workers (72 percent of total number of enterprises included in the survey). Small firms (employing between 6 and 50 workers) stood for 10 percent of the sample. The average firm age of both categories was reported to be low (three years for micro enterprises and 4.1 years for small ones). However, the sample only included micro-firms that employed non-family workers. Hence single-owned micro-enterprises that are usually made up of only one person together with exclusively family-based micro-enterprises were excluded. The rationale behind the removal of these kinds of micro-firms is to weed out subsistence or necessity-driven activities that are usually performed by the poor or the unemployed as a

²⁶ In a comment on the Arab revolution, Hernando De Soto said in an interview with Policy World Journal in the summer of 2011 that those who first revolted against the ruling regimes in MENA were not on salary but rather what he considered as a “social class” of entrepreneurs, “albeit very small entrepreneurs”. He followed up by saying that “the majority of Egyptian and Tunisians are not on a salary. They are earning their own incomes”.

means for gaining a living. The average annual turnover reported by the micro-firm entrepreneurs in the sample was D.T. 291,985 (roughly equal to 182,434 dollars). The turnover is significantly higher than the annual per capita income in Tunisia (for 2012), which was 4237 dollars according to the World Bank.

Most micro enterprises were owned and run by a single owner/manager (76 percent) while only seven percent were family businesses and 13 percent had the form of non-family partnership. Conversely, small firms were more evenly distributed across the three ownership categories. Forty percent were reported to have some form of non-family partnership, followed by 30 percent owned/managed by single entrepreneurs and 20 percent were family businesses.

The rather low reported enterprise age and the high representation of young entrepreneurs (47 between 21 and 30) show that the sample targets this particular category of nascent firms and new market entrants. This characteristic becomes more apparent if the reported firm size is considered also (72 as of micro-size) as nascent enterprises often belong to this category. Moreover, 32 respondents said that they were students directly before they started their own businesses.

Most enterprises included in the survey were nascent (less than 3 years old) standing for 80 percent of the sample. The overrepresentation of this category has to do with the prime interest in entrepreneurship activities, which usually has to do with new market entrants. Nascent enterprises stood for 80 percent of the total sample. Young enterprises (Between 3 and 10 years of age) were 15 percent of the sample and finally established enterprises (Over 10 years) constituted only 5 percent of the total number of surveyed enterprises. As expected, nascent and young enterprises had a much bigger representation of young entrepreneurs (less than 40 years old). This age cohort of entrepreneurs represented 91 and 80 percent of total owners/managers of nascent and young enterprises and only 60 percent of those of established enterprises. Also as expected, firm size reported tended to become bigger across time. While 71 and 87 percent of nascent and young enterprises were reported to be micro, only 40 percent of established firms were so while another 40 percent was small in size.

The enterprises included in the survey show a diversity of ownership structures. Single-ownership was the predominant form (61 of the surveyed enterprises) followed by non-family partnership companies (15 percent) and then family businesses (nine percent). The entrepreneurs owning and managing all three structures were relatively young: below 40 years of age (89, 100 and 80 percent for single, family and non-family ownership, respectively). The highest percentage of female entrepreneurs was found in the family-business category (56 percent) compared to only 26 and 20 percent for the single and non-family ownership enterprises, respectively. As for firm age, the average age reported for single-ownership enterprises was 2.92 years compared to 2.75 years for family business and 6.08 years for non-family. Entrepreneurs that own/manage non-family partnership enterprises were the most educated (93 percent were higher-education graduates) versus 74 and 78 percent for single-owned and family businesses. Firm size tended to relatively increase for non-family partnership enterprises (27 percent reported to own/manage small firms compared to five and 22 percent for single-owned and family businesses).

This section will explore the entrepreneurship ecosystem in Tunisia and the barriers to entry and growth as expressed by the respondents. As in the previous section on Egypt, the analysis will proceed with each component of the entrepreneurship ecosystem.

2- Property rights and the rule of law

As mentioned in part one of the study, the first component of the entrepreneurship ecosystem is the property rights regime and the rule of law. This component has to do with the broadest and most basic institutional framework within which entrepreneurs are expected to operate and exact their transactions. Hence, the entrepreneurs' influence to enter the market and their assessment of uncertainty and risk – and thus, their perception of market opportunities and growth – is taken to heavily influence.

2.1- Business registration and barriers to entry in Tunisia

The questionnaire was designed to catch the entrepreneurs' views and experiences with the access to the formal structure of laws, regulations and institutions. Hence, much emphasis was put on the procedural process of business registration. The barriers to entry to the formal economy refer here to the administrative, regulatory and legal factors that are reported by the survey respondents to have hindered the formal registration of their enterprises.

As in many developing economies, there is always the option for entrepreneurs to operate in the informal sector while bearing the cost of doing so that may take the form of the foregone opportunities for growth; restrained access to finance and to larger markets altogether; and harassment. Hence, by barriers to entry, we primarily mean the entry to the formal economy with registration and license to operate by the government.

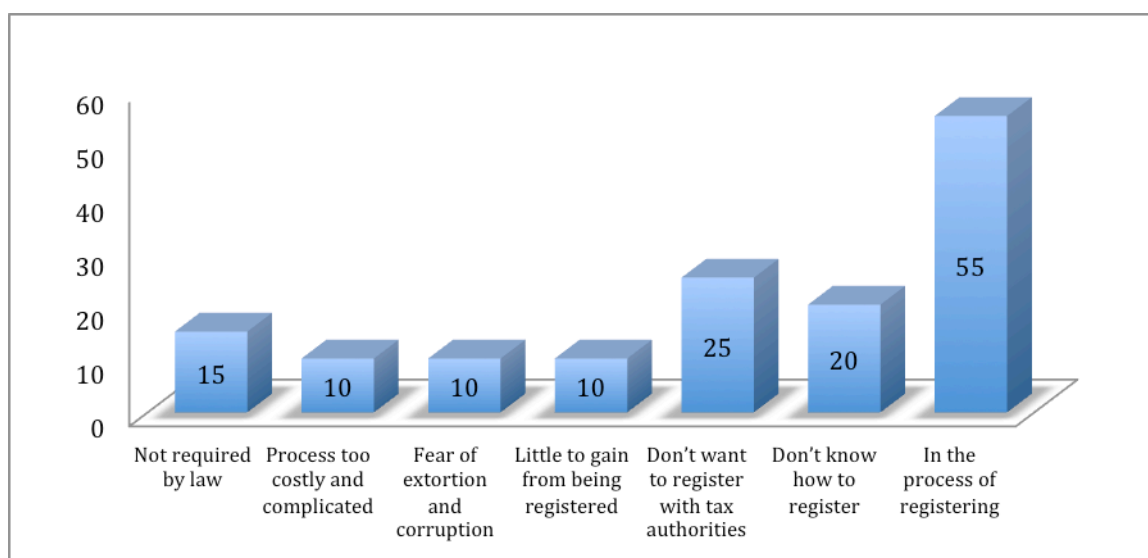
According to the survey in Tunisia, 20 respondents out of a 100 reported not being registered. However, not all non-registered reported cases belong to the informal sector. Eleven out of the total of 20 respondents said that they were in the process of getting their businesses registered. Hence, they are closer to the category of would-be-entrepreneurs rather than that of the informal sector. The remaining nine can be genuinely considered to be operating in the informal sector. The meager representation of this group of entrepreneurs has to do with the way the study defines informality. The focus in this study does not lay on informal business transactions or informal labor but rather targets primarily non-registered enterprises that employ at least one to five nonfamily workers. As was mentioned in the introduction. This is quite rare in Tunisia where the economy is much more regulated than in Egypt.

The author of this report was informed on different occasions that informal businesses were confined to commercial and menial service activities that have no designated or definite place in which to operate. However, it was virtually unperceivable that a workshop or a small factory would operate informally without registration in Tunisia. This assumption is supported by the recent study on the Tunisian informal sector where informal businesses that employ workers constitute almost a negligible percentage of the entrepreneurs' population standing for less than one percent based on a survey of informal workers

conducted in Tunisia in 2013. Informality in Tunisia – which remains sizable at 40 percent of the GDP according to certain estimates – refers more to informal transactions made by registered businesses, be it in the form of smuggled goods, labor without contracts, tax evasion or transactions that are not reported to the state.

Going back to the 20 respondents that reported not having registered their businesses, when asked about the reasons for not registering, 11 said that they were in the process of getting their business registered (55 percent). Five respondents expressed their unwillingness to register with tax authorities (25 percent) followed by four entrepreneurs (20 percent) who said they lacked information about how to register. While 20 percent stated that the law did not require their business registration, 15 percent held the process to be too costly and complex. Another 15 percent said that business registration has a limited economic return. Some respondents gave more than one reason for not registering. The following figure depicts the main reasons for not registering as indicated by respondents:

Figure (3.1): Reasons for not registering as indicated by entrepreneurs (percentage of respondents)



When asked about the reforms that would make them more inclined to register, 13 respondents (65 percent) said that they would register if the procedures and required documents were simplified and reduced in number; 10 respondents (50 percent) demanded cutting the fees and expenses of registration; and four respondents (20 percent) stated that they would register if their exposure to extortion and bribery while registering decreased.

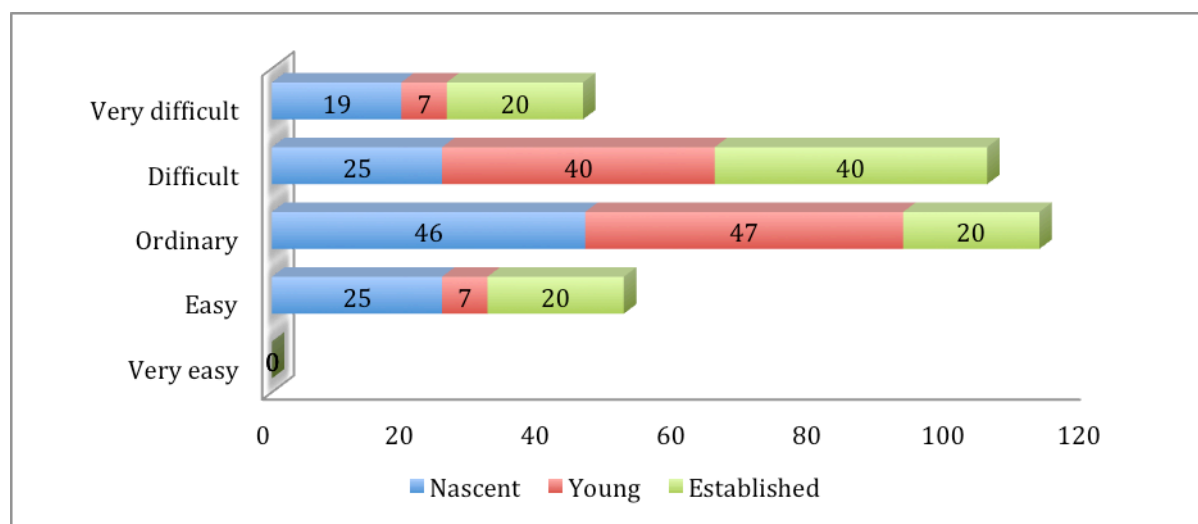
Among those who reported the registration of their enterprises (80 respondents), the average number of government bodies they reported to have dealt with to secure all the required permits and licenses was 3.41. The average time reported by entrepreneurs to get

their enterprises officially established was 5.56 months²⁷.

As for the process itself, none of the respondents indicated that the process was “very easy.” Only four percent said that it was “easy.” Conversely, 45 percent held it to be “ordinary.” Twenty-eight percent and 17 percent of the respondents reported the process to have been either “difficult” or “very difficult,” respectively. From among those who chose “difficult” or “very difficult” from a total of 45 of the respondents, 51 percent said that the problem lied with the laws and regulations while 60 percent said that the source of difficulty was government bureaucracy.

Such results show that a clear of majority of Tunisian entrepreneurs did not sense the administrative reforms that the government implemented in the years prior to the revolution were effective. Has the process become easier through time? Contrasting the views given by entrepreneurs on the basis of their enterprise age may help in answering this question.

Figure (3.2): The difficulty of the registration process by enterprise age as indicated by entrepreneurs (percentage of respondents)



According to the figure above, the percentage of entrepreneurs who held the process to be either “difficult” or “very difficult” has declined over time. The percentage was 60 percent for established enterprises, 47 percent for young enterprises and 44 percent for nascent firm owners/managers. Moreover, the number of agencies indicated by each age group shows a downward trend from an average of four agencies indicated by established-enterprise owners/managers to 3.4 agencies for young and nascent firms. However, despite the relative improvement, a considerable percentage of entrepreneurs still perceive the registration process to be hard, complex and expensive. Such results significantly contradict the reports and indices developed by the World Bank and other international financial institutions regarding the ease of conducting business in Tunisia.

²⁷ This average number of months was calculated with the exclusion of one respondent in Kebili who reported to have taken 10 years in his attempt to register (120 months). The respondent’s case was too exceptional to be included in the average calculation.

However, the disparity can be explained in terms of the sample composition of this study as opposed to that of indices such as “the easiness of doing business.” Whereas the main component in this sample is small and micro enterprises in the capital city as well as in other provincial cities, the *Doing Business* index has focused primarily on medium and large enterprises in mainly capital cities.

One of the interesting findings is that a clear majority of respondents expressed a positive attitude towards registering their business. When asked to evaluate the impact of officially registering their businesses on access to finance, business security and access to markets the following answers were given:

Table (3.2): The impact of formal business registration as indicated by entrepreneurs (percentage of respondents)

The impact of registering	Very Important	Somehow important	Not that important	Not Important at all	No answer
Access to finance	60 percent	15 percent	3 percent	6 percent	16 percent
Business security	57 percent	17 percent	6 percent	6 percent	14 percent
Access to markets	62 percent	13 percent	5 percent	6 percent	14 percent

A clear majority of answers seems to consider the positive impact of registration despite the reported difficulties in business registration. Such observations go along with the earlier indicated reasons for not registering that focused on the fear of dealing with the taxation authorities and not knowing the rules and procedures required for registration. Hence, it is safe to state in the case of Tunisia – as with Egypt – that a majority of entrepreneurs have indicated their willingness to register their businesses and are quite aware of the positive outcome of registration. However, the laws and regulations their application by the administration may deter them from doing so.

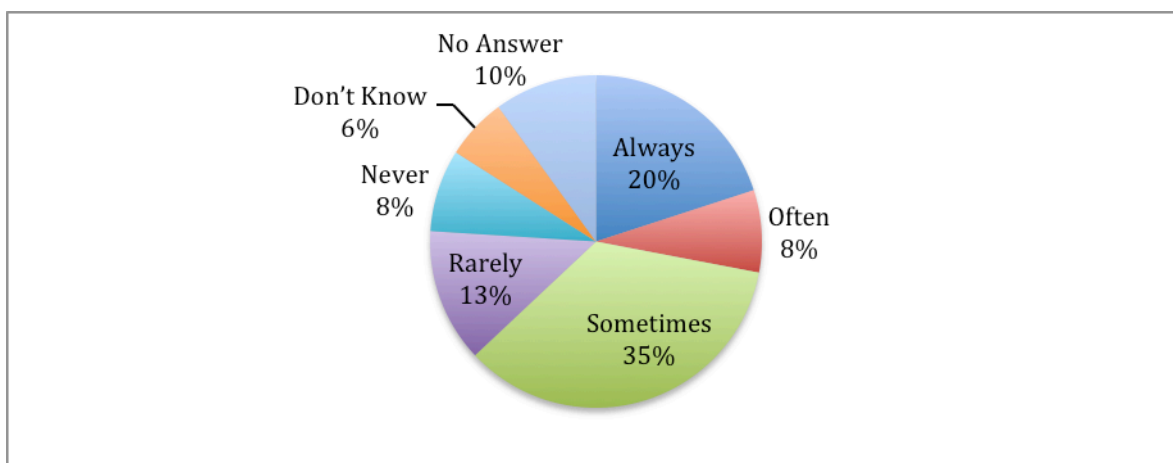
2.2- Contract enforcement

Besides business registration, the resort to formal contracts is another proxy to the entrepreneurs’ accessibility to the property rights regime. Formal contracts in the survey refer to all state-registered agreements and reported transactions that may take the form of a contract, bill or check, among others, as opposed to oral and non-registered – informally enforced – agreements governing transactions. When asked whether formal contracts have potentially a positive impact on their business, 74 of 100 respondents answered in the affirmative. The percentage almost corresponds to those who reported to have their business registered by the state. However, taking a look at the frequency of resorting to such formal contracts provides a closer and more dynamic view of the actual registration of

economic transactions by Tunisian entrepreneurs and enterprises.

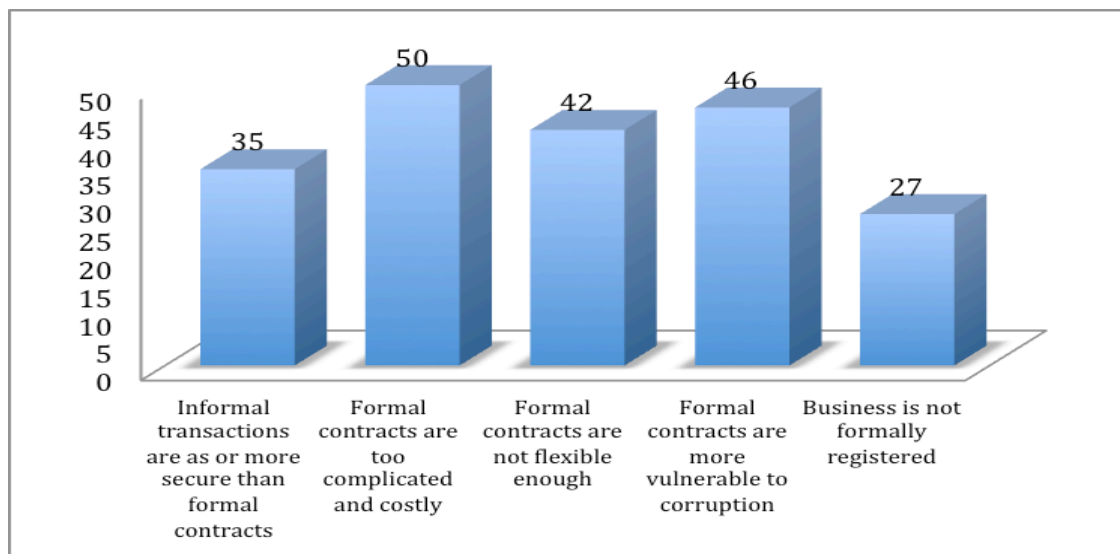
Though a high percentage of entrepreneurs expressed their favorable attitudes toward exacting formal transactions, a significantly lower percentage reported their actual resort to formal contracts. Only 20 percent of the respondents stated that they “always” use formal contracts in doing their business. Eight percent said that they “often” use formal contracts. Conversely, 35 percent reported that they “sometimes” use formal contracts in comparison to 13 percent answered “rarely” and eight percent who never resorted to them. The figures are quite revealing. They provide live evidence for the high percentage of informal transactions that are made through various means other than formal, registered and written contract forms. The figure below depicts the ratios in a pie chart.

Figure (3.3): The frequency of resorting to formal contracts as reported by entrepreneurs (percentage of respondents)



What can explain the rather modest reported use of formal contracts in Tunisia where only 20 percent reported to be “always” using them? Sixty-one percent of the respondents expressed their belief that formal contracts can be defended. As in Egypt, this can be considered a low percentage and a clear sign of the poor status of the rule of law where entrepreneurs may have contracts that do not practically provide them with enough protection. Among those who expressed the view that formal contracts are not enforceable in Tunisia (39 percent of the respondents), 67 percent (26 respondents) said that the legal procedures were too complex, costly and time-consuming. Similarly, 44 percent (17 respondents) held that the problem was with the laws and regulations that they deemed deficient while 38 percent (15 respondents) expressed their distrust in the judiciary. The figure below displays the reasons provided by the respondents on that matter.

Figure (3.4): Reasons behind not resorting to formal contracts as reported by respondents (percentage of respondents)

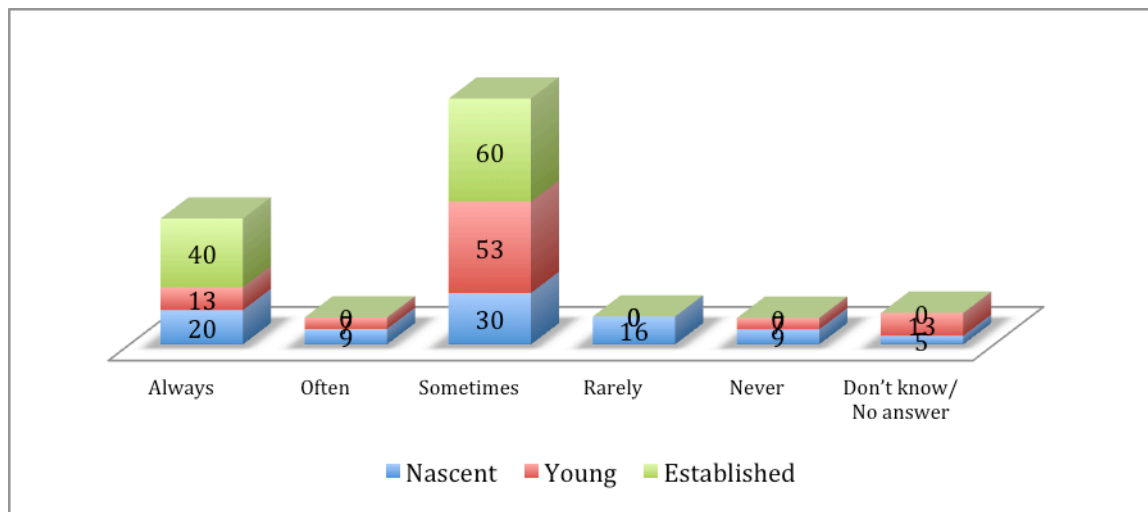


Around 41 of 100 respondents stated that contract enforcement was the principal barrier to growth that they faced. Contract enforcement came as the fourth principal barrier to growth as expressed by respondents. The Tunisian entrepreneurs held contract enforcement as a larger impediment to growth than the access to electricity and land.

Perceived weak contract enforcement and the reported irregular resort to formal contracts may have a detrimental impact on the prospects of business growth, expansion and the chances of accessing finance, capital and markets. As the literature has outlined, it is quite plausible to link the weak status of contract enforcement and the inclination among entrepreneurs to avoid resorting to them with the stifled growth of micro and small enterprises that constitute the majority of privately owned firms. In the absence of robust structures that could enforce contracts between parties, the transaction cost is likely to be quite high due to the high risk attached to the contract. In such an ecosystem, transactions remain confined to narrow circles of trust or they remain short-term with small values and operational only in cash. These are all characteristics of a micro and small-sized private sector that have small prospects for growth. This is apparently the case in Egypt and Tunisia.

However, the overall weak access to formal contracts is not even across enterprise and entrepreneurs' categories. For instance, contrasting the answers given by the reported enterprise age reveals a tendency toward more informality among younger enterprises. The figure below shows that all established enterprise-owners/managers have reported to either "always" or "sometimes" use formal contracts in their transactions. Conversely, 73 percent of young firms and 59 percent of nascent ones reported some form of resort to formal contracts. Twenty-five of nascent enterprise respondents said that they "rarely" or "never" use formal contracts.

Figure (3.5): The frequency of resorting to formal contracts by enterprise age as reported by entrepreneurs (percentage of respondents)



The relatively higher resort to formal contracts reported by established enterprises can be explained in terms of firm size, which tends to increase over time. Established enterprises had a larger representation of small enterprises than micro ones – 40 percent compared to 10 and zero percent for nascent and young enterprises. Entrepreneurs who own or manage small firms have reported a significantly higher frequency of resorting to formal contracts than their counterparts. For instance, whereas 40 percent of small firm-owner/managers reported to have “always” used formal contracts, only 19 percent of micro-firm owners/managers reported doing so. This trend may suggest that enterprises become more formal overtime.

How about entrepreneurs’ age groups? Do younger entrepreneurs – those below 40 – lean toward more or less usage of formal contracts and legal structures? By dividing the respondent entrepreneurs by age, younger ones indicate a lower frequency of resorting to formal contracts than their older counterparts. Approximately 63 percent of the younger entrepreneurs indicated some usage of formal contracts (always, sometimes or often) as opposed to 88 percent of older ones. Moreover, a larger number of the younger ones reported to have “rarely” or “never” used formal contracts (23 percent) than their older counterparts (13 percent). However, interestingly enough, both groups have expressed a strong belief in the positive impact of using formal contracts at 79 and 75 percent for younger and older entrepreneurs, respectively). Moreover, a larger percentage of younger entrepreneurs at 64 percent expressed the belief that contracts are enforceable in Tunisia than their older peers at 38 percent. This can be taken as a positive sign that younger entrepreneurs have more confidence in the formal legal system though they indicate resorting to it less often than their older counterparts. Yet, this may also be a situation in which those who deal more often with the system are the ones that sense its limitations more.

2.3- Competition

A significant percentage of respondents (59 out of 100) expressed the belief that their business has been affected by unfair competition that has limited their access to markets and growth potential. These unfair practices, as stated in the questionnaire, include price fixing, monopoly and the unfair control over supply and production inputs. Weak competition protection and monopolistic or oligopolistic practices also indicate a weak regulatory capacity by the state lending toward a rather hostile ecosystem to new market entrants and smaller business units.

Among those who said that they were affected by unfair competition, 88 percent (52 respondents) held the effect to be negative on their growth prospects. The figures are relatively high and indicate that the markets in Tunisia – as in Egypt – suffer from various practices that limit free competition, and thus, curtail the growth opportunities and market accessibility for many entrepreneurs.

When asked about the reasons behind such unfair competition, a total of 80 percent either “completely agreed” or “agreed” with the statement that laws and regulations in the field of competition were deficient and suffered from major flaws. However, another significant percentage (90 percent) stated that the problem had to do more with the implementation and enforceability of laws and regulations than with the laws themselves. Seventy-six percent of the respondents either “completely agreed” or “agreed” that state officials were biased to certain firms and businessmen. The general view tends to hold that the laws are either too weak or are not enforced and that the state is biased to certain economic actors at the expense of others. The table below depicts the answers in details:

Table (3.3) Views on the factors contributing to unfair competition

	Completely agree	Agree	Disagree	Completely disagree	Do not know
Laws and regulations are deficient and suffer from major flaws	43 percent	37 percent	9 percent	3 percent	8 percent
State officials are biased to certain businessmen	43 percent	33 percent	7 percent	5 percent	12 percent
Laws and regulations are good but the problem is with their application and enforcement	54 percent	36 percent	8 percent	0 percent	2 percent

The answers given suggest that the restraints facing free competition are perceived as one main barrier to market entry. It is noteworthy that such views were expressed by a majority of micro and small enterprise owners and managers that constitute the largest chunk of the sample. Such enterprise owners and managers operate in small segments of the market and seem to suffer from price fixing and the monopolistic control of the factors of production as well as the final product markets.

2.4- Barriers to exit (bankruptcy and asset recovery)

Entrepreneurship is risky by definition and a considerable ratio of market entrants fail to survive, often forced to terminate their activity, at least for some time. Hence, the way bankruptcy and asset recovery are organized in practice is of extreme importance for the overall entrepreneurship ecosystem. Bankruptcy and asset recovery are intimately related to the areas of contract enforcement, the rule of law and property rights protection. Moreover, they are closely tied to the question of access to finance and risk that creditors have to bear to extend money to entrepreneurs.

Twenty-three percent of the total respondents reported that they once started and ended some type of economic enterprise. However, only five respondents of 23 (22 percent) reported to have resorted to formal bankruptcy regulations as organized by law. Conversely, the majority of those who reported to have gone out of business seemed to have dealt with the bankruptcy informally. When asked about the reasons for not resorting to the rules and procedures set by the law, almost all of the respondents (96 percent) said that these rules were too costly, complex and time-consuming, while 70 percent of them held that the laws penalized failure. An equal percentage maintained that resorting to these rules made it more difficult to revamp their enterprises.

As in Egypt, the above figures suggest that market exit is informally managed in Tunisia. Entrepreneurs seldom resort to the extant law and regulations, and they do not often resort to state agencies with regards to asset recovery. This may help in explaining the reported restraints on the access to credit as many institutions shy away from extending credit to enterprises aware of the low chances of recovering their assets upon business failure. It may also explain the reported discontent by entrepreneurs due to the high collateral and guarantee requirements by banks, funds and associations. Moreover, since bankruptcy and asset recovery often happen informally with no state intervention, this may suggest that entrepreneurs conduct their business within narrow circles of trustworthy people and family.

According to GEM (2008: 21; 2010:34), Egypt and Tunisia show low discontinuance rates. The rate was 4.9 percent in Tunisia – 2.2 percent quit their work and 2.7 percent reported closure. The low figures of enterprise churning indicate low entrepreneurial dynamism and less efficiency. For instance, Stevenson (2011: 14) held that the mean annual rate of business entry and exit in nine European countries over the 1997-2000 time period was 8.5 percent and 7.9 percent, respectively, which are almost the double the rates reported in Egypt and Tunisia. Along these lines, the World Bank (2009:120) reported, “The process of entry and exit of firms in MENA countries is less dynamic than in the transition countries of Eastern Europe.” However, the low rate of reported exit may not reflect the

actual number of those who go out of business without going through the bankruptcy and foreclosure procedures, especially considering informal enterprises constitute a sizable part of the private sector²⁸.

3-Financial subsystem: financial barriers to growth and entrepreneurship in Tunisia

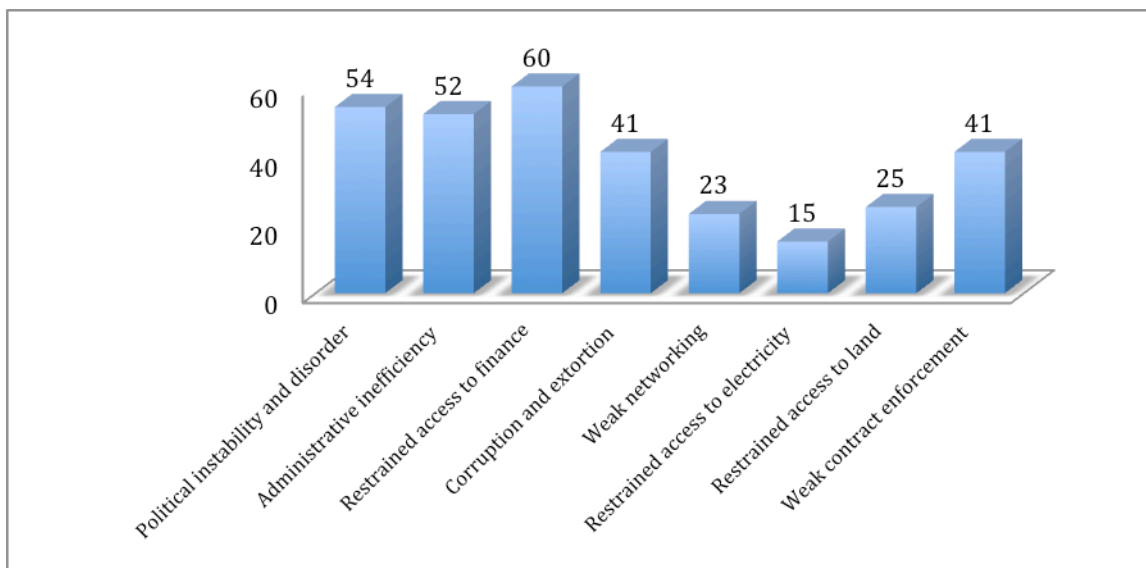
The second pillar of the entrepreneurship ecosystem in this analysis is the financial subsystem. The survey has been designed to catch the views and experiences of the respondent entrepreneurs on issues related to their access to finance and its impact on their growth prospects.

Interestingly enough, approximately 60 percent of the respondents held access to finance as the largest and predominant barrier to growth that they face. The access to finance was followed closely by political instability and public disorder at 54 percent and administrative inefficiency at 52 percent²⁹. It is quite revealing that access to finance was reported to be the top barrier to growth despite the ongoing political turmoil and security hazards in Tunisia following the 14th of January revolution. The figure below displays the barriers to growth as expressed by Tunisian entrepreneurs.

²⁸ A World Bank report (2007: 43) holds that closing a business is more difficult in the Middle East than in many other regions and that the rate of recovery is lower. On average it takes three years to close a business, and the recovery rate on initial capital is 30 percent compared to 75 percent asset recovery and 1.5 years in OECD countries; 30 percent and 2.5 years in Latin America; 20 percent; and four years in South Asia.

²⁹ Interestingly enough, the percentage of Tunisian respondents who held administrative inefficiency to be a top barrier to growth is close to that of Egyptians. Both entrepreneurs' groups have put administrative inefficiency in the second position – rather than corruption or extortion, which occupied the fourth and fifth positions. Inefficiency refers to the general lack of administrative capacity be it with regards to the formulation or the implementation of laws, regulations and implementations that affect business. Tunisia has traditionally scored better than Egypt, according to the World Bank governance matters index, which provides some comparative estimations of the regulatory quality by capturing the perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. Egypt and Tunisia converged – according to that index as of 2008 – as Egypt's administrative reforms caught the World Bank gaze. However, the two economies still operated on levels close to the MENA overall average (46.5% for 2011), which is already low as compared to Europe and Central Asia (70.1%) and Latin America (56.2%) though higher than South Asia (27.7%) and Sub-Saharan Africa (30%).

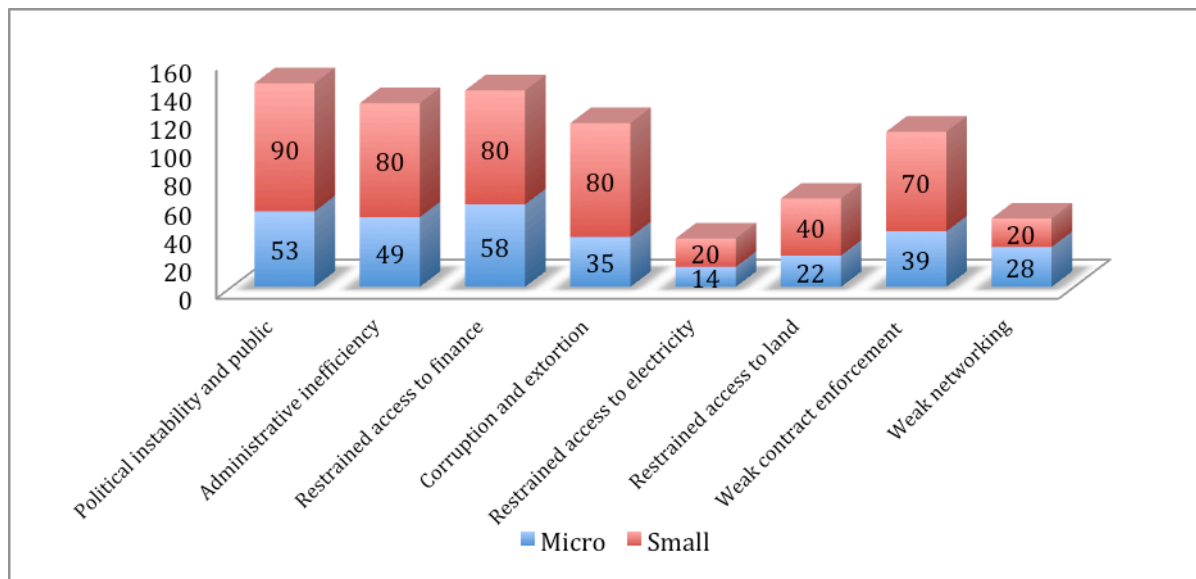
Figure (3.6): Barriers to growth as indicated by entrepreneurs (percentage of respondents)



Exposure to corruption and extortion came fourth with 41 percent of the Tunisian respondents holding it among the top barriers to growth³⁰. However, it should be noted that this barrier is not evenly distributed across all entrepreneurs. A larger percentage of entrepreneurs owning and managing small firms (67 percent) stated that they had to pay some bribe or gift for state officials compared to only 28 percent for micro-enterprise owners/managers. This actually suggests that the larger enterprises become, the more exposed they are to corruption and extortion. As in the case of Egypt, that can be taken as a Russian trait where entrepreneurs have many incentives to remain both informal as well as small so as to escape state predation. As a matter of fact, small firms in Tunisia seem to be facing larger problems in general than micro ones. The figure below depicts a general picture of the barriers of growth by firm size.

³⁰ It is remarkable that higher percentages of Egyptian entrepreneurs included in the survey underlined corruption as a barrier to growth than their Tunisian counterparts. Moreover, Tunisians report a significantly less frequency of paying bribes than Egyptians. These results go in harmony with what the literature has held for sometime that Tunisia is relatively less corrupt and more efficient than other bureaucracies in the region, including Egypt (Erdle 2010; Bellin 1994). This literature argues that the Tunisian bureaucracy has kept some esprit de corps in designing and implementing economic policies that made it less prone to corruption. Conversely, the Egyptian bureaucracy is too bloated to be efficient. Such remarks are supported by the World Bank *Governance Matters* figures for the period between 1996 and 2011 where Tunisia's score of "control of corruption" was higher than the region's average and that of Egypt. Lisa Anderson (2011) held that Tunisia's corruption was concentrated on the top and had to do with the predatory inclinations of Ben Ali's clan while the broad body of the bureaucracy exhibited less signs of petty corruption, unlike the case of Egypt where corruption was at both ends.

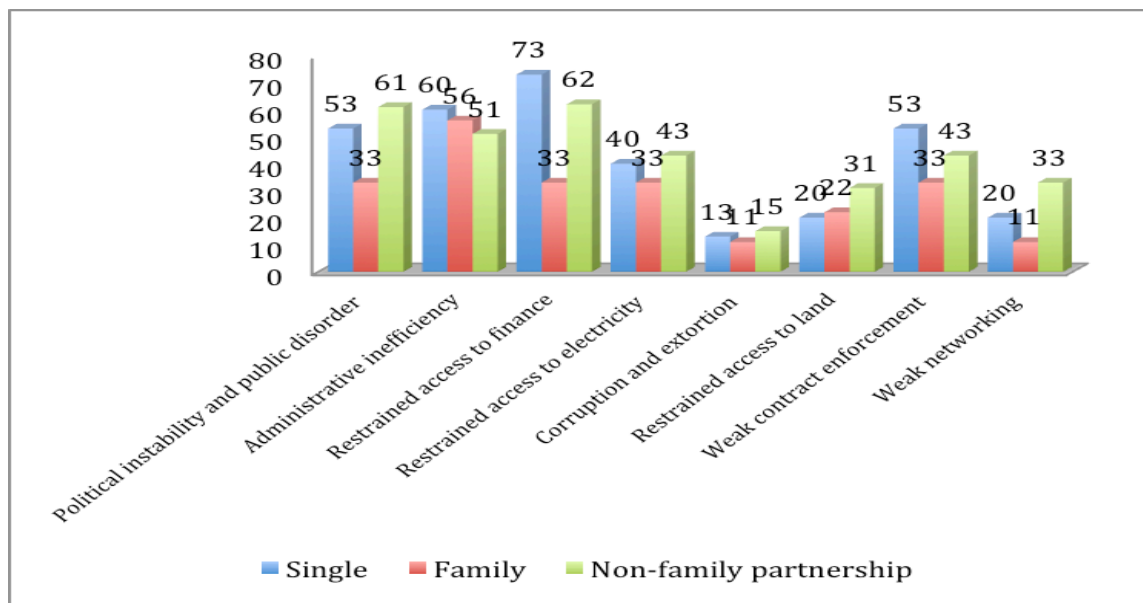
Figure (3.7): Barriers to growth by firm size as indicated by entrepreneurs (percentage of respondents)



Some of the barriers to growth indicated by entrepreneurs owning/managing small firms have to do with the relatively larger scale of activities of small firms as compared to micro ones. For instance, small firm-entrepreneurs are more impacted than their micro-enterprise counterparts when it comes to access to land, finance and electricity because they usually have more need of these resources. However, they perceive themselves to be more exposed to administrative inefficiency, weak contract enforcement and corruption because they are more formal and engage more frequently with governmental agencies.

However, enterprise size is not the sole factor that makes entrepreneurs interact differently with the restraints imposed by the ecosystem. Ownership structures provide very interesting insights.

Figure (3.8): Barriers to growth by firm ownership structure as indicated by entrepreneurs (percentage of respondents)



The figure above shows that a large percentage of entrepreneurs running single and non-family partnership enterprises reported political instability and public disorder (61 and 53 percent, respectively) as a major barrier to growth. Only 33 percent of family business-entrepreneurs reported instability to be a barrier; This implies that this ownership structure provided them with a wider safety net than the other two subgroups.

Family was an advantage as well with regards to access to finance, which was reported as a barrier by 33 percent of family business-entrepreneurs as opposed to 62 and 73 percent of single and non-family partnership entrepreneurs. As in Egypt, family businesses usually have access to more private savings and family-assets that can be used to approach banking institutions. However, it is interesting that single-ownership entrepreneurs reported finance as less of a problem compared to their non-family partnership counterparts though it is usually the other way round. However, this can be explained in terms of the financial and non-financial support structures that became increasingly available for new market entrants in Tunisia. Special banks and funds were primarily designed for single-ownership micro and small enterprises – or at least they did not provide incentives for other forms of ownership structures. This may even explain why the vast majority of young and nascent enterprises in Tunisia take the form of single-ownership in contrast to what has been found in the Egyptian sample where new entrants usually provide non-family partnership forms as a means to pool financial and non-financial resources in the absence of state support structures.

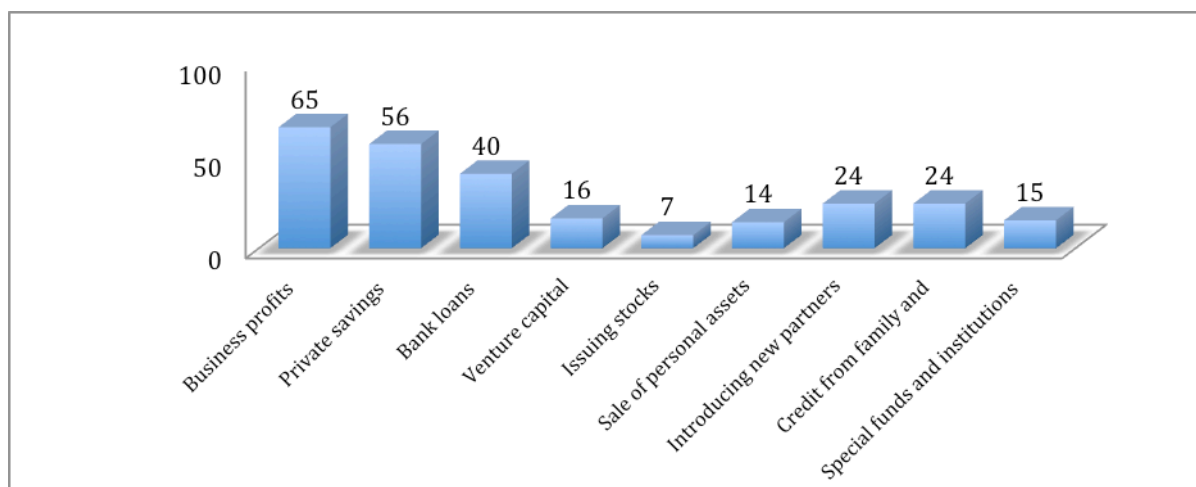
3.1- Finance: the top and foremost barrier to growth in Tunisia

Almost two thirds (65 percent) of the interviewed entrepreneurs stated that access to finance was the principal barrier to growth they faced. Indeed, access to finance has long

been one of the main problems that nascent as well as established entrepreneurs faced in Tunisia. The survey tackled the question of finance through two angles: the sources of finance reported by entrepreneurs while operating their business while and the start-up capital composition at the early stages of starting a business.

According the survey, the two top sources of finance that entrepreneurs reported were business profits at 65 percent followed by private savings at 56 percent. Credit from banks came in the third place at 40 percent. The figure below depicts various sources of finance as reported by entrepreneurs. Special funds targeting SMEs and young entrepreneurs; venture capital; and issuance of stocks came at the end of the list. Only 15 percent reported to have resorted to special funds and 16 percent and seven percent for venture capital and stocks, respectively.

Figure (3.9): Sources of finance as reported by entrepreneurs (percentage of respondents)



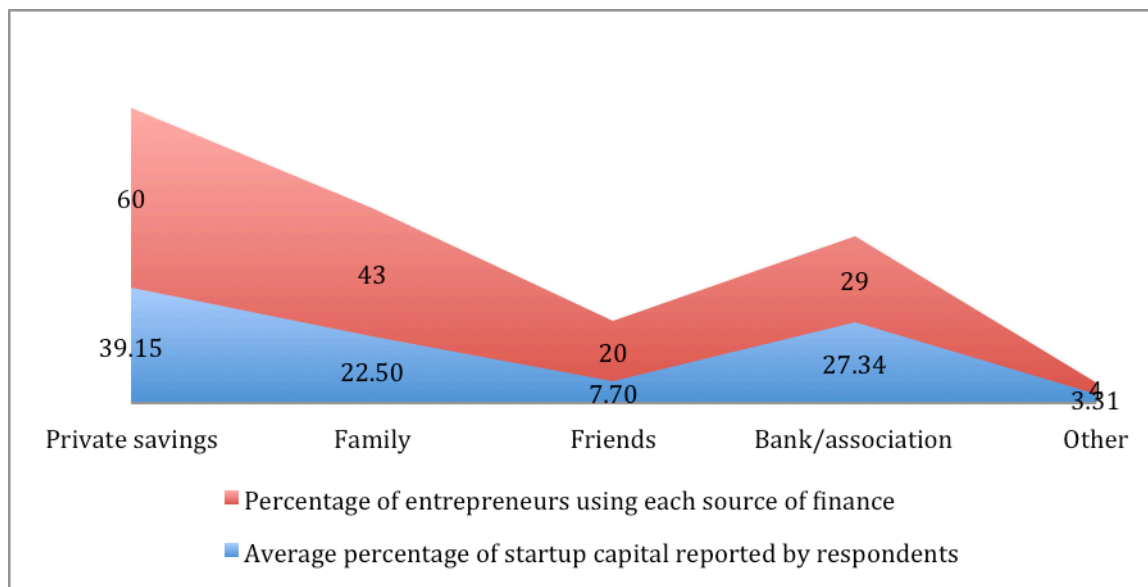
The above ratios clearly show that most entrepreneurs in Tunisia – like in Egypt – depend on some sort of self-financing, mainly on the profits generated by the business itself together with their private savings. The principal institutional channels that should provide debt or equity do not seem to function for the majority of entrepreneurs and the broader base of the Tunisian private sector.

However, despite the fact that bank loans came in third place, the percentage of entrepreneurs who reported resort to bank loans (40 percent) is quite sizable compared to their Egyptian counterparts at seven percent. This actually goes in harmony with other evidence provided by the literature, which holds that Tunisia is among the best MENA countries in facilitating loans for micro and small enterprises. For instance, Rocha et al (2011:22) reports that the share of SME loans to total bank loans in Tunisia was 15 percent compared to only five percent in Egypt; 13 percent for non-GCC countries; and eight percent for the MENA region as a whole.

As for start-up capital, the survey provides two different means of assessing the access to finance at the start-up phase. The first comprises the average contribution of each source of

finance to the start-up capital as reported by entrepreneurs. Meanwhile, the second considers the number of respondent entrepreneurs that reported resorting to each and every source of finance. Contrasting the two can help in assessing how accessible each source is to entrepreneurs. The figure below displays both percentages:

Figure (3.10) Sources of finance at the start-up phase as reported by entrepreneurs (percentage of respondents)



A total of 74 respondents provided valid percentages of their start-up capital composition. As expected private savings constituted an average of 39.15 percent of total start-up capital reported by respondents. This was reported by the highest percentage of entrepreneurs as well at 60 percent. The second source of start-up capital was formal credit from banks, funds and associations – 27.34 percent of the average reported start-up capital. This source was reported by 29 percent of the respondents. One has to also consider that the definition of banks for this study includes special banks such as the BTS and BFPME, which specializes in financing new ventures, young entrepreneurs, and micro, small and medium-sized enterprises³¹.

Despite the relatively large share of formal credit in start-up capital formation, it was only reported by less than a third of the entrepreneurs. Conversely, 43 percent of respondents reported obtaining start-up capital from family and 20 percent from friends. However, their share in the start-up capital formation was merely 22.5 and 7.7 percent, respectively.

While banks and special funds provided the second largest share reported for start-up capital, their base of beneficiaries did not exceed one third of the respondents. This

³¹ According to Rocha et al (2011:2), state-owned banks still play an important role in providing finance to SMEs with a share similar to private banks.. Public banks seem to be taking greater risks than private banks in the SME lending business. They are less selective in their strategies to target SMEs and have a lower ratio of collateralized loans to SMEs.

indicates that access to formal sources of finance remains quite restrictive and restrained for the majority of new entrants who find themselves forced to depend on their – albeit humble – private savings or family and friends for start-up capital.

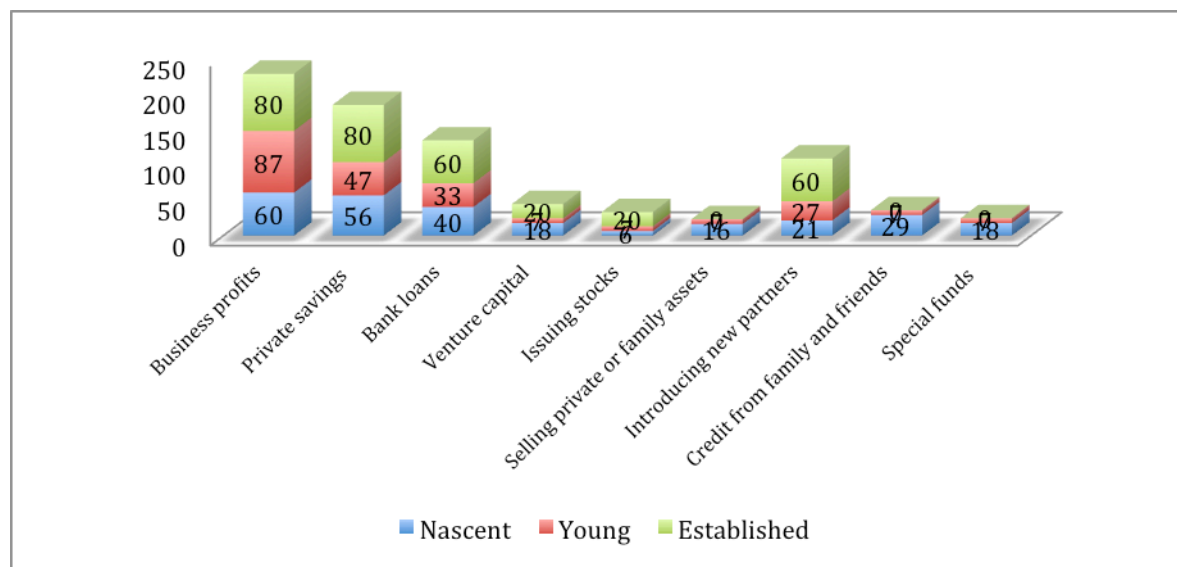
The above figures depict the most general picture of access to finance in Tunisia. However, not all entrepreneurs and enterprises work the same way with respects to restraints imposed by the financial subsystem. In the coming paragraphs, the answers provided on the sources of finance and start-up capital composition will be broken down by enterprise age, ownership structure and age.

3.1.1- Access to finance and young entrepreneurs and enterprises

As the figure below shows, established and young enterprises report a higher resort to business profits than nascent ones. Established enterprises also report higher dependence on bank credit than young and nascent ones, likely because established enterprises are more eligible for bank loans than new market entrants. Yet, a considerable percentage of young and nascent enterprise owners/managers reported using bank loans (40 and 33 percent, respectively). Such figures refer to the relative availability of credit for new ventures in Tunisia through special banks such as the BTS and the BFPME. Similarly, nascent enterprise owners/managers reported higher resort to special funds, which indicates that these programs are oriented towards entrepreneurship activities.

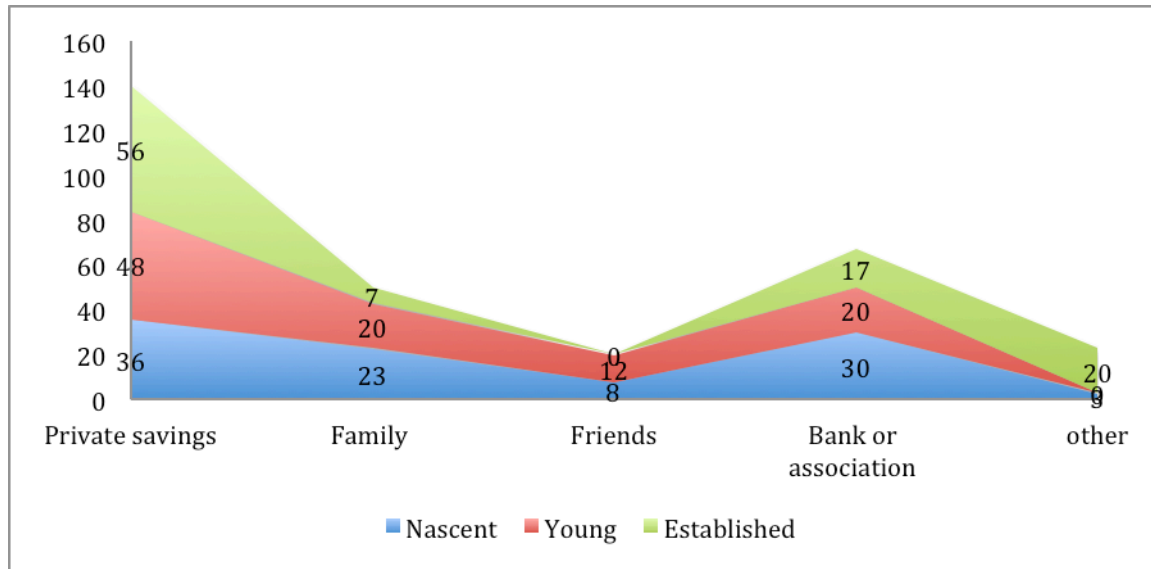
The answers given by surveyed entrepreneurs show that established-enterprise owners/managers are more likely to apply for bank loans at 80 percent compared to nascent and young enterprise owners/managers at 49 and 53, respectively. Though the reported approval rate is the highest for established enterprises at 82 percent, it does not fall far behind for nascent enterprise owners/managers at 75 percent. This gives some positive light for the financial support structure in Tunisia.

Figure (3.11): Sources of finance by firm age as reported by entrepreneurs (percentage of respondents)



Contrasting enterprises on the basis of age can be quite helpful in catching the start-up capital formation in motion. The figure below contrasts the components of start-up capital as reported by each firm-age group.

Figure (3.12) Sources of finance at the start-up phase as reported by entrepreneurs (percentage of respondents)



The figure reveals some considerable changes across time. There is a pronounced trend of less dependence on private savings and more dependence on money provided by family, friends and banks/funds. Whereas private savings were reported to have constituted an average of 56 percent of total start-up capital for established firms – those older than 10 years of age, the percentage was 48 and 36 percent for young and nascent ones, respectively. Conversely, the lower dependence on private savings only meant a shift beyond self-financing into a variety of formal and informal financing. Young and nascent enterprises – those less than 10 years of age – reported much higher percentages of bank credit. This coincides well with the operational expansion of special banks targeting young entrepreneurs, new ventures and small and medium-sized enterprises, namely the BTS and BFPME.

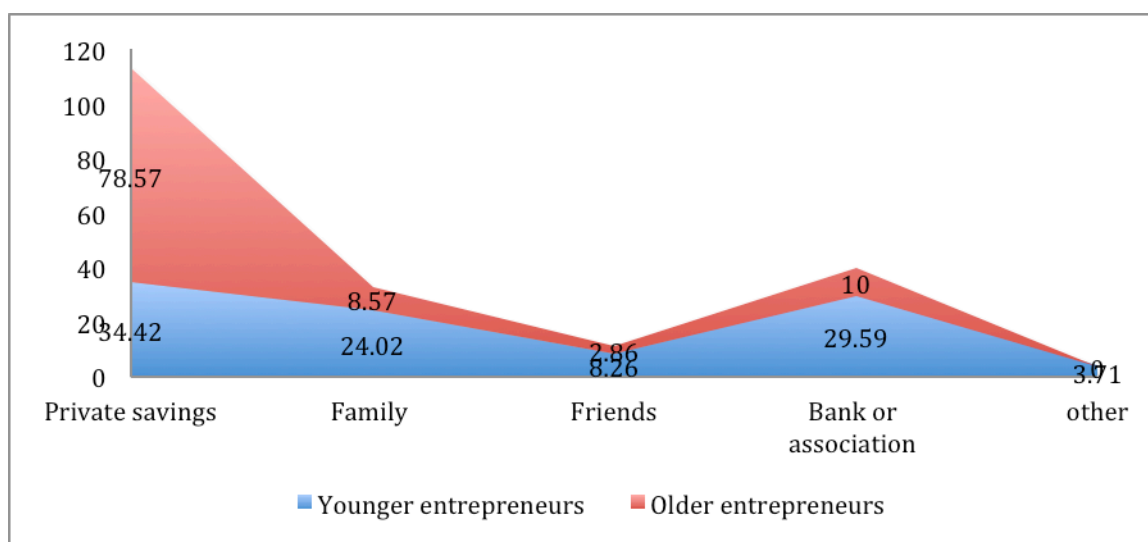
The survey provides some good evidence that some of the new market entrants have access to bank resources at the start-up phase. The survey included ten would-be-entrepreneurs who reported to be in the process of founding their businesses. Seven out of the ten reported to have resorted to bank loans at the start-up phase. Money from banks and funds constituted an average of 62 percent of their reported start-up capital. All would-be-entrepreneurs belonged to the younger age cohort between 21 and 40 years of age, and all reported to be higher-education graduates.

However, it is interesting that both formal and informal sources of finance reported a simultaneous increase over time. This can be at least partly explained in terms of the

requirements set by these very banks and funds for self-financing – *auto-financement* – as a precondition for loan provision. Young entrepreneurs often have to rely on “love-money” from family as well as from friends to provide the required premium so as to secure loans. The same family and friend-based networks are for use in providing a rented office or a piece of land at the early stages of the project.

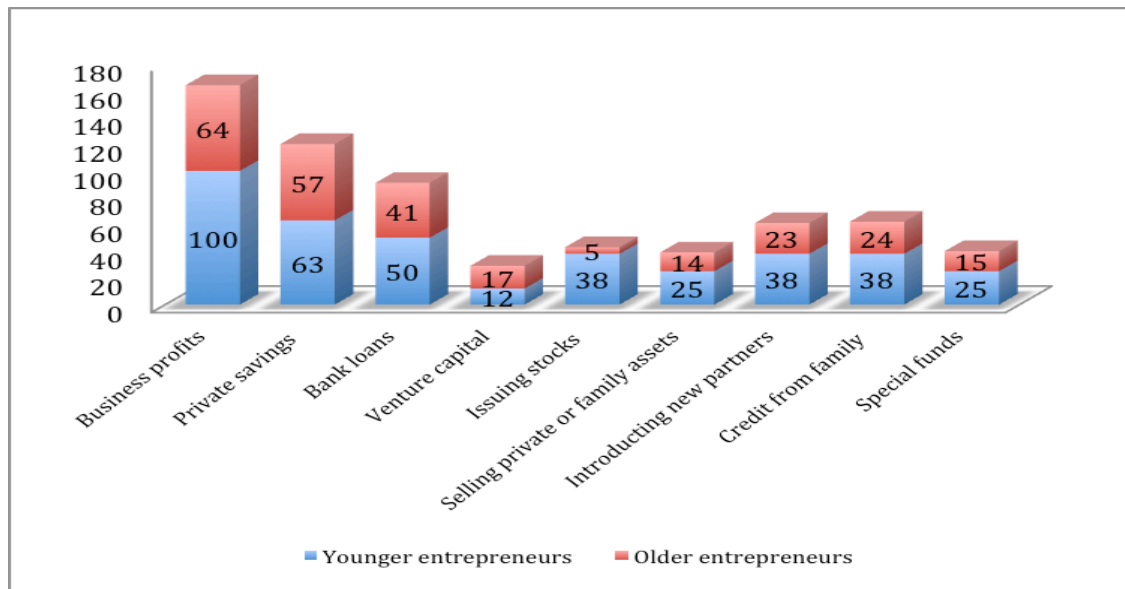
As the bulk of nascent and young enterprises are owned and managed by younger entrepreneurs who are defined to be below 40, it would be interesting to reassert the earlier remarks by contrasting entrepreneurs’ age groups. As the figure below reveals, younger entrepreneurs report less reliance on private savings – the predominant type of self-financing. Conversely, their dependence on family, friends and banks or funds is significantly higher than their older counterparts.

Figure (3.13) Sources of finance at the start-up phase by entrepreneurs’ age group as reported by entrepreneurs (percentage of respondents)



The degree of reliance on certain sources of finance does not directly indicate better access. Formal credit may constitute a sizable share of the average start-up capital reported by younger entrepreneurs. However, this share may just have gone to a limited number of the entrepreneurs indicating that access is not evenly distributed. As a matter of fact, the figure below shows that when it comes to sources of finance – following the start-up phase – a larger percentage of older entrepreneurs, often with well-established firms, reported more resorting to all kinds of finance than their younger counterparts. This can be taken as a proxy to access, which intuitively is better for older entrepreneurs who either have more experience and capital or own and run better-established and older firms.

Figure (3.14): Sources of finance by entrepreneurs' age group as reported by entrepreneurs (percentage of respondents)

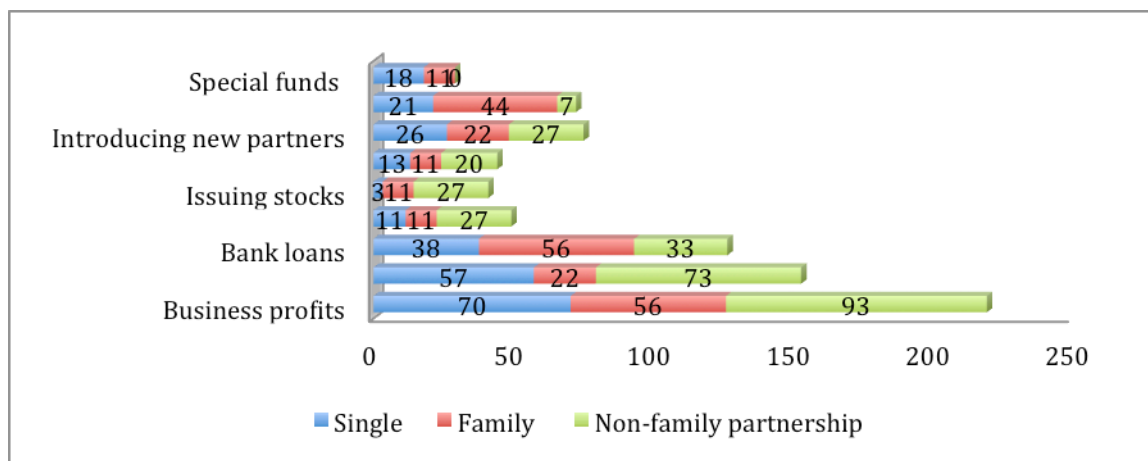


Yet, despite the naturally privileged position of older entrepreneurs and older enterprises, the results obtained from the survey indicate that younger entrepreneurs do not fall much behind. Fifty-three percent of the younger entrepreneurs included in the sample indicated that they applied once for a bank loan while the percentage was 63 percent for their older counterparts. The approval rate was higher for younger entrepreneurs – 74 percent as opposed to 60 for their older counterparts. Of course, this should be considered in light of the presence of banks and funds specialized in supporting new ventures and young entrepreneurs. The trend is even clearer with special funds where the approval rate was 68 percent for younger entrepreneurs and only 33 percent for older ones. That is an indicator that these funds are relatively well targeted and that they serve their purpose of extending support to younger entrepreneurs. However, the high approval rate does not always mean better access for this age cohort as only 29 percent of the younger entrepreneurs in the sample stated that they applied for credit from a special fund, which indicates that there are high barriers to apply in the first place and that those who manage to overcome these barriers often get their applications approved.

Ownership structure is another factor that powerfully shapes how entrepreneurs respond differently to similar restraints imposed by the ecosystem. The figure below reveals that non-family partners and single-ownership entrepreneurs report significantly higher instances of self-financing – via business profits, private savings and the sale of private and family assets – than their family business counterparts. Family business respondents had better access to bank loans as compared to the two other categories. Fifty-six percent of family business-entrepreneurs reported their resort to bank loans in order to finance their business as opposed to 38 and 33 percent for single and non-family partnership entrepreneurs, respectively. It has already been held that family business in both Egypt and

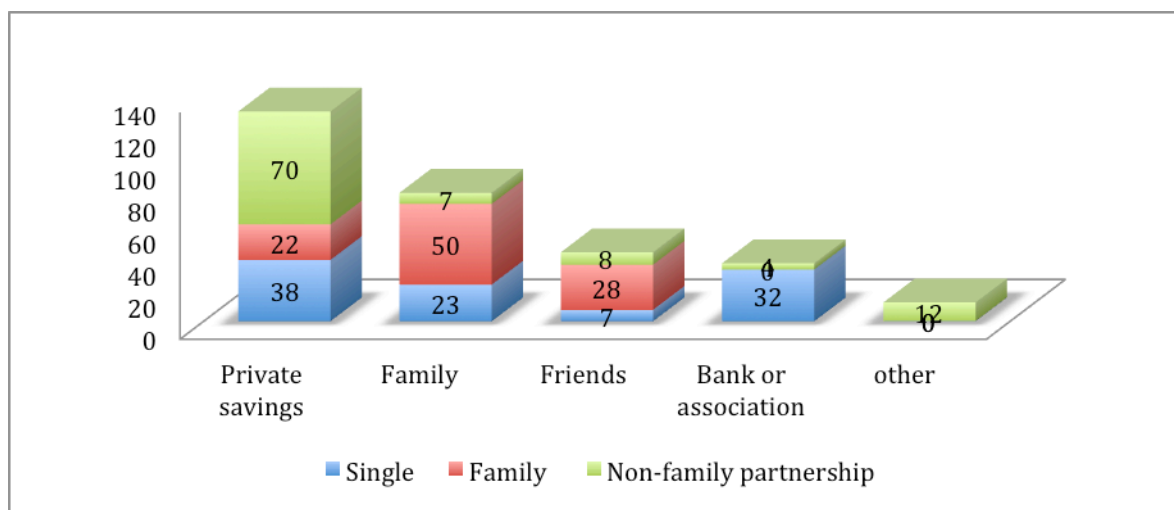
Tunisia has better access to assets and guarantees that can be used to meet the collateral requirements by the banking sector.

Figure (3.15): Sources of finance by firm ownership structure as reported by entrepreneurs (percentage of respondents)



Non-family partnership entrepreneurs are the most open to non-traditional means of financing such as venture capital and issuing stocks. However, it is interesting that most special banks and funds reportedly finance single-ownership and business family structure more than non-family partnership. All three subcategories reported close percentages of applying for bank loans – 56, 67 and 60 percent for single, family and non-family ownership structures, respectively. However, single-ownership entrepreneurs reported by and large the highest approval rate at 82 percent compared to 44 percent for the other two subcategories.

Figure (3.16) Sources of finance at the start-up phase by entrepreneurs' age group as reported by entrepreneurs (percentage of respondents)



Upon classifying responses by ownership structure, start-up capital formation shows very different trends. The figure above shows that private savings was the prime source of start-up capital for non-family partnership and single-ownership structures – 70 and 38 percent, respectively. The high percentage of private savings reported by non-family partners shows that this is the way to pool resources at the start-up phase among partners. While this may be an indicator of the lack of access to bank loans – or lack of preference to pursue bank loans – for non-family partners, it can be taken as a prerequisite for bank loans for single-ownership entrepreneurs who are required to secure some percentage of self-financing before they can secure loans from special banks free of collateral. Intuitively enough family business-entrepreneurs reported the highest percentage of resorting to family funds at 50 percent. This implies that private savings reported by family business-entrepreneurs refer to individual private savings in distinction from family savings. Interestingly enough, family business entrepreneurs reported the highest access to friends' money as well as compared to the two other subcategories. The banking sector seems to favor single-owners at the start-up phase. This has to do with the design of pro-entrepreneurship programs that usually target single-owners and managers. This can also be explained by the fact that single entrepreneurs have no option but to opt for banks and special funds at such early phase while family and non-family partners can pool resources through alternative channels.

3.2- Tunisia's troubled bank-based financial sector

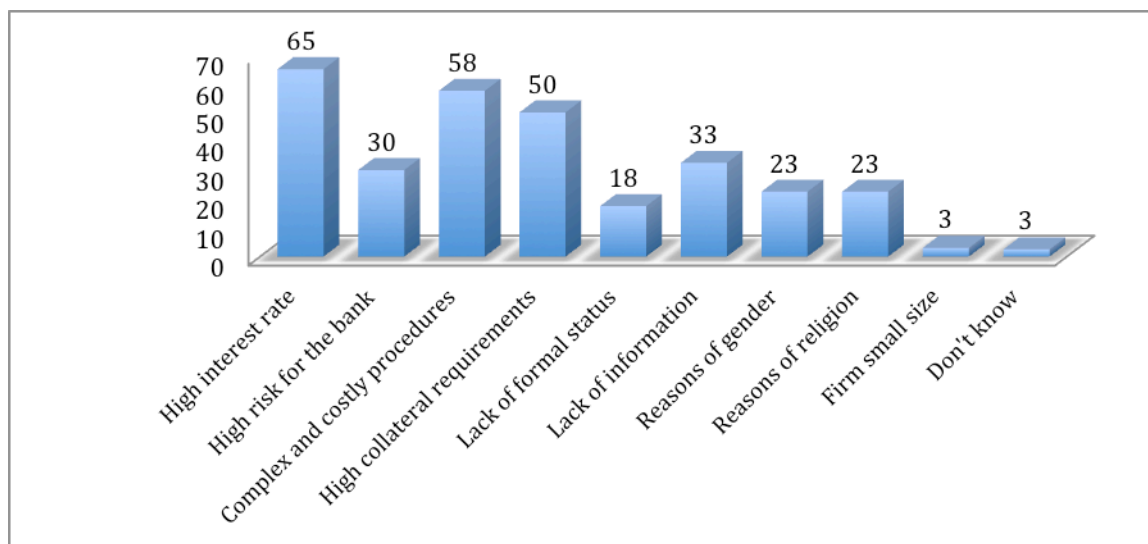
Tunisia has a bank-based financial sector. Other non-bank elements are still underdeveloped and beyond the reach of the majority of Tunisian entrepreneurs, especially small units and new market entrants. Moreover, a few state-owned banks dominate the Tunisian banking sector. This has been apparent in the survey results where only 16 percent and seven percent of the respondents reported to have resorted to venture capital and stocks to finance their businesses. One classical problem with venture capital and angel investing is that they almost work exclusively on non-traditional sectors such as technology. They are not available for the majority of Tunisian entrepreneurs who work in more traditional activities.

Interviewed entrepreneurs and experts have given thick accounts of banking sector issues in Tunisia that hinder the accomplishment of its role as a financial mediator. To start, the broad base of the banking sector – including commercial and investment banks – was reported to shy away from financing new projects. Belal Ben Hemeida – a young entrepreneur who started his company in 2011 in Tunis – said that banks are usually risk-averse. This view was not just confined to young entrepreneurs. Tareq Chaabouni – owner/manager of a big construction company and a prominent member of Tunisia's business community – held that in the light of the general weaknesses of Tunisia's banking sector, commercial and investment banks had to abide by more prudent regulations to minimize their operation risks. As justifiable as this may be, it has driven most banks out of the business of financing new projects. Moreover, Chaabouni underlined the limited capacity of banks to assess risks upon deciding to finance a project. He referred to an anecdote about a law that required banks to establish a risk-assessment unit though the whole bank should function as a unit of risk-assessment.

Though these issues are not solely related to entrepreneurship, they do have to do with the overall health of the Tunisian banking system. Tunisia's banks are over-abundant, small and undercapitalized. The banking sector is running on nearly 20 percent of loans classified as nonperforming³². According to accountant expert Faycel Derbal, "Tunisian banks are sick...and the whole setting is quite fragile. Tunisia missed the chance of adopting Basel II regulations before the revolution in 2011. Now, given the political turmoil and economic recession, the banking sector can hardly bear the cost of an overall restructuring, bank mergers and recapitalization." Such serious structural problems are likely to preclude any efforts to mainstream lending to entrepreneurs and to encourage nascent ventures.

Fifty-one of 100 respondents said they applied for a bank loan. Among those who applied for loans, 73 percent reported the actual receipt of credit. As for the remainder of entrepreneurs, they expressed various reasons for not securing bank loans. The three top factors mentioned were that interest rates were too high (65 percent of respondents); procedures were complex, costly and time-consuming (56 percent); and the required collateral and guarantees were too high (50 percent). The fourth factor was the lack of information (33 percent) followed by the bank's view of the enterprise as too risky to be financed (30 percent). This is quite relevant for nascent entrepreneurs, micro-and small-enterprises.

Figure (3.17): Reasons for not securing bank loans as reported by respondents (percentage of respondents)



³² According to a World Bank report (2009:8): It must also be noted that some other characteristics of Tunisian banks are not in favor of a further increase in SME lending. In spite of an improvement in recent years, Tunisian banks are still burdened by the high level of non-performing loans on their balance sheets. In this context that is not conducive to risk taking, there is some concern that Tunisian banks will continue to remain on the sidelines of SME financing for a while longer and continue to favor consumer credit as they have done in recent years, as the latter is considered simpler and safer.

3.3- Special Banks: The cases of the BTS and the BFPME

Special banks were established in order to overcome the problems that nascent enterprises and MSMEs faced upon seeking credit from commercial and investment banks, namely high collateral requirements. The two prime examples in Tunisia are the *Banque de Financement des Petites et Moyennes Entreprises (BFPME)* and *Banque Tunisienne de Solidarité (BTS)*. Whereas the former specializes in financing SMEs with start-up capital anywhere from 100,000 to 10 million Dinars, the latter specializes in financing micro-projects with start-up capital less than 100,000 Dinars³³. Both banks are state-owned. The BTS was established in 1997 by a presidential decree³⁴. The BFPME was created in 2005³⁵. Both institutions had a clear social mission from the beginning. Their primary targets were holders of higher-education degrees who were likely suffering from Tunisia's extremely high rate of unemployment. Hence both institutions are actually designed to finance new projects and young entrepreneurs and not just established micro, small and medium firms. According to a manager at the BTS, 85 percent of the projects that are financed by the bank happen to be nascent.

A question was included in the survey about the entrepreneurs' experience with special banks, funds and other programs specialized in financing SMEs and new market entrants. Twenty-eight respondents reported to have applied for loans from special funds. Sixty-four percent of those who applied reported having received the loans for which they applied.

Those who received the loans were asked whether their experience was satisfactory or not on a scale from 1 to 5 where 1 indicates the least level of satisfaction and 5 indicates the highest. The average answers were 3.1 for interest rates; 2.84 for the complexity of procedures and conditions; 2.37 for the exposure to extortion and corruption; and 2.77 for loan maturity. The levels of satisfaction expressed were relatively low. During the successive rounds of focus-group discussions across different regions of Tunisia, many young entrepreneurs brought up the issue of timeliness of project finance requests. Many talked of having to wait for months before they could get the final answer. Moreover, some complained of the discretionary powers given to the bank officials in approving or rejecting applications. Whereas the approval committees at the BFPME are public, giving applying entrepreneurs the opportunity to attend and defend their proposals, the BTS committees are not public and are not required to express any reasons for turning down finance requests.

During multiple interviews and focus-group meetings, a core of issues with the two special banks was quite recurrent. As this study is based on collecting the views and experiences of entrepreneurs and would-be-entrepreneurs, the coming part of the discussion will aim at summarizing how Tunisian entrepreneurs reported on their interaction with the BTS and the BFPME and whether it contributed to solving the access to finance problem³⁶.

³³ The Tunisian Dinar is roughly equal to 0.60 US dollars (October 2013)

³⁴ http://www.made-in-tunisia.net/vitrine/4_contact.php?tc1=IKmWm6aX

³⁵ <http://www.bfpme.com.tn/index.php?lang=fr>

³⁶ A World Bank report (2009:10) argued that the Tunisian government initiatives to extend credit to the broadest possible base of businesses and entrepreneurs were disappointingly unsuccessful. The government's substantial commitment to support and grant financing for the private sector and SMEs in the last decade has

To start, many young entrepreneurs and would-be-entrepreneurs expressed their dissatisfaction with the conditions required by the two special banks to extend credit. Officially, both banks should provide loans upon studying and approving proposed projects without requiring collateral or guarantees. As a matter of fact, skipping the collateral requirements is the main *raison d'être* of both institutions. However, some of the accounts given by Tunisian interlocutors suggest that that is not always the case. Two entrepreneurs in Kebili said that the BTS requires de facto guarantees like conditioning the approval of any proposed project with having a rent agreement or what they call “a promised rental agreement.” Such an arrangement usually charges the would-be-entrepreneur with five to six months rent before the project financing is even approved. Another de facto guarantee that the BTS may require is a guarantor who often has to be a state-employee – typically a relative of the would-be-entrepreneur – and who is willing to guarantee the repayment of the loan. Additionally, both banks require that the would-be-entrepreneur raise 10 percent of the capital on his/her own; this precondition is referred to as *auto-financement*, which usually comes from private savings or family donation or credit – love money.

Another young entrepreneur said that he applied for a bank loan from the BTS to establish a small plastic recycling factory in Kebili. They required the 10 percent of self-financed capital together with a rental agreement for the building in which the factory is to be built upon securing the loan. However, the problem was that the bank required the rented site to be built on a registered property, which is not usually the case in inland regions. According to the entrepreneur, such rental agreements on a registered piece of land together with the *auto-financement* would have cost him between 50 and 60 thousand Dinars. He then wondered that if he had such money, why would he file for a loan with the ceiling of 100 thousand Dinars in the first place.

Another recurrent problem that was brought up by young entrepreneurs in Monastir, Tunis and Kebili is the way the loans from special banks are disbursed and allocated for different expenses. Both banks reportedly require that the bulk of the loan be spent on purchasing assets or capital, in the form of machinery or equipment. The ratio can reach up to 80 percent of the total amount of the loan. Several young entrepreneurs said that such requirement leaves them with very little cash money at the start-up phase. According to Belal Belaaj, a professor of economics and an expert with the *Institut Arabe des Chefs d'Entreprises* (IACE), most nascent projects choke with liquidity problems from their moment of inception. He holds that the very way credit is provided undermines the chances of survival of nascent enterprises and new projects.

Why do special banks set these requirements that may prove to be counterproductive as many entrepreneurs and would-be-entrepreneurs hold? The answer provided by a number of experts and bank officials is that special banks are still banks at the end of the day. They have to collect the loans that they extended so as to keep a sound financial position. This leads us to two of the main points of tension that were suggested by the Tunisian interlocutors in the work of the BTS and BFPME.

plateaued at roughly 64 to 68 percent of GDP. This is because there are still a number of constraints on the seamless functioning of the SME financing system. These constraints are largely microeconomic in nature.

3.3.1- Between technical and financial knowledge

The first point is the technical evaluation and approval of the proposed projects. Many entrepreneurs leveled critique and allegations towards the two banks as being primarily and almost solely preoccupied with the financial part of the project without wielding enough expertise in technical matters. Mohamed Mohamed – a manager at BTS – said that the bank has accumulated some considerable expertise during the last few years of operation in evaluating projects. However, he held that the main problem lies with the un-integrated nature of the structures of support of entrepreneurship in Tunisia. According to him, the status quo leaves no room for risk sharing between business centers that help applying entrepreneurs with the technical study of the project and the bank that is designated to provide credit for its realization. Whereas the business center's task ends with writing down the study, the bank has to consider the financial and economic viability of the project, which is not always present in the initial studies that the bank receives. The whole risk falls upon the shoulders of the bank officials. More integration between the tasks of studying and financing new projects has to exist in tandem with more risk sharing between the bank and business centers, according to Mohamed Mohamed.

This point seems to be of great importance. Special banks try to reduce the risk they run with financing new projects, which is high by definition. In this vein, they require *de facto* guarantees, guarantors and *auto-financement* to ensure that potential entrepreneurs are qualified with projects that have high chances for survival and repayment of loan debt. Feycel Derbal – the accountant expert – said as important as it may be that special banks such as the BTS and the BFPME do not require collateral or guarantees to extend credit, both banks share many of the ills of the Tunisian banking sector, generally. They have problems with regards to governance, liquidity and recollection. According to Derbal, they do make efforts to reach out, but their role remains limited.

Special banks are theoretically required to base their assessment of financing new projects exclusively upon the proposal concept and the project's potential for success. However, such banks typically do not have the proper information or expertise unlike the other structures of support that work closely and locally with entrepreneurs such as the business centers, incubators and the work bureaus. The solution proposed by the bank official has been more risk/information sharing and integration. Otherwise, as long as the task of support structures is confined to helping young entrepreneurs get a study written to apply for a loan, the only result is putting the entrepreneur on a clashing path with the bank. This is a clear contradiction between the social and economic missions of the structures of support, holds Mohamed Mohamed. This leads us to the second point.

3.3.2- An economic versus social mission

Ossama Ben Khalaf, director of Manouba Business Center in Le Grand Tunis, hinted at the tension between preparing the project proposal and study on the one hand and seeking finance on the other. He held that bank officials – upon assessing the project study – do not usually have the special expertise and knowledge about the project. Rather, they think in terms of the risk and success potential. Khalaf estimated the ratio of approved studies for financing by 40 percent of the total files sent by the Business Center, which he deems

rather satisfying. For Khalaf, the link between the business center and the bank made sense and seemed complementary. Whereas the center would pay attention to the technical details of the project while working on the study, the bank assesses its financial soundness. Moreover, Khalaf said that the directory board of the business centers meets every several months to study the rejected cases given by the special banks, especially when the reasons are indicated.

The above point leads us to the contradiction between the social and economic priorities that govern the structures of entrepreneurship support in Tunisia that was underlined by a number of entrepreneurs and experts. The BTS and the BFPME were both brought to existence by clear government acts. The two institutions were supposed to provide credit for new market entrants with the special focus on higher-education graduates whom were the most vulnerable to unemployment as previously mentioned. Mohamed Mohamed states bluntly that the idea behind establishing the BTS was brought up in a high-level meeting about unemployment in May 1997.

State efforts were quite conscious from the beginning of the social mission of absorbing higher-education graduates. For instance, the BTS and the BFPME are required to confine their financing on noncommercial projects so as to enable graduates to realize their potential in higher value-added areas in the industrial and service sectors based on their studies in university. Moreover, extending credit is conditioned by submitting a certificate of the scientific degree of the applicant. Business centers, incubators and special banks can approve only projects that correspond to the field studied by the applicant. For instance, a computer-science graduate cannot solicit credit for an industrial project. According to Mohamed, such measures were established by the state with the aim of maximizing the social return of public education. However, the main issue with such preconditions is that they do not prioritize innovation and growth potential as the main criteria against which a project idea could be assessed.

There has been a clear political agenda under Ben Ali (1987-2011) to find some solutions for the oversupply of higher-education graduates. It is within this context that the whole support structure of institutions and agencies started to form starting in the 1990s. The only problem with such approach to supporting entrepreneurship is that the economic and social motives of action become mixed up and often times confused. Tareq Chaabouni – who was once a member of the consultative social and economic council under Ben Ali – said that every time the regime found itself surrounded by the problem of unemployment, some additional procedures and measures were taken by the state. According to Chaabouni, the issue was that entrepreneurs became entitled to some kind of financing regardless of the economic soundness of the project they proposed, making access to finance a purely bureaucratic matter.

Interestingly enough, a young entrepreneur from the inland city of Kebili said that loans from special banks were first provided to Tunisian youth in return for not demanding a job in the public sector. Such a statement is reflective of the moral economy that governs the support structures in Tunisia. It demonstrates the conflicting logics of the economic and social motives of supporting entrepreneurship as a measure to fight unemployment – similar to welfare stipends – and boost investment, innovation and growth. The two may

not be in total harmony in practice as many entrepreneurs have held.

The discussion above has shown that there were socio-political motivations behind the development of Tunisia's support structure since the late 1990s. Ben Ali's regime was quite alarmed by the high rate of unemployment among higher-education graduates. Accordingly, the support structure was not primarily driven by an economic agenda of developing entrepreneurship as an integral part of the country's overall development program. Rather, it was motivated by job creation and the need to appease the young and educated population, which generated income for this broad social category. Hence, it is plausible to hold that entrepreneurship-related funds and preferential credit was used as a sort of patronage distribution as well as for development purposes. This may explain the lack of follow-up of the projects selected for financing and the lack of any impact assessment of entrepreneurship financing in the last several years. Moreover, it may partly explain the focus on finance among other start-up relevant issues at the expense of post-start-up issues such as marketing and networking.

New market entrants in Tunisia clearly have better access to finance at the start-up phase thanks to the extensive support structure that was designed in the late 1990s to target entrepreneurs – not just small and micro enterprises. Yet, how is it that institutional credit is available at the same time access to finance was named as the utmost barrier to growth by the majority of Tunisian respondents? Two main points may explain the paradox:

First, though access to credit was better in Tunisia than in Egypt, only 27 percent of the respondents reported using institutional credit, 38 percent of which were at the start-up phase. Conversely, self-financing through business profits, private savings and family money remain the main source for the majority of Tunisian entrepreneurs. The answers given by Tunisian entrepreneurs suggest that the approval rates of bank loans were fairly high at around 70 percent. However, the percentage of those who reported to have applied to a bank or special funds loan was rather low at less than one third of the respondents. This suggests that there are barriers to applying for institutional credit that exclude a clear majority of young entrepreneurs and nascent enterprises from the outset, dissuading them from applying. Some interviewees in Tunisia said that this has to do with the self-financing requirement set by special banks as a requirement for extending credit, which is usually 10 percent of the value of the loan. Entrepreneurs reportedly are required to raise this money drawing on their personal savings, family and friend's networks. However, the causes behind the low numbers of loan applications in Tunisia needs to be further investigated.

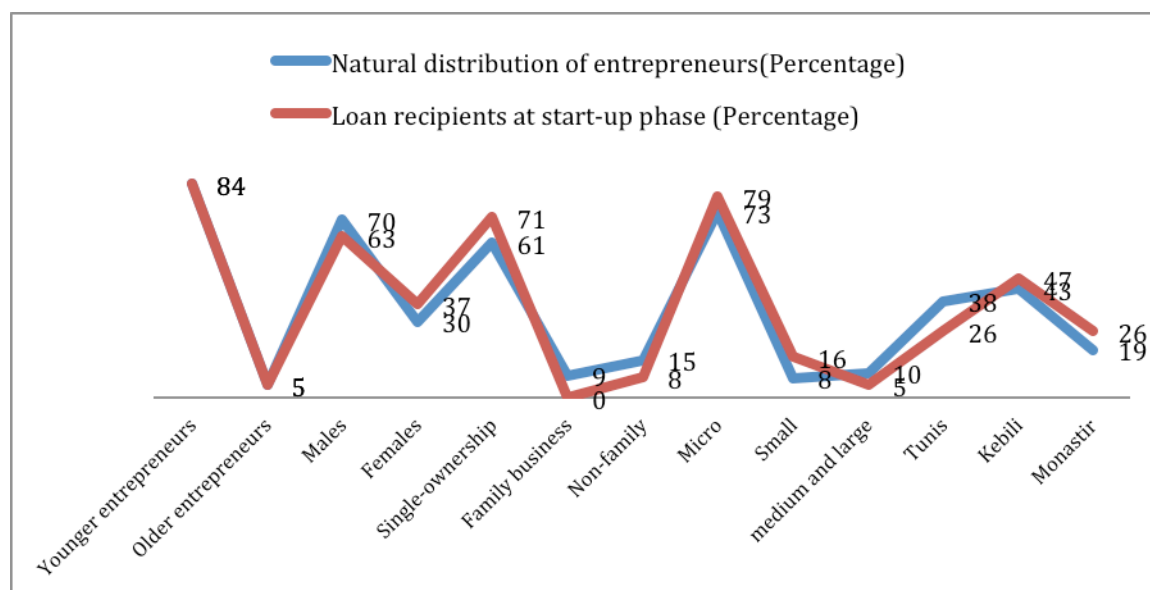
Secondly, the actual securing of institutional credit is only one single proxy to access to finance. There are other factors that are equally important such as the interest rates; collateral and guarantees; and the disbursement of the loan money among others. These conditions may prove hard even for someone who could secure a bank loan. Even entrepreneurs who had access to loans at a certain point in time may report that access was obtained at a high cost.

Who gets bank loans in Tunisia? Does the system discriminate against certain subcategories of entrepreneurs? The two figures below provide a contrast between the actual composition of the sample of entrepreneurs and the reported share of each category

or subcategory in bank loan reception.

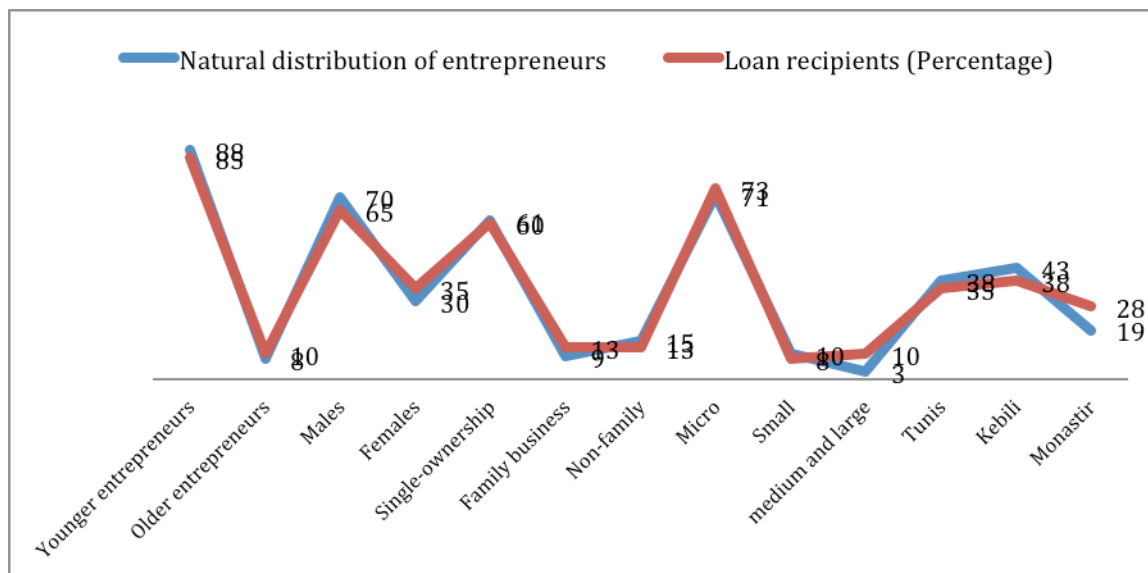
The figures indicated below show that access to loans at the start-up phase is rather evenly distributed and almost matches the natural distribution of entrepreneurs in the sample. The share of younger entrepreneurs in loan reception is equal to their share in the sample. Females are slightly overrepresented. Female share of total loans stood at 37 percent while their share in the sample was only 30 percent. Micro enterprises are slightly overrepresented as well. Whereas they received 79 percent of total loans reported, their share in the sample was 73 percent. Conversely, medium and large enterprises are underrepresented. Whereas their share of the total surveyed enterprises was 10 percent, their share of loans at the start-up phase was only five percent. Moreover, there is no evidence of discrimination along regional lines. The shares of regionally-based entrepreneurs in securing a loan is almost equal to their share of the sample.

Figure (3.18): A map of banks loan recipients at the start-up phase as indicated by entrepreneurs (percentage of respondents)



The picture depicted above does not fluctuate much upon studying the patterns of accessing finance in general beyond the start-up phase. Female entrepreneurs and micro enterprises remain slightly overrepresented. Medium and large enterprises become overrepresented as well, which is fairly intuitive given the established trend in the survey, which indicates that firms secure more institutional credit. Regionally, Monastir exhibit some overrepresentation – 28 percent of loan reception versus 19 percent of the sample – while Kebili-based entrepreneurs report some underrepresentation at 38 percent of total loans received versus 43 percent of the total sample. Yet, the difference is not that flagrant.

Figure (3.19): A map of bank and special funds loan recipients as indicated by entrepreneurs (percentage of respondents)



Unlike the case of Egypt, the Tunisian financial subsystem does not show any pronounced or systemic discrimination against certain entrepreneurial subcategories. This of course cannot be understood isolated from the entrepreneurship-support structure and network of special banks and funds that extend credit at the start-up phase. These institutions clearly favor young entrepreneurs with higher-education degrees and single-ownership structures. Additionally, there is little regard to region or gender. However, such findings in Tunisia do not help in answering the earlier question of why two thirds of the entrepreneurs included in the survey reported to not having applied from the very start of their enterprise formation. This cannot be answered either in terms of cronyism or patronage targeted towards certain entrepreneurs because the average age of surveyed enterprises is three years, which coincides with the Tunisian revolution and the disintegration of the old networks of patronage and corruption partially caused by the Ben Ali regime.

4- Non-financial components of the entrepreneurship ecosystem

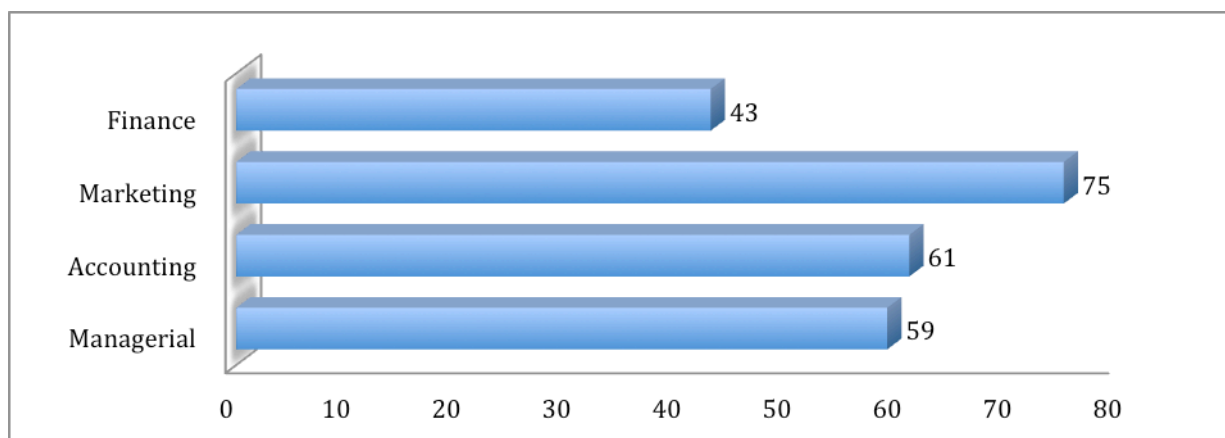
Apart from the financial subsystem, there is a range of other components of the entrepreneurship ecosystem that have a deep impact on the growth potential of entrepreneurs such as labor regulation and quality, taxation policies, regimes, and education and training. These elements are considered as the most significant non-financial components of the entrepreneurship ecosystem. The survey did not require respondents to report their impression or evaluation of the overall system. Rather, the focus has been on the direct experience lived by the respondent entrepreneurs

4.1- Entrepreneurship education and training

A clear majority of the interviewed entrepreneurs (79 percent) held that running their business required the acquisition of certain skills. The figure below shows that a significant majority of the respondents said that their business required some kind of skills. Seventy-

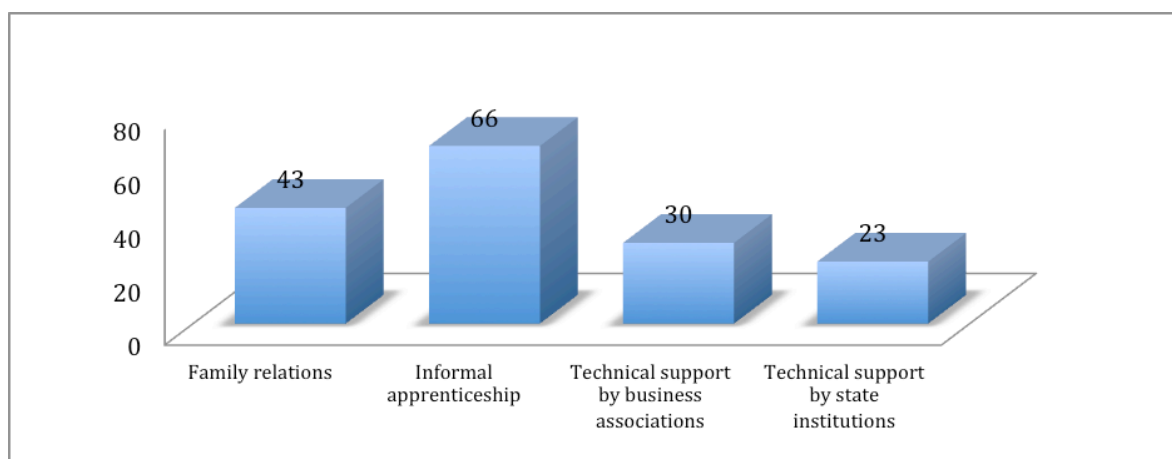
five percent mentioned the need for marketing skills followed by 61 percent who referred to accounting skills. Such results are in harmony with the fact that the vast majority of the entrepreneurs' sample is comprised of higher-education graduates likely to engage in skilled work. Moreover, the large percentage of respondents who underlined the importance of marketing skills resonates with the views that were expressed by a great many entrepreneurs across Tunisia during the focus group discussions as well as personal interviews, which held that marketing was as important as finance to keep the project going past the start-up phase.

Figure (3.20): Skills required for running an enterprise (percentage of respondents)



Where do entrepreneurs usually obtain the skills they deemed important for their business operation? The figure below shows the main sources of skill-acquisition as reported by the respondents. Sixty-six percent said that the main source was informal apprenticeship and mentorship. The second reported source was family relations according to 43 percent of the respondents. Governmental agencies – including business centers, public incubators and training and education facilities – were reported to have helped only 23 percent of the respondents while business and developmental associations were mentioned by 30 percent.

Figure (3.21): Sources of skill attainment as expressed by entrepreneurs (percentage of respondents)



The percentage of respondents in Tunisia who reported having received technical support from state institutions was significantly higher than that reported by Egyptian entrepreneurs, which was as low as 10 percent. Though state support remained at the very bottom of the means of skill transferring – preceded by informal apprenticeship and family ties in Tunisia – the relatively higher percentage can be attributed to the broad network of support institutions that the state had created in Tunisia in the past decade. In the coming section, the role of business centers and incubators will be tackled based upon the focus group discussions and personal interviews that were conducted in Tunisia.

The centrality of family ties and apprenticeship proves to be relevant over time. Forty-two percent of the younger entrepreneurs group underlined family as an important medium of skill transmission as compared to 43 percent of their older counterparts. The high reporting of reliance on family by younger entrepreneurs comes despite the fact that 65 percent of the enterprises they own and manage are of a single-ownership structure and only 10 percent are family businesses. However, the first and predominant source of skill transmission was via informal apprenticeship and mentorship, which was underlined by 66 percent of younger entrepreneurs and 71 percent of older entrepreneurs.

One interesting generational difference is the increasing significance of more formal channels of skills formation and acquisition. Thirty-one percent of younger entrepreneurs reported developmental and business associations as a source of skill obtainment as opposed to only 13 percent of their older peers. Similarly, 25 percent of the younger entrepreneurs made reference to governmental support structures such as business centers and incubators in comparison to zero of their older entrepreneurs, bearing in mind that these state-support structures came to being in the late 1990s and were not consolidated until the late 2000s. However, despite the increasing importance of governmental and associational institutions, informal ties such as apprenticeship and family remain the most significant for the largest number of entrepreneurs, be they young or old.

Figure (3.22): Sources of skill attainment by entrepreneurs' age group (Percentage of respondents)

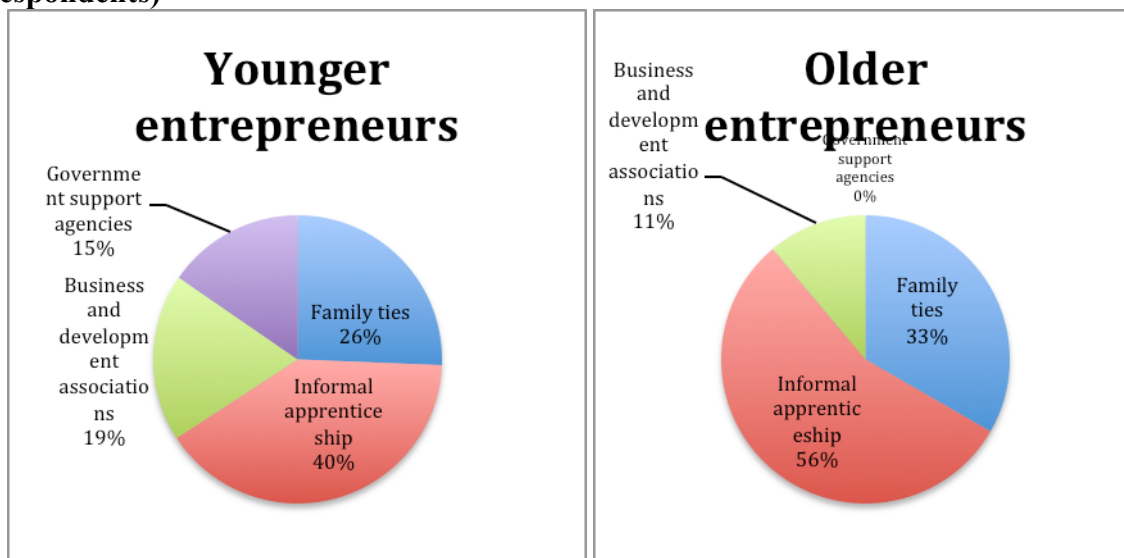
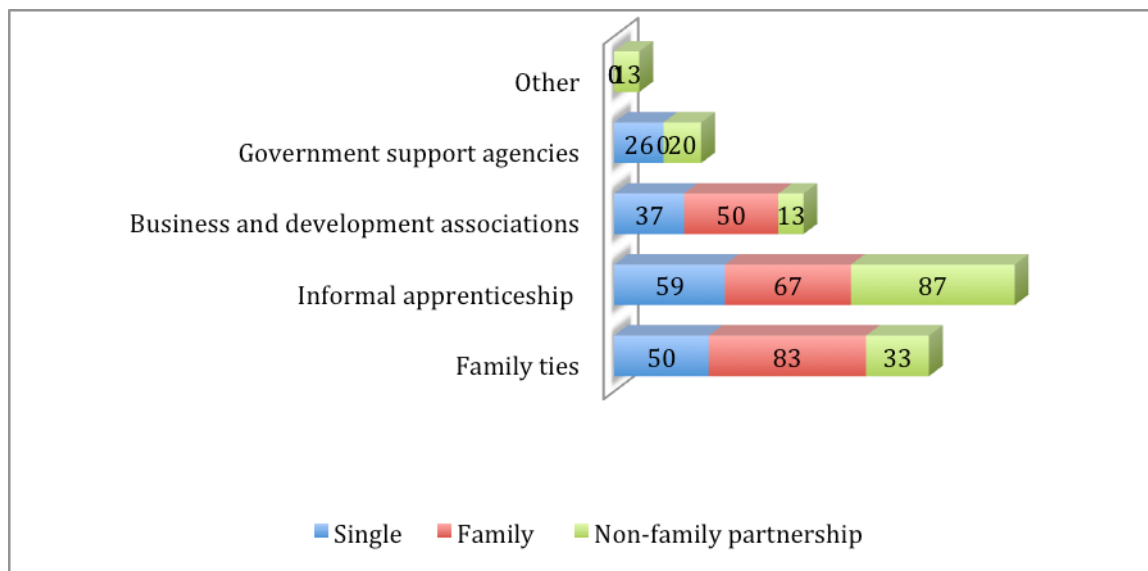


Figure (3.23): Sources of skill attainment by ownership structure as expressed by entrepreneurs (percentage of respondents)



Ownership structure shows interesting trends of skill formation and acquisition by entrepreneurs. Whereas family ties and informal apprenticeship remain reported by the majority of entrepreneurs regardless of the ownership structures of their businesses, there are some noteworthy differences. For family businesses – as expected – family ties are the primary means of skill transmission (83 percent of the respondents) followed by informal apprenticeship, which is still cited by a sizable percentage (67 percent). For single-ownership entrepreneurs, informal apprenticeship was popular at 59 percent though family ties remained relatively important constituting 50 percent of the respondents, which suggests that family as a social unit could perform economic tasks such as passing skills amongst members. Single-ownership entrepreneurs reported the highest dependence on business and development associations and government agencies. However, family-business entrepreneurs reported to have resorted to associations as well at 50 percent.

Non-family partnership entrepreneurs provide quite a different trend. Family ties, as expected, play a relatively small role – 33 percent of the respondents reported them as source of skill acquisition – while informal apprenticeship was reported by 87 percent, which reveals that skill transfer here is another form of resource pooling among partners. However, non-family partners still report reliance on governmental agencies and business associations, albeit with lower percentages than their single-ownership counterparts.

4.2-Tunisia's Support Structure: The cases of business centers and public incubators

Similar to the support structures (*Les structures d'appui*) that the Tunisian state started establishing in the mid-1990s in the field of finance, the state had some initiatives in the fields of entrepreneurship for non-financial support. Reference here is made primarily to two institutions: public incubators (*pépinières*) that started to spring out since the mid-1990s and business centers (*Centres d'affaires*) that were established as of 2005. Both institutions have rather similar tasks to perform with slight differences. However, similar to

their financial counterparts – BTS and BFPME – they were the result of conscious state action under the Ben Ali regime (1987-2011) to contain the ever-growing problem of youth unemployment, especially within the ranks of higher-education graduates.

Currently, Tunisia has around 30 incubators, all publicly-owned and-run. Twenty-six of which fall under the jurisdiction of the Industrial Promotion Agency (*API: Agence de Promotion de l'industrie*), while the rest follow other ministries such as that of commerce, information technology and higher education. Additionally, there are other incubators that are specialized in supporting agricultural projects and fall under the mandate of the Agriculture Promotion Agency (*APIA: Agence de Promotion de l'investissement Agricole*). As mentioned earlier, incubators started operating in the mid 1990s. In 1995, a convention was signed between the API and the Ministry of Higher Education in which incubators were placed in higher education institutes of technological studies (*ISET: Instituts Supérieurs des Etudes Technologiques*). The goal of such move was to directly link the largest source of higher-education graduates directly with the private entrepreneurship support structures even before graduation.

Though incubators cover a great variety of economic activities, their main weight falls on industry and industry-related services. According to Donya Berkati, API has been the main driving force behind multiplying incubators in ISET all over Tunisia. Incubators have been designed to support entrepreneurs with a broad array of services. Some are soft, providing coaching and mentorship together with accountant experts and other forms of awareness (*sensibilisation*) and entrepreneurship education. Other services are more direct in their service, providing access to infrastructure be it in the form of offices (*des locaux/ bureaux*) for new entrants that would relieve them from paying rent at such early stages or through making phones, Internet and faxes available at no cost. As for the capacity of incubators to host entrepreneurs, according to Berkati the capacity differs. Some incubators have a capacity that ranges from 200 to 240 offices.

A majority of business centers was added to the entrepreneurship support structures by 2005. Business centers cover all economic activities. They expand into all the Tunisian provinces where the plan has been to have a business center in each and every provincial capital. Unlike incubators, business centers do not provide any hard support to the entrepreneurs such as a bureau or access to infrastructures. They are far less integrated in the higher education structure as they exist separate from higher education facilities. Moreover, unlike incubators, business centers are required to serve all age groups – not just undergraduates and newly graduating youth. Business centers provide technical support, education and training to would-be-entrepreneurs. They play a role in providing technical and financial expertise for projects understudy, and they the application process for special banks. In addition to incubators and business centers, the older work bureaus were modified in 2005 to become Work and Entrepreneurship Bureaus. The classical mandate of these offices was to help jobseekers find work and so the state added private entrepreneurship as an option.

The support structure that has existed in Tunisia for sometime is no doubt exceptional in the Middle East and North Africa. Nothing similar exists in equally dynamic economies such as Egypt where most entrepreneurship support – in terms of education, mentorship

and coaching – are left to informal ties and private efforts by business associations and angel investors. The development of such state-initiated structures in Tunisia shows that entrepreneurship – as a means of fighting unemployment – has been a serious option for the state for more than a decade. The network of incubators and business centers is quite expansive and has a presence in virtually all-large Tunisian urban centers where potential entrepreneurs are likely to live. However, these support structures suffer from some considerable shortcomings that limit their impact in providing actual support for entrepreneurship in Tunisia.

To start, Berkati and Ben Khalaf admitted that both business centers and incubators lack the necessary information to conduct impact assessments. There is little to no communication with entrepreneurs and enterprises beyond the start-up phase in the case of business centers and after the incubation phase with incubators. After up to 11 years of operation, it remains difficult to determine the impact of incubators on the growth of entrepreneurship-support in Tunisia, according to Berkati. Neither institution holds a current record for client entrepreneurs. It seems that the process is quite bureaucratic. The main criterion by which both institutions are assessed is on the number of entrepreneurs that engaged with rather than the success of the projects.

Another problem that we previously touched upon has to do with the un-integrated nature of the support structure. Business centers, incubators and work bureaus maintain no shared database of entrepreneurs and projects. Moreover, these agencies that operate in the non-financial side often have little to do with the banks that operate in the financial aspect. They do not share the risk with the banks that decide on extending credit. The primary task of business centers and incubators is limited to assisting with the study that is filed for the credit request. Entrepreneurs, bankers and officials have all expressed their discontent and discomfort with the uneasy flow of information between all of these structures so much so that it precludes the chances of a functional servicing of entrepreneurs at the start-up phase.

A third reservation on the support structure is the confusion between the social and economic mission of business centers and incubators. This has been brought up previously while discussing the case of special banks and the rising conflict between their social task of fighting unemployment and the economic goal of boosting investment and creating viable projects. Berkati, who works for an incubator in Tunis, stressed the problems of project viability at the post-creation phase, especially with regards to marketing. In many instances, entrepreneurs retrieve loans and start producing goods or services without adequate knowledge of the market, which is unsustainable.

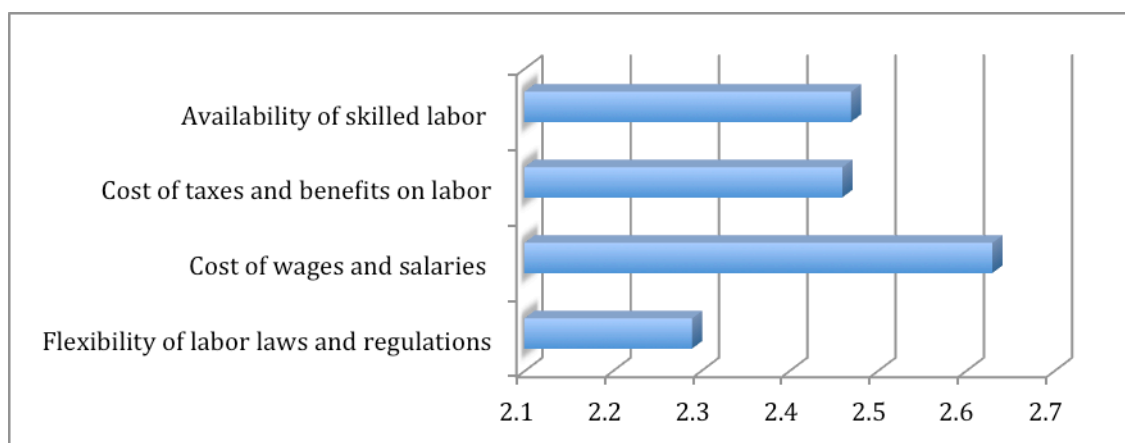
All in all, support structures – be they financial or non-financial – have been primarily created to shield would-be-entrepreneurs and new market entrants from the relatively hostile business environment in Tunisia. Such a strategy may work piecemeal but it is quite unlikely that it would lead to a major shift for the majority of actors for many reasons. Some reasons have to do with the limited capacity of such structures to service the broadest base of entrepreneurs. Others are related to the overwhelmingly negative and sometimes detrimental impact that the general environment may have on young entrepreneurs and nascent enterprises such as weak rule of law, absent contract enforcement and the inaccessibility of land and finance. Accordingly, such support structures should only be

viewed as temporal solutions to an issue that requires larger, systemic reform.

4.3- Labor regulations and quality

The survey refers to labor systems as the laws and regulations governing the relationship between workers and entrepreneurs. The survey respondents were asked to express their degree of satisfaction with four labor-related issues on a scale from one to five in which one indicated the least level of satisfaction. The flexibility of the laws and regulations governing labor received the lowest score at 2.29 followed by the cost of taxes and benefits on labor at 2.46. The availability of skilled labor was only slightly better, receiving a score of 2.4. The issue entrepreneurs seemed most satisfied with was the cost of wages and salaries, which received a score of 2.63. The laws and regulations were reported to be inflexible, which echoes many reports and studies on Tunisia.

Figure (3.24): Scores indicating the degree of satisfaction with labor in Tunisia (five indicates the maximum degree of satisfaction)



Tunisia is among the highest-ranking Arab countries with regards to educational attainment. Access to higher education has witnessed a virtual explosion in the last two decades. Unlike Egypt, the study did not encounter general complaints regarding the lack of skilled-labor. There seemed to be a broad acceptance for the fact that Tunisia has one of the most-skilled labor forces in the region; this has been critical in the efforts for export-diversification since the late 1990s. However, the main point of controversy was whether or not the skills furnished by the educational system actually supported entrepreneurship and business formation. Though some experts were consulted during this study, this was not the case, and the great expansion in higher education with little regards to the market requirements was a recipe for extremely high rates of unemployment among university-graduates and for socio-political instability. However, such a debate – as important and crucial as it is for the future of Tunisia’s socio-political order – is beyond the scope of this study.

4.4- Taxation policies and regime

The views expressed by the respondents on the tax system in Tunisia show that taxation is quite problematic for most entrepreneurs. It is noteworthy that the majority of respondents owned and managed either small or micro enterprises. Almost 72 percent of the respondents “disagree” or “completely disagree” with the statement that tax rates are reasonable and suitable. Fifty percent of them “disagree” or “completely disagree” with the statement that tax collection is efficient. Worse still is that 62 percent of the respondents said that they “disagree” or “completely disagree” with the statement that tax collection is adequately transparent. Whereas the first result indicates a high level of dissatisfaction with tax policies, the second and third reveals that most entrepreneurs have large problems with tax administration.

Table (3.4): Views expressed by entrepreneurs on the tax system in Tunisia (percentage of respondents)

	Completely Agree (Percent)	Agree (Percent)	Disagree (Percent)	Completely Disagree (Percent)	Don't know/No answer (Percent)	Total (Percent)
Tax rates are reasonable and suitable	12	11	32	40	5	100
Tax collection is efficient	14	18	31	19	18	100
Tax collection is adequately transparent	9	7	33	29	22	100

There is a high level of dissatisfaction with regards to tax policies (tax rates) and tax administration with regards to collection efficiency and transparency. It should be noted that the sweeping majority of respondents owned and ran micro and small enterprises. This category is typically too difficult to be pursued for taxation. However, in the case of Tunisia, almost 85 percent of the state annual revenue were from tax sources, which is high compared to the vast majority of Arab countries, including Egypt; tax revenue in Tunisia hovers around 60 percent of total state income (Schwarz 2008). Moreover, informality in Tunisia is of a lesser extent as compared to other MENA countries – more than 80 percent of the respondents reported to hold a tax code. Thus, most companies have to engage with the tax authorities.

5- Female entrepreneurship in Tunisia

Female entrepreneurs constitute around 30 percent of the total number of respondents in the survey. The ratio is closer to GEM estimation of female entrepreneurship in Tunisia, which

was put at 27 percent (GEM 2008). The profile of female entrepreneurs included in the sample resembles that of their male counterparts, especially with regards to average age, educational attainment and professional background. Whereas 87 percent (26 out of 30 respondents) of female entrepreneurs fell within the age cohort of 21 to 40, 85 percent of their male counterparts fell in the same age bracket. The vast majority of female respondents reported to have been either students (33 percent or ten women) or wage-employees (40 percent or 12 respondents) versus 35 percent and 39 percent for their male counterparts. There is a slight difference when it comes to educational attainment. Whereas female respondents were almost entirely withdrawn from the ranks of higher-education graduates (93 percent), the ratio for male entrepreneurs was 76 percent and 23 percent for high-school graduates.

With regards to enterprise profiles, female entrepreneurs reported to be own/manage primarily micro firms, employing less than six workers. The ratio was 80 percent for female entrepreneurs and 70 percent for their male counterparts. Male entrepreneurs had a larger share of small and medium-sized enterprises at 14 percent and three percent of the sample, respectively. This does reflect reality where enterprises owned and managed by men tend to be larger than those owned and managed by females. Lastly, the property structure of the businesses included in the sample is somehow similar among female and male respondents. The predominant form of property is that of the sole owner-manager, which stood for 57 percent of the enterprises owned by females and 67 percent for those owned by males.

This section will contrast the answers given by female and male respondents as a means for discerning how each group of entrepreneurs deals with the same aspects of the ecosystem. The section will focus on the female reported interaction with business registration, contract enforcement, access to finance and corruption.

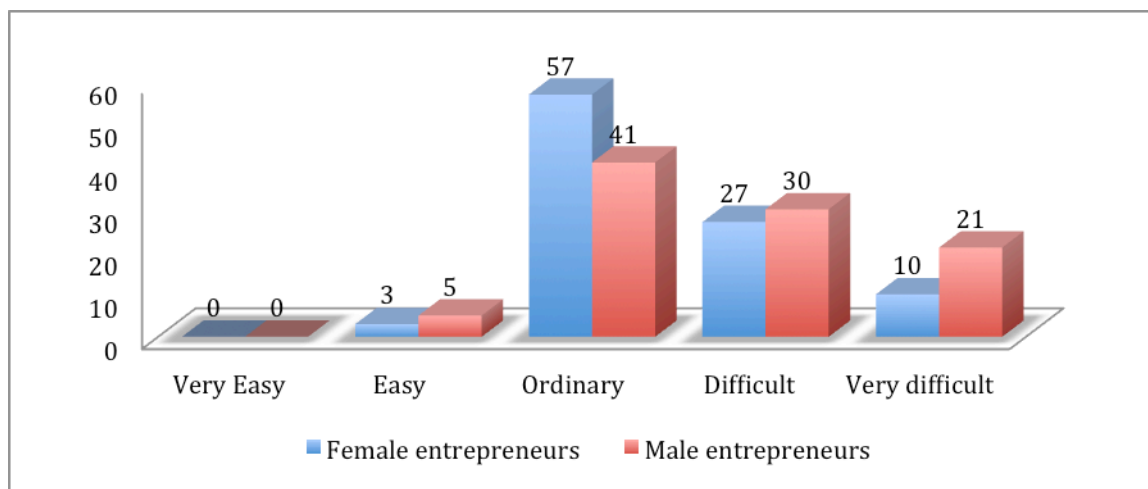
5.1- Business registration and female entrepreneurs

To start, a sweeping majority of female respondents denied that the registration and licensing systems in Tunisia discriminated against women – 22 out of 30 respondents – the equivalent of 73 percent versus only five interviewed females. As was the case in Egypt, this answer indicates that the rules and regulations that are directly related to business registration and licensing are general and gender-neutral but not necessarily gender-sensitive. Formal rules may not discriminate in theory against women but this may be the case in practice. For instance, whereas the average number of agencies and bodies with which male respondents reported to have had to deal with so as to register their business was 3.22, the average number for female respondents was 4.1. This implies that female entrepreneurs face more complexity and red tape when registering and licensing their businesses. With regards to registration time, while female respondents reported an average of 10.68 months, their male counterparts reported just six months as an average – a significant difference. These findings suggest that the application of regulations – and not the way they are written – is the core issue at hand.

However, the views expressed by female and male respondents with regards to their experience with business registration suggest a different story. As the figure shows below,

a higher percentage of female respondents (57 percent or 17 out of 30 respondents) said the process was ordinary compared to only 41 percent among the male entrepreneurs. Conversely, it seems that more male entrepreneurs found the process “very difficult” than females.

Figure (3.25): Views about the registration process as expressed by female and male entrepreneurs (percentage of respondents)

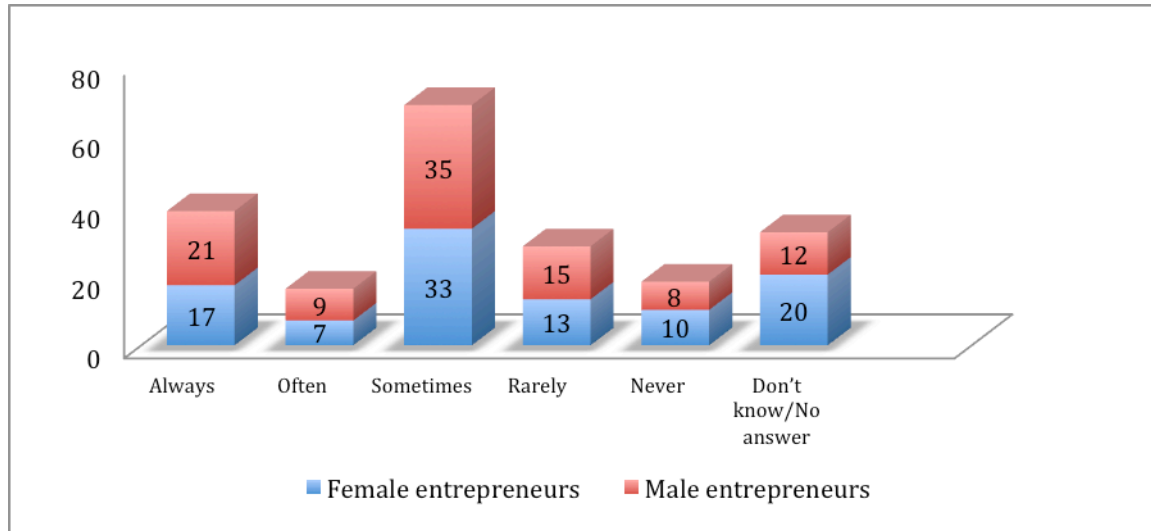


It should be considered that respondents from both gender groups dismissed the categories of “very easy” and “easy.” The bulk of respondents held the process to be either “ordinary” or “difficult.” The implications of having less female respondents reporting the process to be “difficult” or “very difficult” than males were not clear, especially given the earlier evidence from the survey, which shows that female entrepreneurs encounter more agencies, elongating the registration timeline. However, it may be the case that the respondents were referring to the details of the process of registration rather than to the time involved or the number of agencies with which they were engaging. Such claims need further investigation.

5.2- Contract enforcement and female entrepreneurship

Almost 80 percent of the female respondents maintained that using formal contracts has had a positive impact on their businesses. The percentage for their male counterparts was not much different at 74 percent. However, only 57 percent of the female respondents held that contracts could be defended in Tunisia as opposed to 67 percent of the male entrepreneurs. Both percentages are relatively low and indicate a general mistrust in the effectiveness of contract enforcement and the rule of law in Tunisia. The difference between male and female respondents suggests that it is harder for women to get a contract enforced than men.

Figure (3.26): The frequency of resorting to formal contracts as expressed by female and male entrepreneurs (percentage of respondents)

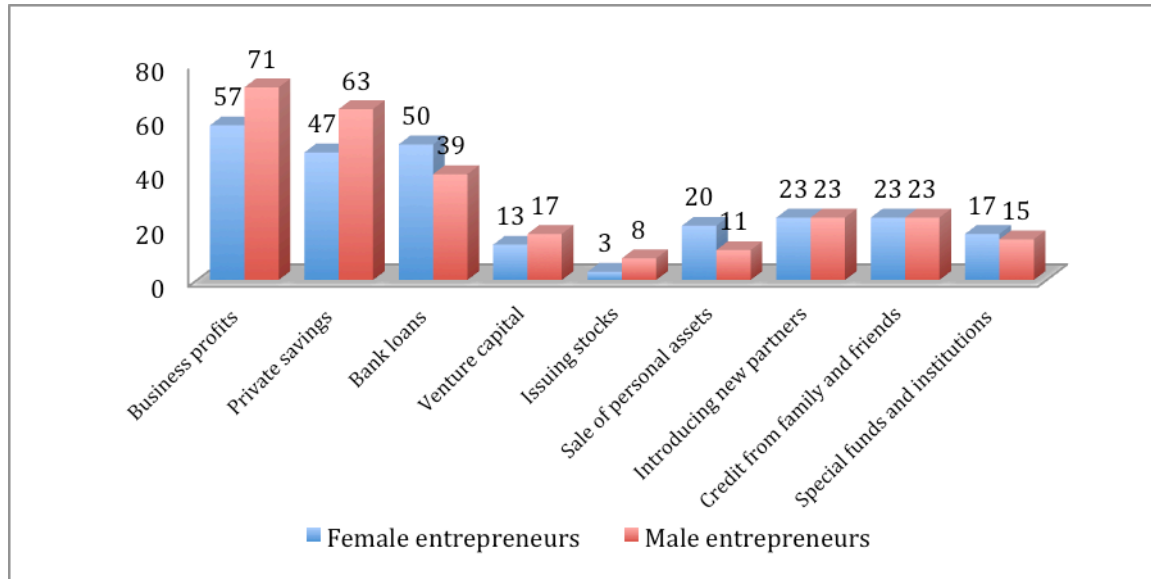


When asked about the frequency of resorting to formal contracts in exacting business transactions, the figures reported by female and male respondents were very close, suggesting no gender-specific differences in this regard. The bulk of respondents – almost one third of both gender groups – reported that they “sometimes” use formal contracts. A smaller percentage of both groups (21 percent male respondents and 17 percent of their female counterparts) said that they always do that. A small percentage of both groups (15 percent for males and 13 percent for females) said that they never resort to formal contracts. All in all, the constant resort to formal contracts covers a small portion of business transactions for Tunisian entrepreneurs indicating a high ratio of informality.

5.3- Access to finance is harder for female entrepreneurs

Access to finance provides a very interesting area of contrast between the answers given by female and male entrepreneurs. The figure below provides a contrast between both gender groups with regards to their principal sources of finance as indicated in the survey.

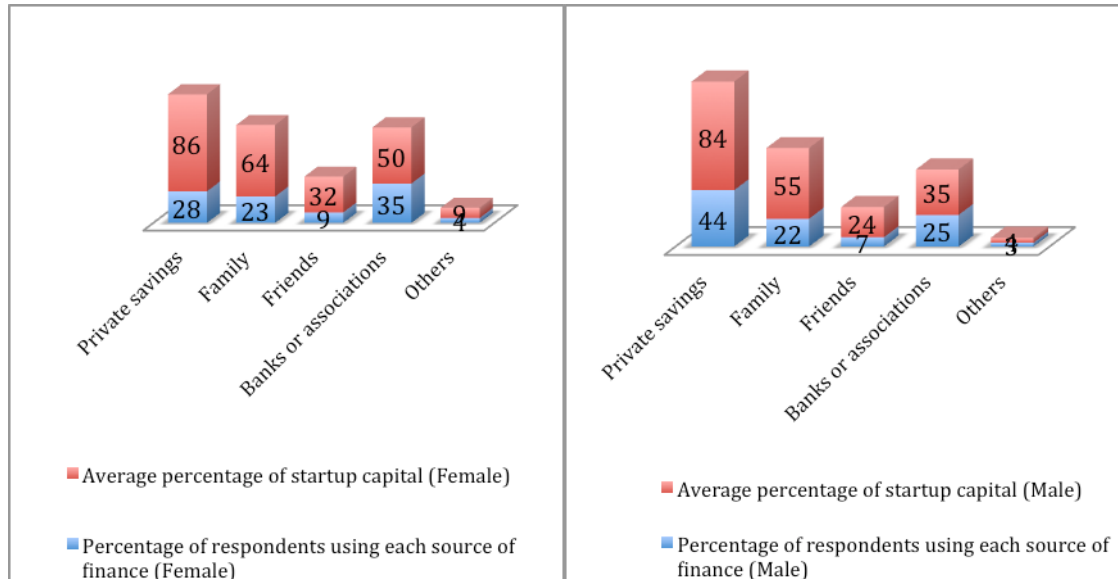
Figure (3.27): Sources of finance as reported by female and male entrepreneurs (percentage of respondents)



Female entrepreneurs reported to have depended on almost the same sources of finance that their male entrepreneurs have reported. The three main sources reported are business profits, private savings and bank loans for both gender groups. Lower numbers of female respondents reported resorting to business profits and private savings (57 percent and 47 percent, respectively) as compared to their male counterparts (71 percent and 63 percent, respectively). This confirms a point in the literature on female entrepreneurship, which has traditionally held that females have less access to assets and income, which applies to both profits and savings.

However, females' share in bank loans does not seem to be lower than that of males. As most of the bank loans in the survey come from special banks that run programs targeting the financing of new ventures and micro and small enterprises. This is a positive indicator of the absence of discrimination against women in practice. One has to bear in mind that these banks usually extend credit without asking for collateral, which may prove to be of greater use for women than men who usually have better access to assets. This point can be further explored if we look at the sources of finance at the start-up phase for both gender groups as reported in the survey. The two figures below depict this point.

Figure (3.28): Sources of finance at the start-up phase as reported by female and male entrepreneurs (percentage of total finance)



The figures above capture a picture of finance at the start-up phase. Each figure shows the average percentage of start-up capital reported by male or female respondents (indicated in red) and contrasts it with the percentage of male or female respondents that reported using such sources of finance (indicated in blue). Clearly, the patterns in both gender groups are close. The highest two sources of start-up capital composition for both gender groups were private savings and family. The third largest component of start-up capital that was reported was institutional credit from banks, associations and funds (50 percent for female respondents and 35 percent for males).

The fact that institutional credit comprises a larger share of start-up capital for females confirms what the survey suggested earlier: Females are not discriminated against during the loan application process. Moreover, bank loans were reported to be available for 35 percent of the total female respondents as compared to 25 percent of their male counterparts. Of course, here, banks refer also to special banks that offer loans without requiring collateral as previously mentioned.

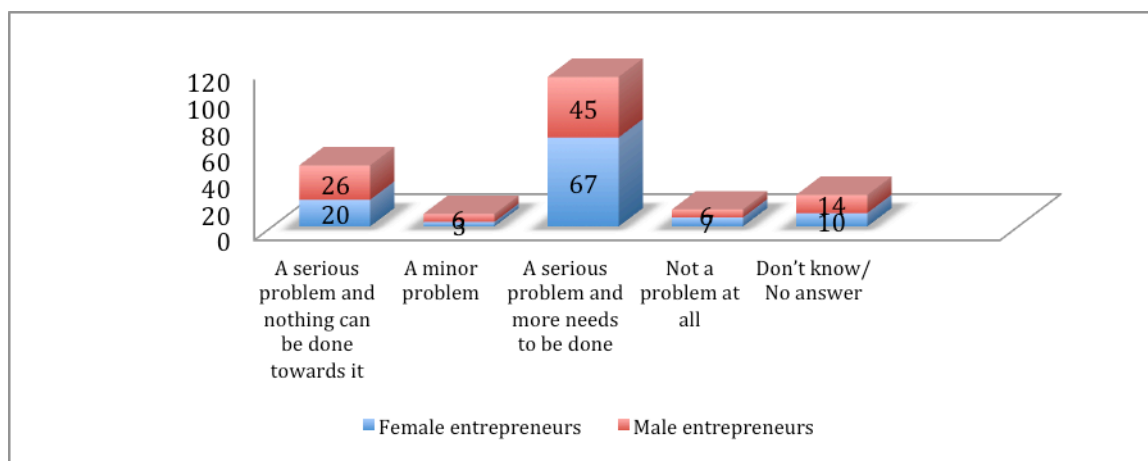
However, calculating the number of respondents who reported securing bank credit at the start-up phase shows that bank credit is beyond the reach of the majority of respondents in both gender groups. Only 35 percent of female respondents and 25 percent of their male counterparts had bank credit to finance their start-ups, despite the fact that this credit proved to be the greatest share of the average start-up capital reported. Meanwhile, a massive 59 percent of female respondents and 91 percent of their male counterparts reported to have depended on private savings and family and friends' money. Again, the exclusion of entrepreneurs from access to formal credit is not gender-based as the percentages are quite similar across both groups. Nevertheless, it is noteworthy that only 25

percent of the female respondents reported to have resorted to private savings versus 44 percent of their male counterparts. This may stand as evidence that females have less access to assets that can be used to self-finance a start-up than males.

5.4- Exposure to corruption and female entrepreneurship

Thirteen out of thirty female respondents (43 percent) said that they were asked to pay some informal payment in the form of bribery or gifts to state officials. This percentage was significantly higher than that of male entrepreneurs at 26 percent. As expected, female entrepreneurs turned out to be more vulnerable to extortion and corrupt practices. The following figure displays the different views expressed by female and male respondents over the issue of corruption.

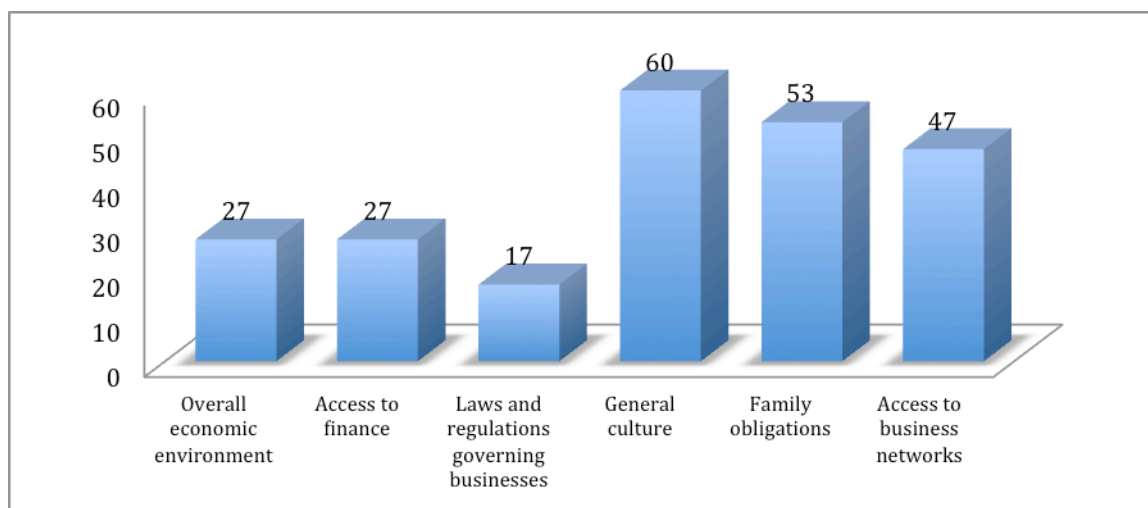
Figure (3.29): Views about corruption as expressed by female and male entrepreneurs (percentage of respondents)



Female entrepreneurs voiced more negative views on the issue of corruption than their male counterparts. Twenty female entrepreneurs (67 percent) stated that corruption was a real problem that needed more attention versus 45 percent for their male counterparts. The percentages of the male and female respondents who held that corruption was a serious problem and that nothing could be done to combat it were very close – 26 percent for males and 20 percent for females.

Lastly, female respondents were asked about the main challenges that they faced in conducting their business. Eighteen out of 30 female respondents (60 percent) held that the main challenge was the general culture of society, which was seen as hostile to female entrepreneurship. The second constraint was family obligations (53 percent or 16 of the respondents). The third challenge was the access to business networks (47 percent or 14 of respondents). Access to finance occupied the penultimate position (27 percent) and the laws and regulations were seen as the least challenging for female entrepreneurs (17 percent or five respondents).

Figure (3.30): Main challenges that face female entrepreneurs (percentage of respondents)



The main challenges expressed by Tunisian female entrepreneurs included in the survey have to do with societal factors rather than with the state. Culture, family obligations and business networks all reveal the possible hurdles that women may face upon deciding to become entrepreneurs. However, such obstacles differ completely from state-related challenges that have to do with the setting and implementation of rules, laws and regulations. Moreover, the fact that only a quarter of respondents (27 percent) believed that access to finance was the largest challenge that they faced as women indicates – together with earlier answers – that finance is not subject to gender-based segregation. Such a result goes in harmony with the overall idea that Tunisia is the single Arab country that made serious strides towards the legal equalization of women and men since the 1950s. Despite the practical and actual challenges that still haunt female entrepreneurship in Tunisia, such early reforms that targeted women status seem to have paid off.

6- Regional dimensions of entrepreneurship in Tunisia

6.1-Contrasting entrepreneur and enterprise profiles across regional

The Tunisian revolution of January 2011 has demonstrated that inter-regional discrepancies do matter and that they may explain a lot of complex socio-political processes in the Arab world and not just in Tunisia. It should not be forgotten that the Arab Spring all started by the self-immolation of Mohamed Bou'azizi – a street vendor in the marginalized inland city of Sidi-Bouzyd. Ever since the revolution, the question of resource distribution – both political and economic – among regions and provinces, has come to the forefront of Tunisia society and politics as well as in other post-revolutionary Arab countries. Not only has the debate been confined to matters of political representation and public expenditure but it has also tackled questions on the distribution of economic opportunities and leveling the

playfield for all market entrants in different regions.

Considering how important is the regional question, the survey includes respondent entrepreneurs from different regions and cities across Tunisia. Even though the focus remains urban, the survey includes respondents from three cities that were held to represent the principal regional divide in Tunisia, which is that between the coast and the inland provinces besides the capital city. Le Grand Tunis has a share of 37 percent of the total number of respondents, which is close to the share of its four provinces³⁷ in the total population of Tunisia. Another coastal city was chosen to represent the rest of the region besides the capital. This city is Monastir, which lies to the south of Tunis and has a representation of 19 percent of the sample. Together, Tunis and Monastir hold the share of 57 percent, which is roughly equivalent to the share of the Tunisian population that lives of the Mediterranean shores (60 percent). Kebili – capital of an inland province to the south – had the share of 43 percent of the sample, which is roughly equivalent to the percentage of Tunisians who live in the inland provinces.

To start, the sample is by no means a census of entrepreneurs or enterprises in various Tunisian regions. Entrepreneurs' profiles of each region do not themselves say anything meaningful. Rather the primary preoccupation of the survey is catching and contrasting the views and experiences of Tunisian entrepreneurs.

The majority of entrepreneurs in the three provinces belong to the age bracket between 21 and 40 years old. This age group stands for 78 percent of the total in Tunis; 88 percent in Kebili; and 100 percent of the respondents in Monastir. The age group is almost equally distributed across the three cities, which meets the goal of the overall sample of targeting young entrepreneurs and new entrants.

The figure reported for education reflects the same trends across the three cities. This does not mean that the educational attainment is equal in the real world but rather reflects the sample preoccupation with the category of young entrepreneurs of higher-education degree holders who constitute the majority of respondents in the three cities. Higher-education graduates stand for 78 percent, 95 percent and 72 percent of the respondents from Tunis, Monastir and Kebili, respectively.

As for firm sizes reported by the respondents, micro-firms employing less than six workers constituted the majority of firms in all three provinces followed by small firms. Micro enterprises stand for 64 percent, 79 percent and 77 percent of the enterprises in Tunis, Monastir and Kebili, respectively. Medium-sized enterprises employing between 51 to 100 workers were almost negligible in all three provinces, which indicates the missing middle syndrome. Lastly, large firms that employ over a hundred workers were primarily based in the capital of Tunis, which is an indicator of how enterprises are more capital-intensive in the capital city as compared to the provinces.

The quick contrast of entrepreneur-and enterprise-sample profiles in the three selected

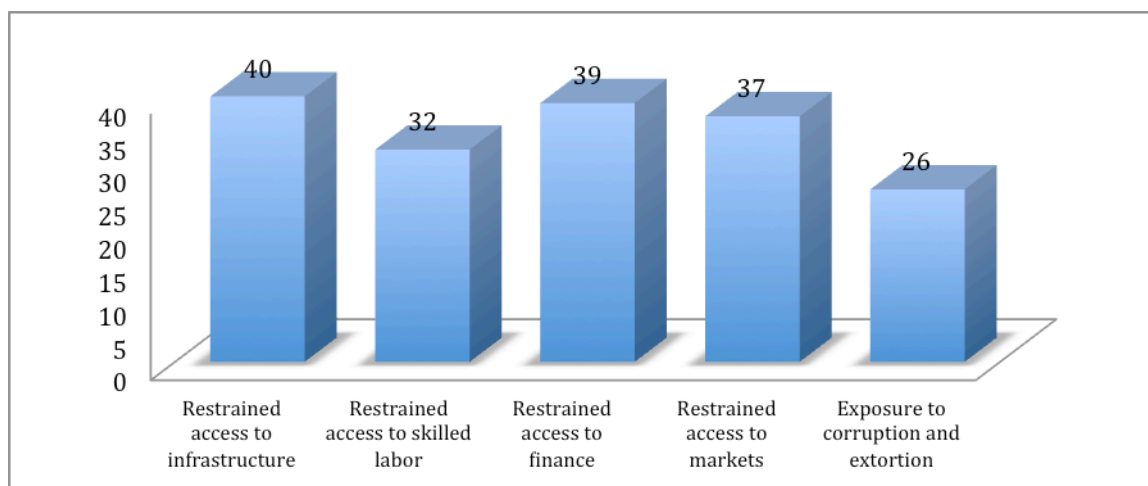
³⁷ Tunisia is made up administratively of 23 provinces or states (Arabic: *Welayat*). Tunisia is a unitary state, and thus, constituent *states* usually refer to governorates, which are administrative rather than political units. We will use the word province instead of state to avoid the confusion with the Tunisian state.

cities shows some considerable symmetry. The question here is how these different entrepreneurs – who look alike in many respects – interact with each other in the entrepreneurship ecosystem that surrounds their businesses. The following section will show the perceptions of the respondents from outside of Le Grand Tunis regarding the barriers they experience and the reforms that can enable them to improve the status of their businesses.

6.2- Perceptions from the provinces about the barriers to growth

Approximately 53 percent of the respondents from outside of Tunis expressed their belief that the opportunities for business growth would have been higher had they been situated in the capital city. Similarly, 31 percent of the respondents said that they would move their economic activities to the capital city if they had the opportunity. Forty percent of the entrepreneurs agreed with the statement that the institutional, legal and regulatory frameworks discriminated against different provinces in favor of the capital city. When asked about the principal barriers to growth they experience, the answers were as follows:

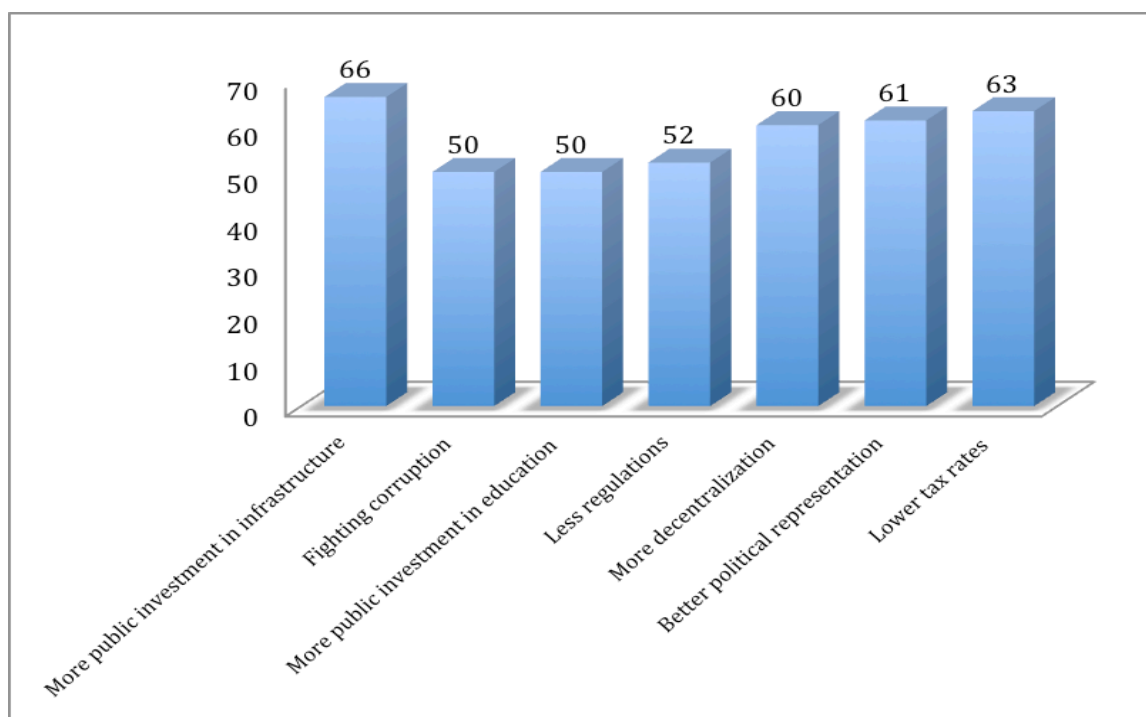
Figure (3.31): Main barriers to growth as reported by entrepreneurs in the provinces outside of Tunis (percentage of respondents)



Forty percent of the respondents reported the weak access to infrastructure to be the principal barrier to growth followed by the restrained access to finance at 39 percent. Access to markets came in the third place expressed by 37 percent of the respondents. The first two mentioned barriers reveal that weak investment in physical capital was among the top reasons for the perceived weaknesses of the business environment outside of the capital city. They reveal the weak access to assets that can be used to solicit credit. However, the fact that access to skilled labor came at fourth place (32 percent of the respondents) reveals the positive impact of the massive expansion in universal education and vocational training that took place in Tunisia throughout the past two decades.

Entrepreneurs from outside of Tunis were asked about the reforms they would deem necessary for the improvement of their growth opportunities. The figure below shows the results.

Figure (3.32): Required reforms to improve the chances of growth in the provinces outside of Tunis (percentage of respondents)



As expected and in harmony with the earlier answers given, a majority of respondents put public investment in physical infrastructure at the very top of the required reforms (66 percent of the respondents). This shows that a sizable percentage of provincial entrepreneurs believe that state policies and plans are still relevant in order to narrow the gaps between regions and enhance the chances of private businesses and entrepreneurs to grow. Infrastructure-related demands were followed by policy-related ones that have to do with the lowering of tax rates (63 percent); provision of better representation for the provinces (61 percent); and push for more administrative decentralization (60 percent).

Interestingly enough, fighting corruption and more investment in human capital via education and training came at the last position (50 percent of the respondents). Fighting corruption occupied the last place among the perceived barriers to growth in the provinces outside of the capital as well (around 30 percent of the respondents). This may have to do with the fact that the state presence in the provinces is generally weaker. It may also have to do as well with the fact that extortion and bribery diminished significantly following the uprising in 2011 as expressed by many entrepreneurs during personal encounters and in focus group discussions. Meanwhile, the relatively lower priority given by respondents to human capital development indicates the effective expansion and penetration of the Tunisian education system into the different provinces of the country throughout the last two decades.

Last but not least, the survey included a question to non-Tunis-based entrepreneurs, which

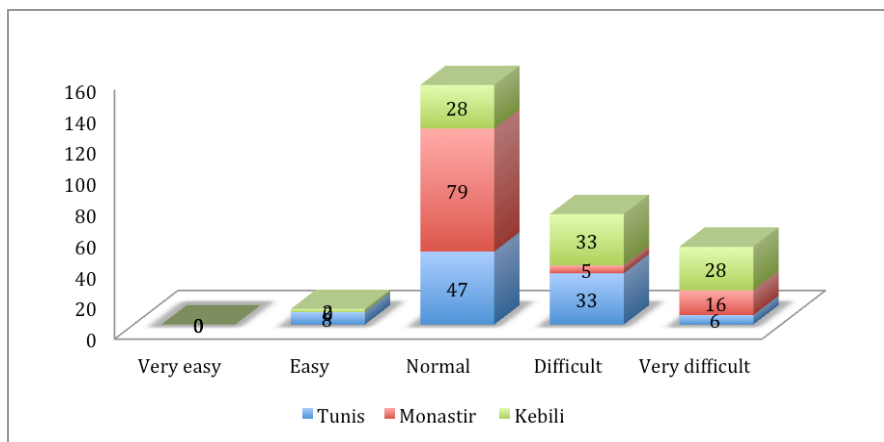
asked whether the chances of applying the above reforms have increased following the revolution on the 14th of January. Only 27 percent of the respondents answered in the affirmative while 45 percent of them said no. These views were strongly present among the entrepreneurs with whom the author conducted focus-group discussions in Kebili. There was a general status of frustration for nearly three years following the revolution. Many believed that the revolution that originated in the inland provinces against marginalization and deprivation has not paid off. There was the general attitude that nothing had changed and that nothing was expected to change, at least with regards to the way the central government governed the southern provinces.

6.3- Contrasting the views of entrepreneurs across Tunisia's three provinces

This section will contrast the answers given by entrepreneurs from the three provinces so as to show the difference, if any, between their experiences. The focus will be on the evaluation of the business registration process; the resort to formal contracts; and the views around contract enforcement, the barriers to growth, access to finance and corruption.

The figure below shows the views expressed by respondents in each province with regards to the easiness of the business registration process. This is taken as a proxy to the interaction with the state bureaucracy and the formal legal and regulatory structures. As the figure reveals, the percentage of respondents who held the process to be “very easy” or “easy” is limited to the three provinces, which indicates a cross-provincial dissatisfaction with the bureaucratic rules and procedures governing the matter. Among those who expressed that the process was “ordinary,” the respondents from the coastal areas have a much greater representation – 79 percent for entrepreneurs from Monastir and 47 percent for those from Tunis – as compared to those from the inland city of Kebili (28 percent). Similarly, the respondents from Kebili were overrepresented for the categories of “difficult” (33 percent) and “very difficult” (28 percent). As a matter of fact, 61 percent of the respondents from Kebili held the process of business registration to be either “difficult” or “very difficult” as compared to only 39 percent from Tunis and 21 percent from Monastir.

Figure (3.33): Contrasting the views about the registration process across provinces in Tunisia (percentage of respondents)



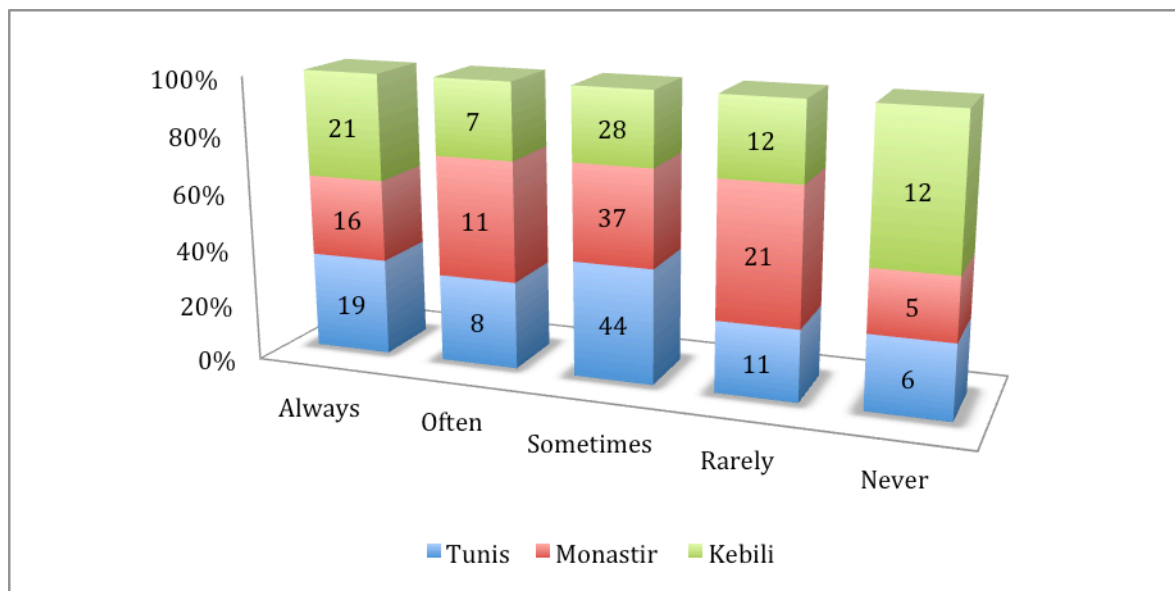
The large discrepancy between the views of the respondents from the three cities suggests that a regional element exists in a way that discriminates against the most marginalized inland provinces. This disparity exists despite the centralized nature of the registration process in Tunisia, as entrepreneurs need to deal with branches of the same governmental agencies and authorities on the central. However, the problem was reported by many Kebili-based entrepreneurs to be in practice rather than in formal rules and procedures.

Again, the main divide seems to be between the coast and the inland provinces. Whereas, the entrepreneurs from Monastir and Tunis voiced similar problems with regards to the bureaucracy, the Kebili-based entrepreneurs and would-be-entrepreneurs had deeper grievances that differed qualitatively from their counterparts in the coastal cities. Several entrepreneurs said that public officials were ill-trained in the marginalized areas and that they seldom internalized the laws and regulations. This was reported to lead to considerable delays in finalizing business-related procedures, as officials had to resort to the central administration for approval or clarification. For example, a Kebili-based entrepreneur who started his business in 2011 said that it took him eight months to register and file for a bank loan while a friend of his based in Aryana – located in Le Grand Tunis – concluded the whole process in a single month. Both were starting up a coffee-grinding shop. He traced this back to what he deemed as the incompetence of administrators in the province and their lack of knowledge of the rules and their proper application. He concluded by saying that this administrative incompetence is common in most inland provinces like Kebili, Kasserine and Sidi-Bouazid.

Other Kebili-based entrepreneurs talked at length about the problems of administrative confusion due to overlapping jurisdictions between various provinces. For instance, the study determined *le cycle administratif* for certain businesses in Kebili had to be completed in neighboring provinces of Gafsa and Gabes even though Kebili was an autonomous province that had the same political and administrative status as the other two. The explanation that an interviewee offered is that Kebili did not become a province officially till 1986. Before that time, it used to be a part of its coastal neighboring province of Gabes. Hence, many administrative units remained in Gabes and were never transferred to the newly-established province. The study found that Kebili had not yet become fully administratively independent, which negatively impacted young entrepreneurs. For instance, transportation administration fell under the jurisdiction of the authorities in Gabes; real estate and environmental authorities in Kebili reported to superiors in Gafsa; and tourism followed the administration in Tozeur to the south of Kebili. To echo many participants in the focus-group discussion, the administrative decision-making for Kebili affairs tended to reside outside of Kebili.

Business registration is one indicator of the access to the country's formal state structure. As expected, the results suggest that considerable regional disparity exists between the coastal and inland provinces. Another indicator is the reported frequency of resorting to formal contracts by entrepreneurs across the three cities. The figure below shows no particular pattern that exists between the three cities. These figures suggest that the resort to formal contracts is relatively equal among the three provinces.

Figure (3.34): The frequency of resorting to formal contracts as reported by entrepreneurs across Tunisia's three provinces (percentage of respondents)



Interestingly enough, Kebili-based entrepreneurs were the least to report that formal contracts can be defended (47 percent) in contrast to 84 percent and 64 percent for entrepreneurs from Monastir and Tunis, respectively. Such figures suggest that the access to the formal apparatus of contract enforcement is unevenly distributed in favor of the coastal cities that are naturally wealthier and more economically active. Similarly, a higher percentage of respondents in the two coastal cities of Tunis and Monastir (83 percent and 79 percent, respectively) expressed their belief that formal contracts have a positive impact on their businesses than those from Kebili (63 percent).

However, one should consider that the overall resort to formal contracts in all three provinces in Tunisia – including the capital city – is rather low, indicating a generally high level of informality that may reach up to 35-40 percent of the GDP as calculated by Schneider (2009). The largest percentage of responses fell into the category of “sometimes,” which suggests an irregular resort to exacting transactions through formal contracts. The “always” and “often” categories remained below the third of interviewed entrepreneurs.

With regards to overall barriers to growth, despite some differences, respondents from the three provinces have put political instability; administrative inefficiency; and restrained access to finance as the top three barriers to growth. Whereas political instability and disorder were expressed as the topmost barrier by entrepreneurs from Tunis and Monastir at 64 percent and 53 percent, respectively, it came as the third for respondents from Kebili together with weak contract enforcement at 47 percent. The relatively high figure for Tunis – as compared to Monastir and Kebili together – suggests that entrepreneurs in the capital are more likely to feel the political turmoil. Moreover, the state presence in the capital city is much more visible and effective than in secondary cities in the provinces.

However, respondents from Kebili voiced more grievances than their counterparts in the two coastal cities concerning access to finance. Whereas a massive 70 percent of the Kebili-based respondents said that finance was the first and principal barrier to growth that they faced, this problem came second for respondents from Monastir at 47 percent and Tunis at 58 percent.

Kebili-based entrepreneurs seemed to be significantly underprivileged in comparison to their counterparts in the two coastal cities with regards to their access to electricity and access to land. Forty-four percent of the respondents from Kebili held restrained access to land to be a major barrier to growth versus only 11 percent of entrepreneurs in both Monastir and Tunis. Electricity – a strong indicator of the access to physical infrastructure – suggests a similar story.

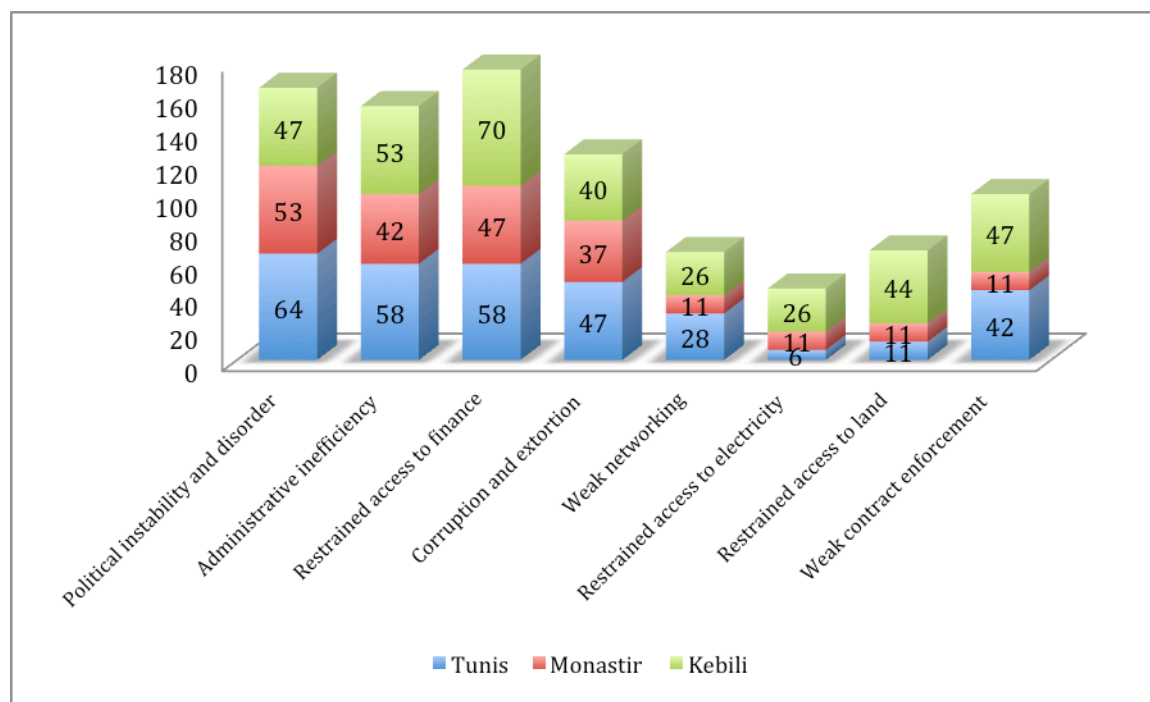
During the two focus-group discussion rounds that were held with young entrepreneurs and would-be-entrepreneurs in Kebili, access to land and its relation to securing credit for business start-ups appeared to be on the very top of the hurdles that entrepreneurs faced there. The problem of land tenure and registration was common between inland provinces, which were historically far from the control of the centralized state in Tunis, including the times of the French protectorate (1881-1956). According to interviewed entrepreneurs, it is particularly hard in Kebili to rent or own a piece of land because most of the land there is non-registered. The majority of the respondent entrepreneurs said that the basic problem was that the land in Kebili was not included in the *titre blue*, which is the state register of estate property. Rather, the land is registered as communal property (*Aradi Ishtirakiya*) of large and extended familial groups that historically existed when the direct management of land was left to tribal or family chiefs. Unlike the Northern part of Tunisia, no sustained effort was made by the state to survey and register land in the inland provinces, according to Assaad Al-Alawi – a Kebili-based entrepreneur. It was claimed by some of the interlocutors that the process of land registration as an individual property may take up to 20 or 25 years.

The link between restrained access to land tenure and that to finance was brought up continuously by young entrepreneurs in Kebili during the focus-group discussions. Three entrepreneurs said that the conditions for extending credit were usually tougher for Kebili-based entrepreneurs due to the land-related problems. They said that they were required to provide some collateral by the BTS to conclude the loan agreement, even though the BTS and BFPME *raison d'être* was to furnish credit without collateral. However, they said that there was a loophole in the governing regulations and the author was shown a bank form in which the bank officer had the mandate to add conditions for concluding the loan upon his discretion. The bank form had an additional line where the bank employee could add conditions by pen in addition to the printed conditions above. The three entrepreneurs concluded by saying that loan conditions may indeed differ from one province to the other despite unitary regulations.

The problems of land tenure has been held as intimately related to the problem of the access to finance in Kebili, which was flagged as the topmost barrier to growth by 70 percent of the respondents there. Unsecured land property makes it hard to use as a guarantee or collateral with banks to solicit credit. Abdel-Samad Sola – officer at Kebili's

business center – held that what makes things much worse in Kebili is that most projects are related to agriculture, which exacerbates the problems of land tenure.

Figure (3.35): Barriers to growth as expressed by respondents across Tunisia’s three provinces (percentage of respondents)



Interestingly enough, exposure to corruption and extortion came as the fifth and sixth barrier to growth by all respondents. Moreover, the percentage of entrepreneurs who stated it to be a major problem was almost equal across the three provinces – 40 percent for Kebili; 37 percent for Monastir; and 47 percent for Tunis. As a matter of fact, the percentage was higher for Tunis than the other two cities. This shows that the problem is large and that entrepreneurs in all three provinces feel its impact equally. However, it suggests that the state presence is felt more in the capital city than in the provinces. The Egyptian sample showed the same pattern as the figures indicating the exposure to corruption were relatively higher in Cairo and Lower Egypt than in Upper Egypt – the equivalent to inland provinces in Tunisia. This can be explained in two ways. There is a probability that it has to do with the presence of state officials, which tends to be higher in the capital city than in the provinces and. It may also be due to the fact that entrepreneurs in Lower Egypt and Cairo have better access to assets and capital, creating an environment conducive to state predation.

The above assumptions are further supported by the following: Tunis-based entrepreneurs recorded the highest percentage of respondents that reported being asked to pay bribes or give away gifts to public officials in order to get business done. Whereas 44 percent of the Tunis-based entrepreneurs said so, only 23 percent in Kebili and 26 percent in Monastir revealed being asked such questions.

All in all, the survey – together with the rounds of focus-group discussions – suggests that a strong regional element is at work in Tunisia. The principal divide is between the coastal and inland areas. Entrepreneurs and would-be-entrepreneurs from Kebili – which reflects all inland provinces – reported a deep sense of grievance and a strong conviction that they have been operating at a disadvantage in areas such as finance, land, infrastructure and administrative competence. Most of these factors are the result of decades of negligence that stretch back to colonial times and the early years of independence. However, many entrepreneurs in such marginalized provinces believe that this underprivileged ecosystem has been a result of conscious public policies by the state that aimed at deliberately marginalizing the South in favor of the coastal areas. A number of examples were given by the interviewees to support that view. A frequently mentioned example was that of Kebili's massive production of high-quality dates named "Dagla." Whereas Kebili is Tunisia's largest producer of Dagla dates, Nabeul – a coastal city to the North – is the nation's largest exporter. Due to the underinvestment in Kebili, dates are collected and shipped to factories in the coastal cities where they are packed for exporting. The result is that most of the value-added goes to the manufacturers and exporters – not to the original producers in the land-locked province.

Some scholars suggest that the Tunisian state has inherited the same discriminatory policies against inland provinces from the French as a remnant of colonization. The ultimate target of such public policies has been to keep the inland provinces as mere suppliers of raw material – phosphate, oil and agricultural produce – and as a source of cheap manpower through the internal migration of workers from poorer areas in the South to the industrial cities of the coast. The discrimination has taken many forms ranging from modest public investment in infrastructure to weak development programs for marginalized areas.

Part Four
Conclusion
Breaking Away from Sub-Optimality

1- Sub-optimal entrepreneurship ecosystems: The cases of Egypt and Tunisia

This study provides a comprehensive assessment of the institutional underpinnings of the entrepreneurship ecosystem in Tunisia and Egypt. The analysis was not confined to examining the formal legal and regulatory structures. Rather, it attempted to depict a close-up picture of how things are done and how different categories and groups of entrepreneurs and enterprises in both countries react to the restraints imposed by the formal structures. The study has addressed two principal questions. One, why has private entrepreneurship in Egypt and Tunisia remained underdeveloped despite decades of economic liberalization and private sector-friendly incentives and reforms? Two, how can the entrepreneurship ecosystem in the two countries develop so as to meet the high expectations of the people – particularly young ones – of having a productive and just socio-economic order?

The study sample was designed to reflect the diversity of Egyptian and Tunisian entrepreneurs in terms of age, educational background, firm size, geographical location and gender. The previous parts of the report have displayed the different views and perceptions expressed by the respondent entrepreneurs according to their own experience. The two samples were predominantly made up of micro and small enterprises – small capital holders – that are not often the focus of many studies on entrepreneurship and private sector development. Moreover, the samples were stratified to include representation from both provincial and female entrepreneurs. A clear majority of the randomly selected respondents in Tunisia and Egypt had some post-secondary or university degree and belonged to the “not-so-young” age cohort aged between 25 and 39. These educated youth constitute a broad majority of the labor force in Tunisia and Egypt, forming one of the most significant demographic categories proceeding the 2011 revolutions.

The survey covered all three components of the entrepreneurship ecosystem – property rights regime, financial subsystems and non-financial subsystems – and sought to catch both the perceptions and the actual experiences reported by the respondents.

Overall, formal legal and regulatory structures have been reported by a considerable majority of respondents in Egypt and Tunisia to be dysfunctional, inaccessible or both. A clear majority of Tunisian and Egyptian entrepreneurs face problems registering their businesses; Many – particularly in Egypt – operate informally without any permits or licenses. A majority of respondents do not trust formal contract enforcement, reporting rather lower frequencies of resorting to formal contracts while exacting economic transactions. The same trend applies to the formal legal and regulatory structures that govern market exit and bankruptcy. Only few report having resorted to bankruptcy procedures while the vast majority of those who report having exited in the past said that they managed the process informally. Access to institutional credit through banks or special funds remains limited, especially in Egypt more than in Tunisia. Equity and non-traditional sources of finance stand for a meager share of total financing for nascent and micro and small enterprises. Still, self-financing through private savings and business profits remains

the main source of finance for the majority in Tunisia as well as in Egypt.

A majority of respondent entrepreneurs in both countries reported resorting to informal means of conducting business; a high percentage of businesses reported operating without registration, especially in the case of Egypt. Tunisian and Egyptian entrepreneurs reported the use of formal contracts of any kind with low frequency. Moreover, the reported cases of closure and bankruptcy were predominantly managed informally away from formal laws and regulations. Self-financing at the start-up phase was the top source of finance reported by entrepreneurs in Egypt and Tunisia. The vast majority of respondents reported their primary dependence on self-financing either through the profits generated by their businesses (73 percent of the respondents in Egypt and 65 percent in Tunisia) or through private savings (66 percent in Egypt and 56 percent in Tunisia).

Essentially, formal structures in Tunisia and Egypt are beyond the access of the broadest base of private sector entrepreneurs.

Although entrepreneurs in both countries developed informal alternatives in order to exact their transactions and survive, the transaction costs remained quite high in the absence of adequate institutions. With no alternative to reforming formal legal and regulatory institutions due to their inclusion of key market actors, the Tunisian and Egyptian entrepreneurship ecosystems will likely remain sub-optimal, if not hostile.

Given the dysfunction and inaccessibility to formal legal and regulatory structures, the broadest bases of private sector entrepreneurs in both countries have grown accustomed to operating under a sub-optimal ecosystem. Sub-optimality refers to the final outcome of the weakness of formal structures and insufficiency of alternative means for doing business informally. The concept of sub-optimality is an institutional way of approaching macro-economic phenomena such as low-productivity, lack of competitiveness and weak growth potential of the private sector in MENA, particularly in Egypt and Tunisia. Additionally, it helps in explaining phenomena already underlined by the literature such as the missing middle syndrome where micro enterprises are deprived of opportunities for small and medium enterprise growth, forming a large majority of private sector firms.

The exclusion from formal structures is not by choice as many strands of literature may claim. One of the interesting findings is that a clear majority of respondents in Egypt and Tunisia expressed positive attitudes toward business registration. When asked to evaluate the impact of official business registration on access to finance, business security and access to markets, a clear majority considered the positive impact of registration despite the reported difficulties and rather high levels of informality that characterize both economies, especially in Egypt. A clear majority (over 74 percent) of the entrepreneurs in both countries expressed the belief that using formal contracts was more secure to their business transactions. However, a sizable percentage of the same respondents showed little trust in contract defense before the judiciary in either country. If the majority is aware of the benefits of formal structures but still cannot register, then exclusion is no longer by choice.

Although Egypt and Tunisia have much in common with regards to the sub-optimality of their entrepreneurship ecosystems, they are not by any means identical. Rather, there are

differences in degree of sub-optimality where Tunisia fares better than Egypt in many respects. Moreover, the institutional sources of sub-optimality tend to differ between the two countries in what can be labeled as the verities of sub-optimality.

2- Varieties of entrepreneurship sub-optimality: differences between Tunisia and Egypt

2.1- Tunisia: an imperfect correction of biases

Many of the survey and interview findings indicate that the broadest base of private sector entrepreneurs in Egypt and Tunisia are operating at a sub-optimal level, which significantly undermines their potential for growth. However, that does not imply by any means that Tunisia and Egypt are identical. Despite many institutional and political-economic similarities, the sources and degrees of entrepreneurial sub-optimality are different.

The overall environment in Tunisia has been less hostile toward young entrepreneurs, nascent enterprises and female entrepreneurs as compared to Egypt. The survey suggests that the Tunisian bureaucracy is relatively more efficient and less corrupt than its Egyptian counterpart. Moreover, the Tunisian government under Ben Ali has developed an extensive support structure that targets entrepreneurship and micro and small enterprises. The support structures that were developed since the second half of the 1990s included a range of administrative, financial and non-financial agencies and institutions such as the two special banks: BTS, BFPME and the network of business centers and public incubators.

Although this support structure has been far from optimal, the survey and personal interviews strongly suggest that it contributed positively in mitigating the biases inherent in the entrepreneurship ecosystem against young entrepreneurs, small capital holders, women and provincial entrepreneurs. One main contribution was that these support structures made finance more accessible at the start-up phase. Hence, Tunisia can qualify into a case of the imperfect correction of biases or a case of half-hearted reforms under Ben Ali.

The survey shows that access to loans at the start-up phase is evenly distributed and almost matches the natural distribution of entrepreneurs in the sample. The share of younger entrepreneurs in loan reception was equal to their share in the sample. Females were slightly overrepresented. Micro enterprises were slightly overrepresented as well. Conversely, medium and large enterprises were underrepresented. Moreover, there was no evidence of discrimination along regional lines. The share of provincial entrepreneurs in loans was almost equal to their share of the sample. The picture depicted above does not vary significantly upon studying the patterns of accessing finance beyond the start-up phase.

Unlike the case of Egypt, the Tunisian financial subsystem does not exhibit any pronounced or systemic discrimination against certain entrepreneurial subcategories. This cannot be understood isolated from the entrepreneurship-support structure, namely the network of special banks and funds that extend credit at the start-up phase. These institutions clearly favor young entrepreneurs with higher-education degrees and usually single-ownership structures. There is little regard to region or gender. However, this picture

of Tunisia does not help in answering the earlier question of why two thirds of the entrepreneurs included in the survey refrained from applying to bank loans at the initial stages of enterprise formation. This cannot be answered either in terms of cronyism or patronage targeted towards certain entrepreneurs because the average age of surveyed enterprises is three years, which coincides with the Tunisian revolution and the disintegration of the old networks of patronage and corruption associated with the Ben Ali regime.

Despite its relative achievements, Tunisia's financial support structure is still imperfect in design and operation, which is reflective of the sub-optimality that marks the overall entrepreneurship ecosystem. Three principal shortcomings were identified through personal interviews and focus group discussions conducted with entrepreneurs and bank officials:

The support structures are quite fragmented and disintegrated. There is a rift between technical and financial knowledge production and processing that are necessary for the efficient and impactful operation of the system. Special banks are theoretically required to base their assessment of financing new projects exclusively on concept and success potential. As it stands, it seems that they have neither the adequate knowledge nor expertise to make such assessments, unlike the other structures of support that work intimately and locally with entrepreneurs such as the business centers, incubators and the work bureaus.

There has been a clear political agenda under Ben Ali (1987-2011) to find some solutions for the oversupply of higher-education graduates. Since the late 1990s, the whole support structure of institutions and agencies started to form. The only issue with such an approach to supporting entrepreneurship is that the economic and social motives of action become mixed up and often times confused. The BTS and the BFPME are required to confine their financing on non-commercial projects so as to enable graduates to realize their potential in higher value-added areas in the industrial and service sectors based on their area of concentration in university. Moreover, extending credit is conditioned by submitting a certificate of the scientific degree of the applicant. Business centers, incubators and special banks can only approve projects that correspond to the field studied by the applicant. For instance, a computer-science graduate cannot solicit credit for an industrial project. Such measures were laid by the state with the aim of maximizing the social return of public education. However, the main issue with such preconditions is that they do not prioritize innovation and growth potential as the main criteria against which a project idea can be assessed.

Given the point above, there is evidence that suggests that financial support structures in Tunisia loosely function as channels for patronage distribution. Interestingly enough, a young entrepreneur from the inland city of Kebili said that loans from special banks were first provided to the Tunisian youth in return for dismissing job opportunities in the public sector. Such a statement is reflective of the moral economy that governs the support structures in Tunisia. It also demonstrates the conflicting logics of the economic and social motives of supporting entrepreneurship: one, to fight unemployment – something close to welfare stipends – and two, as a measure of boosting investment, innovation and growth. The two may not be in total harmony in practice as many entrepreneurs have held. Hence, it is plausible to hold that entrepreneurship-related funds and preferential credit was used

for both patronage distribution as well as development purposes. This may explain the lack of follow-ups with projects selected for financing and the lack of any impact assessment of entrepreneurship financing in the last several years. Moreover, it may partly explain the focus on finance among other start-up relevant issues at the expense of post-start-up issues such as marketing and networking.

2.2- Egypt: sustained anti-entrepreneurial biases

Conversely, the survey results indicate that Egypt's entrepreneurship ecosystem is much more hostile and discriminatory against young entrepreneurs; nascent and young enterprises; female entrepreneurs; and provincial entrepreneurs. Formal structures are quite dysfunctional, corrupt or simply beyond the access of the broadest base of entrepreneurs, significantly more so than in Tunisia. Access to finance is relatively limited compared to Tunisia, and formal structures play virtually no role in entrepreneurship education or skill formation. Given how much formal structures were biased against entrepreneurship, virtually no support structures were set in Egypt – like those in Tunisia – that could have mitigated the systemic biases against small capital-holders and young entrepreneurs. Accordingly, Egypt can be typified as a case of sustained anti-entrepreneurship biases.

According to the survey, the top three sources of finance that entrepreneurs reported were business profits at 73 percent; private savings at 66 percent; and credit from family and friends at 35 percent. All three forms are informal and based on self or family financing.

The principal institutional channels that should provide debt or equity do not seem to function for the vast majority of entrepreneurs and the broader base of the Egyptian private sector. Bank loans; special funds targeting MSMEs and young entrepreneurs; venture capital; and stock issuance came at the end of the list. Only 13 percent reported to have resorted to bank loans followed by six percent for special funds; 12 percent for venture capital, and seven percent for stocks.

Finance at the start-up phase was found to serve a very critical link between access to finance and entrepreneurship. A massive 94 percent of the respondents reported to have relied on private savings followed by 50 percent and 30 percent who depended on funds from family and friends, respectively. Banks and associations provided credit for merely 17 percent of the respondents. The situation becomes even graver when the average share of each source of finance is considered as reported by the respondent entrepreneurs. Private savings stood for 63 percent while credit extended by institutions did not exceed five percent of the average start-up capital. Such figures imply that banks rarely extend credit at the start-up phase. Thus, entrepreneurs are left on their own and to their narrow circles of family and friends to secure their start-up capital.

However, though non-traditional means of finance seem to be limited to a few sectors and an enclave of entrepreneurs, this does not overrule its future potential given the problems with the banking sector. As a matter of fact, there is some evidence to suggest that non-traditional finance – especially in the form of venture capital and angel investment – has witnessed some considerable expansion since 2011. Several interviewees, all young entrepreneurs operating in high-technology sectors, reported that some extensive networks

of start-ups, venture capital, incubators and accelerators, angel investors, competition rounds and exhibitions have been developing in the recent years in an unprecedented way. These networks provide the fluid circulation of information as well as financial, social and human capital at the start-up phase.

Some evidence suggests that the recent expansion in venture capital has been related to transnational networks. The founders of some of the most active venture companies came from a strong background in international finance. There seems to be some conscious copying of successful global experiences. Moreover, there seem to be strong linkages between the recently developed networks of entrepreneurs, incubators and financiers in Egypt as well as in other Arab countries (such as Jordan) and the Silicon Valley, with companies owned by Arab expatriates. There is also evidence to suggest that these expatriates are attempting to copy – or at least benefit from – the examples set by their Indian counterparts based in the Silicon Valley.

The results obtained from the survey cannot be separated from the fact that micro and small enterprises constitute approximately 96 percent of the respondents. Such sample composition reflects the structure of the Egyptian private sector, generally. Indeed, the Egyptian sample shows that most nascent and young enterprises – those less than five years of age – were of micro size (61 and 68 percent, respectively, compared to 47 percent for established firms) while the rest were of small size. There is ample evidence that the banking sector in Egypt is inaccessible for micro and small enterprises. According to Rocha et al (2011:2) “the share of SMEs in loans is eight percent for the region and 13 percent for non-Gulf Cooperation Council countries.” The share of SMEs in total loans in Egypt was only five percent compared to 24 percent in Morocco; 15 percent in Tunisia; and below average of the non-oil economies at 13 percent. In fact, Egypt came after Jordan, Lebanon and Yemen (Rocha et al 2011:22). Egypt is underperforming in an already underperforming region. The World Bank survey reported that only 10 percent of SME investment expenditure in MENA is financed by bank loans (Rocha et al 2011:11). Cull et al (2006:3019) indicated that the share of banks in the sources of finance of small firms – those employing between 10 and 50 workers – was 20.2 percent in Bangladesh; 14.1 percent in Brazil; 18.2 percent in Croatia; and 24.1 percent in Ecuador.

As mentioned earlier, informal entrepreneurs constitute approximately 31 percent of the sample. Contrasting their answers with their counterparts in the formal sector with regards to access to finance reveals very interesting results. Surprisingly, both groups of respondents reported similar ratios of dissatisfaction with regards to access to finance (58 percent versus 60 percent), which implies that the inaccessibility to finance is not just confined to the informal sector but further suggesting that it has other reasons that adversely affect both formal and informal private firms in Egypt.

The largest percentage of respondents of both sectors indicated that their primary source of funding was the very profits made by their enterprises. The percentage was a bit higher for the informal sector (31 out of 40 or 78 percent of the respondents) than the formal one (70 percent of the respondents). The second largest source of finance mentioned by the respondents from the two sectors was private savings. The percentages were quite similar for both sectors: informal sector entrepreneurs (26 out of 40 respondents or 65 percent) as

compared to the formal (67 percent). Only 16 percent of formal entrepreneurs and five percent of their informal counterparts reported their attainment of loans and other forms of credit obtained from banks. Although the percentage of formal sector entrepreneurs who reported to have had access to bank loans is higher than those in the informal sector, it remains rather modest and largely dwarfed by other sources of self-financing.

The figures suggest that most entrepreneurs – be they in the formal or the informal sector – rely heavily on self-financing through the profits generated by their enterprises and private savings. Entrepreneurs in both sectors seem to suffer from major problems in accessing credit from banks. It is quite intriguing that operating in the formal market does not seem to change much of the capacity to access finance.

The report developed a rough map of loan recipients by contrasting the natural distribution of each subcategory with the share of its members in the actual loan reception as reported by the respondent entrepreneurs. Younger entrepreneurs – those below the age of 40 – are clearly underrepresented. Although they constitute 60 percent of the sample, their share in bank loans was approximately 44 percent – a gap of approximately 16 percent. Females are clearly excluded as well. Their share in the total sample hovers around 16 percent yet only seven percent of bank recipients were females. Ownership structure shows some glaring disparities. Family businesses are overrepresented as their share in surveyed enterprises was 32 percent, yet they stood for 48 percent of total loan recipients. Their overrepresentation comes mainly at the expense of non-family partnership-businesses whose members are 30 percent of the enterprises sample though their share was as low as 15 percent of loan recipients.

Regarding bank loan accessibility, the survey shows the same patterns of exclusion against younger entrepreneurs, females, informal, micro and non-family partnerships. Moreover, it shows that family businesses are even more overrepresented in accessing bank/special funds loans at the start-up phase.

3- Why did Egypt and Tunisia end up with such suboptimal entrepreneurship ecosystems?

The drive for capitalist transformation in Tunisia and Egypt stretches back to the mid-1970s when the first investment laws were passed. This was in 1972 in Tunisia and 1974 in Egypt. Since then, successive rounds of price, trade and capital liberalization, privatization of publicly owned assets and the deregulation of sectors have taken place in both countries under the auspices of International Financial Institutions such as the World Bank and the International Monetary Fund. The end result was the emergence of a sophisticated private sector by the 1990s with a considerable share in the total output, value added and employment, as indicated in the study introduction. However, the growing share of private enterprises hardly meant the development of dynamic entrepreneurship in either country, which remained characterized by low productivity, lack of competitiveness and an unrealizable growth potential. This study and survey have traced these deficiencies to the different components of the entrepreneurship ecosystem. However, the question that arises now is why have Egypt and Tunisia ended up with such suboptimal ecosystems? And what

is the way out?

In answering the first question, the sub-optimality of the entrepreneurship ecosystems in Egypt and Tunisia cannot be explained in isolation from the broader political economic context. Much has to do with what the ruling regimes did, especially during the long reigns of Mubarak (1981-2011) and Ben Ali (1987-2011). The suboptimal ecosystem – whose features and dimensions the survey caught and analyzed – is the result of a series of policy and institutional choices that were made (or neglected) by those who were managing the liberalization and privatization programs in the last decades. Hence, it could have been avoided or at least, altered.

3.1- Markets without institutions: the shortcut to crony capitalism

The primary focus of market-creation in Tunisia and Egypt since the 1980s and 1990s was liberalizing trade, capital and prices together with the deregulation of certain sectors so as to allow private investment and the gradual privatization of state owned companies and assets. However, as more and more areas were cleared for the private sector, little institution building was made in the field of property rights protection, rule of law and building of state regulatory and developmental capacities. The end result was some form of crony capitalism where asymmetries of information and power were vastly used and/or abused in an attempt to bring about non-market based profits (Alessa 2007; Adly 2011, 2009, Erdle 2010). The widely held view in the literature is that although reforms in the 1990s continued to focus on increasing the role of markets and decreasing the role of state, they tended to ignore the important role of institutions (World Bank 2005c) (Stevenson 2011: 14).

The absence of functioning institutional rules that regulated the asymmetries of power and information among burgeoning market actors, liberalization, deregulation and privatization that took place in Tunisia and Egypt led to the transferring of once state-held assets and market shares into the hands of a few cronies that were tightly-connected to the incumbent regimes. A small number of well-established enterprises in the region benefited disproportionately from strong market positions. This is the result of regulatory environments that restrict competition and networks of business, financial and political interests with few incentives to innovate and drive change. Consequentially, the total number of enterprises led by economic opportunity and operating formally in higher productivity sectors is smaller than in OECD countries and in dynamic emerging markets (OECD 2013: 16).

In such contexts, access to assets, capital, credit and markets was essentially decided based on political bases. Heydman and Sfaksianis (2004) called it networks of privilege. Adly (2009) labeled it politically-embedded cronyism. Mubarak's regime distributed private property rights in an uneven way that favored some at the expense of others. Accordingly, earlier waves of liberalization created networks and circles of predators that invested further in weak regulatory institutions and the absence of the rule of law. Erdle (2010) theorized about it in Ben Ali's Tunisia by calling it the "Makhzanization" in reference to the overconcentration of power and wealth in the immediate circle surrounding Ben Ali.

Stephan Roll (2013) examined the uneven distribution of property rights on credit allocation in Egypt under Mubarak. Roll noted that the supply of credit to the private sector had almost doubled between 1990 and 2003. Bank loans to the private sector as a share of GDP increased from 29 to 54 percent (World Bank 2010). However, this did not translate into better access to credit to the broader base of the private sector as only 10 percent of SMEs credit needs were met in 2000 (Roll 2013:556). The explanation for this paradox of statistically increased credit supply to the private sector and the virtual shutting out of SMEs from access to bank credit can be found within reports about the lending policy of public banks (2013:556). The World Bank (2008:25) held that as of December 2005, 22 clients with loans of more than LE 1 billion accounted for some 11 percent of total credit outstanding. The next 47 clients, with loans between LE 500 million and LE 1 billion, accounted for some 10 percent of total credit outstanding, meaning that 69 clients accounted for almost one-quarter of total credit outstanding. Adding the next 486 clients implied that more than 50 percent of total loans were represented by a scant 0.19 percent of all clients.

In Mubarak's Egypt and Ben Ali's Tunisia, the most powerful and well-organized actors heavily invested in weak institutional arrangements. The weakness of institutional arrangement refers to the situation where the state has no capacity to uphold equal property rights, enforce the law and regulate the asymmetries of information and power. Public assets in the form of to-be-divested companies, state-owned land and even natural resources such as water, oil and gas were all the objects around which the tightly knitted networks of cronyism and corruption evolved (Adly 2011:6).

3.2- Authoritarianism and low-productivity entrepreneurship

The concept of crony capitalism was used to explain the development model that evolved under Mubarak and Ben Ali. The majority was clearly marginalized in favor of a few. This may explain why the broadest base of the private sector MSMEs, young entrepreneurs and nascent enterprises kept operating in a hostile institutional environment with high barriers to entry to the formal market and high barriers to growth.

Yet, the cronyistic character of capitalism under Mubarak and Ben Ali cannot be understood apart from the authoritarian dynamics that ruled their political regimes. In fact, one important element behind the prevalence of cronyism in these two countries has been the lack of voice of entrepreneurs. Typically, only big businessmen and business families were allowed to establish associations and represent their collective interests with their dense network of informal ties with the top political and bureaucratic echelons. Conversely, small and medium-sized enterprises were locked into state-controlled corporatist structures inherited from state-led industrialization phases. The extant literature has paid little attention to the political and economic implications of the lack of freedom of association to MSMEs, not to mention the informal sector. Issues such as access to credit, MSME-support programs and the formalization of the informal sector all have to be considered in the post-Arab spring phase. Future studies of this topic should examine the associative framework that governs the organization and interest representations of entrepreneurs on the bases of sector and region.

Authoritarianism alone may not explain this kind of low productivity entrepreneurship that resulted from the suboptimal ecosystems. However, it may explain the sustained patterns of marginalization that negatively impacted the broad base of the private sector in Egypt and Tunisia. Hence, viable reform in the future is not possible without founding the political and institutional channels through which stakeholders' interests can be represented and pursued. In this context, reforming the entrepreneurship ecosystem will go hand in hand with deepening and substantiating democracy.

3.3- Policy biases

Low productivity entrepreneurship and the suboptimal ecosystem that surrounded it was not just the result of absent institutional reforms. Policy mistakes and a stifled institutional drive were also factors. Development policies in Egypt and Tunisia were primarily focused on targeting foreign capital, big national businesses and the export sector. The World Bank (2009) and the UNDP (2012) have shown that many MENA economies – including the Egyptian and Tunisian economies – have been relying on a very narrow base of sectors in the generation of its rather impressive growth that directly preceded the revolution. However, such a development model was hardly satisfactory for the majority of people who found themselves excluded from high growth-sectors of the economy and thrown into low-productivity and low-income activities. Moreover, it was not the optimal strategy for the development of a dynamic and well-integrated economy. Most reforms that were undertaken by the governments overlooked young entrepreneurs and nascent enterprises; micro, small and medium sized firms; and the informal sector (Stevenson 2011: 173).

Attracting foreign investment and creating robust big businesses are indeed justifiable strategies that were pursued successfully in a number of countries such as South Korea, Turkey and Japan. However, this should not have implied neglecting the necessary policies, laws and regulations to accommodate the needs of young entrepreneurs and small-sized enterprises that constitute a majority of the private sector. The result of targeting a thin stratum of businesses on the very top of the economy was the creation of small enclaves from which most of the growth was generated. Moreover, such a development strategy created a bifurcated structure of the private sector with an unbridgeable gap between a highly productive, export-oriented and competitive few and a low-production, inwardly-oriented majority. In such a setting, no backward links were established and productivity gains and technology transfers were hardly possible.

4- Breaking out of sub-optimality: possible reform-areas

This section does not aim at providing an exhaustive list of detailed reforms that should be introduced so as to render the entrepreneurship ecosystem friendlier or more efficient in Egypt and Tunisia. Rather, it addresses the general framework within which reforms can take place in the post-revolutionary context in both countries. There is already an extensive literature in the form of academic studies, reports, indices and other material that forward technical reforms to treat the many deficiencies of the entrepreneurship ecosystem. Since the 1990s, this literature has developed a broad variety of institutional and policy reforms in many areas ranging from finance to business registration and contract enforcement, among others.

However, the fact that such reforms did not touch the main components of the entrepreneurship ecosystem through decades of economic liberalization indicates that one significant ingredient was missing: politics. Technical reforms were the only possible way entrepreneurship-related policy and institutional matters could be addressed under the authoritarian regimes of Mubarak and Ben Ali. Technical reforms eventually have distributional consequences making them implicitly political. Moreover, such reforms have a cost – economic, administrative and social – making their adoption and implementation highly inspired if not determined by the different political actors. In pre-revolutionary Egypt and Tunisia, stakeholders were scarcely represented and the broad base of private sector entrepreneurs barely had any weight for the regimes to confront. Only given the political dimension that was for long ignored, one can understand why successive rounds of economic liberalization and privatization in Egypt and Tunisia led to the emergence of an exclusionary model of crony capitalism where the majority of entrepreneurs were denied access to resources – financial as well as non-financial –and eventually, growth.

How is entrepreneurship ecosystem reform related then to the recent revolutionary upheaval in Egypt and Tunisia? As the report has shown in detail, entrepreneurship faces deeply entrenched institutional problems that extend back to decades of state socialism and crony capitalism under authoritarian regimes. Accordingly, such legacies cannot be undone in little time and cannot be changed as part of some brusque move. However, the revolutionary processes that have been occurring in Tunisia and Egypt since early 2011 can provide context for addressing such structural and institutional problems. They can avail the opportunity for new stakeholders to emerge; sweeping reforms to be made; and old vested interests to be undone. In one sentence, the revolutionary processes make entrepreneurship ecosystem reform part and parcel of the emergence of the new post-revolutionary political and socio-economic order.

Accordingly, no matter how technical entrepreneurship-related reforms may turn out to be, they are embedded in a broader political and institutional environment. Six main reform areas appear to be at the forefront of post-revolutionary Tunisia and Egypt:

1) The undoing of old cronyistic networks: Much of the hostility of the entrepreneurship ecosystems in Egypt and Tunisia have to do with the denied access to financial and non-financial resources to the broader base of private-sector entrepreneurs. This is the other side of the cronyistic character of economic liberalization under the Mubarak and Ben Ali regimes. Cronyism has to be undone justly and transparently so as to liberate enough resources for the broader base of entrepreneurs. The undoing of cronyism does not just have to do with the expropriation and sequestration of the capital and assets that were illicitly acquired by the old regime cronies. It also has to do with the changing of the rules – formal as well as informal – that govern the allocation of resources and the access to markets and capital and information.

2) The state is too big and too important to ignore: The three decades of failed capitalist transitions in Tunisia and Egypt clearly demonstrate that market making is not contingent on getting the state out. Rather, it is contingent on guaranteeing that functioning institutions are set so as to uphold property rights and regulate the asymmetries of power and information. The state is still very important in both countries. Thus, state reform in terms

of policies and institutions cannot be ruled out in favor of further economic liberalization or privatization. Formal legal and regulatory structures should be made more accessible to the broader base of entrepreneurs so as to lower their transaction cost, enabling them to grow. Regulatory institutions must be functional so as to proactively move against monopolies and other predatory practices. Moreover, the state is still required to play a significant role in both countries in the supply of basic infrastructure, investment in human resources and the narrowing of the gaps between regions. State affirmative action is needed as well to remove the discrimination against entrepreneurs on the bases of age or gender.

3) Deep democratization and better interest representation: Democracy should not be confined to elections and referendums. Rather, it assumes a deeper form of guaranteeing collective action and interest representation in a way that would enable the socially and politically marginalized to express their interests and to become relatively empowered, enabling them to participate meaningfully in the formation of policies and rules that govern their environment. The emergence of societal stakeholders in the post-revolutionary context is a precondition to the re-regulation of the economy and institutional reform. Society's interests must inform reforms and their implementation.

4) Access to information lies in the very heart of reforming the entrepreneurship ecosystem: The lack of information and the asymmetrical access to information lies in the very heart of the current problems witnessed by entrepreneurs in Tunisia and Egypt. Information is necessary for both market contenders and the state. On one hand, public information must be made equally accessible for all market actors. This requires a broad variety of legal and institutional reforms that would collect, process and make information available. On the other hand, information about entrepreneurs and enterprises must be made available for state agencies. This is the only way through which the state can gather and process information so as to set accurate plans and strategies. Moreover, this is the way through which access to financial and non-financial resources can be made available across the board to private sector entrepreneurs. However, information-related problems and solutions are not solely technical. They are social and political as well, requiring the building of mutual trust between economic actors – whom are themselves social actors – and the state. Such trust is contingent on meaningful democratization and genuine interest representation.

5) Entrepreneurship support and encouragement should be well-integrated into the overall development strategies of both countries: Entrepreneurship and all the administrative and legal reforms related to it should cease to be treated only from the social angle of providing jobs for unemployed youth or the distribution of patronage in the form of loans for micro firms or new market entrants. Rather, targeting entrepreneurship should be made part and parcel of the general development strategy by adding a clear economic dimension to the policies and institutional measures that deal with the private sector. Such a comprehensive view that addresses the economic together with the social can help in the gradual overcoming of the bifurcated structure of the economies in Egypt and Tunisia, where most growth has generated a handful of large enterprises with strong ties with the global economy. Of course, this requires that state planning capacities be built and that genuine interest representation takes place – another point where the state articulation with the market becomes clear.

6) Given the weak formal legal and institutional structures in Tunisia and Egypt, entrepreneurs in both contexts have developed alternative means and channels to survive and grow: The survey has revealed that many respondents depend on forms of family or friends-based social capital to access financial and non-financial resources as well as gain business security and predictability in the face of macroeconomic and political uncertainties. Such forms of social capital should substitute or subvert formal structures and rules as they do now. There should be some synergy of both formal and informal settings in a way that would make informal social capital amassed by entrepreneurs complimentary to formal institutional settings.

The examination of the cases of Egypt and Tunisia has shown that family-businesses have better access to institutional credit via banks. This is a clear case of the conversion of social capital into financial capital with families serving as socio-economic units for the accumulation of wealth and assets that can be used as collateral. They may provide the network for guarantors as well – another precondition for extending bank loans in some instances. Beyond finance, the Egyptian sample has shown that a large percentage of new entrants establish non-family partnerships. This is method used to access the necessary skills for operating a business. These instances exhibit that entrepreneurs in Tunisia and Egypt have developed informal means through financial and non-financial resources such as skills, information and access to markets. Some of this social capital can be used to supplement or complement existing formal institutions. The example of the Grameen bank is an excellent model where community-based trust and networks were used to extend micro-credit.

Tunisia and Egypt are in the middle of a lengthy and painful process of political and economic transformation. Not only are the people of these two countries engaged in the redesign of a more representative and inclusive political system but they are also involved in the process of reinventing an economic model that is to be just, legitimate and productive. Entrepreneurship ecosystem reform is key to the remodeling of the failed capitalist transformation that the countries witnessed under the dictatorship of Mubarak (1981-2011) and Ben Ali (1987-2011). Such reforms can only come about through the simultaneous political and economic enfranchisement of nascent enterprises, small capital holders, and female and provincial entrepreneurs.

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- Al-Gammal, Tareq. Board member of “Ebda” business association. Cairo, 1 June 2013
- Al-Okda, Farouq. Former Governor of the Central Bank of Egypt, Cairo, 23 May 2013
- Al-Qotb, Ahmed. Young entrepreneur in the audio-visuals sector. Cairo, 23 May 2013
- Al-Said, Dalia. Officer at Start-up Cup enterprise. Cairo, 3 June 2013
- Aouichri, Leila. General Manager of an entrepreneurs’ consulting company. Tunis, 18 June 2013
- Belaaj, Bilel. Professor economics and expert with IACE. Interview through Skype, Tunis, 21 June 2013
- Ben Ayad, Al-Mondher. Chairman of a high-tech. company. Tunis, 17 June 2013
- Ben Eissa, Nawfal. Chairman of an energy company. Tunis, 18 June 2013
- Ben Hamida, Bilel. Young entrepreneur in the service sector. Tunis, 17 June 2013
- Ben Khalaf, Ossama. Officer at Manouba business center. Tunis, 19 June 2013
- Berkati, Donya. Innovation responsible operational in an incubator. 19 June 2013
- Chaabouni, Tareq. Chairman of a construction company. Tunis, 18 June 2013
- Derbal, Feycel. Tax expert, accountant and Chairman of an accountant agency. Tunis, 19 June 2013
- Hassanein, Ossama. Entrepreneur and Chairman of a high-tech company. Palo Alto, 1 November 2013
- Medhat, Mai. Young entrepreneur in the high-tech sector. Cairo, 11 June 2013
- Mohamed, Mohamed. Manager at the Solidarity Bank of Tunisia. Tunis, 19 June 2013
- Soliman, Moataz. Young entrepreneurs in the high-tech. sector. Palo Alto, 11 November 2013
- Wahba, Abdel-Rahman. Young entrepreneur in the high-tech. sector. Cairo, 3 June 2013
- Zouali, Samia. Businesswoman and head of the MEPIT initiative. Tunis, 18 June 2013

Focus group discussions

- Focus group session with 15 young entrepreneurs and would-be-entrepreneurs, Kebili, Kebili Business Center, 24 June 2013 (First round)
- Focus group session with 14 young entrepreneurs and would-be-entrepreneurs, Kebili, Kebili Business Center, 26 June 2013 (Second round)
- Focus group session with 19 young entrepreneurs and would-be-entrepreneurs, Monastir, Monastir Business Center, 2 July 2013

Questionnaire on the entrepreneurship ecosystem

Enterprise:

Telephone:

- Male
- Female

- Yes
- No

If the answer is no, why not register?

- Not required by law (Yes – No)
- Process is too complicated/costly/time consuming (Yes – No)
- Fear of being exposed to extortion (Yes – No)
- Little to gain from being registered (Yes – No)
- Don't want to register with tax authorities (Yes – No)
- Don't know how to register (Yes – No)
- Other reasons (specify):

Would you register if the following changes were made?

- Reduction in number of required procedures & documents (Yes – No)
- Reduction in fees and expenses (Yes – No)
- Reduction in potential bribes and extortion in the process (Yes – No)
- Other factors (specify):

How many licenses or permits did you have to obtain to start your business?

How do you describe your experience when dealing with the government agencies during the establishment process?

- Very easy
- Easy
- Ordinary
- Difficult
- Very difficult
- Don't know

How long did it take you to register your enterprise?

If the answer is Difficult or Very Difficult, who do you feel is responsible for these problems?

- Laws and regulations
- The bureaucracy
- Other factors (specify):

For each of the following, would you say that the firm's registration is very important, somewhat important, not very important, or not at all important?

- Access to credit (V. Imp – Somewhat important – not v. imp. – not at all)
- Security for business (V. Imp – Somewhat important – not v. imp. – not at all)
- Access to the market (V. Imp – Somewhat important – not v. imp. – not at all)

In operating your business, what factors most adversely affected the growth of your business?

- Corruption (Yes - No)
- Lack of electricity (Yes - No)
- Political Instability (Yes - No)
- Bureaucracy (Yes - No)
- Access to land (Yes - No)
- Access to finance (Yes - No)
- Poor networking (Yes – No)
- Crime and insecurity (Yes – No)
- Excessive taxation (Yes – No)
- Weak contract enforcement (Yes – No)
- Other factors (specify):

How often do you use formal contracts in your business transactions (with suppliers, partners, creditors, distributors, and subcontractors)?

- Always
- Often
- Sometimes
- Rarely

- Never
- Don't know

Do you believe that formal contracts have a positive impact on your business security, competitiveness and potential to grow?

- Yes
- No

If the answer is no, why not?

- Informal transactions are as or more secure (Yes – No)
- Formal contracts are too complex and costly (Yes – No)
- Formal contracts are not flexible enough for your business (Yes – No)
- Formal contracts are more vulnerable to corruption (Yes – No)
- Business is not formally registered (Yes – No)
- Other reasons (specify):

Are you able to defend a contract in your country?

- Yes
- No

If the answer is no, why not?

- Partial or corrupt judiciary (Yes – No)
- Complex, costly and time consuming procedures (Yes – No)
- Bad laws and regulations (Yes – No)
- Other reasons (specify):

Do you feel that your business has been affected by unfair competition that limits your access to the market and potential to growth?

- Yes
- No

If the answer is yes, how do these practices impact your business?

- Positively
- Negatively
- Have no effect
- Don't know

To what extent do you think each of the following contributes to unfair competition?

- The laws and regulations have major flaws (Very much – Somewhat – Not much – Not at all - Don't know)
- State officials are biased to certain businesses (Very much – Somewhat – Not much – Not at all – Don't know)
- Weak enforceability of strong laws and regulations (Very much – Somewhat – Not much – Not at all – Don't know)
- Other factors (specify):

Have you previously started an enterprise that went out of business?

- Yes
- No

If the answer is yes, have you used the insolvency and bankruptcy laws and procedures?

- Yes
- No

If the answer is no, why not?

- Because they penalize failure
- Because they are so costly, complex and time consuming
- Because they make it hard for a fresh start
- Don't know
- Other reason (specify):

How do you evaluate the following factors on a scale from 1 to 5 (1 indicates the least satisfaction while 5 indicates the most)?

- Flexibility of labor laws and regulations (1, 2, 3, 4, 5)
- Cost of wages (1, 2, 3, 4, 5)
- Cost of taxes and benefits on labor (1, 2, 3, 4, 5)
- Availability of skilled labor (1, 2, 3, 4, 5)

How do you evaluate the tax system in your country?

- Tax rates are reasonable (Completely agree – Agree – Disagree – Completely disagree – Don't know)
- Tax collection is time and cost efficient (Completely agree – Agree – Disagree – Completely disagree – Don't know)
- Tax collection is transparent (Completely agree – Agree – Disagree – Completely disagree – Don't know)

As for the access to finance, what financing resources do you rely on for your business the most?

- Business profits (Yes – No)
- Private savings (Yes – No)
- Bank loan (Yes – No)
- Venture capital (Yes – No)
- Issuing stocks (Yes – No)
- Sale of personal assets (Yes – No)
- Introducing new partners (Yes – No)
- From family and friends (Yes – No)
- Special funds and institutions (Yes – No)
- Other sources (specify):

Can you estimate the percentage of each of the following in your starting capital?

- Savings %
- Loan from family %
- Loan from friend %
- Loan from a financial institution %
- Fund from Donors (include international Donors Fund) %
- Other sources (specify): %

Have you ever applied to a bank loan?

- Yes
- No

If the answer is yes, did you receive the loan?

- Yes
- No

If the answer is no, why not?

- High interest rate (Yes – No)
- High risk to the bank (Yes – No)
- Complex and costly procedures (Yes – No)
- High collateral requirements (Yes – No)
- Lack of formal status (Yes – No)
- Lack of information (Yes – No)
- Reasons of gender (Yes – No)
- Reasons of religion (Yes – No)
- Firm small size (Yes – No)
- Don't know

Have you ever applied for special funds or institutions specialized in financing micro, small and medium-sized enterprises?

- Yes
- No

If the answer is yes, did you get the loan?

- Yes
- No

If the answer is yes, how do you evaluate the following factors on a scale from 1 to 5 (1 indicates the least satisfaction while 5 indicates the most)?

- Interest rates (1, 2, 3, 4, 5)
- Complexity of procedures (1, 2, 3, 4, 5)
- Maturity of loans (1, 2, 3, 4, 5)
- Exposure to bribery and extortion (1, 2, 3, 4, 5)

Which of the following statements about corruption in government is closest to your view?

- Minor problem
- Not a problem
- Refused/don't know
- Significant problem and nothing can be done
- Significant problem and more needs to be done

How often are you asked to pay bribes or give gifts to get your business done?

- On daily basis
- Weekly
- Monthly
- Annually
- Not regularly

Does running a business require certain skills?

- Yes
- No

If the answer is yes, what kinds of skills are most important in running a business?

- Managerial skills (Yes – No)
- Accounting (Yes – No)
- Marketing (Yes – No)
- Finance (Yes – No)
- Other entrepreneurial skills (specify):

And, how have you acquired these entrepreneurial skills?

- Through family relations (Yes – No)
- Informal apprenticeship (Yes – No)
- Technical support by business associations (Yes – No)
- Technical support by state institutions (Yes – No)
- Other sources (specify):

For female respondents only, do you believe that the registration system discriminates against women?

- Yes
- No

What do you think are the main challenge for women owned businesses?

- Overall economic environment (Yes – No)
- Access to finance (Yes – No)
- Laws and regulations governing businesses (Yes – No)
- General culture (Yes – No)
- Family obligations (Yes – No)
- Access to business networks (Yes – No)
- Other challenges (specify):

For respondent from outside of the capital only

Do you believe that your business would have grown at higher rates had it been in the capital city or close to it?

- Yes
- No

Would you move your business to the capital city if you had the chance to?

- Yes
- No

Do you believe that the current institutional and regulatory system discriminates in favor of the capital city against provincial ones?

- Yes
- No

If the answer is yes, what do businesses outside of the capital suffer from the most?

- Less access to infrastructure (Yes – No)
- Less access to trained labor (Yes – No)
- Less access to finance (Yes – No)
- Less access to markets (Yes – No)
- More vulnerable to corruption (Yes – No)
- Don't know
- Other factors (specify):

Which reforms can improve the business chances to grow in the provinces?

- More public investment in infrastructure (Yes – No)
- Fighting corruption (Yes – No)
- More public investment in education (Yes – No)
- Less regulations (Yes – No)
- More decentralization (Yes – No)
- Better political representation (Yes – No)
- Lower tax rates (Yes – No)
- Don't know
- Other reforms (specify):

Do you believe that the chances of applying these reforms have increased after the revolution?

- Yes
- No

Thank You