

ANOTHER PIECE OF THE JOB CREATION PUZZLE:

DEVELOPING THE MSME SECTOR IN EGYPT

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Introduction: The Egyptian revolution resulted in key challenges but also opportunities. It has highlighted the need for more jobs, a level playing field, good governance (transparency and accountability), as well as a fair and competitive environment to accelerate inclusive growth. It is essential to address the challenges the country faces and build on the opportunities at this historical time.

Cronyism and the Egyptian Revolution: Crony capitalism—the privileged access of certain elites to favorable legal and regulatory treatment, access to markets, and the coincidence of political and economic power—was a major contributing factor to the uprising in Egypt. Many saw privilege and corruption as the source of unemployment and inequality, effectively raising barriers to entry and growth for most entrepreneurs. Among others, practices such as lending to those who were well connected and providing preferential land allocations, contributed to the poor performance of key institutions underpinning the market economy. At this historic time, for the Egyptian government to achieve the aspirations of their people and attain sustainable and inclusive development, it needs

to expand private-sector led employment and create entrepreneurship opportunities.

The recent slow-down in economic growth as well as on-going demonstrations and political unrest has sharply exacerbated the problem of unemployment, especially among youth and women. Furthermore, the demographic transformation in Egypt has led to an abundance of young working-age adults. Egypt faces a rising labor supply that has outstripped demand, leading to stubbornly high unemployment rates—with even higher female unemployment rates – which at 23% are twice as high as the rates for men. The informal economy has expanded and absorbed a large number of both unskilled and discouraged educated workers. Broad-based growth is essential, to boost employment and improve productivity.

MSMEs Contribution to Job Creation: Micro, Small and Medium Enterprises (MSMEs) are the main source of private sector jobs in Egypt, and in the MENA region as a whole (Figure 1). A recent World Bank analysis of 99 countries shows that firms with less than a hundred employees account for the lion's share of employment creation.² MSMEs make up over 99% of private enterprises in Egypt. In addition, over 80% of MSMEs are informal enterprises, with low value-added, low

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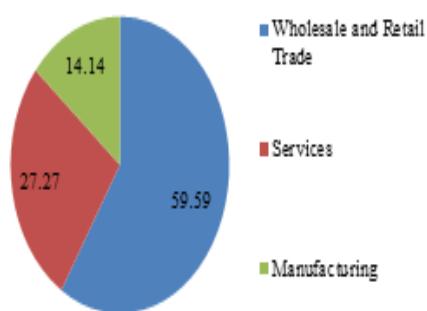
² Ayyagari, Demirguc-Kunt, and Maksimovic (2011).

production quality, and poor export performance.

A growing literature on the vital role of fast-growing SMEs ("gazelles") in employment creation has focused attention on the characteristics of high-growth firms, highlighting the importance of building their capacities and skills, while reducing constraints to their entry and operation.

Challenges to MSME Development: Despite the important role MSMEs play in the economy, they are confronted with major obstacles, which constrain their development and hinder their potential to create private-sector jobs and entrepreneurship opportunities. MSME's access to finance is limited (Figure 2) and their growth potential constrained by lack of access to start-

Figure 1: Distribution of Micro and Small Enterprises by Sector



Source: World Bank ICA (2012)

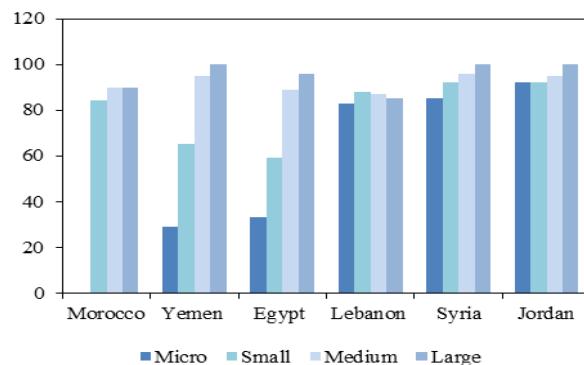
up or growth capital. Although MSMEs contribute significantly to GDP and to private sector employment in Egypt and the MENA region, they often lack access to the type of investment and financial services that they need to start-up, operate and grow. Access to employment and income-earning opportunities through MSMEs, whether as owners or employees, is a topical and prominent issue in the MENA region. Research by Ayyagari, Demirguc-Kunt and Maksimovic (World Bank,

2011) confirms that small firms are important contributors to total employment and job creation, but suggests that their productivity and growth is held back by MSME-specific constraints. Among others, key constraints include the regulatory and supervisory framework, poor financial infrastructure, the weak capacity of financial intermediaries to effectively reach MSME borrowers, as well as enterprise management skills and capabilities.

MSME's Importance to the Egyptian Economy: Despite these constraints, the number of MSMEs has grown at an average annual rate of over 4% and associated employment has increased at an annual rate of over 5% - underlining the dynamism of the sector and its potential even in the absence of a significantly improved enabling environment. These numbers make MSMEs the primary source of employment growth in the labor force over the last ten years, *albeit* much of it in an informal way. However, this growth did not have an effect on poverty reduction - and the current slow-down in economic growth threatens to worsen the poverty situation further. Creating a more enabling environment and improving access to finance is essential to accelerate MSME growth and create much needed employment opportunities.

World Bank Support to MSEs: Launched in 2010, The World Bank's *Egypt Enhancing Access to Finance for Micro and Small Enterprises Project* (MSE) is the first project in the MENA region

Figure 2: % of Firms with a Bank Account by Size for Selected Countries



Source: World Bank Enterprise Surveys (2012).

that comprehensively addresses the development of the MSE sector. The project aimed at improving enterprises access to finance, with the objective of creating employment and entrepreneurship opportunities for MSEs. Through gender mainstreaming, the project has also promoted women's economic empowerment, and improved the quality of life of their families and children.

Moreover, it has played an instrumental role in helping to narrow geographic disparities by targeting poor rural villages that were previously underserved. All this will ultimately lead to poverty reduction, and improvement in the standard of living of those who were adversely affected by the deteriorating economy and contribute to shared prosperity in Egypt at this critical time of transition.

This operation, with its US\$ 300 million line of credit, of which 65 % has been disbursed, and more than 91 % has been committed, has helped unlock the potential of the MSE sector while using innovative delivery mechanisms and financial products to reach out to the underserved segments of society.

The project also built upon strong synergies between the International Bank for Reconstruction and Development (IBRD), and the International Finance Corporation (IFC). This project was also developed in cooperation with other development partners, active in supporting MSE development, to ensure effective coordination of efforts.

The Social Fund for Development (SFD) and the MSE Sector: The Bank team working on the MSE project redefined the way in which the Social Fund for Development (SFD), the apex institution for MSEs, operated in Egypt, thereby impacting micro and small finance operations in a broader and more general sense. Specifically, in accordance with international best practices, SFD undertook the following

reform measures: (i) removed ceilings on interest rates that microfinance institutions (MFIs) and Microfinance NGOs charged to end beneficiaries; (ii) raised the previously low LE 5 million ceiling of its loans to NGOs to LE 25 million, allowing for further expansions; (iii) moved from the balloon payment arrangement to quarterly or semi-annual payments over a longer period of time; (iv) developed a performance-based system for allocation of funds to the best performing NGOs; (v) improved and streamlined the reporting requirements for NGOs to make it less burdensome and focus instead on a few key profitability, portfolio quality, efficiency and productivity indicators; (vi) implemented CGAP best practices from the Consultative Group to Assist the Poorest (CGAP)³ and revised its operational manual accordingly; and (vii) set up an integrated, reliable information system that included accounting, procurement, and monitoring systems with on-line links to all SFD Regional Offices in rural and urban areas thereby strengthening accountability and transparency.

Despite today's challenging environment of ongoing political and economic uncertainty, actual disbursement has remained ahead of the projected schedule. The total amount disbursed from the World Bank to SFD is US\$ 193 million, accounting for 65% of the total loan amount. More importantly, of the US\$ 163 million, SFD has disbursed to participating financial institutions; approximately US\$ 140 million has now been disbursed to end beneficiaries.

Overall, this means that more than 50% of the full US\$ 300 loan has been disbursed to end beneficiaries at a difficult and challenging time for Egypt. It is worth noting that to date 91% of the loan is already committed through existing contracts with banks and microfinance NGOs.

³ For more see: <http://cgap.org/>

Text Box 1

Egypt Enhancing Access to Finance for Micro and Small Enterprises Project (MSE)

The project has been widely recognized for its gender mainstreaming feature – one of the key cross-cutting themes in the strategy of the World Bank’s MENA region. The project was also selected by the International Women’s Business Leaders Council to showcase the importance of the economic empowerment of women. Time Warner prepared a video usable for websites, blogs, and tweets on women and access to finance. The project has also been selected as part of the Think Equal Campaign, and videos, showing the impact of the project on the life of women were broadcast during the IMF/World Bank Annual Meeting 2012 (See links below) It and has been awarded a SMART Economics first prize for contributing to the Gender and Development, Women in Business Special Competition entitled: Banking on Women—How Credit Lines Can Target Women Most Efficiently.

<http://www.youtube.com/watch?v=aV2X9rHnrtU&list=PLF492053A176B1716&index=100>

The project contributed to improving access to finance for MSEs between 2009 and 2012. This is evidenced by the increase in the number of MSE loans provided by participating financial intermediaries by 68%; and the rise in the volume of the outstanding MSE portfolio by 115%. The SFD micro finance portfolio doubled over the same period with a portfolio at risk of less than 5%. Furthermore, the project reached out to disadvantaged areas and poor villages, strengthening inclusion. To date, approximately 82% of small enterprises financed under the line of credit are located outside of the urban metropolises of Cairo, Giza and Alexandria, and 38% of the small enterprises served by the project are located in the much poorer Governorates of Upper Egypt (Assiut, Menia, Sohag). All this has led to an increase in job and entrepreneurship opportunities, especially for previously marginalized segments of society—a key demand of the revolution. The operation

demonstrated the World Bank is at its best, helping countries achieve poverty reduction, inclusive growth and enhancing shared economic prosperity.

Moving Ahead on the MSME Agenda: Credible reforms, effective policies, and equitable enforcement of laws are needed for sustainable, private-sector led growth. In that context, it is important to remove constraints to competition and entry, enabling a new generation of entrepreneurs to emerge who can engage in global and domestic markets based on their firms’ performance, not on privilege. For this to happen, business-friendly policy reforms will need to level the playing field for all entrants and remove inequitable sources of rent and privilege.

The government can play an important role in enhancing access to finance for MSMEs as a regulator and enabler. Investing in improving the financial infrastructure, reforming the regulatory framework, enhancing the data available, and supporting product diversification is critical. Increasing the capacity of regulators to monitor MSME finance providers, and strengthening consumer protection are all important steps that need to be taken by the state if they wish to see the MSME sector flourish.

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