



STIMULATING BUSINESS AND EMPLOYMENT IN YEMEN

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Introduction: Yemen is at a crossroads. Two years after popular unrest led to the ousting of the former President, there is now a coalition government, and the beginnings of a national political transition. March 2013 saw the launch of the National Dialogue Conference (NDC) that has brought together political and civil society actors from across the spectrum to formulate a constitution and bring closure not only to the unrest that began in 2011, but to decades of unresolved grievances and conflicts within Yemen.

Expectations are high and much is riding on the outcome of the NDC, not least of which is the future direction of the Yemeni economy. As in most developing countries, the Yemeni private sector consists predominantly of micro, small, and medium enterprises (MSMEs) – over 97% of firms (about 290,000 in number) have less than 25 employees with total estimated employment of over 600,000 workers, including approximately 30,000 women². The inclusion of these MSMEs in Yemen's economic recovery is critical for social stability as they represent a significant portion of the jobs outside the public sector and a significant source of income for segments of the Yemeni population. Even more crucially, they also represent an important source of potential future job growth.

The importance of MSMEs in the recovery is underscored by the unlikelihood of foreign or

large scale investment in the current political and security climate. Beyond possible private partnerships in public investment infrastructure or similar large-scale projects, which may take some time to materialize, conventional foreign direct investment (FDI) is not likely to fuel early recovery. On the other hand, domestic firms, including MSMEs, are invested in and closely tied to the national economy, hungry for growth, and have little, or no, option to move their businesses elsewhere.

Accordingly, private sector job creation, and particularly in MSMEs, is high on the agenda in Yemen. The Transitional Plan for Security and Development (TPSD) prepared by the transitional government put job creation at the center of the economic transition, linking MSME development not only to private sector development, but to the social equity and protection agenda. The Joint Social and Economic Assessment (JSEA) undertaken by the World Bank, UN, EU and Government of Yemen to set the socio-economic transition agenda emphasizes accelerating private sector development through policy reforms and improved operating conditions and access to finance for SMEs³. The Mutual Accountability Framework, a statement of priority reforms and investment action committed to by the Government of Yemen (GoY) and the development agencies, includes commitments to support SME growth and job creation for youth and women during the transition period (through February 2014).

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² The data is from the Building and Establishment Census of 2004, Central Statistics Office. More recent data is not available.

³ For more on the JSEA see *Joint Social and Economic Assessment Republic of Yemen*, MENA Knowledge and Learning Quick Note Series, Wilfried Engelke, the World Bank. August 2012, #70.

The Challenging SME Environment in Yemen: This is no small task especially given the limitations and restrictions under which MSMEs in Yemen operate. The 2012 rapid assessment of the effects of the crisis on businesses in Yemen found that the large majority of enterprises (over 75% of firms surveyed), including small and medium enterprises, identified electricity, macroeconomic uncertainty, political instability, and corruption, as major or severe obstacles to their business. All of these obstacles increased in reported severity since the last Investment Climate Assessment in 2010. The 2012 assessment of the effects of the crisis on the private sector also found that over 40% of small enterprises reported shedding more than 40% of their labor force and losing over half of their sales by value since the beginning of the crisis in December 2011. These effects were found to be more pronounced for small businesses over the medium and large businesses, likely reflecting the more limited coping mechanisms and shallow financial resources available to small businesses. While this may have improved since the survey last year, it is likely that the vast majority of smaller businesses are still struggling to recover⁴.

The World Bank and Donors Respond - The Enterprise Revitalization and Employment Pilot (EREP) Project: The GoY and international donor agencies have begun to respond to the challenge of creating jobs in a private sector dominated by MSMEs with limits on their capabilities and within a challenging business environment buffeted by political and economic uncertainty. The World Bank, supported by the multi-donor MENA Transition Fund⁵, has launched the *Enterprise*

Revitalization and Employment Pilot (EREP) project piloting a dual approach that tackles the issue from two angles, (i) improving the business capabilities of firms and (ii) facilitating entry of recent graduates into the job market through internships and training.

The EREP project aims to inform private sector development policies and programs in Yemen, with a particular emphasis on SME development and employment. This focus on SMEs and employment stems from the conflict-affected nature of the country context and evidence of the importance of SMEs in private sector development. Private Sector Development can be a vital tool in conflict-affected environments. In the World Bank's 2011 World Development Report (WDR) on Conflict, Fragility and Development and elsewhere, it is now recognized that low GDP per capita and unemployment are major drivers of conflict. This is supported by survey data cited in the WDR. Asked for the reasons why young people join rebel groups or gangs, the biggest share of respondents indicated unemployment as the main reason. The report concludes that the path to longer-term development and peace "is dependent on a healthy private sector".⁶ Private sector development and growth is therefore crucial, "especially if creating jobs and incomes is to out-last donor-funded, short-term emergency works."⁷ Since in Yemen, as in many other developing countries, the private sector consists predominantly of micro and small, and medium enterprises, this places their competitiveness and growth at the top of the development agenda in fragile and conflict situations.

Improving SME Business Capabilities in Yemen: Literature on small and medium enterprises (SMEs) suggests that the majority of new jobs in diverse economies are generated by a small percentage of fast-growing SMEs, or "gazelles". While accounting for some gaps in available data, being a high employment

⁴ *The Plight of Yemeni Private Enterprises since the 2011 Crisis: A Rapid Assessment*, MENA Knowledge and Learning Quick Note Series, Andrew Stone, Lina Badawy and Nabila Assaf, the World Bank, September 2012, #72.

⁵ In May 2011, the G8 launched the Deauville Partnership as a response to the historical changes underway in several countries in the Middle East and North Africa region. The Deauville Partnership was launched as a long-term, global initiative that provides Arab countries in transition with a framework based on technical support to: (i) strengthen governance for transparent, accountable governments; and (ii) provide an economic framework for sustainable and inclusive growth. To support the countries in transition to formulate policies and programs and implement reforms,

the Deauville Partnership set up the MENA Transition Fund. For more see: <http://www.menatransitionfund.org/>

⁶ World Bank, 2011. *World Development Report 2011: Conflict, Security, and Development*, Washington D.C.: World Bank.

⁷ Ibid

growth SME in MENA is positively correlated with specific initiatives and activities including new/improved product development, offering workers formal training, having international quality certification, and having a company website.⁸

And yet these are precisely the types of practices that smaller firms are particularly challenged to adopt. Business owners are often reluctant to take decisions to invest in learning and innovation that are essential to meet market requirements. They under-invest in business and technical skills, know-how, information and advice and tend to seriously undervalue the gains from using business development services (BDS) to deal with competitiveness adjustments. In many cases they simply cannot afford them in the near term. They also tend to be unconvinced that the substantially higher initial investments in learning and pre-competitive investments required to grow are justified by expected benefits. This is particularly true in fragile and conflict contexts where small businesses may be more isolated and often less sophisticated than their counterparts in other countries with similar income levels.⁹

In addition to these typical challenges, private enterprises in Yemen face a particularly difficult business environment and the negative impact of the 2011 crisis. Overcoming these combined factors will require an intervention that can address both the short-term challenges of revitalizing businesses after the 2011 crisis and assuring competitiveness and growth in the longer term. The 2011 WDR emphasizes the importance of early results and confidence building measures which promote jobs and business confidence, including initiatives for private sector recovery. The WDR takes note of approaches that have been effective in fragile and conflict situations, including matching

grant facilities for new market development. These are based on the private sector's capacity to innovate and help entrepreneurs develop new product lines while sharing the risk of investment, and value chain approaches that address breakdowns in business and market linkages.¹⁰

EREP and Matching Grants for Business Development Plans:

The EREP project will pilot small scale matching grants to finance business development plans for up to 400 firms seeking to improve products and processes or enter new markets. By virtue of design, the project would aim to support mainly small scale firms, but micro or larger firms would not be excluded. The results of these grants are expected to be improved business capabilities in terms of improved products and services; upgraded management, manufacturing, or service delivery; and development of new markets. In the process, these grant activities are expected to improve the familiarity of firms with BDS and their capacity and willingness to procure these types of services in the future, which will be key to their future growth.

EREP's Outreach activities will be undertaken to reach SMEs, with specific steps to reach women owned and managed businesses. The project will engage with businesses in different sectors or clusters on good management practices, standards and regulations, quality systems and certification, export market requirements, advanced buyer requirements, and technology. Such initiatives may involve workshops and training, technology transfer activities, hosting of exporters and market experts, coordination and organization of BDS providers, and linkages between academic/vocational education and specific sectors on job skill needs. Both this and the internship component would be implemented in two locations, Sana'a and Aden.

Facilitating Youth Employment: Engaging SMEs on upgrading their business skills also creates an opportunity to leverage their interest in improving their capabilities by linking their business development activities with job opportunities for youth. The EREP project will

⁸ *SME Innovators and Gazelles in MENA - Educate, Train, Certify, Compete!*, MENA Knowledge and Learning Quick Note Series, Andrew Stone and Lina Tarek Badawy. the World Bank, September 2011, #43.

⁹ *Private Sector Development in Conflict Regions: Viable Support Options in the West Bank and Gaza*, MENA Knowledge and Learning Quick Note Series, John Nasir, Ranan Al-Muthaffar, and Rimal Kacem. World Bank, January 2012, No. 52.

¹⁰ Ibid

pilot an internship matchmaking program that aims to place up to 400 interns in Yemeni private businesses to help the interns gain practical experience. This should improve their employability and ultimately lead to permanent employment either in their host businesses or elsewhere. The program rests on a matchmaking process that will match vocational college and university graduates applying for internships with firms that have applied to receive subsidized interns. The firms are expected to pay half of the intern's stipend, and will have the opportunity to interview and select the interns to be placed in their firms. This is intended to increase the likelihood that the host business will utilize the intern for jobs requiring higher level skills and hire the intern at the end of the internship period.

A World Bank evaluation of wage subsidies to provide hiring incentives has found that this approach can have positive impact on individual employment but that the improved job outcomes depend on interns *acquiring higher-level skills* during the internship and that such programs can suffer from low firm uptake.¹¹ Linking the internships with support for business capability upgrading may contribute positively towards both of these outcomes. Testing the validity of this hypothesis will be one of the aims of the project's impact evaluation.

Evaluating EREP's Impact: The project includes a rigorous component for impact evaluation. This is deemed essential to this project due to the relative dearth of impact evaluations on both matching grant and internship programs. In addition, the World Bank and other development agencies have expressed potential interest in scaling up this type of program and developing similar programs in Yemen, so having a body of evidence on the efficacy of these approaches will be invaluable moving forward. The impact evaluation component will try and measure the effect of the BDP grants program on firm capabilities (new products, process, and markets developed) and, if reliable data can be collected, on actual sales and export

performance. The project will seek to determine the impact of the internship program not only on the employment status of the beneficiaries after the internship, but also the impact on specific technical skills. Direct testing will be used for this and the project will also look at the specificities of the hiring firms. This additional aspect of measuring the success of the internship program is important in reflecting the benefits of internship programs in creating a cadre of skilled graduates. The limited availability of such a group is a constraint oft-cited by firms in investment climate assessments in Yemen and MENA. The internship program can also demonstrate to the GoY, academic institutions, and the private sector a model of private sector-led job training and inform the introduction of other such programs in Yemen.

The EREP and Public Policies on MSME Development and Employment: The Mutual Accountability Framework (MAF) agreed between the Government of Yemen and international partners commits both parties to develop policies and programs for the support and development of MSMEs and employment, particularly for youth and women. This project will contribute to this agenda. The outcomes and lessons learned from this pilot project will inform the technical assistance aspect of the project and lead to policy notes and analysis to inform public policy in the short and medium term. Finally, and most importantly, if the project is successful – it will be scaled up in Yemen to ensure faster PSD growth and more rapid job creation.

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¹¹ *Youth Employment Programs – An evaluation of World Bank and IFC support.* IEG, World Bank. September 2012.