ENTREPRENEURIAL FINANCE FOR JOB CREATION IN THE ARAB WORLD: ELEMENTS OF A STRATEGY

- Working Group 4 -

The challenge today for the economies of the MENA region is to leverage the opportunity from increased liquidity, invest in new job creation, and nurture key sectors for diversified, sustainable growth. This chapter shows how financing entrepreneurship is a promising path in this direction, and highlights the opportunities and challenges. This paper does not seek to propose a comprehensive job creation strategy, but to outline steps necessary to reinforce the potential role that entrepreneurial finance can play in job creation, show evidence of success along these lines, and point to policy steps that can be taken in this direction.

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*The author wishes to thank the following for their support and insightful comments at different stages of a research project started four years ago, and which has produced various papers, this among them: Rainer Geiger (OECD), Mustapha K. Nabli (World Bank), Josh Lerner (Harvard University), Kenneth Morse (MIT), Augusto Lopez-Claros (World Economic Forum), and Phil Anderson (INSEAD). For this paper, Manal Halwani, my student from AUB contributed excellent research assistance.

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1. THE MENA REGION'S PRIORITY CHALLENGE TODAY

1. By far the strongest and best-substantiated conclusion from economic research on MENA is the urgent need to stimulate job-creating growth in a region with the fastest growing population in the world. MENA's population quadrupled since 1950, and is expected to double from today's 280 million, in the next 50 years. Unemployment rates for the non-oil producing economies of MENA average 20 percent, among the highest in the world. Unemployment for those under 25 is over 40 percent, with serious economic/social exclusion and brain drain implications.

2. Over the next ten years, with population growth rates estimated to hover around 1.9 percent, the MENA region must create 47 million new jobs to keep pace with new entrants to the labor market. An estimated 6.5 million additional jobs would be needed to reduce the regional unemployment rate by half. This means that the current employed workforce would need to expand by approximately 60 percent over the next decade, an accomplishment not achieved even by the East Asian economies during the height of their employment growth periods. With an average annual GDP growth rate of 3.1 percent over the past ten years, the projections that the rate for the next ten years will not exceed 3.3 percent are alarming. Labor force growth averaged 3.4 percent in the 1980s and 3.6 percent in the 1990s, with projected rates declining slightly, at 3.5 percent per year, for the period 2001-2010 (World Bank 2003). For the period 1990-99, the gap between *observed* GDP growth, and GDP growth that would have been consistent with labor force growth (including increases in unemployment rates) averaged 2.4 percent.[1] The challenge today is to bring about growth rates that can ease the pressure on labor markets.

3. There is now a broad consensus that the way out of MENA's unemployment trap is through higher private sector investment and growth. But these have not materialized, despite widespread macroeconomic and structural policy reforms during the 1990s (sometimes labeled "the lost decade"). Today, a second generation of reforms is necessary, aimed in particular at creating employment for first-time job seekers, who constitute the largest component of the region's rising unemployment.[2] Among this group are the potential entrepreneurs of MENA: fresh graduates anxious to prove themselves and start making a living, willing to take risks and innovate, not easily intimidated by early setbacks. The policy challenge is to maximize their chances, equip them with skills needed in their markets, and link them with capital when their ideas have promise.

[1] Based on figures for Algeria, Jordan, Kuwait, Morocco, Oman, Saudi Arabia and Syria (Keller et al. 2002).

[2] See Keller et al. (2002) and Gardner (2003).

2. THE MENA REGION'S CURRENT ECONOMIC OPPORTUNITY

4. Over the past two years, the Middle East North Africa (MENA) region entered a period of increased financial liquidity unmatched since the petrodollar boom of the 1970s. This period is likely to last several years, due to a confluence of factors, including the rise in oil prices, repatriated funds since the end of 2001, and less attractive investment opportunities on global stock markets relative to the second half of the 1990s. The combined backflow and retention of Arab capital in Arab economies has resulted in local stock market capitalization growth rates averaging over 200 percent for the 2002-2004 period, reaching 400 percent in some countries. These unprecedented developments have created concerns about speculative "bubbles" in more than one sector, and underscored the need for new job creation, to fill the increasingly widening unemployment gap in the region.

5. Current monetary and financial sector trends in MENA point to a clear window of opportunity for renewed investment strategies, including in entrepreneurship. Partly due to the rise in oil prices, and partly due to billions of dollars of repatriated capital since the events of 9/11, ratios of M2/GDP (a measure of financial sector depth) in MENA averaged 84.1 percent in 2003 Q4, up from 65.5 percent in 2000 Q4.[3] When we isolate growth rates in M2 alone for the period 2001 Q4-2003 Q4, we get a 21 percent change in MENA compared with a small contraction in the G7 countries. Where has the increase in M2 gone in MENA? During 2001Q4-2003 Q4, the growth of claims on the private sector as a proportion of M2 for the MENA region averaged a mere 5.5 percent (0.9 percent for the GCC and 6.8 percent for MENA excluding the GCC). The growth rate of claims on the public sector as a proportion of M2 was negative, averaging -1.9 percent for the region (1.9 percent for the GCC and -4.3 percent for MENA excluding the GCC). In contrast, other sectors posted significant growth. During this period, the private equity sector in the MENA region went from US$400 million in total assets under management in 2000, to US$1 billion today, and it is estimated that the sector will grow to about US$2.5 billion in the next three years (Eid, industry interviews 2002-2004). The public equity sector also reflected this increase in the general availability of capital for investment with "bubble-like" rates of return in the range of 14-17 percent on GCC stock markets over the period 2002-2004.

6. These trends are corroborated by changes in savings rates for the MENA region. Estimates of national savings show a net increase over a two-year period of world recession in most countries in MENA—a region where savings rates are among the lowest in the world and tend to be slow to increase. National savings rates for the GCC states between 2000 and 2002 increased by 2.65 percent, while they averaged a 0.50 percent increase for the MENA region. Higher levels of savings, in addition to international factors, led to a gradual lowering of interest rates throughout the region over the period 2000-2004.

[3] The MENA countries for which data was available for this analysis are Bahrain, Egypt, Jordan, Iran, Kuwait, Morocco, Oman, Saudi Arabia, Syria, Tunisia, UAE and Yemen. The data for all figures in this section come from International Financial Statistics and from the World Development Indicators, IMF and World Bank respectively.

7. However, despite the clear opportunities they have today, most countries in the MENA region continue to post low rates of creation and success of new firms, which explains part of the reason why growth rates have tended to be either low or volatile, owing to low diversification, not just in sectoral terms, but also in terms of firm size. Large state-owned enterprises still dominate many of the economies of the region, at a time when small dynamic firms have become recognized as the main pillars of economic growth from Lebanon to Switzerland to the United States to Singapore to Hong Kong. Promoting the creation, survival and growth of such firms goes beyond the traditional support of the private sector through supply-side institutions, like providing a hospitable business and macroeconomic environment, which are admittedly key to maximizing chances of success for private-sector-led growth anywhere, but which do not appear to have been sufficient. Reform must take the form of a new generation of proactive policies and programs, including technically "smart" financial and educational institutions, revamped legislation and targeted incentives[4], as well as financial instruments, ranging from private equity to microfinance funds, and policies that reorient knowledge development programs in the public, private and non-profit sectors.

8. Today, in most of the MENA region, financial, regulatory and educational barriers remain high when it comes to firm creation and firm expansion. More importantly, no serious monitoring of these issues to measure gaps and or progress is evident anywhere. The region urgently needs reform programs to address these hurdles. There is a marked absence of institutions (public, private, or some combination thereof, whatever works given local specificities) similar in mandate (but not in impact) to the Small Business Administration (SBA) in the United States, for example, whose function is to strengthen the economy by enabling the establishment and viability of small businesses. While this model might not necessarily be the exact right one for the MENA countries today, and while the SBA itself faces the need to restructure what it does particularly its relevance to it own market, important lessons can be still learned from the SBA's years of experience, and methods for assessing its own effectiveness in supporting dynamic firms, which I will return to later.

9. But perhaps most interesting for our purposes, is that the SBA declares in its mission statement, its mandate to favor and support "disadvantaged" groups (meaning ethnic and geographical ones with less established access to resources than the average private sector firm) and disaster areas. Drama aside, it is not unreasonable to think of the thirty percent (and growing) unemployed youth in the MENA region today as a "disadvantaged" group *vis-a-vis* the established private sector, nor is it implausible to think of the region's unemployment time bomb as an imminent disaster. Perhaps there are insights to glean from the experience of the SBA and similar agencies in other parts of the world.

10. The recent experience from global markets is useful, and inspired many of the ideas presented in this paper. The 1990s was a decade of bounty that played a central role in promoting entrepreneurial initiative throughout the world, led by the industrialized countries, but with quick knowledge transfer going to the rest of the world, mostly owing to Internet technologies. As more money chased fewer ideas, we saw the development of a whole industry of business plan producers and consumers, from the innovator to the professor, to the venture capitalist, to the consultant, to the bankruptcy lawyer. Now that the dust has settled, we know that the popularization of the private equity industry (including its venture capital component), the proliferation of its product range, and the lessons from its failures, have all yielded

[4] "Smart" finance is a phrase increasingly used in business circles to indicate investment that comes with a significant equity stake and governance control, and as a result, fairly specific, hands-on knowledge of the business being invested in. The author extends the term to "smart institutions" to convey a sense of appropriateness and technical sophistication.

valuable experience, much of which is carried back to the developing world through young professionals. When they choose to return to their countries, they are keen to apply what they have learned elsewhere.[5] Such individuals are an asset many economies in the MENA region do not capitalize on sufficiently. These tend to be the economies experiencing significant brain drain by economically "disadvantaged", but educated youth. From our university campus we see this in Lebanon every day.

11. The policy challenge for MENA is to create the "institutional complementarities" necessary for the financial sector to leverage this talent. A notion that comes from new developments in organization economics (see Eid 2005a), 'institutional complementarities' is self-evident for people in the market, but perhaps not so for the policy world. If financial institutions are not "complemented" with the right skills and know-how, they cannot create private sector activity, and similarly, if finance and skills are not "complemented" with regulatory institutions that serve *their* needs, they cannot create businesses that make profit, and ultimately drive the economy forward.

12. MENA countries must seek to create a "virtuous triangle" of complementary institutions between finance, regulation and education. Currently we have "non-complementarities" in that at least one of the three is missing in every country in MENA. Hence, the importance of a regional strategy, alongside country-level reforms, a point I will come back to later in this paper.

13. Clarifying Three Key Concepts

a. <u>Focus on dynamic new business creation.</u> New "job creation" strategies for MENA should target first-time job seekers to tackle the most pressing end of the labor market, but should also include policies that target unemployment for those who have already entered the labor market. Among other things (which are not the subject of this paper), a focus on dynamic new business creation can help address both needs at the same time, as new businesses tend to absorb all levels of experience.

b. <u>What is a "job"?</u> All types and levels of employment are our target for the purpose of this paper, ranging from the selling of used books among college students, to starting a regional transport sector leader, to conducting advanced scientific or policy work. Furthermore, low-level jobs, especially for first-time job seekers, comprise partial education and certainly an investment in training for more complex jobs, attainable through concomitant levels of education at every stage. The notion of a job in industrialized economies begins with the high school level summer responsibilities at camps and beaches and extends through the highest ends of the job market, for the same people at different stages in their lives. Nuclear physicists also start out as lifeguards and newspaper delivery boys and girls. This notion is not as present in the Arab world, partly, as I learned through my work on poverty assessments with the World Bank, because our own school textbooks cast excessive glamour on white collar jobs, and disdain blue collar jobs. As a result, many young people are not encouraged to take on such jobs early in their lives, which can in fact prepare them for more sophisticated responsibilities later on in life. The phenomenon of "queuing unemployment" in many parts of the Arab world is partly a result of this expectation mismatch created partly through inappropriate education from early on.[6]

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[5] According to data from new research underway, the vast majority of investment firm managers in MENA today employ professionals with some education and/or experience from the United States.

[6] A related tragic extreme are the young "hittis" of North Africa.

c. "New" Firms vs. "SMEs". "New firms" is a slightly different concept, but it does not necessarily exclude the now-established SME concept. Since it is based on firm size, the term SME can include enterprises that fit this category by virtue of their size, but are neither dynamic, nor growing, and therefore are not necessarily competitive, but continue to exist for various reasons, including state subsidies and private sector connections. As such, new firms can become and remain SMEs over time, despite their lack of dynamism. Additionally, new firms that are truly successful can quickly outgrow the SME category if their products and market strategies achieve rapid capture of large market shares. A "new firm creation strategy" should aim, among other things, at the generation of firms capable of growing into the 'HPs' and 'Easyjets' of the region, and not just at encouraging and supporting SMEs. Examples from the region today include the Olayan Group, the Rotana Croup and Aramex. Dynamic. These and others growing firms are what is needed, for example, to begin to address the problem of low levels of incoming FDI flows to the Arab world. A disproportionate amount of global FDI takes form of mergers and acquisitions. Moreover, regions that do not supply attractive international and/or regional M&A opportunities are at a distinct advantage with respect to others on this score (Eid et. al, 2003). According to latest statistics, the MENA region attracts the lowest levels of incoming FDI of all regions of the world.

3. GLOBAL EVIDENCE ON GROWTH THROUGH ENTREPRENEURSHIP

14. There is strong evidence that investing in entrepreneurial finance can pay off. For example, between 1991 and 1995, net employment in European venture capital-backed companies increased, on average by 15 percent yearly, while the 500 most profitable non-venture capital-backed European companies created, on average, 2 percent more jobs each year for the same period. They also experienced exceptional sales revenue growth of 35 percent, twice as fast as the 500 most profitable companies (Coopers et al. 1995, 1997). In the US, employment by venture capital-backed companies increased by 25 percent on average every year for the period 1989-1993, while employment by non-venture capital-backed Fortune 500 companies—the 500 U.S. companies with the highest turnover—dropped by a yearly average of 3 percent for the same time period. Also, over the same period, venture-backed companies in the United States reported compound average sales growth of 41 percent, as against 2 percent for Fortune 500 companies, while compounded GDP growth for this period was 5 percent (Coopers et al. 1995). Related, less perfectly comparable statistics are emerging in Eastern Europe and Central Asia.[7] These constitute a fist body of evidence that private equity is desirable path for employment generating growth strategies.

15. The second, body of similar evidence is from MENA.[8] While the labor market in Tunisia grew by a net average of 3 percent per year over the period 1989-1997, and by an average of 3.7 percent for the region (Keller et al., 2002)[9], firms in the Tuninvest portfolio yielded a net job growth rate averaging 17 percent per year for the period 1995— 2002. The figures from Tuninvest are impressive, especially since a majority of the firms in the portfolio were not start-ups at dates of entry. Newly created firms tend to report high growth rates because they are based on small initial numbers, creating a statistical illusion.

[7] See Karsai (2000), Wyznikiewicz et al. (1993) and Central Asia OECD-UNIDO (1999). There is evidence that while some countries have higher growth than would be expected from their level of entrepreneurship activity, there are no countries that have a high level of entrepreneurial activity and low growth. See also Global Entrepreneurship Monitor Executive Reports (1999, 2000, 2001).

[8] Three new research papers are underway by the author on private equity and optimal contracting, including the use of Islamic finance contracting in the MENA region. Strong evidence is apparent that this sector will continue to grow in size and sophistication in the region.

[9] The regional average is calculated based on figures for Algeria, Bahrain, Egypt, Iran, Jordan, Kuwait, Morocco, Oman, Tunisia, and Yemen.

16. Initial data from similar firms in Morocco, Algeria and Egypt confirm that these results may be obtained from other firms, in other parts of the region. Interviews and survey work carried out for this paper indicate a strong desire to move in the same direction of establishing funds and searching for ideas, in the Levant and the Gulf, with Lebanon, Jordan, Dubai and Kuwait in the lead. The total number of firms specializing in private equity in the MENA region today does not exceed 15. A statistically significant group of ten responded to a survey conducted for this research. The respondents constitute a representative sample of the three geographic parts of the MENA region: The Levant, the Gulf Cooperation Council states and North Africa.

17. Managers of finance firms in these countries have responded by saying that promoting the private equity sector is "very important," an opinion shared by managers not exclusively focused on private equity.[10] What they need, in order to move forward, is a series of inputs, such as well-articulated business ideas and legislation that reinforce what they are trying to do. These are the institutional complementarities necessary for actions to be mutually enhancing, and for economic systems to move toward new points of equilibrium.

18. Given the urgent need for employment creation in MENA, a broader base of equally compelling evidence could imply the need to create new microeconomic or sectoral adjustment programs along these lines, which rapidly facilitate the creation of more institutions (of different levels of sophistication) that channel funds, and others, that mobilize the creation and vetting of business ideas. Today we only have a handful of such institutions, and virtually none of them is reinforced by the right complementarities. People and firms in this sector are "swimming against the current." Even if existing firms do not fail, their relative impact remains extremely low given MENA's challenges. To get a sense of how the private equity market perceives the situation, a fact-finding survey was carried out, covering the population of private equity groups across the MENA region. Eid (2005b) contains the full set of results.

19. For example, when asked about obstacles facing the private equity sector (table below), none of the firms ranked "lack of funds" as an obstacle among the top four.[11] While the Gulf States today enjoy significantly higher levels of liquidity than, for example, Morocco, Tunisia or Lebanon, this reply by private equity firms about access to capital still merits some attention. The implication is that private equity firms perceive that (for their sector) there is a general abundance of liquidity, i.e. potential investors are available, regardless of whether the private equity groups are domiciled in a country of high or low relative liquidity in the MENA region. This is the case for two reasons: (1) there is an increasing awareness on the part of investors in the potential of the private equity sector, and interest in it, and; (2) financial markets within the MENA region are increasingly integrated, and investors from the high liquidity countries are making larger and higher numbers of investments in low liquidity countries, and primarily in private equity activities.

[10] Industry review and survey work by the author, 2002-2003.

[11] The survey was sent to the population of 15 private equity firms in MENA. Ten firms responded in time to be included in this research. Firms were asked to rank a series of obstacles (Table 2) and priority outcomes (Tables 2 and 3) related to the private equity sector in the economies where they are doing business. The numbers in bold in the right hand columns are coded firm names, and the numbers below those represent firm responses, which reflect their rankings in order of importance of issues lis ted in the left-hand columns. The column T ("total") tallies the results by assigning 4 points to the issue that was ranked first, and declining cardinal rankings, down to 1, to the fourth issue ranked. For this, and the following tables, the penultimate column provides an aggregate of the results of these rankings horizontally across respondents, to give an industry ranking of issues. The final column reports the standard deviation of the rankings.

20. The recent growth of Sharia-compliant (Islamic) private equity is important to take note of in the context of this discussion. Through its logic favoring risk-sharing, Sharia is inherently hospitable to private equity, and the growing adoption of Sharia-compliant contracting across the MENA region provides an opportunity to facilitate the flow of capital across the region through such financial vehicles, which are comparable in structure and accepted in philosophy and spirit.[12] This development points to the importance of updating and properly regulating legal infrastructure governing private equity, Islamic and otherwise. We turn next to the remaining conclusions from our fact-finding survey, as further evidence that entrepreneurial finance is a promising new path that merits attention in policy reform efforts.

21. Six of the ten firms (Table 1 below) cite "lack of business and entrepreneurial skills/ideas" as the number one obstacle facing the private equity sector. Seven out of ten firms point to "inadequate regulation/legal infrastructure" as impediments ranked between 1 and 4. If the obstacle "inadequate minority investor protection" is added to this count, then eight out of the ten firms would have pointed to legal/institutional factors as being among the top four facing the private equity sector in MENA. The aggregate scores in column **T** confirm this concern about institutions; "the absence of an exit market" and "inadequate regulation/legal infrastructure" are scored highest, with a total of 20 and 19 points respectively.

22. It is interesting to note that the former of these two parameters yields the lowest standard deviation (0.8), denoting a high level of convergence on opinions on exit markets throughout the region. On the other hand, "inadequate legislation/legal infrastructure" gets the highest standard deviation (5.9), implying some divergence of opinions, due to the fact that some countries in the region are ahead of others in upgrading their legislation. Close seconds in terms of total scores are "the family-focused nature of business" and "lack of business/management skills in general", which receive total scores of 17 and 16 respectively. Average scores are useful for a relative comparison of rankings across firms. In the table below, "lack of entrepreneurial skills and ideas" receives the highest average ranking (3.3), and a standard deviation of 1.5, implying a high level of consensus among the respondents of their significance for improving investment opportunities in MENA. The average score of 2.4 allocated to "the family focused nature of business" provides confirmation of a widely known fact among researchers on private equity: this mode of financing is as relevant to the expansion and institutionalization of family-held firms as it is to creation of new firms or "start-ups".

Table 1: What do you think are the principal obstacles facing the private equity sector in the economy (ies) where you work?

Firm	**T Score**	**Average**	**Standard Deviation**
Lack of entrepreneurial skills and ideas	**13**	**3.3**	**1.5**
Lack of business/management skills in general	**16**	**2.7**	**1.5**
Lack of funds			

[12] A more detailed discussion of Sharia-compliant private equity is forthcoming from the author. This work is based on a database of 139 (30 percent of the population) private equity transactions across the MENA region, 30% of which are Islamic.

Inadequate regulation/legal infrastructure	**19**	**2.7**	**5.9**
The absence of an exit market	**20**	**2.5**	**0.8**
Inadequate minority investor protection	13	**2.2**	**0.8**
The family-focused nature of business	**17**	**2.4**	**1.0**
Lack of early stage funding		**1.0**	**0.0**
Culture not accepting PE industry and /or method of investment		**1.0**	**0.0**

23. Country level receptiveness among potential new entrepreneurs appears to be quite high, judging from first hand experience by the author in Lebanon, the U.A.E, Saudi Arabia, Jordan, Tunisia and Morocco. The success of the entrepreneurship program launched in Lebanon in 2001 (Box 1) is an example.

Box 1. What business plan competitions can do: The case of "Spark" from AUB

A business plan competition is a mechanism for encouraging the creation of new business ideas that are rewarded with prizes and investor recognition. One of the earliest and most well known competitions is the MIT 50k, which, ten years into its creation yielded several IPOs at impressive capitalization records. Many types of business plan competitions exist. The most successful of these in terms of results and impact have been those that integrate academia with the business community and the financial sector, as does Spark, the Lebanon Entrepreneurship Competition, which was launched out of the American University of Beirut. Spark was inspired and assisted by the MIT 50k.

The Design

Spark was conceived by a team of professors, students and private sector entrepreneurs over a two year period that involved the creation of a non-profit organization and university entrepreneurship club, fund raising, an awareness campaign, jury recruitment, and the determination of transparent and credible selection criteria. From the outset, Spark was open to all disciplines and universities in Lebanon, required private sector participation in every team (creating a high "real world" threshold for students), and encouraged cross country teams, which attracted participants ranging from Canada to France to Jordan who collaborated online then traveled to Lebanon for events organized around the various selection cuts. Spark involved the private sector very closely from brainstorming sessions at the design stage, to fundraising and sponsorship, to business plan assessment and revision and live "elevator-pitch" evaluation during a roundtable the day of the final count down, to networking to connect the winners with financiers. By the end of the first cycle, Spark had accomplished the following.

A Crop of New Business Ideas

At a time when world financial markets had hit rock bottom in 2002/3 and the Lebanese economy was perceived to be on the brink of financial collapse, Spark attracted 35 new business ideas from seven universities, two of which were based on inventions already patented in the United States, and three of which involved participants from other countries who collaborated online with their Lebanon-based team mates. The ideas ranged from industrial manufacturing, to high tech, to the restaurant business, to the advertising, tourism, publishing, and health care sectors.

The Impact on Academia

Starting with the learning my students and I had to do as the lead organizers, the process involved an unprecedented daily collaborative effort between academia and the business sector, that brought high level (mostly young) CEOs into the university campus on a regular basis, and vice versa as students went to their offices to negotiate pro bono and sponsored packages for advertising, television and radio time slots, printing, catering, entertainment, and prizes. In addition to Hewlett Packard, smaller sponsors were Microsoft, Cisco Systems, the Virgin Megastore (for a huge party!), Aramex, and the local financial sector including EFG-Hermes from Egypt. But perhaps most importantly, this process generated insights on one of the most challenging areas of business education today: how to render what we teach relevant and continuously adapted to the market.

The various events organized around Snark constitute a networking and exchange podium for business leaders to point to the sort of talent they wish to see join their firms, and the types of ideas and energy they like to see generated in spin offs from and/or innovations within their firms. Concretely, as a business school, we found ourselves rushing to invite a pool of experienced professionals to teach business plan writing, pitching and pitfalls, and eventually incorporated this, along with a host of related entrepreneurship courses into our revised curriculum at the Olayan School of Business.

Other Special Features

• The 150,000 dollars of in-kind prizes from HP that made Spark possible were the largest single project grant allocated by HP across that globe that year. It is interesting to
note that the grant had been earmarked, two years prior to the creation of Spark, to an innovation in E-Government. The inter-ministerial committee in charge of its disbursement was stymied, and the award was reallocated to Spark upon its creation.

• The process of soliciting and finalizing business plan entries for Spark generated a system of mentorship by private sector entrepreneurs who helped, evaluated, listened to and criticized (quite harshly) the ideas in process. From abstracts to first draft plans, to practice sessions, to final versions and "elevator-pitches" there were five evaluations in all, and quite a bit of sweat and nervousness, along with amusement for all. Between total participants and finalists, the ratio of women always hovered around 50%.

• In a country with a rich Diaspora, Lebanon offered the perfect opportunity to create an innovative system of governance for the selection process of the business plan competition. All evaluations of business plans were carried out online based on a publicly posted set of evaluation criteria. The jury members were high-level professionals in finance, management consulting and entrepreneurship from firms such as Credit Suisse
First Boston in Los Angeles, to J.P. Morgan Chase in NY, to McKinzie and Co, in Montreal, to Booz Allen in Paris, to Aramex in Amman, to the Amana Group in Dubai.

The governance of this mechanism was transparent to all and achieved the following:

• Absolute respect for the selection process, and in a country where confessional equilibrium is a constant source of scrutiny, not a single question was raised about the outcomes at any stage. This lay in sharp contrast to a system where confessional politics start on the college campus and permeate through the private sector before they blossom at the highest levels of government.

• A role for the Diaspora that generated reactions ranging from the emotional, to the romantic, to the nostalgic, to the entrepreneurial, to the speculative.

• An exciting illustration of the importance of cross national knowledge exchange in education, particularly in business education, where the real time challenges have grown exponentially over the past 15 years, and where academia has by and large been unable to keep up.

Taking a step back: What does Spark imply for developing an entrepreneurial economy?

Spark was founded against a current of local, regional and global economic recession, in a country experiencing one of the highest brain drain rates in its history, and in a region where youth are by and large disillusioned for lack of opportunity. The experience is evidence that each of these odds can be surmounted with the appropriate vision, design, and fairly minimal resources. By way of example, the total cost of founding and first cycle of Spark was approximately USD300,000. Such resources are the most abundant asset in the MENA region today.

4. INVESTING IN ENTREPRENEURSHIP FOR ECONOMIC DEVELOPMENT: WHAT DOES IT MEAN AND WHAT WOULD IT TAKE?

24. A range of sizes and complexities of private sector finance will be necessary, not just for private equity and venture capital, but also to support entrepreneurship at all levels of the organization. This is precisely why the case of Lebanon might be instructive in creating a strategy for an entrepreneurial economy. In Lebanon, it is estimated that a fairly significant proportion of jobs in the labor market is directly or indirectly created and/or supported by non-governmental organizations that promote different entrepreneurial initiatives. A range of educational institutions and NGOs offering entrepreneurial education in Lebanon today constitute part of a continuum of complementarities that could be the subject of policy design. But support for such organizations, even in Lebanon, remains insufficient, and careful evaluation of their economic impact should be a priority.

25. Job-creating entrepreneurial initiatives can exist at all levels of the economy, from water collection and jam production by village micro-enterprises, to mechanic shops and wedding dress rental boutiques in both rural and urban areas.[13] It can even include elementary school children learning how to price and sell toys they no longer want[14], high school students balancing a cheque book or writing basic business plans to sell tutoring services[15], or college students selling advertising on the Internet. All these projects have economic and educational/experiential value that are mutually reinforcing over the lifetime of a job market entrant. The question is how to promote the most organized and productive ones, and what institutional complementarities are necessary to have in place.

26. The most basic complementarities are legal - financial legislation and regulation -and broadly educational, including private sector corporate governance skills. For example, NGOs whose mandate includes significant job creation should be easy to register, receive donations without difficulty, benefit from special tax exemptions, and be evaluated carefully for their impact. Therefore, they should be subject to strict governance, accounting and transparency requirements. Finally, they should be widely

[13] For example, the Entrepreneurial Development Foundation in Lebanon offers training modules in basic business and accounting skills to adults with a high school education, but not necessarily a university degree, and encourages them to submit business plans by the end of their training workshop. Some of these plans receive loans, with a ceiling of US$10,000. The businesses proposed range from Internet cafes, babysitting services, and wedding dress rental shops, to proposals to expand existing farms with additional cattle, or set up jam production facilities or apiaries in rural areas.

[14] A child entertainment center called Rainbow Island in Lebanon organizes a fair for this purpose every year.

[15] Over a period of two years, Junior Achievement (JA) Lebanon taught 2,600 high school students a course in how to balance a cheque book, prepare a business CV, etc. The course, called "Personal Economics," is offered by university students and young professionals who volunteer to teach for JA. The course has reached 10 high schools, of which four are public. JA Lebanon is sponsored by some of the most important financial institutions in the country.

advertised and publicly rewarded for their accomplishments. Such systematic complementarities are not currently in place in much of MENA, with any degree of consistency.

27. Each economy has its specificities and these permeate the economy ranging from the level of sophistication of the financial sector and the relative availability of liquidity, to the types of jobs that need to be created. In countries, such as Morocco, Algeria and Egypt, with their large low-skilled rural populations, microfinance complementarities are the number one priority. In economies such as those of Lebanon, Jordan and Tunisia, or urban areas of Egypt, Morocco, or the Gulf states, microfinance complementarities are not as important as those related to the high value-added end of the labor market, where the brain-drain problem is most pressing.

28. In addition, efforts must be made to encourage innovative education, such as broadly-based programs to encourage entrepreneurship, i.e. how to create economic value, especially jobs, from innovative ideas in all sectors. A whole range of topics can be taught related to innovation, entrepreneurial finance and economics, and small business at all educational levels, including executive education. From my own academic experience in the region, we do not do nearly enough of this. Complementary educational programs can range from teaching how to write a rudimentary business plan for "small" finance projects of US$5,000-$ 10,000, to encouraging participation in high-tech business plan competitions networked with venture capital, locally, regionally and globally.

29. Programs that encourage the creation of startups around the world today are common at universities as different from each other as MIT and Earth University in Costa Rica, which has a mission of environmental biodiversity. Universities can act as clearinghouses of information in MENA, a role that is currently undervalued and undercapitalized. An important factor in the development of the agricultural sector in the American mid-west was a series of Agricultural Extension Offices created in the mid-1880s at the Land Grant Colleges throughout the country. These centers essentially turned a group of "sod busters" into a sophisticated and mechanized agricultural sector. A modern equivalent of this program in MENA, where the world of learning and the world of business interact but little, could be just as important in bringing them together. Our experience with the business plan competition in Lebanon gave us an excellent sampling of the synergies that ensue when the two worlds meet.

5. WHERE TO BEGIN: ELEMENTS OF A STRATEGY

30. What follows is an additional normative set of ideas meant to be suggestive and adaptable depending on the country case at hand. In the area of finance, the pillars of a new growth path are sets of institutional complementarities at three main levels of the job ladder ranging from micro-finance to "high finance" (private equity and venture capital):

a) Develop risk finance institutions (along side, not in lieu of, standard commercial lending)

i. Private equity/venture capital funds for firm expansion/new firm creation requiring large amounts of investment
ii. Intermediate level risk finance institutions (ranging from $5,000 to $50,000, for example)
iii. Micro finance (but not just for poverty alleviation purposes).

b) Complement risk finance institutions with requisite educational/training institutions at all levels.

i. Invest in the creation of appropriate undergraduate, MBA and executive education programs, in addition to continuing education programs that can be provided through entities like private sector associations, business, industry and otherwise.

ii. Support the creation of educational institutes that provide certificates and partial degree programs offering skills relevant to business creation, marketing and management (financial and otherwise), emanating from the full range of educational disciplines, ranging from the teaching of languages to the establishment of mechanics shops, to the running of restaurants, to name a few.

iii. For the micro-finance level of job creation, encourage NGO-type activity that is already prevalent and quite enthusiastic about such work, generally for social reasons. Typically the problem is one of getting permits for NGOs to operate, and not availability of funds, in MENA.

c) Complete this 'virtuous triangle' by ensuring the existence and proper functioning of regulatory institutions necessary.

i. Undertake financial sector legislation revamping (e.g. laws in place often do not understand or facilitate private equity contracting). Indeed the rigidity of the financial system in many countries of the MENA region poses among the most serious obstacles, particularly in countries where the financial sector remains largely state-owned and therefore unresponsive to market incentives. But even within private sector financial institutions, the capacity for risk taking is minimal, pointing to the importance of risk guarantee schemes to assist the evolution of 'investor culture'. From Lebanon, the example of the government-sponsored Kafalat program is a case in point. There are others, both nascent and more established across MENA, but neither the number, nor their volume of transactions and total capitalization are sufficient given the challenge at hand.

ii. Educational sector reform (in terms of providing correct regulation for degree programs described in part b above). This is largely a capacity building dimension that Western multilateral agencies are both well equipped and well endowed to perform. The effort required would need to be narrowly focused on this method of job creation, and intense in its delivery. Emergency "sectoral" adjustment programs might be worth considering. Most importantly, we are not talking about comprehensive education sector reform here. There are other programs underway for this purpose. Coordination with these would be key.

iii. Non-profit sphere reform (in terms of rapid establishment, funding, audit, removal if necessary, of job creating NGO activity). In most of the Arab region, NGO activity is difficult to register, and recent events are rendering it virtually impossible to finance. Yet, this sector makes important contributions by any measure. Some informal estimates, for example from Lebanon, about the numbers of families whose jobs are directly or indirectly dependent on (legal and officially registered) NGOs are to the tune of 40% of the labor market. This sector is an important source of employment generation, and the requisite legal infrastructure for it to operate (and be regulated and audited) with flexibility and agility should be made available where it is still lacking in the MENA region.

31. Sample objectives and measurable target results for such a reform can be gleaned from the SBA, as summarized below.

- Minimize the regulatory burden on small business through effective advocacy.
- Ensure equity and fairness in the Federal regulatory enforcement processes.
- Minimize the tax burden on small business through effective advocacy.
- Minimize the health care cost burden on small business.
- Simplify the interaction between small businesses and the Federal government through
- the use of the Internet and information technology
- Increase the opportunities for small businesses to receive open and fair access to
- Federal contracts.
- Increase the positive impact of SBA assistance upon the number and success of small business start-ups.

32. Sample Measurable Target Results include:

- Achieve a total of 50 States (in MENA, a number of countries that have formally considered legislative or executive action to increase regulatory flexibility for small businesses, by the year 2008.
- Insert Advocacy data and reports into the curricula at 80 of the top 100 universities with major entrepreneurship programs, by FY 2008.
- Achieve savings of $16 billion from reducing the unnecessary paperwork burden
- On small business, from an FY 2002 baseline of $160 billion in annual costs.
- By FY 2008, achieve a savings of $358 million through the deployment of electronic tools to facilitate compliance with government laws and regulations.
- Meet the government-wide goal of awarding 23 percent of government contracts to small businesses.
- Track the percentage of successful start-ups lasting at least one year that were assisted, as well as small firms, assisted by SBA, exceeding the national average job creation rate.
- Track firms assisted by SBA, existing for 1-2 years and exceeding the national average survivability rate for the same time period.

- Track small firms, assisted by SBA, exceeding the national average revenue growth rate.

33. Cost Considerations

Some subsidies will be necessary (must begin with series of funds, adapted to needs of each individual economy, keeping regional complementarities in mind). Educational reform must be approached as a long-term investment that must start to yield short-term successes quickly. Hence, initial sets of reforms have to be narrowly focused and targeted, with measurable outputs. Finally, it would be important to regard certain types of failure as a success. For example, one failed start-up by a university graduate can be equivalent in learning to an entire MBA degree. This type of investment is worth a re-allocation of government subsidies from lower priority areas.

34. The Role of Research and Audits

A strategy must include a research and audit function. It would be useful to start by mapping out the terrain in the MENA region:

- What are job creation needs in each country, in what sectors is there potential, for what levels of the job ladder?
- How can the financial sector respond to such needs? How much risk capital is present already, versus total amounts of capital? What have respective growth rates of these been, relative to overall increases in liquidity? What are projections, in terms of evaluating future potential?
- What are educational sector offerings and how well do they respond to the region's needs at every level of the job ladder? How large are the gaps?
- Identify the regulatory gaps and address them as part of MENA-OECD country initiatives.

35. Implementation stage must incorporate the following actions:

- Plan and execute priority areas of 'new generation' reforms outlined above, with individual country priorities and capacities in mind.
- Launch new initiatives as part of reforms, to help drive and capitalize on reform momentum. These could be along the lines of the following:

  a.. National Entrepreneurship Councils, for example as part of the National Investment Reform Agendas being formulated in the different countries of MENA.

  b. National entrepreneurship information campaigns.

  c. International business innovation and knowledge-transfer links, for example within the scope of Euro-Mediterranean programs for applied research exchange between the northern and southern shores of the Mediterranean. These would have, among other things, the objective of financing the transfer and outsourcing of business ideas and exchanging best practice on innovation.

  d. Develop national entrepreneurship training programs for all levels of the job ladder, from micro finance to high finance. These would be part of action plans that would also include (e) below.

e. Identify and train trainers for all those interested in working to promote entrepreneurship.

f. Foster entrepreneurship networks within and across countries in the region, leveraging media tools such as television programs for entrepreneurship competitions, star entrepreneurs who can serve as role models, and rewards for business innovation in all sectors, across the region, again at all levels of the job ladder.

6. OPERATIONAL RECOMMENDATIONS

36. This paper argues that when a region's priorities demand employment generation, the financing and promotion of entrepreneurship are important. Compelling evidence from MENA, and other parts of the world, shows that the private equity path has promise for emerging economies. The survey of private equity actors in MENA shows that the institutional complementarities shown to be important in theoretical economics are also central to job creating growth. The notion of complementarities is extended to all levels of the job ladder, and examples are offered of how entrepreneurship can be promoted in various parts of the economy. Operational conclusions can take the form of the following roadmap:

- Prioritize financial infrastructure regulation reform, including in the area of Islamic finance, with particular focus on creating the capacity for financing of innovation. Create tailor-made national strategies that take into account local specificities and the relative sophistication of the existent financial sector. Incorporate an audit function into the strategy, with a timeline and measurable outputs.
- Create various mechanisms and levels of risk capital, including more Islamic private equity houses, and various types of risk guarantee schemes, financed through private, public, or public-private monies.
- Reallocate some existing (but ineffective) economic subsidies toward risk capital. This measure is particularly relevant to countries in MENA with relatively low liquidity levels, but "large" government sectors including numerous subsidy schemes with varying levels of effectiveness. Reallocating some of such funds (even if for temporary periods of time) could prove to be welfare improving in the medium to long run.
- Conduct educational sector audits and devise strategies, with the assistance of multilateral agencies, to incorporate various 'appropriate' versions of entrepreneurship education and capacity building at all levels, ranging from executive education and awareness raising, to the education of young women in schools, to micro finance for those with limited education and means in rural and urban areas.
- Create mechanisms to connect promising business ideas with finance at all segments of the labor market described above, along the lines described in section 5.3.

7. CONCLUSIONS

37. The normative task at hand for the MENA region is twofold: first, the region must create the institutional infrastructure appropriate for the development of entrepreneurship, especially financial legislation; second, MENA must promote the creation of parallel educational programs to cultivate entrepreneurial skills at all levels of a given economy, including the non-governmental sector.

38. Evidence shows that finance is not the biggest hurdle in the Arab world today. Rather, what it lacks are channels that link finance with promising entrepreneurs. The task for research is to study the design and impact of such channels. To be sure, larger macro-economic and governance reforms are essential, but this research points to the importance of sectoral strategies, even if their efficacy is only fully optimized when all other reforms are carried out.

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