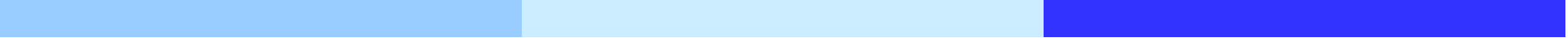


*Entrepreneurial Finance:
What it Means, and What it Means for
Arab Countries*



AIWF

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Retrospective on this Research: 2000-07

- Urgent need for job creation in MENA
 - 100 million new jobs by 2020 to attain sustainable unemployment rates
 - Unemployment Avg. 20%; Up to 40 % for those under 25
 - GDP growth rates required to bridge gap: higher than those of “Asian Tigers”

- WEF paper (2003) on FDI in MENA ~1% of global flows only
 - Arab world mostly promoted Greenfield, while the bulk of FDI is M&A
 - M&A FDI necessitates the existence of dynamic competitive firms
 - This requires entrepreneurial finance
 - But now things appear to be changing...

- Abundance of entrepreneurial talent is clear
 - Regionally/globally competitive family groups
 - Young entrepreneurs: program launched with MIT
 - Some results: (1) 2 patented inventions, (2) economically diverse business ideas, (3) 50% women
 - Program regionally replicated in various ways...

A Snapshot of Liquidity in MENA

- ❑ M2/GDP: from 65.5% in 2000Q4 to 84.1% in 2003Q4
- ❑ M2 alone: between 2001Q4-2003Q4 up 21%, while G7 saw a contraction (so –ve growth)
- ❑ Between 2001 and 2005, M2 alone: grew 61.7% (G7 excluding France and Italy grew 38.2%)
- ❑ Where has increase in M2 gone?
 - 2000-2005 growth of claims on private sector as proportion of M2 for MENA averaged 3.0%, up from ~1.5% in the 1990s
 - Growth of claims on public sector over M2 was -26.5%
- ❑ Liquidity mostly went into real estate, speculative & public investments (but most private sector financing in Arab world is private, NOT PUBLIC)
 - Dubai Financial Market was oversubscribed by 300 times
 - PE ratios reached range of **30-50** (subsequent correction, down to 10-14)

Entrepreneurship: What's New?

- The 1990s:
 - ⇒ Private equity á la carte and business plans “to go”...
- An evolution in economics:
 - ⇒ From the production function to asset complementarities
 - ⇒ The market understands this well, but not policy.

MENA Today:

Where will the “bubble” go?

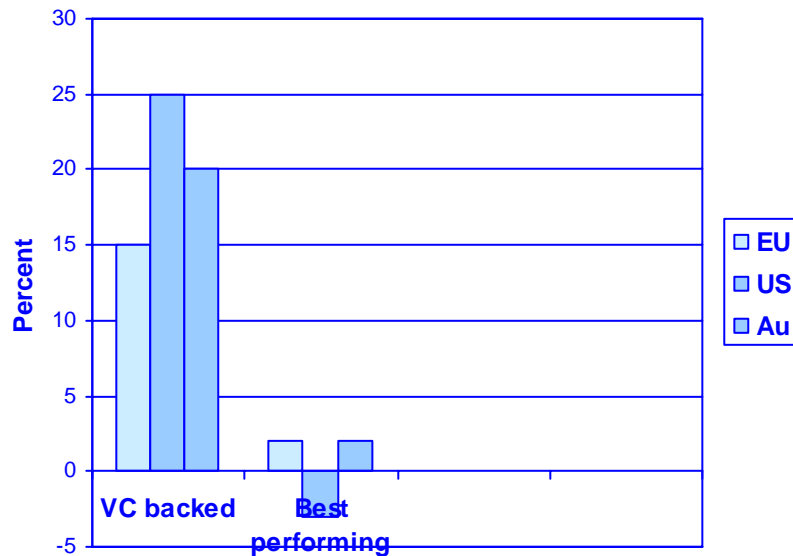
- A chance to diversify through new generation of reforms
 - ⇒ Must go from “SME assistance” to “investing in innovation”

- Compelling evidence from private equity in MENA:
 - ⇒ 17% net job growth in some firms, compared with a regional average of 3.7% (Eid 2005).

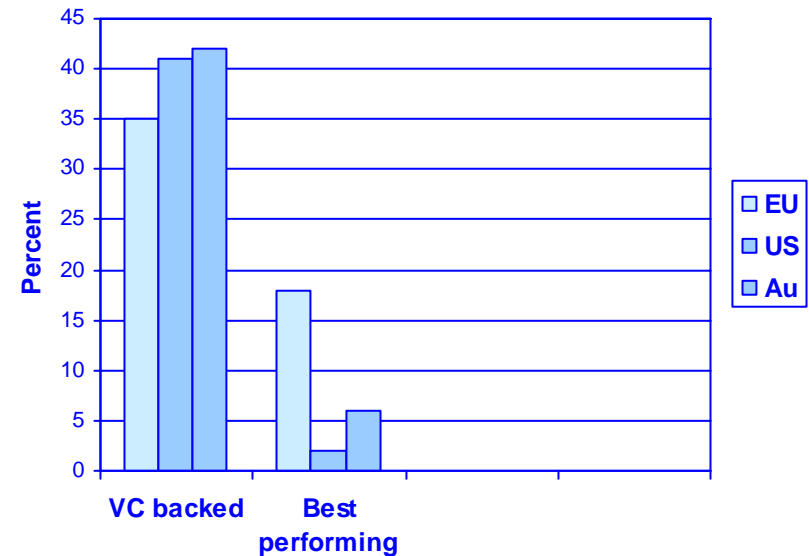
- Looking forward, we need:
 - New institutions, especially financial and educational
 - Support for entrepreneurs at all levels of the labor market, from micro finance to venture finance.

Global Evidence on Private Equity and Entrepreneurship

Average yearly job creation



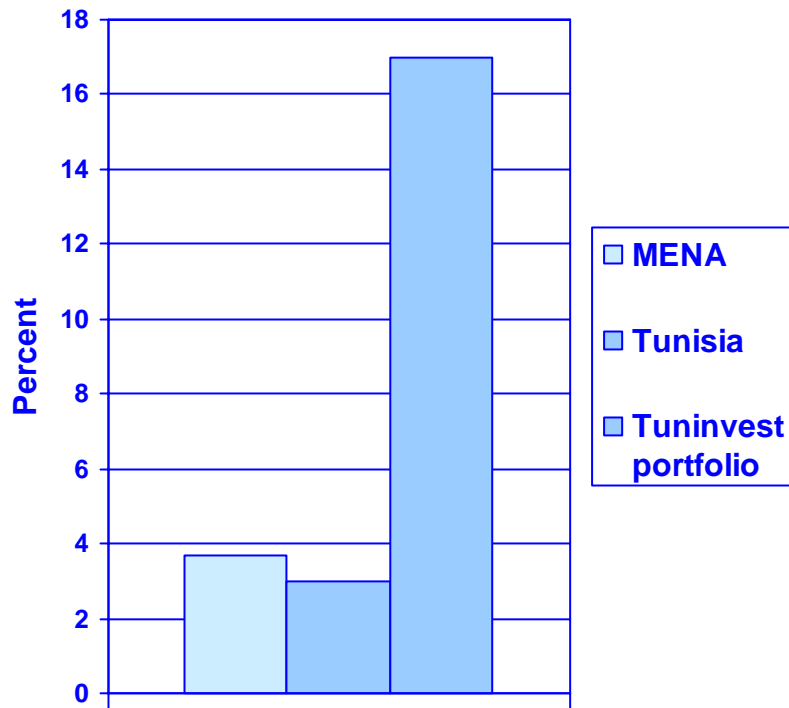
Sales growth



- Comparison of VC-backed firms, in Europe against the 500 most profitable firms in Europe (1991-1995), in the US against the Fortune 500 (1989-1993) and in Australia against the top 100 Australian firms (1993-1996).
- Similar, less perfectly comparable statistics come from Eastern Europe and Central Asia.

Private Equity Evidence from MENA

Yearly job creation



- Comparison of net average yearly job growth rates for Tunisia and MENA in 1989-1997 against those for the firms in the Tuninvest Finance Group portfolio in 1995-2002.
- Data from Morocco and Egypt show similar results.
- Some figures, next...

Job Creation and Turnover Figures from the Tuninvest Finance Group Portfolio

Company invested in	Date of entry	Number of employees			Turnover (in '000 of nominal Tunisian Dinars)				
		<i>At entry</i>	<i>Present</i>	<i>growth</i>	<i>At entry (nominal)</i>	<i>Present (nominal)</i>	<i>Present (real)</i>	<i>growth (real)</i>	<i>% growth</i>
INTER CHEM	1996	15	50	35	1,083	5,439	4,059	2,976	73.3
SOPAT	1995	200	700	500	6,405	26,012	18,486	12,081	65.4
STI (ACCOR)	2001	600	850	250	5,454	32,462	30,916	25,462	82.4

Zeroing-in on Private Equity-Financed Entrepreneurship: Creating the Right Complementarities

Most important *obstacles* to the private equity sector:

- ❑ Lack of business and entrepreneurial skills/ideas
- ❑ Inappropriate legal/institutional structures
- ❑ ***** Lack of funds IS NOT an important obstacle *****

Most important *reasons to develop the sector*:

- ❑ Institutionalizing and formalizing entrepreneurship
- ❑ Developing modern business skills, market experience
- ❑ Improving private sector governance
- ❑ Attraction of foreign investment
- ❑ Mobilization of local investment

Priority areas for intervention:

- ❑ Higher and better quality deal flow
- ❑ Legislative reforms, developing an entrepreneurial culture

Fact-Finding PE Survey:

Sample Question

What do you think are the principle obstacles facing the private equity (PE) sector in the economy (ies) where you work?

	Total score	Average score	Standard deviation
Lack of entrepreneurship skilled and ideas	13	3.3	1.5
Lack of business/management skills in general	16	2.7	1.5
Lack of funds			
Inadequate regulations/legal infrastructure	19	2.7	5.9
The absence of an exit market	20	2.5	0.8
Inadequate minority investor protections	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

More Complementarities...

National non-complementarities

- ❑ Financial legislation not adapted to support private equity
 - Subject of new research underway, looking closely at relative optimality of contracting
- ❑ Educational systems not adapted to the cultivation of entrepreneurial talent

Regional non-complementarities (or potential complementarities)

- ❑ For e.g., relatively higher availability of funds in the GCC and relatively older educational infrastructure in the Levant, to capitalize on entrepreneurial talent

MENA is *Not* Short on Three Key Ingredients

Finance

- ❑ Capital, especially funds retained in the region due slump on international financial markets, and 9/11 repercussions
- ❑ Evidence that some Arab investors prefer private equity funds to FDI (monitoring and agency problems minimized).

Expertise and talent

- ❑ Many successful entrepreneurs, who like to serve as mentors
- ❑ Members of the Diaspora willing to teach and monitor young entrepreneurs

Entrepreneurial energy

- ❑ Large number of first-time job seekers in MENA are, by definition, potential entrepreneurs.

Entrepreneurship for Economic Diversification

- ❑ *What does it mean and what would it take?*
- ❑ ⇒ Complementarities at all levels of the job ladder. Private equity is not a panacea.

- ❑ **Micro finance** complementarities in countries with a large low-skilled rural population (Egypt, Morocco & Algeria)
- ❑ Complementarities for the **high value-added** end of the labor market where the **brain drain** is most pressing (Morocco, Lebanon, Syria).
- ❑ Efforts to encourage **innovation through education** of different forms and at all levels (all of MENA)
- ❑ Greater interaction between the **worlds of business and learning**.

What can we conclude so far?

The task at hand:

- ❑ **Create a new generation of institutions** aimed at linking finance with promising business ideas, at all levels of job ladder.
- ❑ Promote the creation of **parallel educational programs** adapted to the cultivation of entrepreneurial skills at all levels of the economy
- ❑ **Research the design and effectiveness** of such institutions.

Prospects are Promising

Evidence from the MENA Region

- ❑ Growth of P.E. sector from \$400 mill. in 2000 to \$1 bill. today, to a projected \$3.5 bill. in 2007.
- ❑ Launch and success of entrepreneurship program during economic recession in Lebanon, similar efforts elsewhere.
- ❑ Interest of high-level public authorities in similar programs throughout region: Tunisia, Morocco, Egypt, Bahrain, Syria, Jordan, UAE, Saudi Arabia.
- ❑ Favorite story from U.A.E.