Reforming the Entrepreneurship Ecosystem: A Study on Barriers to Growth in Tunisia and Egypt

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Article at a glance

• This article summarizes the main barriers to entry and growth as experienced by entrepreneurs and business owners in Egypt and Tunisia, and looks at regional differences within each country, differences between formal and informal enterprises, and differences by gender of business owners.

• Top barriers to growth in 2013 were reported to be political instability and public disorder, administrative inefficiency, and restrained access to finance. Even among formal businesses, informal mechanisms often compensate for the absence of effective state institutions and the rule of law.

• Administrative reforms and deeper investments in infrastructure and human capital are needed to build the business-friendly ecosystem needed to generate jobs, grow the economy, and create opportunities for all citizens.

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Introduction

Years after the Arab Spring uprisings, which were sparked by economic grievances, entrepreneurs and business owners in Egypt and Tunisia still face numerous hurdles when it comes to starting, expanding, and operating their businesses. Both countries saw decades of economic liberalization, but their economies never fully embraced market competition, nor expanded to include everyday citizens and offer them real opportunity – a trend which has continued under the new regimes. The weak business environment means that a majority of entrepreneurs and business owners in these countries are still denied access to the resources and opportunities that they – and their countries – need to thrive.

This article presents selected findings from a study conducted by the Center on Development, Democracy, and the Rule of Law in cooperation with the Center for International Private Enterprise. The study aimed to assess the main barriers to entry and growth as experienced by entrepreneurs and business owners in both countries. It asked business people to identify the top barriers to entrepreneurship and business growth, and looked at regional differences within each country, differences between formal and informal enterprises, and differences by gender of business owners.

The study cast a wide net, since the economic future of these countries will depend on the creation of a level playing field where all types of businesses and business owners have a chance to succeed. Around 96 percent of the respondents own micro or small businesses, which is the typical size of businesses in these countries. The study is based on a survey of 131 Egyptian business owners and 100 Tunisian business owners, conducted between June and September 2013.

Although the business environment and entrepreneurial ecosystem in both countries are generally poor, the situation is better in Tunisia than in Egypt. As a rule, opportunities in the capital cities outstrip opportunities elsewhere and transaction costs involved in operating a business are high for most entrepreneurs. Tunisia and Egypt both should make it an urgent priority to improve the business environment across regions and broaden the entrepreneurial ecosystem. This would foster the kinds of businesses and entrepreneurs that these countries need to create private-sector jobs and grow their economies.

Barriers to Business

Ongoing political uncertainty and disruptions in governance in the wake of the uprisings that began in December 2010 in Tunisia and January 2011 in Egypt strongly influenced business conditions at the time of this study. Both countries had undertaken substantial reform efforts under the prior regimes, and yet, as this study discovered, the effects of reform were not uniformly felt across geographies, types of business, and segments of the population.

Respondents from Egypt and Tunisia reported the top barriers to growth in 2013 to be political instability and public disorder, administrative inefficiency, and restrained access to finance. Political instability and public disorder came first among Egyptian entrepreneurs while restrained access to finance came first for Tunisian respondents.

A clear majority of Tunisian and Egyptian entrepreneurs faced problems registering their businesses. The average time Egyptian business owners said it took to register a business was 5 months, and on average they had to deal with about five different agencies in order to secure all required permits and licenses. Overall, business registration did not look much easier in Tunisia, where the average time reported for registration was 5.6 months. A majority of Egyptian and Tunisian respondents were positive about the idea of registering their business, in spite of the
challenges, because doing so would provide greater access to markets, access to finance, and business security.

In both countries, even respondents with formal (registered) enterprises reported that they mostly relied on informal contracts. In fact, many registered companies carried out transactions in the informal market despite their formal status. For instance, officially registered companies often use informal outlets and subcontractors to lower the burden of tax compliance, which can be excessively complex and expensive or can expose them to bribe-seeking officials.

Interestingly, formal sector respondents suffer more from administrative inefficiency, political instability, and exposure to extortion and corruption than their informal counterparts. Fifty-six percent of the formal sector entrepreneurs stated that they were asked to pay bribes while only 45 percent of the informal sector entrepreneurs mentioned that. Formal enterprises deal more often with government bodies and this makes them vulnerable to being extorted for bribes. In addition, informal sector enterprises are generally smaller and thus not as tempting targets for corrupt officials. Owners of small enterprises (employing between 6 and 50 workers) reported higher exposure to corruption (58 percent) than did enterprises employing less than 6 workers (48 percent).

A little over half of Egyptian respondents “disagree” or “completely disagree” that tax rates are reasonable and suitable, that tax collection is efficient, and that tax collection is sufficiently transparent. In particular, a system based on presumptive tax payments gives low-level officials much more discretion, creating opportunities for corruption and administrative headaches for small and micro enterprises. However, the difficulty of the registration process still appeared to be a bigger disincentive to business registration than the threat of corruption. When asked why they did not register their business, the majority of
informal business owners (60 percent) said it was because the registration process was too complex, costly and time-consuming, versus 53 percent who felt that registering would expose them to more extortion and bribe-seeking from government officials.

On the subject of finance, an almost equal percentage of formal and informal business owners said that the difficulty of obtaining capital was a major barrier to growth (57 versus 60 percent). The vast majority of respondents in Egypt and Tunisia reported that they depend primarily on self-financing – either through profits generated by their businesses (73 percent of the respondents in Egypt and 65 percent in Tunisia) or through private savings (66 and 56 percent in Egypt and Tunisia respectively) – to invest in the growth of their businesses. Alternative and non-traditional forms of finance, including venture capital, remain quite limited in both countries.

Access to institutional credit through banks or special funds remains especially limited in Egypt. Only 13 percent of business owners reported receiving bank loans. The problem seems not to be in the overall access of the private sector to credit but rather in the uneven distribution of this access, which favors larger, more established firms to the exclusion of others.²

Access to credit from financial institutions was much better in Tunisia. Tunisian business owners were more than three times as likely to report receiving bank loans as Egyptians – 40 percent said they had done so. Since the mid-1990s, the Tunisian government has sought to extend access to finance to young entrepreneurs and small and medium-sized enterprises by establishing specialized banks and funds that extend credit without requiring collateral.

Subnational Patterns

The major geographic disparity in both Egypt and Tunisia seems to be not simply between the capital cities and the provinces but between the North and the South. Although Egypt has a highly centralized government, public administration and the business environment vary significantly across regions. Only a third of respondents in Cairo held the business registration process to be either “difficult” or “very difficult,” compared to half of respondents in Lower Egypt (the northern part of the country) and 74 percent in Upper Egypt, in the south. In fact, nearly all barriers were felt most keenly in Upper Egypt. When asked about particular problems with the business environment in the provinces, respondents outside of Cairo cited weak infrastructure and the shortage of skilled labor (54 percent each), followed by limited access to finance (49 percent).

Still, the highest percentage of those who received requests for bribes was actually in Lower Egypt (58 percent) followed by Cairo (54 percent) and then Upper Egypt (43 percent). It may be that a beneficial side effect of the weaker state presence in Upper Egypt is less exposure to corruption and extortion. This difference may also be due to the fact that businesses in Lower Egypt and Cairo have better access to assets and capital and thus make more tempting targets for extortion.

Within Tunisia, business owners from the regions covered by the study had markedly different experiences with public administration. Entrepreneurs based in the southern region of Kebili had deeper grievances than did their counterparts in the coastal cities of Monastir and Tunis, the capital. Several entrepreneurs said that public officials are ill-trained in the marginalized areas and seldom know by heart the laws and regulations. This was reported to lead to red tape and considerable delays in concluding business-related procedures, as officials must contact the central administration for approval or clarification. Forty percent of the respondents outside of Tunis reported weak access to infrastructure to be the principal barrier to growth followed by the restrained access to finance (39 percent). Access to markets came in third (37 percent).
During two focus-group discussions held with young entrepreneurs in Kebili, access to land and its connection to securing credit for startups appeared to be the largest of the hurdles that entrepreneurs there face. The problem of land tenure and registration is common in Tunisia’s inland provinces, which were historically far from the control of the centralized administration in Tunis. It is particularly hard in Kebili to rent or own a piece of land because most land there is registered as the communal property of extended familial groups. As in Egypt, entrepreneurs in the more developed areas such as Tunis (47 percent) complained more of corruption than did those in Monastir (37 percent) or Kebili (40 percent).

Challenges According to Gender

In Egypt, female respondents were asked about the main challenges they face in doing business. Sixteen out of 21 women responding held that their family commitments were a barrier to the success of their businesses. Thirteen stated that the general business environment, and nine that society’s general culture, were hostile to women’s entrepreneurship. Seventeen out of the 21 female Egyptian respondents, though, held that the registration and licensing systems do not discriminate against women. Even so, informality is much higher among women entrepreneurs.

In Tunisia, which has made greater strides towards legal equality between women and men, 18 out of 30 female respondents held that their main challenge was the general culture of society, which was seen as hostile to women’s entrepreneurship. The second most serious constraint was family obligations (16 respondents), and the third challenge was access to business networks (14 respondents). Again, a majority of women responding denied that the registration and licensing systems in Tunisia discriminate against women. Women’s access to bank loans does not seem to be lower than men’s.

Conclusion

The popular frustrations leading to the 2011 revolutions in Tunisia and Egypt were epitomized by an informal entrepreneur, Mohamed Bouazizi, who as a street vendor peddling fresh fruit, met with barrier after barrier in an effort to simply provide for his family. Facing constant harassment and, ultimately, expropriation of his property by police acting under the cover of capricious rules and regulations, Bouazizi publicly immolated himself on December 17, 2010. His act was a catalyst for protests that ousted Tunisia’s authoritarian government and inspired popular uprisings in countries throughout the Arab world.

However, the transition from authoritarianism has not eliminated the kinds of problems that led to Bouazizi’s suicide and deep economic grievances among the broader population. Despite attempts at reform, the situation for entrepreneurs and business owners in both countries remains precarious.

In the kinds of poor business environments found in Egypt and Tunisia, business tends to be transacted in narrow circles of trust. Even among formal businesses, informal mechanisms of enforcement often compensate for the absence of effective state institutions and the rule of law. These problems have limited access to opportunity for the wider population of business owners and entrepreneurs.

In both countries, judging by responses from business people across different regions, administrative reforms and deeper investments in infrastructure and human capital are needed to build the business-friendly ecosystem that these countries need to generate urgently-needed jobs, grow the economy, reduce corruption, and create opportunities for all citizens.

Endnotes

1 The full study is available from Stanford University’s Program on Arab Reform and Democracy at the Center on Democracy, Development, and the Rule of Law: Amr Adly, “Reforming the Entrepreneurship Ecosystem in Post-Revolutionary Egypt and Tunisia,” Policy Brief
Amr Adly is also a nonresident scholar at the Carnegie Middle East Center, where his research centers on political economy, development studies, and economic sociology of the Middle East, with a focus on Egypt. He is author of State Reform and Development in the Middle East: The Cases of Turkey and Egypt (Routledge, 2012), and has been published in a number of peer-reviewed journals, including Business and Politics, the Journal of Turkish Studies, and Middle Eastern Studies. Adly is also a frequent contributor to print and online news sources, including Jadaliyya, Alshorouk, Ahram Online, and Egypt Independent.

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