Startups and Innovators Wanted

Private Sector Growth and Job Creation

Summary

Problem

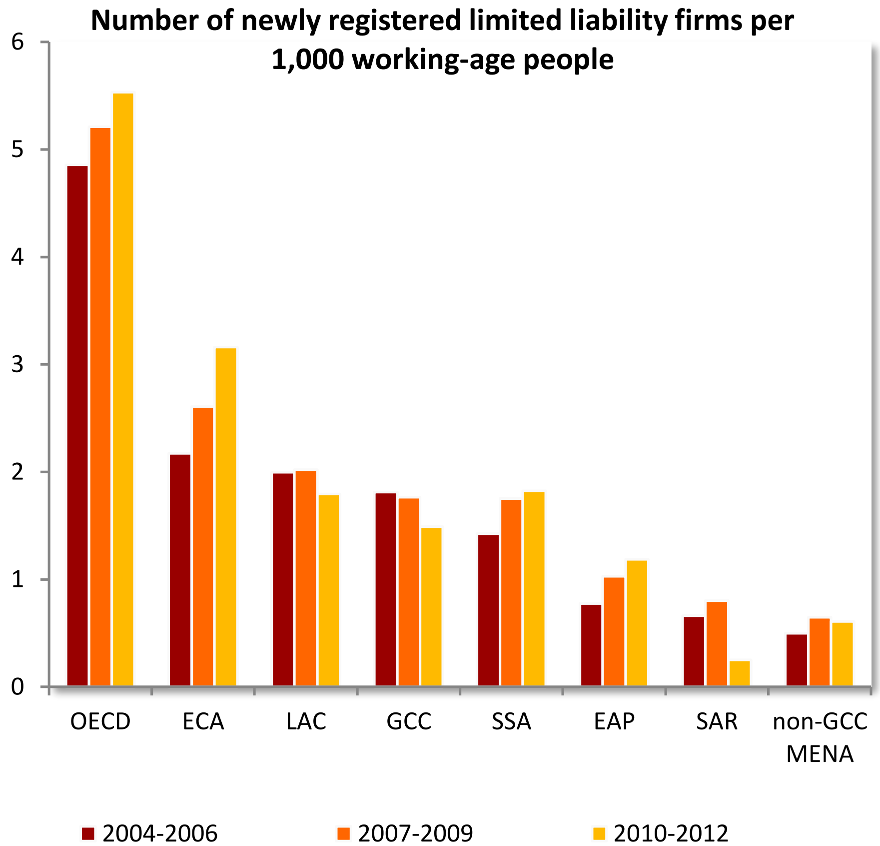
Most workers are employed in micro firms representing low-productivity, subsistence activities.

Analysis

The private sector has been characterized by low firm turnover – firm entry and exit – and slow productivity growth, limiting the pool of startups and productive firms which create most jobs in MENA.

Solution

Remove barriers to entry and exit and competition. The targeting of private sector development programs should focus on startups and innovative firms instead of small firms.



PROBLEM

GDP per capita growth was moderate and driven by an increase in the share of the working age population (i.e., demographic change) rather than by labor productivity. The private sector did not create enough jobs to absorb the expanding labor force into the formal economy.

- Formal sector workers as a share of working-age population in MENA are only 19% compared to 27% in Latin America & the Caribbean (LAC), and 40% in Eastern Europe & Central Asia.

Most workers are employed in micro firms representing subsistence activities rather than a vibrant informal sector.

- The share of total employment in micro firms with less than five employees ranges between 37% in Tunisia and 60% in Egypt. The share of employment in large firms with over 1,000 workers is below 10%.
- Lower productivity services in retail trade, personal services and hotels and restaurants create the majority of jobs, mostly in the informal sector.

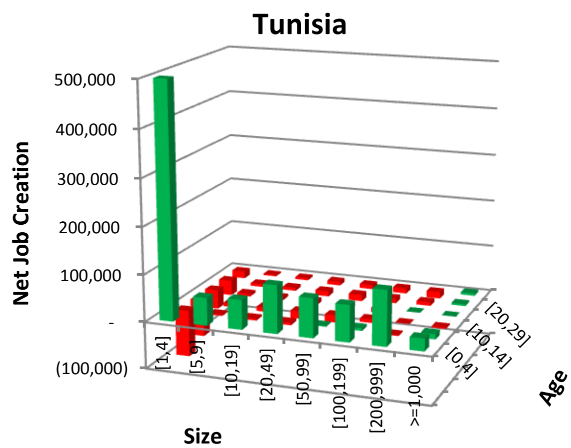
ANALYSIS

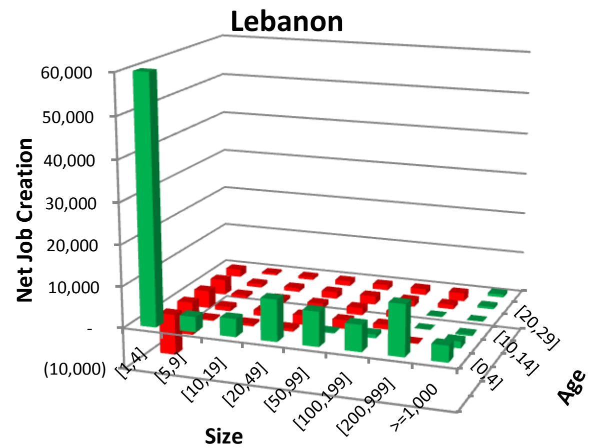
The drivers of job creation around the world…

- Young firms, especially startups, are the engine of job creation.
- More productive firms also create more jobs.
- Among the pool of young firms, a small number of rapidly growing firms – the so-called 'gazelles' - drive aggregate job creation.

The drivers of private sector job creation in MENA are no different

- **Job creation in MENA is dominated by young firms.** Independent of firm size, young firms grow faster and





Micro-startups – firms less than five years old and with a maximum of four employees – accounted for 92% of net job creation in Tunisia between 1996 and 2010 and 177% in Lebanon between 2005 and 2010.

create more jobs, particularly during their first four years of activity.

- **More productive firms create more jobs.** Firms with higher productivity experience higher subsequent job growth in all MENA countries with available data.

- **A few fast-growing firms (the "*gazelles*") account for a significant share of job creation.** Gazelles are firms which double their employment over a four year period. They are 4 to 6 years younger and more productive than non-gazelle firms. Gazelles accounted for 64% and 42% of total net job creation in Jordan and Tunisia and all net job creation in manufacturing in Morocco and Egypt.

- **However, most firms in MENA did not grow over time, especially small firms.** After 25 years in operation, surviving firms only double their number of employees in Egypt, Jordan, or Tunisia. Between 40% and 87% of all firms in MENA that employ less than ten workers do not grow beyond ten workers, during a five year period. The probability that medium-size manufacturing firms (between 20-49 workers) grow to employ more than 50 workers is small; 12% in Egypt and Morocco, and 10% in Jordan.

Why has job creation been weak?

- **Low turnover (firm entry and exit) limits the pool of young firms.** Entry and exit rates are remarkably low by international standards. In MENA for every 10,000 working-age persons, on average, only 6 limited liability companies were created annually. In contrast, the average across 91 developing countries was 20 and as high as 40 and 80 per 10,000 working-age persons in Chile and Bulgaria, respectively. Moreover, Tunisia, Lebanon and Morocco all have exit rates below 7%, whereas exit rates in Columbia or Turkey are about twice as high.

- **Low within-firm productivity growth reduces the potential for job creation.** After 35 years in operation, establishments in Tunisia and Egypt barely increase their productivity whereas establishments in Mexico, India, and Turkey increase their productivity about two-or three-fold over the same life cycle.

- **Low efficiency in the allocation of resources across firms has also diminished prospects for job creation.** Estimates for the efficiency in resource allocation in Egypt and Morocco are lower than those of Chile, Columbia, or Indonesia. Given that more productive firms create more jobs, the misallocation of resources towards less productive firms reduces aggregate job creation.

SOLUTION

Increasing the pool of younger firms and more productive firms – the engines of job creation – requires more competition and equal opportunities for all entrepreneurs.

Governments should reform policies that unduly constrain competition and equality of opportunity for all entrepreneurs to increase firm entry and thus the pool of young and productive firms.

In addition, the findings of this report suggest that if governments want to pursue private sector development programs targeting specific types of firms, they should target startups and innovative firms instead of the traditional approach focused on supporting small firms.

For references and detailed analysis and policy recommendations, refer to Chapter I in the complete 2014 World Bank Regional Report: "Jobs or Privilege: Unleashing the Employment Potential of the Middle East and North Africa".