Challenges facing the Lebanese SME Sector

Zeina El Khoury
Head of Enterprise Team
Ministry of Economy and Trade
What is an SME? There is no universal definition of SME; different countries follow different criteria, but all agree that they are enterprises with considerable growth potential.

### Definition of SMEs

<table>
<thead>
<tr>
<th>Country</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>European Union</td>
<td>≤10 employees ≤ € 2 M Turnover or ≤ € 2 M Balance Sheet</td>
<td>≤50 employees ≤ € 10 M Turnover or ≤ € 10 M Balance Sheet</td>
<td>≤250 employees ≤ € 50 M Turnover or ≤ € 43 M Balance Sheet</td>
</tr>
<tr>
<td>Unites States</td>
<td>≤20 employees</td>
<td>≤100 employees</td>
<td>≤500 employees</td>
</tr>
<tr>
<td>Egypt</td>
<td>≤5 employees</td>
<td>≤15 employees</td>
<td>≤50 employees</td>
</tr>
<tr>
<td>South Korea</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Manufacturing SME**: ≤300 employees
- **Service SME**: ≤200 employees
- **SME**: ≤300 employees < 100 M Turnover
SMEs contribute substantially to their economies and play a central role in enhancing economic dynamism, job creation and innovation.

### SMEs Contribution to Economies

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Generate employment</td>
</tr>
<tr>
<td>II</td>
<td>Increase output with value added</td>
</tr>
<tr>
<td>III</td>
<td>Increase household income</td>
</tr>
<tr>
<td>IV</td>
<td>Increase firms and national competitiveness and productivity</td>
</tr>
<tr>
<td>V</td>
<td>Spur innovation</td>
</tr>
<tr>
<td>VI</td>
<td>Increase exports</td>
</tr>
<tr>
<td>VII</td>
<td>Generate fiscal revenues</td>
</tr>
<tr>
<td>VIII</td>
<td>Create competition</td>
</tr>
<tr>
<td>IX</td>
<td>Nurture entrepreneurship culture including that of women and youth</td>
</tr>
</tbody>
</table>

**Increase Growth**

**Decrease Poverty**
Worldwide, they represent more than 95% of enterprises, employ around 68% of developed countries working population, their share of exports amounts to 37%, and they contribute to 53% to their GDP on average.

### SMEs Contribution to Employment, Exports and GDP

<table>
<thead>
<tr>
<th>Developed Countries</th>
<th>SMEs share of Total Workforce</th>
<th>SMEs share of Exports</th>
<th>SMEs contribution to GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>88%</td>
<td>69%</td>
<td>Spain 64%</td>
</tr>
<tr>
<td>Germany</td>
<td>79%</td>
<td>69%</td>
<td>China 58%</td>
</tr>
<tr>
<td>Spain</td>
<td>79%</td>
<td>56%</td>
<td>Japan 57%</td>
</tr>
<tr>
<td>China</td>
<td>75%</td>
<td>46%</td>
<td>France 54%</td>
</tr>
<tr>
<td>Japan</td>
<td>70%</td>
<td>42%</td>
<td>Germany 53%</td>
</tr>
<tr>
<td>France</td>
<td>61%</td>
<td>39%</td>
<td>USA 52%</td>
</tr>
<tr>
<td>Malaysia</td>
<td>59%</td>
<td>32%</td>
<td>UK 51%</td>
</tr>
<tr>
<td>USA</td>
<td>56%</td>
<td>22%</td>
<td>Korea 50%</td>
</tr>
<tr>
<td>UK</td>
<td>54%</td>
<td>19%</td>
<td>Singapore 40%</td>
</tr>
<tr>
<td>Singapore</td>
<td>52%</td>
<td>16%</td>
<td>Egypt 33%</td>
</tr>
<tr>
<td>Lebanon</td>
<td>51%</td>
<td>12%</td>
<td>Australia 32%</td>
</tr>
<tr>
<td>UAE</td>
<td>42%</td>
<td>6%</td>
<td>Malaysia 30%</td>
</tr>
<tr>
<td>Egypt</td>
<td>38%</td>
<td></td>
<td>KSA 25%</td>
</tr>
<tr>
<td>KSA</td>
<td>25%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Developed Countries: 68% worldwide
Exports: 37%
GDP: 53%
Given their importance and potential, most countries have included SME development in their growth strategies, thus shaped large scale support mechanisms and created agencies to develop this sector.

**SME Institutionalization**

<table>
<thead>
<tr>
<th>Ireland</th>
<th>France</th>
<th>Singapore</th>
<th>Turkey</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Enterprise Ireland Logo" /></td>
<td><img src="image" alt="OSEO Logo" /></td>
<td><img src="image" alt="Spring Logo" /></td>
<td><img src="image" alt="Kosgeb Logo" /></td>
</tr>
</tbody>
</table>

- **Funding support** – a range of grants, loans, credit guarantees and co-investments
- **Export assistance** - local market information
- **Support companies to become leaner**
- **Incentives to stimulate in-company R&D**
- **Assistance with R&D collaboration**
- **Training and mentorship**
- **Connections and introductions to customers overseas**
- **All their advisory services are sector specific**

- **Innovation support and funding**, favoring technology transfer and innovative projects with genuine market potential
- **Guarantees for bank loans and equity contributions**
- **Financing for investments and working capital requirements**

- **Advisory services and customized advised to SMEs to enhance productivity**
- **Support innovation through five research and polytechnics centers, and through innovation voucher**
- **Training for SMEs on leadership, branding, customer service, design, IP management and marketing**
- **Service Excellence Programs**
- **Grants relating to consultancy, training, and certification**
- **Funding, loans and credit guarantee schemes**

- **Interest subsidized loan for export activities, working capital, employment**
- **Financial support for domestic fairs, consultancy, training, energy efficiency, industrial property rights and business trips abroad and R&D**
- **Loans for Industrial Implementation Support Program**
- **Applied Entrepreneurship Training Program**
- **Supports financially and technically SMEs by getting them into capital market**
Supporting this sector is key to help Lebanon overcome its challenges, most importantly, JOB CREATION

Pressing Challenges Facing Lebanon

1. Unemployment
   - 45% of the Lebanese population are young
   - Lebanon will need to create 23,000 jobs per year, 6 times more, to absorb the new entrants to the Labor market*
   - Unemployment is 11%, 35% among the youth (1 out of 3)

2. Economic Slowdown
   - 1.5-2% in 2012 and forecasts around 2% in 2013, well below Lebanon’s potential

3. Loss in National Competitiveness
   - Increasing operational and production costs
   - Depleting Infrastructure

4. Substantial Brain Drain
   - High rate of youth and skilled emigration
   - Brain drain losses are huge and outweigh the benefits, mainly remittances
   - Lebanon ranks 120 out of 144 countries in the world in brain drain losses, according to the Global Competitiveness Index

Despite the existence of several scattered policies and initiatives to support SMEs, they still face challenges. To overcome those, a COMPREHENSIVE SUPPORT STRATEGY needs to be formulated.

Focus of this presentation

**SME Strategy Formulation and Implementation**

1. **Assessment of the Current State**
   - Take stock of already existing initiatives
   - Assess Lebanon’s standing in Business Environment indicators
   - Define drivers for SME development
   - Assess drivers and identify challenges

2. **Policy and Initiative Formulation**
   - Transform challenges into prospect initiatives
   - Consult with stakeholders and secure buy in
   - Assign owners for initiatives
   - Agree on timelines and implementation plans

3. **Implementation**
   - Implement initiatives as per agreed-upon action plans and timelines
   - Track and report progress of initiatives
   - Identify potential improvement opportunities
   - Adjust implementation accordingly

4. **Monitoring and Evaluation**
To start with, a review of Lebanon’s standing in key business environment and competitiveness indicators was conducted - highlighting a backsliding performance.

### Business Environment Snapshot: Key Competitiveness Indicators

<table>
<thead>
<tr>
<th>Index of Economic Freedom, Heritage Foundation</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ease of Doing Business, International Finance Corporation</td>
<td>115</td>
<td>112</td>
<td>Not Comparable</td>
<td></td>
</tr>
</tbody>
</table>

#### Top 3 Constraints/Problematic Factors
- Dealing with construction permits
- Resolving insolvency
- Enforcing contracts

<table>
<thead>
<tr>
<th>Index of Economic Freedom, Heritage Foundation</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise Survey, World Bank</td>
<td>Not Applicable</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Top 3 Constraints/Problematic Factors
- Political stability
- Electricity
- Access to finance

<table>
<thead>
<tr>
<th>Global Competitiveness Indicator, World Economic Forum</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>N/A</td>
<td>91</td>
<td>89</td>
<td>92</td>
<td></td>
</tr>
</tbody>
</table>

#### Top 3 Constraints/Problematic Factors
- Inadequate supply of infrastructure
- Inefficient government bureaucracy
- Government Instability

<table>
<thead>
<tr>
<th>Index of Economic Freedom, Heritage Foundation</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>91</td>
<td>90</td>
<td>89</td>
<td>89</td>
<td></td>
</tr>
</tbody>
</table>
Furthermore, a detailed assessment of the SME sector was undertaken based on the key drivers of SME development and startup creation.
Access to finance is considered to be one of the top constraints SME development, in spite of the significant improvements in the last decade.

Challenges

- SME share of total loans amounted to 16% in 2010, significantly lower than 26% in developed countries
- High levels of collateral needed
- Very limited venture capital deals, equity and angel investments. One reason is the lack of exit strategies for these investments due to
  - Weak capital markets
  - Lack of an efficient insolvency framework for businesses and bankruptcy law
  - Family owned nature of SMEs is reluctant to equity investments (77.6% of firms interviewed by MoET in 2007 found equity financing unattractive)
- Low microfinance penetration, with a large market gap estimated by IFC in 2008 to be around 88%
- Substantial number of informal firms
- Limited access to finance for women entrepreneurs, 51% of female business owner sought loans but only 17% were granted. (IFC survey 2011)
Despite the high level of education in Lebanon, there is a mismatch between the supply and demand for skills and SMEs face difficulties in finding skilled workers.

### Challenges

- Persistent gap or mismatch between the skills acquired at university and the requirements of business
- Relatively under-developed Vocational Education systems and no link between businesses and vocational education
- No forward looking vision or sectoral studies to help determine the future market needs and the labor demand to align with university policies and degrees
- Low levels of employee training on the job

### Key Illustration

Percent of firms identifying an “Inadequately Educated Workforce” as a major constraint

- Lebanon: 55.5%
- Latin America & Caribbean: 35.8%
- Eastern Europe & Central Asia: 29.5%
- Middle East & North Africa: 29.3%
- East Asia & Pacific: 22.2%
- Sub-Saharan Africa: 21.8%
- High-income OECD: 21.7%

*World Bank Enterprise Survey, 2009*
Despite high levels of creativity among entrepreneurs and the sophisticated consumer behavior, SMEs still lag behind in terms of innovation and technology.

### Challenges

- **Low levels of R&D investments**
- **Low research collaboration between universities and industry**
- **Low levels of technological sophistication among new startups and SMEs** (MoET study in 2007 shows that only 15% of firms use state of art technology)
- **Weak state of cluster development** (Lebanon ranks 109 according to the GCI 2012, and 108 in GII 2012)

### Key Illustration

**Innovation Pillar – Global Competitiveness Indicator (119/144)**

- Availability of scientists and engineers: 37
- PCT patents, applications/million pop.: 67
- University-industry collaboration in R&D: 95
- Capacity for innovation: 114
- Company spending on R&D: 122
- Quality of scientific research institutions: 129
- Gov’t procurement of advanced tech products: 141

**Innovation and Use of Technology among Early Stage Entrepreneurs**

- **Novelty in Products**
  - New: 16
  - Some: 18
  - None: 66

- **Use of Latest Technology**
  - Latest: 14
  - New: 23
  - Not New: 62

*Global Competitiveness Index, 2012. Global Entrepreneurship Monitor, 2009*
A number of support programs and institutions exist, but offered support is small in magnitude and uncoordinated leading to missed opportunities of synergies.

### Support Programs and Institutions

#### Challenges

- Limited awareness of different support initiatives
- Insufficient training and advisory services for SMEs
- Business development centers focus more on startups and have limited financial capacity in offering support
- Little mentorship initiatives despite recent progress
- Little business matching opportunities are offered
- Limited impact evaluation to assess the efficiency of these programs

#### Key Illustration

**Uncoordinated Support Along Various Components of SME Development**

- Financial Support
- Training
- Quality
- Incubators
- Export Support
- Business Matching
- Research
- Networking
Access to markets and internationalization are still problematic for SMES, hampering their benefits from the different trade agreements in place.

**Challenges**

- Customs and trade regulations are a major constraint for their business and export.
- Limited levels of compliance with international standards hindering the export potential of firms. (According the 2009 WBES, only 17.9% of firms have an internationally-recognized quality certification)
- Narrow access to information on standards, regulations and customs reporting requirements due to scattered and multiple sources

**Key Illustration**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percent of firms identifying customs and trade regulations as a major constraint</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lebanon</td>
<td>36.6</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>21.9</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>19.7</td>
</tr>
<tr>
<td>Middle East &amp; North Africa</td>
<td>18.7</td>
</tr>
<tr>
<td>Eastern Europe &amp; Central Asia</td>
<td>14.4</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>12.7</td>
</tr>
<tr>
<td>High-income OECD</td>
<td>7.3</td>
</tr>
</tbody>
</table>

*World Bank Enterprise Survey, 2009*
In addition, business regulations, political situation, infrastructure readiness, and macro-economic environment are not conducive for investments.

To illustrate, consider the ease of doing business in 2012-13 ranking. The graph shows a breakdown of蹉跎, political, and economic constraints faced by firms. For instance, political instability, access to finance, and corruption are significant inhibitors, with figures indicating the percentage of firms affected. Additionally, business regulations, political situation, infrastructure readiness, and macroeconomic environment are not conducive for investments.
Weak institutional linkages between the different institutions and programs targeting SMEs are leading to suboptimal results

Challenges

- No clear framework for policy with institutional roles and mandates among stakeholders involved in policy setting
- Minimal public private dialogue and coordination resulting in lack of awareness of the support offered and challenges not addressed

Key Illustration

Segmented Approach for Policy Setting for SME Support

Institutional Structure
There is a severe dearth of statistics and research on SMEs and entrepreneurs in Lebanon hindering the formulation of evidence based policies and targeted support.

### Challenges

- Lack of statistics that map the size of enterprises with any other variable
  - Access to finance
  - Number of start ups
  - Technology
  - Sector
  - Performance
  - Training needs
  - SMEs lifecycle
- Lack of sectorial studies that take into account competitive advantage, sector potential, market opportunity, value added and employment multipliers

### Key Illustration

#### Indicators and Reports available and used

#### International Indicators and Reports

- World Bank Enterprise Surveys (2009)
- Doing Business (Yearly)
- Global Competitiveness Index (Yearly)
- World Bank, OECD, IMF reports and databases (Yearly or often)

#### Local Indicators and Reports

- Executive Opinion survey (2012)
- Kafalat, Subsidized loans (not mapped to size) (Yearly)

#### SME Performance Review (Yearly)
Given that we have identified the challenges facing SMEs, what is most important now is to transform these challenges into initiatives and this is the purpose of our next presentation.

SMEs are the key to unlock the vast potential of the Lebanese economy!

A CALL FOR COLLECTIVE ACTION!

Thank you for your attention!