The Triumphs and Struggles of Arab Startups

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1 Summary

According to one study, in 2011, family businesses represented up to 70% of the MENA private-sector economy – a higher share than in any other region. The conventional wisdom of drawing on friends, family, and fools for new business endeavors seems to translate in the MENA region as, "If you are not a friend or family, you must be a fool." While this might help to contain risk, it also fosters a risk-averse business culture. A second major hindrance to innovative entrepreneurship in the MENA region lies in the way governments manage their critical role as clients. But in MENA countries, the conditions for doing business with the government – including tendering requirements, payment schedules, and bureaucratic demands – tend to be prohibitive for small firms (10-50 employees). Companies in these industries tend to be not only family-owned, but also large in size and heavy in capital investment, and they do not typically view startups as potential strategic business partners.

2 Article

DUBAI – The recent STEP conference in Dubai – the biggest startup conference for the Middle East and North Africa (MENA) region – attracted a lot of buzz. It seemed to indicate that the region's startup scene was coming of age. Yet MENA entrepreneurs are still facing serious structural impediments to progress.

The successes of the region's startups should not be underestimated. According to Wamda, a regional accelerator platform, more than a dozen startups – including Bayt, Careem, MarkaVIP, Namshi, News Group, Propertyfinder, and Wadi.com – now have estimated valuations above $100 million. Souq.com, a 3,000-employee company founded in 2005, is poised to be the region's first "unicorn," with a valuation above $1 billion.

Yet the regional environment remains far from conducive to entrepreneurship. Beyond the wars, terrorism, and political turbulence plaguing the Arab world – not to mention the usual challenges facing entrepreneurs outside Silicon Valley, such as lack of adequate risk capital, talent, or infrastructure – is a slew of deep-rooted structural problems.

One of those problems relates to enterprise demographics. According to one study, in 2011, family businesses represented up to 70% of the MENA private-sector economy – a higher share than in any other region. This means that a large segment of the business community raises funds, shares equity, and manages operations within small, tight-knit social circles.

The conventional wisdom of drawing on friends, family, and fools for new business endeavors seems to translate in the MENA region as, "If you are not a friend or family, you must be a fool." While this might help to contain risk, it also fosters a risk-averse business culture. And yet a willingness to take risks is pivotal to innovation and entrepreneurship. Moreover, keeping businesses in the family reduces their disruptive potential, even when they do manage to innovate.

This family-oriented, or "tribal," business culture is the result of a long history of inefficient commercial judicial systems, arbitrary nationalization programs, and a lack of effective corporate governance. While most countries have made improvements on these fronts, the tribal business tradition remains entrenched, and will take time to dislodge.

But steps can be taken now to help mitigate some of the problems associated with this business culture, such as a lack of availability of adequate risk capital for new entrepreneurs. In Lebanon, for example, the central bank has launched an unprecedented startup support initiative, Circular 331, through which it guarantees up to 75% of risk capital made available by local banks, amounting to up to 3% of their assets. Since its launch in 2013, the program has generated more than $400 million in risk capital.

A second major hindrance to innovative entrepreneurship in the MENA region lies in the way governments manage their critical role as clients. Through the procurement of goods and services – which comprises about 10-15% of GDP in developed countries and up to 20% of GDP in developing countries – governments can serve as important drivers of growth and innovation. Silicon Valley's genesis and growth, it should be recalled, was propelled by government contracts and procurement.

But in MENA countries, the conditions for doing business with the government – including tendering requirements, payment schedules, and bureaucratic demands – tend to be prohibitive for small firms (10-50 employees). With small businesses unable to access the market for public goods and services, they miss out on important opportunities to mature and expand, which limits their capacity to spur broader economic growth and development.

A third major impediment to innovative entrepreneurship in MENA countries relates to the industrial structure. Construction, banking, telecommunications, tourism, and traditional manufacturing represent a significant share of the region's private-sector economy. Companies in these industries tend to be not only family-owned, but also large in size and heavy in capital investment, and they do not typically view startups as potential strategic business partners.

All of this implies high barriers to entry for new businesses, which face severely limited opportunities to disrupt, spin off, or even leverage major industries. Even startups that make some initial headway struggle to scale up in the B2B sector. Unsurprisingly, in these major industries, disruptive entrepreneurship and innovation tend to arrive slowly and late. While telecommunications is something of an exception in this sense, even its development is hampered by government regulation.

MENA startups have achieved the most success online, where the large established players did not show early interest and barriers to entry, in terms of capital investment and market access, are relatively low. Indeed, most of the successful companies in this domain sell directly to consumers and conduct transactions via digital payment services that enable them to avoid transactional barriers, such as government procurement regulations and high bank fees.

The progress that such startups have managed to achieve highlights their potential to spearhead innovation and generate economic growth. It should thus serve as a powerful incentive for MENA governments and businesses to change their approach. Specifically, governments should do more to leverage their spending to support new, innovative businesses, while established companies should open up their operations and cooperate with startups to scale up innovative activities that can inject dynamism into markets.

Startups are proven hubs of innovation and drivers of economic growth, employment, and development. It is time for the MENA countries to make the most of that potential.