SMEs are key growth and job drivers: Op-ed in The Jordan Times, 12 June 2013

This op-ed piece was published in The Jordan Times [http://jordantimes.com/smes-are-key-growth-and-job-drivers] on June 12, 2013.

The great financial crisis and its sister, the great contraction, crystallised the imperative to create jobs, bolster economies and eliminate barriers for inclusive growth. With that comes a renewed global focus on small and medium enterprises (SMEs), entrepreneurship and access to capital.

Banks that survived the great financial crisis furnace face growing regulatory burdens and higher cost of capital. Bank-based lending and financing of SMEs faces insuperable barriers. It is clear that new financing channels and mechanisms need to be established and fostered to fill the funding void facing SMEs.

Middle East SMEs and family businesses are not only significant contributors to GDP but also account for the majority of private sector employment. One of the key lessons from the Arab Spring is the need for sustainable employment generation: job creation should be the top policy priority for policy makers in the region.

Arab governments wake up each morning to a nightmarish demographic landscape: their young and fast-growing populations are unemployed. This is the explosive mix underlying the Arab Spring.

Over 55 per cent of Arab populations (some 380 million) are currently younger than 24 years. The labour force will grow from 146 million to 185 million by 2020. Youth unemployment averages 35 per cent, with the young female unemployment rate in excess of 45 per cent.

These young and unemployed are restless and despairing, not least because sclerotic educational systems have made so many of them unemployable.

Young women feel dejected and schizophrenic: their higher educational attainment rates are perversely associated with low labour force participation and exclusion from economic and political life.

The Arab world will need to create some 60 million new jobs by 2020 merely to keep unemployment rates constant, and some 30 million more if women are to increase their labour force participation rate to average global levels.

We need "Chinese" growth rates in excess of 8-9 per cent per annum, not the miserly current rates of 3 per cent (largely based on high oil prices) to create the jobs.

Cushy government jobs, appealing given the security of tenure and less demanding in terms of skills and pressures, have often been the first choice for the youth in the region. Indeed, in the GCC, more than 80 per cent of nationals are employed by the public sector.

But government jobs do not lead to productivity growth, innovation, entrepreneurship or international competitiveness. They are a dead end for our region.

We need to create jobs in the productive private sector. That means fostering entrepreneurship, SMEs, growth companies and family businesses.

To date, support of SMEs has been focused on easing entry and to partially lower the cost of doing business.

MENA governments are putting in place frameworks to nurture and support SMEs. However, despite these efforts – including subsidised loans and guarantees – it is the SMEs lack of access to long-term finance, in particular equity capital, which is the real stumbling block.

The MENA region’s financial enablers are underdeveloped. There is overwhelming dependence on bank financing, which accounts for roughly 65 per cent of the total capital market size, followed by equity (25 per cent) and bond (less than 10 per cent) markets.

However, even within the large banking sector, only 20 per cent of local SMEs reported having a loan or a line of credit, the lowest percentage of any region in the world.

Only 10 per cent of SMEs’ investment expenditures is financed by a bank loan, also among the lowest worldwide.

Financial access for women is worse: a recent IFC report revealed that among MENA region’s women business owners, 64 per cent of respondents had sought capital, most – 41 per cent overall – had encountered difficulties in accessing this needed finance and the rest despaired.

The major hurdles for these women entrepreneurs ranged from high interest rates to lack of collateral guarantees, complicated processes, lack of a business track record as well as discrimination by banks due to being a woman business owner.

Already limited in scope, MENA equity markets offer little alternative opportunity or accessibility for SMEs, tending to cater to large corporation and state-owned enterprises.

The regulatory burden and cost of raising capital on public markets is prohibitive for SMEs and growth companies.

We find ourselves today in the perfect storm.

The world is changing faster than ever before – people today have the capacity to innovate, create and engage online whenever and with whomever they like.

Coupled with the difficult economic landscape for SMEs and the absolute necessity in which we need to ensure their success, the stage is set for game-changing shifts in the structure of doing business.

We need to do things differently by harnessing the power of new technologies, of networks and their ubiquitous reach.

Given the exponential rate at which people are going online and broadband penetration, new technologies for intermediation are disruptive in how business and engagement happens.

We are on the verge of a veritable transformation in access to finance for SMEs. The recent launch of Crowdfunding platforms in the region brings new sources of capital investment, a new class of investors and provides direct, online access to capital.

Crowdfunding – which stands for “capital raising online while deterring fraud and unethical non-disclosure” – was initially established to provide a marketplace for projects or ideas to gain funding in the form of donations. It was a natural progression to witness the emergence of equity Crowdfunding where growing businesses that are in need of capital for their growth and scalability would seek out funding from the crowd in exchange for equity.

We see “friends and family network” fundraising every day offline. But the dynamic changes in our ability to interact online, globally, have made equity Crowdfunding possible.

No longer do SMEs have to depend on a few investors to take big chunks out of their business to gain funding. Many small investors can come together to provide investment capital, enabling businesses (and economies) to grow.

Crowdinvesting creates an open, equitable platform, a level playing field where the crowd can come together to filter, judge, analyse, conduct due diligence and connect with businesses to help their growth. It is due to that level of transparency that crowdinvesting platforms will succeed.

It is these principles and values that are built into Crowdfunding platforms that embody best practices, like Eureeca.com

Investor protection guidelines are built into any crowdinvesting platform just as they would be in offline investments.

However, a central difference is that the involvement of the crowd in asking questions and conducting due diligence transparently online ensures a robust filtering mechanism that reduces investor risk.

We are on the cusp of a transformation of the financial landscape, with Crowdfunding, online capital raising and lending opening new vistas for SMEs, entrepreneurs and growth companies. It is the dawn of “democratic capitalism” in its literal sense.

Governments and the financial sector should harness these new financial technologies to improve access to finance for SMEs and their kin, allowing them to reach their business and economic potential.

Crowdfunding is a new financial fuel that entrepreneurs and SMEs can use to grow, realise their potential, and help drive economic growth and the job creation urgently needed in our region.