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Access to Finance for Entrepreneurs in MENA Region

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ABSTRACT

The paper analyzes different financial investment mechanisms on offer for entrepreneurs of MENA regions. Whereby, a literature review-based study was carried out, while collecting resources from various online resources, to give a context of different financial mechanism like Angel investment, Micro financing and Islamic Banking. After giving a thorough analysis of different financial methods, recommendations were provided to further improve these methods to make it feasible for entrepreneurs to excel.

1. INTRODUCTION

Entrepreneurship: It can be defined as the effort to initiate or expand an economic activity by identifying new market, product and/or process opportunities and taking advantage of these opportunities. In the concept of entrepreneurship, which can be defined as a phenomenon in this way, the entrepreneur is the person who makes the effort mentioned above in the simplest way.

In the classical sense, the entrepreneur is defined as a person who is engaged in production activities by organizing the factors of production and aims to make a profit with the risk he undertakes. However, in recent years, elements of "doing something new or different and adding value to society" have been added to the definition of entrepreneurship (Abdulsaleh & Worthington, 2013). The importance of entrepreneurship lies in the fact that entrepreneurs identify the needs of the society and transform it into investment and eventually into social welfare. While businesses provide funds through borrowing from some of these resources, they provide resources in the form of capital increase from the other part. The importance of investors is increasing day by day and it is being examined more and more in the entrepreneurship literature (Bakhouche, et al., 2020).

Entrepreneurs basically establish their businesses with their own capital or capital obtained from their spouses and relatives (seed stage investments). Investors known as angel investors in the summer and Individual Participation Investors in MENA region support early stage entrepreneurs (www.oecd.org). Venture capital funds, on the other hand, are a financing tool that plays a role in the later stages of the venture. However, in addition to these methods known as capital financing, and in fact much more frequently used financing instrument is bank loans, which are expressed as basic debt financing. Therefore, although equity capital is an important element, it is often not sufficient to start and, more importantly, grow an enterprise. It is very difficult for many entrepreneurs to bring their venture to a certain point without using external financing. Therefore, Entrepreneurs' access to financial resources in MENA region is generally realized through two channels: free market and public resources. From a free market perspective, the banking system is the most important financial resource provider. Apart from the banking system, private venture capital firms can also be considered as an important financial resource provider for entrepreneurs.

In MENA region, as in most parts of world, banks are the most important source of finance for SMEs. Since small enterprises have more problems in accessing bank loans compared to large enterprises, various support programs are

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implemented by the public to increase the access of these enterprises to credit. These supports can be in different forms such as executing loan programs with favorable conditions (such as low interest rates, long-term) in line with policy priorities, creating loan guarantee systems and micro-credit systems. In recent years, developed countries prefer less intrusive policies to the market, such as developing credit guarantee systems and making improvements to the macroeconomic and financial system (Dubai, 2019).

In this way, the present study is focused on knowing what factors, internal or external to the company, affect the financial investments for entrepreneurs and how they make adoption decisions for investments. The Research Questions are:

- What is the existing mechanism for financial investments for entrepreneurs?
- What factors influence the adoption of type of financial mechanism in entrepreneurs?
- What are the latest trends for the adoption of financial investment mechanisms in entrepreneurs?

2. LITERATURE REVIEW

Problems in accessing affordable financing also pose a significant obstacle to the establishment and growth of SMEs. Compared to many developed and similar developed countries, banking sector loans provided to enterprises in Turkey are at a lower level, and loan interest rates are higher when compared to these countries. In addition to these, the fact that the majority of SMEs are micro-scale enterprises with weak financial and institutional structures is an important factor that makes it difficult for them to access credit.

SMEs are predominantly micro-structured businesses with a traditional structure, most of which operate as family businesses. In these businesses, the owner and the manager are usually the same person or the business owners are very close family members. Therefore, all decisions taken in such businesses depend on a person or group, and the knowledge, skills and management capacity of the person(s) have a significant role in the performance of the businesses. In addition to the low level of institutionalization, these businesses also experience difficulties in human resources, financial management, marketing and new product and service development. These data show that SMEs have institutionalization problems besides financing.

3. METHODOLOGICAL ASPECTS

The study used the literature review based approach, whereby, various online repositories like Google Scholar, Research Gate and Semantic Scholar has been utilized to compile a list of sources with keywords “Entrepreneurs and financial investments”, “MENA region”. Shortlisted articles were further analyzed and a thorough analysis has been performed in this regard to determine the answers to research questions.

4. RESULTS & ANALYSIS

Alternative Methods in Financing Entrepreneurs

Venture Capital (Venture Capital)

Venture capital is based on a startup or small company. For the capitalist, at the initial stage of the idea. Being a partner when the product is not in existence and its usability or acceptance in the market has not been proven or tried increases the return. On the other hand, while the entrepreneur cannot try the product or service he wants to present due to lack of capital, he increases his chances of achieving the desired size by providing capital to his company thanks to venture capital.

Venture capital is equity investment. The capitalist becomes a partner to the company instead of providing financing through lending. Since the shareholder is a partner in the company through shares, he also gets the right to participate in the management. The risk in venture capital investment is; is the risk of producing a new product and keeping it on the market. However, in this financing model, which is based on the fact that high risk will bring high returns; In case the risk taken turns into success, the high profit margin to be provided and the increase in efficiency resulting from the large sales volume constitute the benefit of the investors who provide financing by partnering with these companies.

The first application of venture capital is the United States of America. With the success of American venture capital companies, such companies have been established and developed in other countries. Among these countries, Japan, Israel and European countries, especially England, take the lead. Venture capital is a financing method that has reached very important dimensions in terms of amount and number of investments after the 1970s in the USA. Venture capital investments, which reached a record level of 105 billion dollars in terms of annual total investment amount in 2000, have been in an increasing trend most of the time, although they have followed a fluctuating course since 2000.

In MENA region, venture capital has not been able to be implemented for many years. Both the inadequacy of domestic capital, the lack of information, and the inadequacy of legal regulations have distracted the attention from this point. After the mid-1990s, especially with the regulations of the Capital Markets Board, venture capital started to attract attention in with the start of operations of foreign funds. However, venture capital in MENA region did not develop much until the beginning of the 2000s and was not considered a widely used type of financing. Although there are many reasons why venture capital could not develop for many years, the most emphasized point is that the stagnant structure of the economy limited venture capital investments.

The first attempt in venture capital in MENA region, in context of Turkey was made by banks. The first fund established for this purpose was Vakıf Risk A.Ş. is a total of 12 venture capital investment trusts (www.spk.gov.tr) licensed by the Capital Markets Board (SPK), 6 of which are open to the public GSYO company. By the end of 2013, portfolio values of publicly traded REITs reached $541 million. As stated above, REITs contain different investment alternatives. It is seen that venture capital investments have a significant weight among these investment alternatives and this weight has also increased in recent years. According to 2013 data, among the portfolio values of GSYOs. The weight of venture capital investments was 77.15%.

The venture capital investment partnership system in MENA region does not invest in projects at the core, start-up and management acquisition stages. Especially since the risk of companies in the core stage is quite high, these companies are considered to be in the valley of death and no investment is made. Investments are generally made in companies that have passed the idea stage, established their company and started to make profits, but need financing in order to grow and continue their investments.

Angel Investment

The concept of angel investment is a term first used by stockbrokers on Broadway to express the rich who make risky investments for the continuation of Broadway shows. In order to define angel investment, first of all, it is necessary to talk about two basic elements that make up angel investment. The first of these is the entrepreneur, and the other is the angel investor, who undertakes the risk largely and is called Individual Participation Investor (IDA) (Jones & Mosteanu, 2019).

Entrepreneurs can be defined as people who come up with an idea and have a business plan attached to it and need capital to grow their venture. According to study entrepreneurs are; Having three key features: vision, mission and ambition, forward-thinking, self-motivating, self-confident (Chemli, 2014). They are people who are resistant to stress, have a solution-oriented approach to problems, and have a dominant individual character.

Angel investors, on the other hand, invest in startups that are at such an early stage that venture capital institutions cannot invest, usually in small amounts (100,000 $ - 1,000,000 $) financing and with this financing, they are wealthy individuals who support entrepreneurs in sales, marketing, human resource supply and training, management. Angel investors is defined as individual investors, many of whom have previously established their own businesses, and wish to transfer their wealth and experience to small startups (El-Zoghbi, et al., 2019).

About 300 million people in the world; about 150 million new jobs are trying to start. Every year, about 1/3 of them, 50 million of them, or about 130 thousand of them every day, are born as a new company. Most of these firms disappear unsuccessfully, while some grow successfully. Entrepreneurs; In their applications to banks, bank-like financial institutions in order to find financing for their ventures, they do not obtain financing due to reasons such as too much risk of investment in their ideas, lack of collateral. The fact that venture capital companies or private equity funds provide financing to more advanced companies has created gaps in early stage venture financing. At this point, angel investors have become an important alternative finance source for individuals with new ideas and early stage startups.

Although applications for angel investment started about 35 years ago in the USA and 25 years ago in Europe, the history of applications for this alternative finance method in MENA region dates back to about 10 years ago and there were very limited applications. According to the data obtained from ACA (Angel Capital Association) and EBAN (European Trade Association for Business Angels, Seed Funds and other Early Stage Market Players) as of the end of 2013; In the visible and invisible angel investment markets in the USA, a total of 298,000 individual angel investors, 32,000 in the core phase, 29,000 in the initial phase and 9,000 in the growth phase.

It has invested approximately $25 billion in 71,000 angel investment deals. In Europe, 271,000 individual angel investors, 3,677 in the idea phase, 7,355 in the core phase, 18,053 in the initial phase, 2,340 in the growth phase, and 2,005 in the other phases, have a total of 33,430 angel investment deals of approximately 6.8 billion. $ investment has been made (Emara & El Said, 2020). The number of European angel investment networks exceeded the number of US angel investment networks after 2007, and this trend has continued until today. As it can be understood from here, after the 2008 financial crisis, Europe realized the importance of angel investment, albeit late, and took serious steps in this regard. In MENA region, as of today, preferred sectors for angel investment are internet, health services, mobile applications and software. While the investment per deal was $265 thousand in the USA, this figure was approximately $204 thousand in Europe. In MENA region, this figure is around 127 thousand dollars.

The angel investment sector, which was registered in accordance with the regulation issued after 2013, was encouraged by the states. In this context, the government applies tax exemption of 75% to 100% in some cases to investors who make angel investments for enterprises, and the incentive rate applied in terms of tax incentives worldwide takes the first place and this increases the attractiveness for angel investors.

Islamic Banking

The Islamic financial system has a century-old history. The system created for the financing of the productive activities and consumer needs of the Muslims has worked very effectively for centuries during and after the heyday of Islamic civilization. However, as the center of the economy shifted predominantly to the western world, western financial institutions dominated for centuries and the Islamic tradition remained passive. In recent years, especially after the 2008 global crisis, Islamic finance has gained great importance (El Fadel, et al., 2013).

The Islamic Banking model is basically based on the principle of transferring financial resources from economic units with surplus funds to economic units that demand funds without interest. Legal entity in the intermediary service; It operates the resources collected from savers on a profit/loss basis and adds its labor and/or capital (Hoang & Ngoc, 2019).

The Islamic Banking system, which has a small but growing share in the global financial system, has been increasingly used as an alternative model in Islamic countries as well as in various countries of the world where financial markets are developed recently. The total asset size of the World Islamic Banking sector, which was $140 billion at the end of 1995, reached $1.7 trillion at the end of 2013 (Khatib, et al., 2022).

The first examples of Islamic Banking were established in 1983 under the name of “Special Finance Institutions” and with the Banking Law No. 5411, private finance institutions were named “participation banks” in 2006. Participation banking is defined as institutions that are established to include savings that are kept as gold, foreign currency and real estate in the country and abroad, or even stored under the pillow, in the production process and operate as a profit-loss partnership, not being deposited in banks due to their religious beliefs. As of the end of 2020, participation banks constitute 5.5% of the banking sector in terms of balance sheet size, 6.2% in terms of loan (funded funds) size and 6.5% in terms of deposit (funds collected) size. Despite the fact that these ratios do not occupy a large place in the total, it is likely that participation banking will increase its weight in the banking sector in the coming years, given that they increase steadily almost every year.

An indicator of the importance of Participation Banks in terms of financing of entrepreneurs is the distribution of the funds provided in terms of loan type. As stated before, the share of SME loans (25.9% for 2013) in total loans of deposit banks is compared to that of corporate/commercial loans.

While 42.4% for the year 2018 and less for individual loans (31.7% for 2018), this situation differs in favor of SMEs in participation banks. As of the end of 2019, the share of SME loans within the funds extended by Participation Banks was 46.4%, while this rate is in corporate loans 34% and 19.6% in retail loans. This situation reveals a situation where Participation Banking resources are more accessible for SMEs.

Participation banks use the funds they collect through various transactions that have found their place in Islamic law and have been used for centuries, such as mudaraba, musharaka, murabaha, şerike and icare. Among these transactions, the privileged function of the participation banks for the financing of entrepreneurs and which, as stated in many sources, largely overlaps with the venture capital financing method, and which is considered to be an indispensable element of Islamic banks in the Islamic banking literature, is the mudaraba system. Because the mudaraba system is the element that replaces the profit/loss sharing system and the interest system in the Islamic financial system. However, most of the transactions of participation banks consist of murabaha that is, buying in cash and selling on credit.

Mudaraba is the "interest-free financing" option in the service stock of Participation Banks, which was established to evaluate the capital of individuals who want to evaluate their cash capital, but have low expertise or risk appetite and "interest (riba)" concern. Mudaraba financing system is the process that ends when the investor or intermediary bank, who has savings to invest and whose risk-return expectation is higher than the market rate of return, provides financing to projects promising high returns and receives a share from the income at the rate agreed during the investment decision.

The important points here are as follows (Kljucnikov, et al., 2020):

- The share of the financing source from the probable return of the investment must be specified as a ratio. Determining it as a certain amount is considered inappropriate/wrong since it is against the principle of uncertainty of the future and the principle of profit-loss sharing.
- If the funded project causes a decrease in capital (loss) other than the fault of the entrepreneur, the entrepreneur is not responsible for the financing of the loss. All losses belong to the source of financing. However, if the negligence of the entrepreneur caused the damage, the supply of the damage can be demanded.
- If the financing source and the new venture have investments in the same sector, there is also the "Closed Mudaraba" system, where the financing source can set a field limit for the entrepreneur.
- The sector in which the venture will be made should not contradict the Islamic rules. However, at the point of use of resources, there is a missing point according to the applications. This situation shows that although Participation Banks are an important alternative and Islamic Banks in the world in terms of financing entrepreneurs, they do not fulfill their responsibilities sufficiently. In this sense, mudaraba financing is an issue that needs to be studied in terms of the financing of entrepreneurs.

Today's deposit banks are turning to short-term commercial loans instead of long-term investment loans for development goals; This attitude is an obstacle to the development of developing countries. It is thought that Islamic Banks can fill a deficiency in developing countries by financing investment projects for development purposes. From this point of view, it is important to focus on the mudaraba system, which will allow participation banks to evaluate their savings by financing their venture projects, and to expand the application area of the most reliable form of profit/loss sharing and to contribute to the economic development existing in the founding philosophy of interest-free banking.

Microfinance

Microfinance is the financial services provided to the poor and low-income individuals, families and micro-enterprises. It is a financial support method developed to provide opportunities for the poor who need a small initial capital to engage in an income generating activity, a micro financial support given by the financing institution to a micro-entrepreneur for the purpose of developing his business is expressed as microcredit. Micro-credit is generally given for purposes such as meeting the working capital needs, purchasing raw materials and materials, purchasing the fixed equipment required for manufacturing (Kljucnikov, et al., 2020). Apart from this, services such as savings, insurance and money transfer provided to those who are outside of the traditional credit, deposit, insurance and valid financial system or who cannot reach these institutions are also counted among the microfinance services.

Microfinance has become an important tool in reducing poverty in developing countries. Traditionally, microfinance funding has been provided by public and private donations and non-profit charities. However, in recent years, the share of non-profit institutions and investors in the funding sources of microfinance has been decreasing. However, more diversified funding sources are emerging. Microfinance has turned into a commercial field with the 2000s and commercialization is taking place rapidly. National and international commercial banks are increasingly showing interest in microfinance institutions not only in developing countries, but also in developed countries.

With the commercialization of microfinance, microfinance institutions have expanded their traditional service areas. These institutions, which focused on providing microcredit in the form of small loans to women and the poor in the past, have now developed from microcredit to microfinance. Microfinance is no longer just a field created by microcredit institutions that provide small loans to women and the poor. Microfinance, which points to a wider scope than microcredit, is a type of financial resource that transfers funds to small entrepreneurs and businesses along with a number of supporting services.

Demand for microfinance services is evaluated in terms of micro and small businesses and poor and low-income households. Micro and small businesses demand microfinance services to maintain or develop their activities, while poor and low-income people demand microfinance services to establish a business or meet their consumption and other needs. In this case, formal and informal sector entrepreneurs, agriculture sector and households will be the ones demanding microfinance services.

It is seen that there were not many studies in parallel with the microfinance applications in the world until recently. However, the first applications that can be evaluated in the context of microfinance services appear as cash foundations. Cash foundations are a type of foundation that is formed when a charitable person donates his money rather than real estate. It is out of the question to take back the money that has been donated. It is operated by the foundation and the profit is spent for the purpose of establishment of the foundation.

The foundation's capital, which consisted of cash, which was the absolute property of the donating foundations, was transferred to the needy people who wanted to borrow, and then at the end of a certain period, they paid the foundation an extra amount of money together with the principal. This excess money was used for religious and social purposes. In a society where health, education and welfare were largely financed by donations, cash foundations were a very important factor in the survival of the social order. However, they provided large amounts of capital input to the economies of the cities in which they operated.

Although microfinance or microcredit applications differ in many aspects in venture capital, it can be considered as a mechanism to support venture capital organizations that will be organized regionally, since it is an application that will support people in rural areas with more poverty to have a job.

5. CONCLUSIONS & RECOMMENDATIONS

After general explanations on alternative methods in the financing of entrepreneurship, the following general determinations and suggestions can be made on the development and more widespread use of these methods. The success of angel investment depends on having a high entrepreneurial potential. Research has shown that the characteristic differences between entrepreneurs and entrepreneurship are parallel to the culture of the society. In these studies, it has been determined that some cultural structures are more prone to entrepreneurship than other cultural structures.

As a result of these features, it has been seen that MENA region people adopt individual business ownership rather than partnership structure. In addition, in the report of BNP Paribas, it is stated that 78% of entrepreneurs consist of people with a family background on entrepreneurship. As the main reasons for this situation, young people in the education system; As a civil servant, it can be expressed that he is raised as individuals who can choose from the options offered to him and cannot create his own option, whose biggest dream is to work in a place that pays well, who do not know what to do and are ready for the job and instruction to be given.

In order to increase angel investment activities and create new ideas, the share of R&D studies is great. However, the money spent on R&D investments. While its ratio to the gross national product is 3.3% in Europe, this rate is very low in MENA region. According to the researches, the entrepreneur and entrepreneurship world, lack of education on entrepreneurship, financial problems, technological inadequacies, lack of workforce and knowledge on R&D studies, individual skill weakness and negatively affected by psychological factors; Entrepreneurship is positively affected by factors such as being ambitious, dynamic population, decision and risk taking skills, innovativeness and awareness of opportunities. The investment decisions of angel investors are affected by social, economic and personal reasons. The main factors that lead angel investment to success are; legal assurance of new business ideas, risk-taking behaviors, innovation and proactivity (Hoang & Ngoc, 2019).

While incentives and regulations for angel investors are applied on a regional basis in the world, there are incentives and regulations applied from a single center. This has resulted in the concentration of angel investment activities around big cities. The resources transferred to the development studies show significant developments over the years, the angel investor profile in MENA region is improving. As a result of this study, the following suggestions can be made to increase angel investment and venture capital activities and success:

- In order to reach a level comparable to developed countries, the entrepreneurial environment should be developed and the entrepreneurial culture should be expanded to include the whole society
- Training and consultancy services for entrepreneurship and angel investment should be expanded throughout the country
- Entrepreneurship course should be added to the curriculum in the 4th and 5th grades and our young people should be raised as individuals with an entrepreneurial culture from a young age
- On entrepreneurship and angel investment; Supporting activities such as competitions, awards and incentives, university promotion events should be carried out throughout the country
- Coordination between entrepreneurs and angel investment organizations should be ensured by creating structures such as the "Entrepreneurship Council"
- Joint activities should be carried out by the business world, universities and researchers in each region on entrepreneurship and angel investment
- R&D studies should be increased and the availability of new ideas and products should be increased as a result of R&D studies
- Existing angel investors on the basis of individual and angel investor networks should be encouraged to open offices on a regional basis and to reach startups and new business ideas at the source
- Incentives and regulations regarding angel investment should be handled on a regional basis and new incentives

and regulations should be implemented by taking into account socio-cultural and socio-economic differences.

When existing venture financing sources such as venture capital and angel investment are examined, it is seen that they determine the examination of completely new business ideas and ventures as a field of expertise. However, the implementation of the mudaraba system, which is used by the Participation Banks and has the potential to be an important alternative in terms of financing entrepreneurship, is experiencing problems at this point. The mudaraba system can only be used by participation banks. Although they are participation banks, banks work with the general system of using the funds they collect as loans. Financial statement analysis is given great weight in the selection of credit institutions. However, due to the nature of the new venture, Enterprises in need of financing are excluded from the traditional lending process because they do not have sufficient operating history. At this point, the evaluation of initiatives requesting funds requires a separate expertise.

The fact that participation banks can also use other financing methods and that they currently have to compete with conventional banks keeps them away from financing high-risk new ventures. In addition, the relatively high profit share ratios make it easier for banks to make profits in line with their expectations. Banks that satisfy their desire for profit with normal funding methods do not consider adding high-risk products to their portfolios.

Raising awareness in academia about these suggestions and new proposals for the more effective and widespread use of alternative financing methods that are used in the financing of entrepreneurship and entrepreneurship and that have the potential to be used, and the widespread discussion of this issue in workshops and symposiums will make an important contribution.

Competing Interests

The authors have declared that no competing interests exist.

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