# Digital Integration of the MENA Economy

*This article explores the effort to integrate the economies of the Middle East through digital startups, which are growing in both number and relevance. While these startups offer the best hope for a strong, regional economy, they still face institutional and regulatory barriers.*

The Arabic word *qawmiyya* connotes a feeling of connectedness that is unbound by borders. For the Middle East and North Africa (MENA), the later 20th century has been a failed experiment in forming its *qawmiyya*. The Arab League's vision of a prosperous pan-Arab identity post-World War II that attempted to unite 22 different MENA nations and over 400 million people via a common culture has instead left a region that *The Economist* notes is more nationalized and brittle than ever in modern history. Indeed, economic and cultural development has been driven via state-based institutions that are often inward-looking rather than regionally active. With limited common ideological or economic links to stitch together the region, institutions like the Arab League have now become symbols of the failure in achieving the goals of free cross-border movement of culture, talent, trade, and investment. Apart from the United Arab Emirates, no Arab nation has a shared know-how of how to build a diversified post-oil economy. And excluding Tunisia, the region is less democratic and more fragmented across distinct dictatorial lines than a decade ago.

Nevertheless, a nascent attempt at modern pan-Arabism is emerging today. This attempt lies not in archaic cross-border institutions or governmental bureaucracies, but rather in a digitally driven commercial movement, with emerging Arab businesses and investors taking advantage of an untapped digitally savvy consumer *qawmiyya* across the region. Tech startups are growing fast within the region, with multiple funds focusing on cross-regional communities. Much of this recent growth has been initiated by venture capital as well as sovereign wealth funds, both of which are looking to the MENA startup economy to secure a stake in the region's long-term growth, generate returns across nations, and in the process contribute to an economically prosperous pan-Arab movement. This trend demonstrates that the scalability of the MENA digital startup economy will be a key driver in developing a sustainable pan-Arab identity in the coming decade.

For this movement to reach its full potential, continuing reform of existing governmental interference is required to both reduce and harmonize cross-border commercial regulations. With that reform, the ease of doing business across MENA will improve, and the organic movement to grow commerce across the region will further push the cause of an integrated pan-MENA identity.

Historically, MENA economic integration has been a core pillar of pan-Arab movement, with multiple institutional attempts to facilitate the movement. The Arab League, formed in 1945, proposed the PAFTA (Pan-Arab Free Trade Agreement) in 1997 to eliminate local tariffs and enable increased trade amongst the MENA nations. There have also been other sub-regional pacts including the Agadir Agreement in 2007, Maghreb Arab Union in 1989, and the most successful one — The Gulf Cooperation Council in 1981.

These integration efforts haven't borne substantial results due to embedded economic and geopolitical challenges that include repeated regional conflicts, tariffs and non-tariff protectionist safeguards, and institutional corruption. Yet the concept of MENA integration has remained alive within the region, with the belief that it has the potential to bring about improved economic outcomes.

## Regional Integration through Startups: A Digital Oasis in the Desert

Careem, one of MENA's most successful startups, draws on the Arabic word for "generous," which it has been for regional economic cohesion. Co-founders Mudassir Sheikha and Magnus Olsson reflected in a recent interview with Entreprenuer.com that they launched the eponymous ride-hailing company in 2012 with 20 drivers and the aim of transforming the transportation industry in the United

Arab Emirates. In 2019, the company was acquired by Uber for $3.1 billion, making it the largest exit for a Middle Eastern startup and paving the way for a new generation of founders in the region.

According to World Bank data, the MENA region has a vast population with approximately 400 million residents and $2.6 trillion of combined GDP. With strong elements of shared transnational identities, the region is conducive for integration through the technology startup ecosystem. As technology companies are scalable across geographies in theory, the region represents a fertile ground for cross-border entrepreneurs to grow their businesses by targeting consumers with a shared set of cultural and socioeconomic attributes.

After achieving unicorn status in 2016, Careem stated that it created “over 1 million employment opportunities” and generated “over $2 billion in earnings across 15 markets.”

> “Venture-backed technology startups that have the potential to scale beyond their countries can attract more capital and have been more successful in MENA.”

Their service proposition was targeted at a pan-MENA consumer, leveraging a marketing and growth model that appealed to similar demographics and cultural attributes, connecting populations across nations and in turn driving cross-regional economic cohesion.

From an investors’ standpoint, startups like Careem attempting to extend cross-regionally also access a larger market size, both in terms of population and GDP. Individual nations in MENA have either small or economically unattractive markets in isolation. Thus, venture-backed technology startups that have the potential to scale beyond their countries can attract more capital and traditionally have been more successful in MENA.

The trend of cross-border operations of digital startups, however, brings about a set of contradictions with it. The first challenge from a digital integration standpoint is that investment distribution is not spread evenly across nations. The second challenge is around regulatory issues that inhibit the speed of digital integration and bring about memories of roadblocks faced in the pre-digital era.

## Uneven Investment Distribution in MENA

According to Magnitt Research, 88% of the capital invested in 2020 was concentrated in three countries: UAE, Saudi Arabia, and Egypt. In fact, while the UAE holds 2.5% of the region’s population and 16% of the GDP, it received over 50% of the investment capital. The rest of the MENA nations received less than 12% of the capital.

Cross-border investments have been on the rise since January 2016, but they represent a very small portion of the overall technology investments in the region. For instance, Morocco, with 9.3% of the region’s population and 4.3% of GDP, received less than 1% of the startup investments.

The low proportion of cross-border investments and concentration of investments and startups in the three largest economies can be attributed to three major reasons: strong leverage of rich countries, limited capital markets, and corruption or lack of transparency.

The strong capital base advantage in UAE and Saudi Arabia has led to the concentration of startups in those nations. It has also led to strategic decisions such as attracting strong talent pools and consolidating resources from other MENA nations within their own nation-state boundaries.

An investor from Abu Dhabi who requested anonymity explained, “When investors from UAE or Saudi invest in startups in Egypt or Jordan, the startups are expected to move their base and employees to cities from the investee countries. This helps in increasing the educated pool of engineers and scientists, and also in the nations reaping the benefits of an integrated and imported technology ecosystem. UAE has less than 10 million population of its own and is increasingly looking to get talent from elsewhere to improve their future movement towards a knowledge economy. The city of Masdar’s transformation into a tech hub is one such instance where startups from all across the Middle East and the world are moving.”

In an Atlantic Council talk, Ayman Soliman, the CEO of the Sovereign Fund of Egypt and Tariq Abdulqader I, discussed how the lack of exit opportunities poses another threat when it comes to investments in smaller regions. Not all countries in MENA have capital markets that can support companies going public, which limits exit opportunities. Some companies are listed on local exchanges and are traded below their value. Other companies operate in countries without exchanges altogether. With no guaranteed way to exit on an investment in a foreign company, this increases the risk of investing across borders.

The quantum of historical cross-border investments showcases the large variations in ecosystem maturity within the region's nations. These friction points are exacerbated through the regulatory challenges and lack of a common framework to bring the nations together economically.

## Institutional and Regulatory Hurdles

The policies surrounding digital services are useful to measure the extent to which digital startups are driving economic integration in MENA. A 2020 World Bank report on digital trade in MENA concluded that the region is "falling behind in establishing a modern governance framework for the digital economy." Among the many policy features that affect economic integration, a few are particularly endemic and restrictive to early-stage startups seeking to expand in the region: non-transparent regulations, the high cost of entering new markets due to a lack of regulatory consistency and coordination, and nationalistic policies.

Founders need to be able to access the regulatory requirements necessary to move into a new market. Often, this isn't readily available and founders are blindsided by fines or regulatory interference. Mohammad Albattikhi, the founder of Bilforon, an app for home-based kitchens, notes that all MENA countries do not have regulations that are clearly defined and easily accessible to founders. In Albattikhi's experience, regulatory complexity is a result of governments struggling to keep up with the changing business environment, and these issues are exacerbated by the lack of interregional coordination.

As Albattikhi observes, "Unlike the U.S. or Europe where standard rules exist, every country [in MENA] has different regulations that are not in sync with each other," making entering new markets costly.

Tamer Al-Salah, managing director of Jordan-based Beyond Capital, said, "Entering each market takes a license that costs an arm and a leg, and you probably need to go through a sandbox to have the regulations defined, and then you can get the license." He recalled that when Liwwa, a Beyond Capital-supported micro-lending startup, tried to sell direct-to-consumer in Egypt, the cost of acquiring a license to perform its services was around $2 million. Such a fee is nonviable for most early-stage companies.

> "The strong capital base advantage in UAE and Saudi Arabia has led to the concentration of startups in those nations."

Another important issue in the integration of markets is that the richer, larger markets exert power to advance their own economies at the expense of regional integration. Workforce mandates represent one potent example of restrictive nationalist policies. For example, when Liwwa tried to register in Egypt, the employment law there required 90% of the total number of employees in an entity to be Egyptian. To comply, Liwwa would have to hire a new Egyptian team, which was simply not feasible, Al-Salah said.

It's important to note that there has been much easing of regulation in recent years in order to remove barriers for digital services operating across borders. While the digital economy has catalyzed policy reform, small companies and those operating in certain industries like fintech continue to struggle to scale regionally. While investments and regulations still present a huge barrier to the integration of digital startups across the MENA region, the growth of the digital economy is forcing governments to introduce new initiatives on both fronts.

On the regulatory front, governments across the Middle East recognize that reducing the barriers to digital startup investment and expansion is within the best interest of their citizenry. In its 2020 edition of the Doing Business Report, the World Bank singled out four MENA nations — Saudi Arabia, Jordan, Bahrain, and Kuwait — for their efforts to reduce the hurdles to starting and expanding businesses via regulatory reforms.

## The Road Ahead

In the last few years, many of the essential reforms MENA nations undertook were in response to the emergence and growth of digital startups and their expanding digital economy. Since 2016, eight regulatory sandboxes have been introduced in the MENA region specifically to propagate startups. The Abu Dhabi Global Market (ADGM) pioneered this movement by introducing ADGM Reglab in 2016. Per ADGM, ADGM Reglab is the second most active regulatory sandbox globally and has successfully contributed to the development of the UAE's financial sector. Regulatory sandboxes serve an important function of increasing transparency across and within fintech industries and reducing the investment costs of starting up these businesses.

Governments have also taken steps to reduce the costs to register and introduce foreign startups within their nations. MENA governments have implemented specific reforms to make starting a business or entering their economies easier. The World Bank reported that the UAE improved its online registration process in 2019, and a year later reduced the fees for business incorporation. Similarly, the Saudi Arabia General Investment Authority (SAGIA) has undertaken several reforms since 2016 to streamline the business registration process, eventually creating a one-stop-shop for doing so. It has also made it easier for women to register companies and reduced registration fees. Creating one-stop-shops has become increasingly popular across the region, with Kuwait and Egypt joining in. Additionally, Kuwait, Bahrain, Algeria, and Qatar have each reduced capital requirements for starting a business. As the startup economy grows throughout the region, governments are supporting the change by reducing hurdles and increasingly fostering them.

Governments are also recognizing the benefit of allowing foreign ownership and thus reforming nationalistic policies. While defense and other security-related industries remain tightly controlled, the desire to integrate the growing digital startup economy has prompted reforms in consumer-facing sectors like financial services. Reuters reported in June 2021 that the UAE decided to allow full foreign ownership of companies in specific industries. Similarly, complete foreign ownership is now possible in Saudi Arabia, Oman, and Kuwait under specific circumstances.

On the investment front, there are increasing instances of institutionalized cross-border investment funds from the richer nations that could lead to improved digital and economic integration. In 2019, Mubadala, Abu Dhabi's state investor, announced the launch of MENA tech funds that planned to invest over $250 million in startups in the region. This initiative was part of a broader move to reduce the dependence on oil and transition to a tech-based economy. Another example is the Saudi Jordan Investment Fund, which aims to increase investments from Saudi Arabia to Jordan in various industries and segments. The fund made its maiden tech investment of $15 million in the Jordanian tech startup Opensooq in June 2021.

## Conclusion

The MENA story has the potential to be one of modern-day success. Following a long history of individual nation-building, it is the organic proliferation of digital commerce that seems to be succeeding in economically integrating the region where numerous political and diplomatic attempts from history failed. The story is not perfect yet; challenges on equitable investment distribution and regulatory barriers exist. Yet with the continued success of startups like Careem and those following its footsteps, optimism exists. Indeed, we have already witnessed a series of course-correcting strategic steps from both enterprise and governments that will go some way toward harnessing the full digital potential of the region. There's a famous Arabic proverb that translates to, "What is coming is better than what has gone." The region's vision of *qawmiyya* remains both alive and digitally charged in its days ahead.

---

*This article was written by Deva Saxena, Meghana Pannala, Kent Hamlin, Nizar Taifour, and Shashank Singh, members of the Lauder Class of 2023.*

The Lauder Institute
Wharton · Arts & Sciences
University of Pennsylvania

THE LAUDER GLOBAL BUSINESS INSIGHT REPORT | 2022

# Building a Better Future

Wharton
University of Pennsylvania