Entrepreneurship in the Middle East and North Africa: How investors can support and enable growth
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The Middle East and North Africa region is on the cusp of a potential entrepreneurship gold rush. Public and private investors that follow six best practices will be poised to support and enable the growth of the region’s burgeoning start-up ecosystem.

By Ahmad J. Alkasmi
Omar El Hamamsy
Luay Khoury
Abdur-Rahim Syed
Entrepreneurship in the Middle East and North Africa: How investors can support and enable growth
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1. Executive summary

The Middle East and North Africa (MENA) region is one of the most digitally connected in the world: across countries, an average of 88 percent of the population is online daily, and 94 percent of the population owns a smartphone. Digital consumption is similarly high in some countries; for example, Saudi Arabia ranks seventh globally in social media engagement, with an average of seven accounts per individual.

However, despite this sizable appetite for online content and services, key digital sectors remain nascent, and entrepreneurship potential is yet to be fully tapped. Across MENA, only 8 percent of small and medium enterprises (SMEs) have an online presence—ten times less than in the United States—and only 1.5 percent of MENA’s retail sales are online, five times less than in the United States. Research by Digital McKinsey suggests that the Middle East has only realized 8 percent of its overall digital potential, compared with 15 percent in Western Europe and 18 percent in the United States.

However, we believe the region is at the start of a new s-curve: MENA is experiencing a startling growth in both the number of successful start-ups and the amount of investment funding available to them. From digital music to digital logistics, start-ups are scaling by adapting offerings and business models to serve local needs. Examples of this abound, from Fetchr’s use of GPS technology to power delivery in a region with few addresses, to Fawry’s local network of retailers that anchors its payments network and overcomes barriers in the fintech space.

Moreover, the number of investors in the region increased by 30 percent from 2015 to 2017, while total funding increased by over 100 percent in the same period. Corporate venture capital funds (CVCs) in particular are rapidly emerging in the evolving MENA investment ecosystem. In 2015 and 2016, 14 new, significant CVCs entered the MENA market. Corporate VC assets under management (AUM) grew by over 2.4 times from 2012 to 2016, reaching 20 percent of total venture capital (VC) AUM in the region.

Furthermore, from targeted, VC-like investment funds to structured incubator and accelerator programs, public institutions are also playing an increasingly key role in the start-up ecosystem. Recent examples include the establishment of Fintech Factory in Egypt, Fintech Hive in the United Arab Emirates, and National Fund for SME Development in Kuwait.

For the purposes of this report, we rely on the World Bank’s definition of the Middle East and North Africa (MENA) region: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, the United Arab Emirates, the West Bank and Gaza, and Yemen. (“Middle East and North Africa,” World Bank, accessed March 20, 2018, worldbank.org.) The research assembled for this report draws from various regions that may define the region slightly differently.


Enrico Benni, Tarek Elmasry, Jigar Parel, and Jan Peter aus dem Moore, Digital Middle East: Transforming the region into a leading digital economy, October 2016, McKinsey.com.

MAGNITT interviews conducted March 2017

Overall, the ecosystem supporting the growth of MENA’s start-up landscape has been falling into place. However, distinct gaps remain for investors in properly identifying potential in new business models, and in scaling chosen start-ups. We recommend investors in the start-up space adopt six best practices to unlock the potential of entrepreneurship in the MENA region:

- Develop robust investment theses leveraging local context
- Capture and proactively engineer network effects
- Invest at scale
- Manage performance with a patient, programmatic growth mind-set
- Secure investment independence in governance, to win the right talent
- Monitor KPIs in line with the value creation model

Local entrepreneurs have demonstrated they can be innovative and bold to meet changing demand. With the appropriate adoption of best practices in venture investing, significant value can be created for investors, promising new businesses, and for the entrepreneurship ecosystem in the region.
Entrepreneurship in the Middle East and North Africa: How investors can support and enable growth
2. MENA has high, but mostly untapped, entrepreneurship potential

MENA’s digital future is bright. Entrepreneurship is a key engine of economic growth and innovation. A 2016 report on the Middle East’s economic recovery and revitalization highlighted the impact of entrepreneurship’s “multiplier effect” on an economy. The report noted that for every ten successful new enterprises, nearly $1.5 billion in new valuations and more than 2,500 jobs are directly created.8

Undergoing a period of great social, political, and economic transformation, the Middle East and North Africa (MENA) region is becoming a burgeoning hub of commercial innovation and entrepreneurship. Home to a population of more than 430 million people across its constituents and with a GDP of USD $2.8 trillion,9 the states across the region are experiencing a new wave of economic activity, and their digital future looks even brighter. MENA is projected to exhibit real GDP growth in the coming years, reaching $3.4 trillion in GDP value by 2020; however, the region has in fact realized only 8.4 percent of its digital potential.10

This growth potential has been attributed to many factors, including the region’s large, youthful population. Currently, approximately 60 percent of the overall MENA population is under the age of 30, while 30 percent falls within the 15–29 age bracket.11 We expect these young people to fuel the rapid expansion of the digital sector in the coming years.

A second powerful variable, dramatically interacting with the comparatively young population, is the region’s rapidly increasing access to technology as well as its propensity for digital adoption and consumption. Today, 88 percent of the Middle East’s population are online daily; 94 percent own a smartphone device, on which they spend an average of three hours on mobile daily; and 38 percent of the population are active social media users. Moreover, in 2016 alone, the number of active social media users increased by 47 percent.12

However, as smartphone penetration rates have spiked in certain countries—namely Gulf Cooperation Council countries—they have remained far lower in others. Kuwait, Saudi Arabia, and the United Arab Emirates (UAE) boast even higher penetration than the United States. At the other end of the spectrum, Algeria, Egypt, and Morocco stand in stark contrast with far lower penetration (Exhibit 1). This diversity signals a deep underlying heterogeneity across the region’s digital economy—another key driver of the untapped growth potential.

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8 “Entrepreneurship in the Middle East: The time is now,” Endeavor Insight, June 29, 2016, ecosysteminsights.org.
10 The IMF Data Mapper, International Monetary Fund, December 2017, imf.org; Enrico Benni, Tarek Elmasry, Jigar Parel, and Jan Peter aus dem Moore, Digital Middle East: Transforming the region into a leading digital economy, October 2016, McKinsey.com.
As smartphone penetration and online accessibility have increased in some countries, so too has digital demand—which is therefore disproportionately high in those countries compared with those with lower penetration. As consumers increasingly get online through improved 3G/4G data access and reach (Exhibit 2), greater hunger for online content and services has followed.

Take Saudi Arabia, for example. The country ranked seventh globally by number of individual accounts on social media in 2017, with an average of seven accounts for each individual. It also ranked first among MENA countries in Twitter and YouTube usage in 2017. The number of Instagram users in Saudi Arabia grew sixfold from 2016 to 2018, to 13 million from 2.1 million, and the country’s Snapchat penetration grew from 24 percent in 2014 to 74 percent in 2016—while the global average moved from 12 percent to just 23 percent.

Of course, Saudi Arabia is not alone. According to Ericsson, smartphone data consumption across MENA will increase from 1.8 GB in 2016 to 13 GB in 2022.

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14 “Media use in the Middle East 2017.”
15 “Media use in the Middle East 2017.”
However, despite this sizable appetite for online content and services, key digital sectors are still nascent. E-commerce, for example, has significant potential for further growth. Across MENA, only 8 percent of small and medium enterprises (SMEs) have an online presence—ten times less than in the United States. Moreover, only 1.5 percent of MENA's retail sales are online, five times less than in the United States.\(^{18}\)

Beyond e-commerce, untapped digital potential throughout the region is a common theme. Research by Digital McKinsey suggests that the Middle East has only realized 8 percent of its overall digital potential, compared with 15 percent in Western Europe and 18 percent in the United States. In fact, the region stands poised to unlock an additional $95 billion per year to its annual GDP through the digital economy if it reached the levels of global leaders.\(^{19}\)

Moreover, global players rather than regional ones are capturing the bulk of the digital value being created. Digital giants such as Facebook and Google, and enterprise IT behemoths such as IBM and Microsoft, remain the leading players catering to local demand.

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\(^{19}\) Enrico Benni, Tarek Elmasry, Jigar Parel, and Jan Peter aus dem Moore, Digital Middle East: Transforming the region into a leading digital economy, October 2016, McKinsey.com.
Relative to global GDP contribution, local digital markets are just a fraction of their potential size (Exhibit 3). This is costing local champions significantly; in e-commerce alone, more than 80 percent of local spending goes to global suppliers and service providers as global giants enter the market through acquisitions, joint ventures, or their own direct entry into the markets. The situation is similar in digital payments, where local players have left 70 percent on the table. In a market where the global transaction value in online, mobile, and contactless payments increased 20 percent from 2015 to 2016, reaching $3.6 trillion in value, there is significant room for local players to capture a greater share.

Exhibit 3: 
**MENA has lost revenue potential for local champions**

<table>
<thead>
<tr>
<th>Sector</th>
<th>MENA revenue potential (%)</th>
<th>Actual MENA revenue share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digital payments</td>
<td>100%</td>
<td>30%</td>
</tr>
<tr>
<td>Digital gaming</td>
<td>100%</td>
<td>45%</td>
</tr>
<tr>
<td>E-commerce</td>
<td>100%</td>
<td>17%</td>
</tr>
</tbody>
</table>

Revenue pools are being captured by global players instead of local champions

1. 100% = Global market revenues * (MENA's GDP/Global GDP) per sector
2. Actual MENA market size as a % of potential market; lost revenue potential due to revenues that are captured by international players or untapped

SOURCE: Various sources (Gartner, Magna global, 451 Research)

Across the Middle East, the digital economy’s contribution to GDP is generally low compared with other regions, at just 4.1 percent—half that of the United States (Exhibit 4). There is again variance at the country level; for example, Bahrain’s digital contribution to GDP, which is driven by digital exports, is akin to that of the United States.
In sum, MENA’s digital economy has seen and will see even more significant growth and disruptions. These changes will be propelled by the region’s shift away from oil-based economies toward more service-oriented industries with a strong digital presence; the demographic shift to a younger, tech-savvy population; and the exponential evolution of technology and channels.

However, for MENA to unlock the untapped entrepreneurship potential associated with the digital economy, crucial questions remain: Will the high smartphone penetration rates in some countries spread to the rest of the region to facilitate online accessibility? Will the region succeed in enabling the growth of key digital sectors, such as e-commerce? Will local entrepreneurs successfully capitalize on the regional digital demand? Fortunately, native successes such as Careem, a ride-hailing app company based in Dubai, suggest that indeed, regionally specific digital services can exist and can even flourish, despite the formidable global competition of giants such as Uber.
Entrepreneurship in the Middle East and North Africa: How investors can support and enable growth
3. Digital entrepreneurship is beginning to thrive in MENA

Across digital spaces, a generation of local MENA start-ups have emerged and gained a foothold throughout the value chains of various sectors. Five examples—e-commerce, digital music, last-mile delivery and logistics, fintech, and travel—illustrate the growth of local digital entrepreneurship.

3.1 E-commerce

Within e-commerce, the most mature digital sector in MENA, a variety of entrepreneurial solutions have emerged—from pure-play marketplaces, such as Dubizzle in Dubai, that offer a diverse array of sellers a platform to sell their goods, to full-fledged e-retailers, such as Namshi, that offer digital storefronts, payment facilities, and delivery solutions (Exhibit 5). Moreover, hybrid models, such as Amazon’s Souq.com, have thrived offering both marketplace and e-retail offerings.

Exhibit 5: E-commerce sector offers a variety of solutions across the value chain – it is the most mature yet still sub-scale

<table>
<thead>
<tr>
<th>Value chain</th>
<th>Attract customers</th>
<th>Run the store</th>
<th>Process payments</th>
<th>Deliver products</th>
<th>Engage &amp; care</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local characteristics</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Platform</td>
<td>Currently few marketplaces rely purely on customer-to-customer sales</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Integrated</td>
<td>Scant examples of integrated marketplaces (e.g. JadoPado acquired in 2017)</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Hybrid model (marketplace &amp; e-retailer)</td>
<td>Starting as e-retailers, many companies have developed hybrid models to offer more products to customers</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Integrated</td>
<td>So far, only two major integrated players with sufficient scale to dominate the marketplace</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>E-retailers</td>
<td>Most e-retailers have started to offer hybrid model to customers</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Integrated</td>
<td>Some e-retailers have started to offer payment and delivery options</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
</tbody>
</table>

1 Platform describes the internet platform without any integrated services (e.g. logistics or payment processing)
2 Integrated describes a company that is integrated along the value chain (e.g. eBay also has their own payment processor)
3 Assumption according to current plans for Noon

SOURCE: Publicly available information, team analysis

3.2 Digital music

Based in Lebanon, Anghami, the region’s largest local music-streaming service, launched in 2012 and provides unlimited streaming access to Arabic and international music. As of early 2017, the service’s 30 million users streamed 500 million songs a month.²⁰ The company has flourished, with revenues in range of $20 million in 2017,²¹ despite fierce competition from

the likes of global players Apple Music and Spotify. Anghami also recently entered a new direct licensing deal with Warner Music Group to bring the group’s catalog of music to the region. 22

The company generates 65 percent of its revenue through paid subscriptions, which have grown 300 percent year over year. 23 Anghami has built an innovative offering that caters directly to local tastes; for example, it has Arabic language functionality across its platform, exclusive deals with the region’s largest artists, and several partnerships with local media and telecom networks. The company is also mobile-first, with 95 percent of its consumption occurring on mobile devices. As the region’s access to 3G and 4G data is expected to double between 2015 and 2020, the music streaming user base will also increase, leading to significant room for further growth of Anghami and similar services.

3.3 Last-mile delivery and logistics
As many consumers in MENA lack traditional home addresses, last-mile delivery can be a costly and time-consuming exercise. Fetchr, a Dubai-based company, uses smartphone GPS technology to accurately locate users for package delivery. Fetchr and other similar services, such as what3words, offer solutions catered to developing markets by overcoming contextual infrastructure barriers. As industries such as e-commerce continue to grow rapidly in the region, solutions that address infrastructural shortcomings will prosper from complementary effects. Global investors have begun to understand this concept, highlighted by Fetchr’s recent $41 million Series B financing round. 24

3.4 Fintech
According to Payfort, a Dubai-based payment processing company owned by Amazon, the region saw a 23 percent increase in online payments even back in 2015—suggesting the fintech space is growing quickly, particularly in leading countries such as Saudi Arabia, which exhibited year-on-year growth of 40 percent. 25 In this context, and enabled by the growth in e-commerce, locally owned digital payments start-ups have sprung up across the region.

**Exhibit 6:**
**Fintech activities are intensifying**

<table>
<thead>
<tr>
<th>$50mn</th>
<th>Investments in 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>2X</td>
<td>The increase in fintech investments up to 2016 but still &lt;1% of global investments</td>
</tr>
<tr>
<td>105</td>
<td>Fintech start-ups in 2015 up from 30 in 2011</td>
</tr>
<tr>
<td>50–60%</td>
<td>Compound annual growth rate for UAE fintechs over 4 years up to 2016</td>
</tr>
</tbody>
</table>

**Rise of accelerators and funds**
- Fintech Hive at DIFC
- Fintech Factory by Payfort
- Fintech VC fund and accelerator

**Change in regulations**
- RegLab: First fintech regulatory framework and sandbox
- Sandbox and licenses for nonbanks

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For example, Fawry, launched in 2010, is an Egypt-based, multichannel digital payment platform that enables customers to transfer money without the need for a bank account. It operates in more than 65,000 locations and has a presence across a multitude of channels including online, ATMs, mobile wallets, and brick-and-mortar retail stores. Fawry has used its local knowledge and network to build partnerships with several retailers, including a range of small businesses such as groceries, pharmacies, and post offices. Each partner is equipped with adapted point-of-sale machines—advances notoriously difficult to make for a non-local company. Fawry claims more than 20 million customers, performs more than 1.5 million financial transactions daily, and processes $113.2 million annually in payments. As connectivity grows in the region and smartphone penetration increases further, the payments market is poised to grow rapidly, with Fawry in prime position to gain even more ground.

Payfort (now an Amazon company post acquisition) has grown into one of the leading payment platforms in the Arab world. It claims a wide array of partners, including Jumbo Electronics, talabat.com, and Air Arabia. It has regularly updated its offering to cater to specific segments; in 2015, it acquired White Payments to fast-track the online payment options of start-ups and small businesses. At the same time, it has successfully delivered broader innovative products and services, such as the recent card-on-delivery for UAE customers and merchants.

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PayTabs, a Saudi alternative payment solution gateway with a head operations office in Bahrain, has placed a strong emphasis on fraud prevention in e-commerce transactions. PayTabs helps its clients reduce the payment bottleneck from e-commerce transactions and provides more than 130 alternative payment options. It has gained a strong foothold in the market: in 2017, the company raised $20 million in financing to facilitate its expansion to 20 markets in MENA, Africa, Europe, India, and Southeast Asia.  

3.5 Travel
Wego is MENA’s largest travel search engine. Founded in Singapore in 2005, Wego has grown to generate more than $1.5 billion per month in booking referrals to its various partners. Initially the company focused on local preferences, with a strong emphasis on being mobile-friendly and using its network to build partnerships with local travel agents, airlines, and hotels. It has since invested in innovative solutions, such as its progressive web app, which has led to an increase of 35 percent in average time spent on its iOS app, and the use of advanced analytics to better target customers.

In August 2017, MBC (MENA’s largest multimedia company) invested in Wego through a deal worth $12 million. This strategic partnership should allow Wego to harness MBC’s various digital platforms to reach millions of local customers using video content and product merchandising. With significant consolidation in the global travel search engine market as dominant players such as Expedia and Priceline spread their weight, MBC’s investment shows confidence in a service that caters to local tastes.

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28  “PayTabs raise $20M investment,” ArabNet, August 22, 2017, news.arabnet.me.
4. The MENA venture capital ecosystem to support entrepreneurship is flourishing

The VC investment ecosystem in MENA is thriving. Incumbent VCs have ramped up activity, while new VCs have emerged from both within and outside the region. We estimate the total number of VC-like investors in MENA grew from just nine in 2008 to 145 by the end of 2016. Of these investors, significant classes include regional and international VCs actively investing in the region, as well as accelerators, incubators, and angel investors (Exhibit 7).

Exhibit 7: MENA incubators, accelerators and co-working spaces (illustrative and non-exhaustive)

As the number of investors increases, of course, so too does capital access for entrepreneurs and early-stage companies. Indeed, total funding in the region has increased significantly, from $53 million in 2014 to $410 million in 2017 (Exhibit 8), as investors such as Middle East Venture Partners (MEVP), STC Ventures, Turn 8, and Wamda Capital have raised significantly sized funds. The number of deals doubled, from 131 in 2014 to 258 in 2017, and average ticket size also increased, at a compound annual growth rate (CAGR) of 54 percent from 2014 to 2017.

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32 Note: Deals sourced by Careem and SOUQ have been excluded from the data because they disproportionately skew the figures, with deal sizes of $275 million and $350 million, respectively.
These additional investments are generating outsized returns for investors. Souq.com, the region’s largest e-commerce player (which was recently acquired by Amazon for $650 million), generated a return of more than 50 percent for its consortium of international and local investors—including Baillie Gifford, IFC Venture Capital Group, MENA Venture Investments, and Tiger Global Management—despite a lower valuation relative to its previous round. The acquisition also brought several strategic advantages to the region such as an established logistics and fulfillment service and a full-fledged, operational payments platform.

4.1 Corporate venture capital is becoming increasingly relevant

While VCs in general are proliferating, CVCs in particular are rapidly emerging in the evolving MENA investment ecosystem. CVCs take diverse forms; they can be anything from “outsourced R&D departments” to investment vehicles nearly indistinguishable from a traditional VC. Interestingly, the CVC structure seems especially suited to MENA’s nuances. The competitive advantage for CVCs relative to their VC counterparts is typically their ability to leverage parent company synergies and scale in attracting and growing the most promising start-ups. CVCs can offer start-ups key value-added advantages, from operational support and customer and distribution access to fast-tracked exit options. In a start-up ecosystem still disadvantaged by typical emerging market shortfalls, CVCs’ value proposition of rapidly scaling new ventures can be attractive for budding entrepreneurs.
And indeed, in 2015 and 2016, 12 new CVCs entered the MENA market (Exhibit 9). Notably, Saudi Telecom’s STC Ventures was among the largest external investors in ride-hailing unicorn Careem, especially in the Seed, Series B, and Series C rounds.  

Exhibit 9: 
Investors in MENA are increasing

Accordingly, corporate VC AUM grew by more than 660 percent from 2012 to 2017, reaching one-fifth of total MENA VC AUM (Exhibit 10). The lion’s share of that growth came from 2016 to 2017, and we expect CVC funding to further increase in 2018 and beyond, given average ticket size in 2017 for CVCs was $29 million—more than double the average in 2016. CVCs are clearly expressing heightened interest in MENA start-ups.

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4.2 Government-led initiatives are focusing on ecosystem growth

Augmenting the private sector’s increasing involvement in MENA start-ups, government-led efforts to catalyze digital entrepreneurial growth have emerged across the region. From targeted, VC-like investment funds to structured incubator and accelerator programs, public institutions are playing an increasingly key role in the start-up ecosystem. Examples include:

- **UAE:** Fintech Hive at DIFC, Abu Dhabi Global Markets RegLab.
- **Saudi Arabia:** The government has set aside SAR 2.8 billion in public sector stimulus for a government VC to support angel investors and private-sector VC funds. Furthermore, the sovereign wealth fund has a fund-of-funds that will invest in VC and PE, and the government has created an SME authority with a mandate to develop the whole entrepreneurship and SME ecosystem beyond just financing—for example, improving ease of doing business, demand stimulation, business support, innovation, culture, and education.
- **Egypt:** Fintech Factory by Payfort.
- **Morocco:** Morocco’s capital of Rabat is home to several start-up spaces. The government has launched programs to support organizations and incubators aimed at promoting social entrepreneurship, and it has succeeded in improving the creation of social enterprises.
- **Kuwait:** National Fund for SME Development.
- Bahrain: home to a Fintech VC fund and accelerator, with a specific Regulatory sandbox and tailored licenses for fintechs.
- Jordan: The Central Bank of Jordan and the World Bank have partnered to launch the Innovative Startups Fund, which will pool US $98 million in early-stage financing for innovative start-ups and SMEs with high growth potential.35
- Lebanon: Central Bank of Lebanon start-up fund.
- Tunisia: The “Startup Act” is a draft law to encourage the establishment of a new legal framework and an ecosystem conducive to the emergence of innovative start-ups.

The UAE, currently ranked 26th in the Global Entrepreneurship Index,36 has been a MENA pioneer in its start-up ecosystem development efforts (Exhibit 11). New initiatives with innovative value creation theses, such as the Dubai Future Accelerators, harness public- and private-sector staff, expertise, and mentors to help companies from around the world address local opportunities in a variety of digital sectors, without any requirements for a financial stake. Participating start-ups have seen great successes—with 64 percent of companies progressing to later-stage investments.37

Exhibit 11:
UAE efforts

SOURCE: Wamda Research Lab's Country Insight 2015, Venture capital in the Middle East, MENAScape

Saudi Arabia’s government has similarly committed to significant investments both globally, through the Vision Fund, as well as through other entities like the SMEA. The joint effort by Japan’s SoftBank Group and Saudi Arabia’s PIF has created the world’s largest fund (with more than $93 billion raised to date), to invest in technology sectors including emerging tech such as artificial intelligence and robotics.38

The Central Bank of Lebanon has launched multiple initiatives, including the setup of EntrepreneursLebanon.com. This central online platform provides multiple services, including entrepreneur collaboration spaces, connections with investors and funders, information on support organizations, and a calendar listing local and regional entrepreneurship-focused events. The Central bank promises $400 million worth of investment in the knowledge economy, of which $200 million is a recent new commitment to help guarantee Lebanese commercial banks’ direct investments in local start-ups or VC funds.39

4.3 Exits are a key challenge in the region
Over 2012-2017, 60 MENA start-ups have exited at an estimated valuation of approximately $3 billion in aggregate.40 However, the majority of exits in the region are strategic exits—direct equity sales to large, family-owned groups or multinational companies. The predominant exit valuation for over one-third of the region’s exits was between $10 million and $20 million.41 Overall, more than 60 percent of the disclosed deals were for less than $50 million.42 Some notable examples were Amazon’s acquisition of MENA-focused Souq.com;43 Alabbar Enterprises’ purchase of the UAE’s JadoPado;44 Delivery Hero’s trio of acquisitions, including Turkey’s Yemeksepeti, as well as Kuwaiti food delivery companies Talabat and Carriage;45 Tiger Global Management’s acquisition of the daily deals website Cobone.com;46 Thomson Reuters’ purchase of the business information portal Zawya;47 and Japan’s Cookpad taking over the Lebanese recipe website Shahiya.48

In contrast, public listings, or IPO exit opportunities, are limited in the region. Of the more than 1,000 IPOs around the world in 2016, less than 10 percent were on exchanges in the

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41 Magnitt News, “Startup fever.”
42 Magnitt News, “Startup fever.”
46 Triska Hamid, “Daily deal website Cobone has new owner,” National, December 7, 2014, thenational.ae. Note: Cobone has since been purchased from Tiger Global Management by Middle East Digital Group for an undisclosed amount.
Middle East.\textsuperscript{49} Across MENA, the IPO market readiness is low relative to more developed markets, lacking depth and maturity.

Varying factors impact the IPO readiness, such as regulatory hurdles, types of institutional investors involved, valuation potential, exchange listing standards, and fees. Regulatory readiness remains a critical hurdle to be overcome in MENA, where currently highly complex procedures and high tax rates involved in exits act as a major deterrent to the process. One common example is the 20 percent capital gains tax imposed in Saudi Arabia on foreign parties exiting their shares in unlisted companies.\textsuperscript{50} Moreover, a lack of uniform transparency and disclosure hinders overall start-up investment in every stage, especially exits.

\textsuperscript{49} Global IPO trends: Q2 2017 Investor confidence is growing, Ernst & Young, 2017, ey.com.

5. Six best practices for start-up ecosystems players to turbo-charge MENA entrepreneurship

Overall, the ecosystem supporting the growth of MENA's digital entrepreneurship potential has been falling into place, with thriving demand, bolder entrepreneurs, proliferating VC firms, and increased government enablement. However, to unlock all its entrepreneurship potential, we recommend that all public and private investors—including VCs, CVCs, family offices, public entities, and so forth—adopt six best practices.

5.1 Develop robust investment theses leveraging local context

The first of the core elements essential to succeeding in emerging entrepreneurial ecosystems is to craft investment theses that provide a disproportionate ability to create value. Investment theses will guide investors and entrepreneurs in their investment decisions and allow local investors to establish their goals in the MENA context. The right thesis not only capitalizes on the investor’s distinctive value proposition (aside from capital), but also helps attract the right investment talent and LPs. Four prominent types of theses include insight-driven, vertical-driven, asset/capability-driven, and geographic-driven (Exhibit 12). Each is borne of a different set of beliefs.

Exhibit 12: Types of investment theses (outside-in view)

<table>
<thead>
<tr>
<th>Types of investment theses</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insight-driven</td>
<td>VC believes it has insight on how start-up space will evolve and where future value will be created. Union Square Ventures looks for network effects: “Large networks of engaged users, differentiated through user experience, and defensible through network effects.”</td>
</tr>
<tr>
<td>Vertical-driven</td>
<td>VC believes in growth of a specific vertical and therefore hires top investment minds in specific vertical. Deep Space Ventures focuses on eSports: “How big the eSports market is... how early we are in the evolution of the market, how fast it is growing, and how intensely passionate the individuals who comprise this market are about playing, improving, and following the space.”</td>
</tr>
<tr>
<td>Asset/capability-driven</td>
<td>VC invests where it can add disproportionate value from its own assets or portfolio, or the start-up can add disproportionate value to investor’s portfolio. Typical of CVCs. Intel Capital invests in start-ups with strong core value: “…focus on investing more money in fewer start-ups that are strategically aligned with the company’s lines of business, moving away from chasing opportunities based solely on their financial returns…”</td>
</tr>
<tr>
<td>Geographic-driven</td>
<td>VC invests in geography it believes is under-invested in and holds much promise. Typical of emerging market VCs. SAIF Partners focuses on India: “The $350 million fund... was now focused only on the home country and its buzzing start-up ecosystem.”</td>
</tr>
</tbody>
</table>

SOURCE: Deal Street Asia, Intel Capital, Deep Space Ventures, Union Square Ventures

5.2 Capture and proactively engineer network effects

The start-up investment landscape reveals the power law distribution in practice: returns are concentrated in a select cadre of start-ups. For that reason, co-investing with other funds can allow for a healthy pipeline of deals while minimizing downside risk associated with the seed level given that investments are diversified across a larger number of potentials hits (and misses).
In Silicon Valley, for instance, larger-scale, top-performing VC firms tend to have higher levels of deal syndication than single-investor CVC firms (Exhibit 13). Accordingly, these network effects likely lead to significantly higher deal flow—that is, more business proposals and investment offers. Investors across MENA can adopt a similar approach, overcoming structural gaps in the current landscape by putting additional effort in maintaining a broad and diverse set of deal partners.

Exhibit 13:
Top performing VCs have significantly higher deal syndication – broad deal flow is critical to success

In addition, for investors, the benefits of network effects extend beyond deal flow syndication. As generations of start-ups graduate from seed to revenue-generating growth ventures, they become active and passive assets within their networks. In leading global accelerator Y Combinator, for example, program graduates become mentors to later cohorts of aspiring founders.

To date, a limited number of public and private players in the MENA ecosystem have engaged in network engineering. In Saudi Arabia and the UAE, some government initiatives and programs have connected all stages of the start-up life cycle, from support to innovation and seed-stage, to early-stage incubators and accelerators, to revenue-generating and SME development programs. In the VC space, some entities have similarly taken a multistage approach to partnerships with other entities, building deal flow ranging from seed and early-stage through active VC investing on later-stage ventures. For example, Flat6Labs and Sawari Ventures have maintained a portfolio of investments across these stages to engineer their own microecosystem.
5.3 Invest at scale

The capital managed by the ten largest US VC firms has doubled over the past decade, bringing myriad advantages. Economies of scale within a fund can be leveraged to acquire and retain better talent, as well as to expand a quality network with strong links between VC general partners and entrepreneurs to boost quality deal flow and exploit synergies within the portfolio or parent company.

As a result, such scale has led to the largest funds generating top-quartile internal rate of return (IRR) performance relative to smaller funds. Over the past several decades, the top 5 percent of US VC firms by measure of AUM have, on average, been more than twice as likely to be top performers relative to the smallest 75 percent of US funds by AUM (Exhibit 14).

**Exhibit 14:**
Frequency of top quartile performance

<table>
<thead>
<tr>
<th>Frequency of top-quartile performance among US VC firms, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest 5% of funds in each vintage</td>
</tr>
<tr>
<td>Smallest 75% of funds in each vintage</td>
</tr>
</tbody>
</table>

Indeed, a breakdown of US VC funds by AUM further reveals the IRR performance gap enjoyed by the top 5 percent (Exhibit 15). While funds in the three smallest quartiles performed in the top quartile less than a quarter of the time, the largest quartile of US VC funds by AUM exhibited disproportionate top-quartile IRR performance of 32 percent. Narrowing down to the top 5 percent of US VC firms by AUM, an impressive 41 percent of the largest firms exhibited top-quartile IRR performance.
Investors across MENA must integrate this key lesson: investing with scale is more likely to sustainably yield significant returns in the long run.

5.4 Invest and manage performance with a patient, programmatic growth mind-set

Too often, traditional VC investors take a short-term approach to IRR expectations. Adjusting the typical investment horizon from short-term earnings to medium and longer-term gains will require a shift in mind-set in the region’s ecosystem players, especially public investors and CVCs. Typically, CVCs face annual and quarterly targets, whereas VC return horizons are much longer (8–12 years). Growth without discipline can lead to bloated portfolios that lack focus and the ability to adapt rapidly to shifts, such as technological advances and contextual changes in the region.

Instead, performance should be managed by setting and monitoring investment progress against specific key performance indicators (KPIs) that address strategic, operational, and cultural issues.

The approach of four large Chinese firms to investing in US technology companies has demonstrated that a patient, disciplined, and programmatic strategy can create significant value in the medium to long term. From 2011 to 2017, these four Chinese firms increased their investments into US tech companies at a CAGR of 24 percent (Exhibit 16). The more than 800 deals involved $8 billion in focused capital.
Exhibit 16:  
The number of Chinese-backed deals from 2011 to 2017 had a CAGR of 24 percent

Chinese-backed deals into US tech companies, # of deals by year

SOURCE: PitchBook

5.5 Secure investment independence in governance, to win right talent

It’s crucial for VC firms to separate core business KPIs and earning expectations from VC investments. CVCs, in particular, often find it difficult to find the right governance balance. On the one hand, CVCs need to let the start-ups and VCs operate with enough independence to move rapidly. On the other hand, a system has to be in place to ensure that the investments made align with the strategic objectives of the parent. In addition, the metrics used for start-ups (adoption, traction, etc.) are significantly different from usual financial metrics adopted by corporate investors.

Getting governance right is critical and requires balancing between two equally important objectives: ensuring the independence of investors while aligning them with the cause, and maintaining an independent investing body allocating capital independently of the investors who contribute funds. Firms’ widespread use of the “2+20” fee (that is, 2 percent of total asset value and 20 percent of any profits earned) and carry incentive schemes underlie these governance models—focusing incentives on variable, performance-based compensation to ensure general partners are focused first on generating returns.

VC talent is rare, and it requires much different talent acquisition, retention, and performance management/compensation methods. These may not automatically align with corporates existing setups and getting the governance right to attract the right talent requires a concerted effort. MENA investors must bear this in mind as they optimize for getting governance right.
5.6 Monitor KPIs in line with value creation model

From the onset, VCs need to consider what KPIs to track for the investment made. Typical VCs are usually financially driven by IRR or cash in simple terms. However, some theses-driven VCs should have a strategic KPI to facilitate investing in a particular start-up, be it exposure to a certain sector or stage of funding.

In general, CVCs have a much broader set of KPIs than other investors (Exhibit 18). In addition to pure financials, CVCs factor in whether and how a potential investment ties in with their overall strategic vision. For instance, what synergies can the parent company drive in terms of complementing products? How can it help mitigate risks via industry diversification? How can it help be a disruptive innovator? Another traditional CVC KPI relates to the organizational impact of an investment. How can the employees of both companies interact with each other? Is there a way to facilitate technology and knowledge transfer between them? How can a parent gain from the faster pace innovation timelines of a start-up so that it become more agile?

Exhibit 17:
Typical VC, CVC KPIs

<table>
<thead>
<tr>
<th>Financially focused CVC &amp; VC</th>
<th>Core-driven CVC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial</strong></td>
<td><strong>Core-driven CVC</strong></td>
</tr>
<tr>
<td>• Internal rate of return (IRR)</td>
<td>• Internal rate of return (IRR)</td>
</tr>
<tr>
<td>• Cash-on-cash returns</td>
<td>• Cash-on-cash returns</td>
</tr>
<tr>
<td>• Net asset value</td>
<td>• Post-acquisition ROE</td>
</tr>
</tbody>
</table>

| **Strategic**                 | |
| • Proportion of deals in line with sector/stage investment thesis | • Strategic moves (complementary products, services, market/segments access, operational improvement) |
| • N/A                         | • Network expansion (build and use partner network, start-up ecosystem) |
|                              | • Risk mitigation (industry diversification and strategic hedging vs disruption) |

| **Organizational**            | |
|                              | • Knowledge (ie, integrate technology and market knowledge into core) |
|                              | • Employee engagement (eg, involvement in cross-unit activities) |
|                              | • Corporate innovation (eg, new initiatives, products and features, R&D, etc) |
6. Conclusion

Given MENA's strengthening digital presence; demographic shifts toward a younger, tech-savvy population; and the exponential evolution of technology, digital consumption in the MENA region is growing exponentially. However, the digital entrepreneurship landscape has remained limited, as the bulk of the region's digital potential is not being tapped and exit options are limited for start-ups that have ventured into the digital space. Furthermore, competition from foreign players is eating up a major chunk of the market.

That said, we are in the midst of an uplift of digital entrepreneurship in MENA, with visible acceleration in the number of start-ups and funding opportunities, especially through CVCs. However, the coming of age of entrepreneurship in the MENA region will hinge on the right enabling environment to support investor financing, growth, and value creation. To unlock the start-up system, private and public investors must play an active role and take deliberate and concerted actions regarding investment theses, networking, growth mindset, investment scale, governance and performance management. The best practices offered in this article are just the beginning—but they form a crucial foundation for the future of investment in MENA entrepreneurship.
About the authors

Omar El Hamamsy is a senior partner in McKinsey’s Dubai office. He leads McKinsey’s Telecom, Media & Technology practice for the Middle East region, as well as co-leads the firm’s entrepreneurship practice in the Middle East.

Abdur-Rahim Syed is a partner in McKinsey’s Dubai office. He is part of the Telecom, Media & Technology practice, as well as Digital McKinsey. He co-leads McKinsey’s entrepreneurship practice in the Middle East.

Luay Khoury is an associate partner in McKinsey’s Dubai office. He is part of the Telecom, Media & Technology practice, and co-leads McKinsey’s Advanced Analytics service line in the Middle East.

Ahmad J. Alkasmi is an associate in McKinsey’s Dubai office, and specializes in innovation and entrepreneurship topics across the Middle East and North America.

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Contacts

Omar El Hamamsy
Omar.El.Hamamsy@mckinsey.com

Abdur-Rahim Syed
Abdur-Rahim.Syed@mckinsey.com