UNLOCKING THE POTENTIAL OF THE MOROCCAN PRIVATE SECTOR

An analysis of firm dynamics and productivity

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EXECUTIVE SUMMARY

Context and Objectives

A more dynamic private sector with enhanced productivity is essential if Morocco is to realize its development ambitions. Before the COVID-19 pandemic, Morocco had enjoyed two decades of economic growth, resulting in notable socioeconomic advancements. However, growth has been decelerating since the 2000s, driven by a productivity slowdown. As a result, the labor market has struggled to generate enough jobs for the expanding workforce, causing a drop in labor force participation rates.

The 2021 New Development Model (NDM) identified solutions to address these challenges and propel Morocco toward more ambitious objectives, including doubling per capita income and significantly increasing the proportion of formal employment by 2035. The NDM recognizes that a more dynamic private sector will have a pivotal role in achieving these targets.

Morocco has implemented a vast array of policy interventions to support private sector–led growth and job creation. Reforms have sought to improve the business environment, by making it easier to create a business, obtain permits, digitalize business procedures, and obtain financing. These policies led to considerable results, fostering the growth of new businesses and encouraging their formalization. However, the structure of the Moroccan private sector remains dominated by micro and small firms, a small share of large companies, and a large informal sector. Du to lack (until recently) of available microdata, the underlying dynamics of firms, as well as their productivity and performance remain poorly understood. A better understanding of firms' dynamics is critical to inform the design of public policies to accelerate economic growth and job creation in Morocco.

This note exploits the dataset compiled by the Observatory of Very Small, Small, and Medium Enterprises (OMTPME), an institution created by the Central Bank and its partners in 2016. OMTPME collects and harmonizes data from key public administrative sources, based on firms' identifiers and periodic declarations: the tax administration (Direction Générale des Impôts (Tax Administration [DGI]), the social security fund (Caisse Nationale de Sécurité Sociale [CNSS]), the central bank (Bank Al Maghrib [BAM)], the Ministry of Industry and Commerce (Ministère de l'Industrie et du Commerce [MIC]), the Moroccan Office for Industrial and Commercial Property (Office Marocain de la Proprieté Industrielle et Commericiale [OMPIC]), and the national agency for the support of SMEs (Maroc PME). The OMTPME dataset covers a panel of roughly 370,000 registered corporate firms, with data from 2012 to 2022. This policy note is the output of the first collaboration between the world Bank and the OMTPME. The analysis focuses on the period from 2016 to 2019, preceding the COVID-19 pandemic and the subsequent policies introduced to mitigate its impact, which may have produced effects that are challenging to interpret for the years 2020-2022.

Key Findings

Morocco's firm density has increased significantly in recent years, thanks to a high entry rate and dynamism in business creation combined with an unusually low *de jure* exit rate. The recent evolution of formal firms' density compares favorably with most of its peers, although it is still far from advanced economies. The survival rate after five years is estimated at 53 percent and the official exit rate by deregistration is only 1.2 percent. However, the *de facto* exit rate, which captures firms that do not officially close but remain inactive for at least two years, is also unusually high, at 7.3 percent. This finding suggests that Moroccan entrepreneurs do not face excessive constraints to administratively start a new business but are reluctant to formally close them, opting instead for leaving firms dormant. This could be partly due to inefficient and costly bankruptcy and liquidation procedures.

Most formal firms in Morocco are small and grow slowly with age. Firms with 10 or fewer employees contribute to nearly 86 percent of employment in Morocco, compared with 35 percent on average in countries in the Organisation for Economic Co-operation and Development (OECD). Although firms do grow with age, the average size of all firms that have been in business for no more than 10 years is below 10 employees, and the average size of mature firms (firms that have been in business more than 10 years) is only 26 employees. The average size of firms has tended to decrease, which could be partly explained by the increased formalization of microenterprises, resulting from the implementation of public policies aimed at easing creation procedures and improving the business environment.

The density of high-growth firms (HGFs)— is very low in Morocco, contributing to insufficient job creation and the weak emergence of new large companies. As a result, incumbents are rarely challenged by new entrants. High density of HGFs is generally indicative of private sector dynamism and innovation. Recent literature shows that economies' net job creation tends to be driven primarily by the dynamism of HGFs, sometimes referred to as gazelles (Goswani, Medvedev, and Olafsen 2019).

The productivity performance of the formal private sector has been lackluster. The firm-level data used in this note suggest that the labor productivity of the Moroccan corporate sector has lagged that of the overall economy. This finding may be partly explained by the authorities´ success in gradually formalizing firms that previously operated in the informal sector. While formalization is a positive development, these newly formalized firms may have lower productivity levels than pre-existing formal firms. As a result, their transition to formal status could initially reduce the average productivity of the formal sector. However, this trend also evidences that more is needed to sustain productivity gains in the Moroccan private sector as part of the country's economic growth strategy.

Between 2016 and 2019, Morocco's nonagricultural formal private sector gradually became more services oriented. This trend increased labor productivity. Formal employment in the nonagricultural private sector gradually reallocated toward retail, education, and other services. Although fully assessing the contribution of structural transformation within the formal nonagricultural sector would require an analysis with a longer time horizon, results suggest that the sectoral reallocation of employment made a positive contribution to the productivity growth of the formal nonagricultural sector.

Labor tended to shift toward less productive firms in the years leading to the COVID-19 pandemic, a sign of allocative inefficiencies at the firm level.[1] Between 2016 and 2019, the productivity of the average Moroccan formal firms increased. However, the positive impact of this upgrading on the productive efficiency of the country's businesses was partially offset by the fact that less productive firms expanded faster (in terms of employment) than more productive firms, raising questions about allocative efficiency. This suggests that Moroccan markets do not allow more productive

[1] Firms' dynamics following the pandemic have been heavily influenced by the extraordinary exogenous forces at play since 2020, calling for caution in the interpretation of some of the changing trends observed from then onward. For this reason, much of the analysis presented in this note focuses on the 2016–19 period.

firms to access production factors efficiently, which could be due to shortcomings in the country's competitive environment.

The allocation of factors appears to be more inefficient in industry than in the services sector. The firm-level dataset suggests that labor productivity declined in the industrial sector, driven by a decline in allocative efficiency, coupled by an insufficient level of upgrading, which could be partly explained by a decline in the average quality of installed physical capital or by insufficient innovation and adoption of new technologies. By contrast, in the services sector, the reallocation of labor toward more productive firms made a modest but positive contribution to labor productivity growth.

The life-cycle dynamics of Moroccan firms point to the presence of significant market distortions. Older Moroccan firms are on average larger even if their productivity is lower than that of younger firms. Pointing in the same direction, larger firms are less productive than their smaller counterparts. Similarly, some indicators suggest that more productive firms are too small relative to their optimal size. This is another sign of allocative inefficiencies, which are likely to constrain the development potential of the Moroccan formal business sector and the growth prospects of the economy.

Despite the comparatively large size of the Moroccan credit market, lack of access to credit by many firms may be contributing to the misallocation problem. Credit is concentrated among larger and older firms, penalizing new entrants and potential market challengers.

Policy implications and Next steps

Over the long term, productivity is the key determinant of countries´ income level. Implementation of policies and regulations should therefore be a priority to foster economic growth and job creation :

The note highlights several important areas for potential interventions to help reach the country's growth objectives:

- Provide conditions for all firms to grow and for the most productive to thrive. Productive Moroccan firms, most of which are small or medium-size enterprises (SMEs), struggle to grow at their full potential and to challenge incumbents. This trend constitutes a disincentive to investment in innovation and competitiveness enhancement, which could hinder growth at the macro level. Policies could help ensure that more productive firms, including smaller and younger business have access to the resources they need to scale up their production. They could also ensure that firm's productivity is rewarded, through an efficient competitive environment.
- Evaluate indirect incentives to firms to remain small. International experiences show that size-based measures can incentivize businesses to remain small or keep part of their activities informal. A review of size-based incentives and their impacts could shed light on such effects in Morocco, especially related to tax regimes or active labor policies and business support.
- Encourage the exit of inactive firms. Too many firms stop operating without formally closing. Public policies should therefore ensure that the high rate of inactivity does not create inefficiencies in the economic environment by ensuring that bankruptcy procedures are efficient and that the legal and administrative procedures to close businesses do not impose an excessive burden on entrepreneurs.
- Morocco has focused on manufacturing-led development since the 2000s, with the emergence of sectors such as automobiles and aeronautics. Data show that aggregate productivity growth is primarily driven by the services sector and that more productive services firms grow more rapidly than less productive ones, possibly suggesting that this sector in Morocco is marked with less market distortions and greater allocative efficiency. Alongside industrial policies, Morocco could further leverage the development the services sector to deliver productivity growth and jobs by leveraging technology and connectivity.

Additional analysis will need to be conducted to inform public policies. The OMTPME database provides an invaluable tool to address key policy-relevant questions on how to overcome identified constraints. During the second phase of their joint analytical engagement, the World Bank and the OMTPME team intend to tackle the following research questions, leveraging the ongoing expansion of variables made accessible to OMTPME by partner administration departments:

- Analyzing the market distortions that are likely to have reduced allocative efficiency, benefiting older and larger firms at the expense of newer more productive ones. They may include shortcomings in the competition framework, obstacles to the entry and exit of firms, and constrained access to key inputs. A more granular sectoral analysis combined with a systematic review of product market regulations could help shed light on these distortions.
- Evaluating whether the structure of the corporate income tax, tax incentives, and other programs of public support for firms have contributed to the productivity performance and dynamics of Moroccan businesses. This analysis will try to determine whether measures are in place that incentivize businesses to remain small and whether incentives geared toward larger firms favor incumbents at the expense of the renewal of the economic fabric with new, more productive entrants.
- Sharpening the understanding of the characteristics of firms that manage to grow, including size, industry sector, market dynamics, and others. By identifying common patterns and unique attributes that contribute to firms' sustained growth, this analysis will provide insights that can help policy makers revitalize a critical segment of the corporate sector.
- Collecting more detailed information on the type and quality of physical capital used by Moroccan businesses, to understand why the increase in physical capital per employed worker has not translated into more robust productivity growth. This analysis could include a comparative analysis of productivity of firms with domestic or foreign capital.
- Reviewing the factors that explain the asymmetric access to finance for Moroccan firms.

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