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Wednesday 29 September 2010

Panel VI - SME Investments – The panel was moderated by **Richard Ensor** (RE), Managing Director, Euromoney Institutional Investor PLC, with the following panelists: **Walid Abdel-Rehim** (WA), Deputy Director, Cairo Office, KFW Development Bank, **Khaled Al-Gazawi** (KG), Chief Executive Officer, Agha Khan Agency for Microfinance, **Tamer Badreldin** (TB), Chairman, Badr Plastic, **Hanaa El Hilaly** (HH), General Manager, Planning and International Cooperation Group, The Social Fund for Development, **Nevine Loutfy** (NL), Managing Director and Chief Executive Officer, National Bank of Development, and **Adham Nadim** (AN), Executive Director, Industrial Modernisation Centre (IMC). Below are excerpts from the session.

RE: SMEs are one of the biggest employment creators in Egypt. Can we define what we are talking about when we talk about SMEs?

WA: It differs from one group to another. I don't see that there is one definition.

KG: SMEs are entrepreneur projects for micro-economic groups looking for borrowers. We say that it starts from companies with 5 employees.

RE: When do companies get too big to be SMEs?

KG: When they have paid back the first micro-finance loan, then we consider them to have outgrown the definition of SMEs.

NL: We define SMEs as companies that have an annual sale of anywhere between EGP 5 million to EGP 50 million.

HH: There is a lot of dispute over the definition of SMEs. Micro companies are defined as those with a capital of up to EGP 50,000 and SMEs are defined as those with a capital of up to EGP 1 million, but this definition differs from bank to bank. This is how banks define these companies.

TB: The definition varies some SME loans start at EGP 50,000, others at EGP 10,000. To be considered an SME business it should have an annual turnover of EGP 50 million, for medium sized businesses the turnover is anywhere from EGP 50-250 million per year; anything smaller than EGP 50,000 is considered a micro-company.

AN: 80% of the companies we serve employ less than 50 people. To me it's not really important to search for a definition; each institution has a different definition. The main idea is to ensure that we are addressing the needs of our target audience.

RE: There are some very different definitions of SMEs. SMEs always say they have problems with capital and the lack of capital available to them, whilst on the other side banks complain they can't find SMEs to finance. 75% of SMEs apply for loans, 95% of these companies have less than US\$ 2 million in capital, of these companies 90% are rejected for funding. What capital shortages are there, where are these shortages, and what problems are making these shortages worse?

HH: Access to finance is very important. SMEs are still seeking bank financing. There are 750,000 students graduating each year that are jobless. We need to go back to banks and look at their corporate customers. Funds are there; this is certainly not the problem, their funding of corporate clients makes it clear the problem is not one of liquidity. Social funds also have access to finance. So it's not that the money is not there.

NL: Banks deal with large companies. Special margins and structures streamlining the approval process need to be implemented to make the process less costly. We need certain infrastructures and collateral deposits; we need many changes for banks to be able to facilitate these loans.

KG: Banks are not looking at what micro finance has done in the market so far. We have helped them to move from micro finance to SME's. We look at our clients and their financial status. Banks are not willing to sit with owners and see them in the context of their specific business. They don't supply them with the support they need. You have to reach out to your clients and speak their language. We provide finance and have aligned with PDS.

RE: How much shortage in the capital available for SMEs is there?

TB: The problem is finding banks that will finance medium and long term projects.

RE: Adham you see a lot of borrowers. How do you decide who gets financing?

AN: There are many ways for SMEs to access finance, in addition to banks there are NGOs and of course the social fund. The segment of the market which has a real problem are those SMEs with a turnover of between EGP 15-100 million, and we are

not only targeting local investments, we are targeting foreign investments as well. This segment is having a lot of problems. At this size, banks want too much documentation. This sector has a real problem which is not being address

WA: Capital is there, the problem is that the capital for SMEs is too short. In 2007, reports said that banks were liquid and we shouldn't think about refinancing banks.

RE: What are the barriers to long-term financing?

WA: Banks prefer shorter-term loans because the risks involved in long-term financing are more risky. Now we are assessing the exact needs of our clients, and finding that they prefer short-term loans too.

NL: Credit enhancement programs should be introduced and some sort of guarantees should be in place. We should also consider the asset base SMEs create for the market.

RE: What are the institutions willing to implement these solutions?

NL: We are one of them and many banks are willing to do so too.

AN: A big portion of finance goes to real estate. The housing sector now has long leases, but there are still no mechanisms for supporting industry facilities. We need finance innovation; we should introduce bond bidding and stop locking up finances.

HH: We support long term loans to certain sectoral projects in the SME market, but we need new tools. Tenures should be extended but this depends on the sector, project and specifics of the company. In the real estate industry there is a lot of financing from international companies that can cater to the sectors need for long term funding.

KG: The issue of banks being involved is stagnant. The investment climate is not changing. For this change to happen we need to have trust, and we need vehicles that can help create this trust. This could be done by service companies that banks outsource to do this work for them and funding agencies who provide collateral for short to medium term loans. Look at Jordan. They started out with banks completely refusing to finance SMEs, but now we see they are fighting to get micro-financing.

RE: Are there enough SMEs looking for finance?

HH: 2.9 million jobs are being financed by SMEs.

RE: Isn't it about finding suitable SMEs to finance. Approximately 12% of SME borrowers default. So we have to say that we are financing the wrong borrowers don't we?

NL: There may be certain sectors where we can say that there is a high default rate amongst SMEs but usually borrowers are looking for short term funding to finance long term assets. The entrepreneur is desperate for financing but there is a mismatch. This is the most common reason for defaulting. Banks need to restructure.

AN: We need to support SMEs by offering credit guarantees, this doubles trust in our clients. All those rejected before being guarantee did not default after being guaranteed. The guarantee is an extra blanket, but it was not needed or used by banks.

## Discussion

1) Banks don't like to finance SMEs.

NL: I believe that we have to start thinking about them the same way we do corporate clients. There are tools to reduce default rates that we see in other countries which will reduce this rate down to 1-2%.

2) Banks are not reluctant to finance SMEs because of the default rate. The risk is actually very low if we look at portfolio risks, the way we do with corporate clients, we should look at SME portfolios as well. Profit is generated over a long period.

RE: If we have finance, what else do SMEs need?

TB: Labor, a lot of people want to work but there is a mismatch between those seeking employment and the jobs that are available in the market.

RE: You provide your workers with training?

TB: We provide them with training, but we would hope universities would start to provide this training at some point. 10.4% of graduates have technical education. We need to build a stronger industrial base. Education in Egypt is weak.

HH: We should be tackling access to finance through non finance services, like licenses. It used to take months to finalize a business license and now, with one stop shops, after one month a license becomes formal. We need feasibility studies, we need a non-commercial services package and collateral guaranteeing the SME. Access to markets need to provide these SMEs with better access to tools.

KG: We have to look at the other side of the coin, the ugly side. We have a department helping people register licenses, out of every 25 we try to register around 20 fail to register. The government is not helping register entrepreneurs, so people prefer to work outside of the system. SMEs need to learn how to run businesses away from haphazard practices, things like family businesses that have no book keeping, are common. We need to know how to make enough profit and get clients and make deals, we need capacity building. SMEs need to know how to create their own business plans, instead of relying on others to do it for them.

RE: What can the government and private sector do to help?

AN: Create incentives and help with legal procedures. The government is not helping small companies to legalize. With all mechanism we claim to have, if they had been working we would have abolished unemployment.

RE: Everyone is talking about one-stop-shops, but the government still employs some 9 million people. What are these one stop shops really doing?

HH: We need to be more announced. People don't know that finance and one-stop-shops are available. We need to create an advertising campaign that creates this awareness.

KG: We need trust, which will come through incentives and transparency. When you look at South East Asia, whose indicators compare to Egypt SMEs contribute to a large part of their GDPs and started the region has started to get trust from the public.

NL: I would like to see a small business administration for credit enhancement. The government must be serious about executing processes that streamline the legal and court system, there won't be trust in system of collateral until this happens. I would like to see CDC centers established and providing business and technical management for SMEs

RE: Why are the government and not the private sector responsible?

NL: The private sector is profit making and these are above normal risks.

RE: Is government going too far?

KG: Government should be moving faster, like with regards to social laws and labor wages. These laws have still not been passed. I would like to see more focus on support of the whole financial landscape. I would like to see the government subsidize venture capital. Banks by their nature have clients and are businesses.

## Discussion

RE: What should Egypt be doing to get more FDI?

AN: It's not just Egypt it's what everyone should be doing. Why don't companies help themselves?

HH: Citizens working abroad showed interest in working in their own country. This is a shortage of FDI and we should capitalize on this.

NL: Egypt should improve its ways of doing business. Egypt is still ranked 70 in the index of most difficult countries for doing business. It's still very difficult for FDI and we need to make it easy.

RE: The state of entrepreneurship is important for SMEs. What do we need to improve entrepreneurship?

Adham: Level field and facilitate people joining businesses.

RE: If it's too easy there won't be real entrepreneurs.

Tamer: We have a lot of obstacles. We have a lot of necessity but no innovation and high value added companies. We need media support, training education. Image is negative and doesn't encourage university students. There is no belief in entrepreneurship at mass level, as there are usually family businesses. We need to highlight success stories.

Hanaa: From government perspective we need to launch media campaign. The government should focus on enhancing entrepreneurship this will encourage bank financing. Open up channels in universities and sporting clubs, include entrepreneurship in the syllabus. Introduce proper incentives to get a 5 year tax break.

Niveen: Financing is available and this encourages entrepreneurs to exist.

Walid: Government should reduce employment opportunities. This ghost labor is driving people to entrepreneurship. Young grads need practical internship opportunities. There is something the government can do.

Khaled: In the short term we need opportunities. If opportunity is not there nor the tools to drive it, then there is nothing. Provide incentives. Let's leave financing to banks.