



CENTRAL BANK OF EGYPT
Egyptian Banking Institute



Access to Finance

Forms of Financing for SMEs in Egypt



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Foreword

Small and Medium Enterprises (SMEs) are considered one of the most important economic multipliers in any growing economy. In many ways, the SME sector is unique and faces distinct challenges. It has been the target of study, assistance and development aid by several parties, including governmental and non-governmental organizations as well as international donors. New mechanisms have been devised to develop this important sector and eliminate obstacles hindering its development, in order to push forward economic growth and development.

In Egypt, despite their contribution to the country's economy in terms of their sizeable share in production, employment generation and GDP, SMEs have not received adequate attention, particularly when it comes to their finance, particularly that access to finance is a major pre-requisite for a vibrant and fast growing SME sector. The EBI is aware that with the increasing competitiveness of the global market as a result of the credit crunch, the need for SMEs to grow and develop will undoubtedly exacerbate. Recognizing the implications of the financial crisis and the importance of the SMEs sector, EBI established an SME unit in January 2008 in order to facilitate their access to finance. This initiative aims at targeting both the banking sector and small and medium business owners to create a constructive dialogue between them and eliminate impediments where access to finance is concerned. EBI seeks to ensure that the financial sector is able to provide an increasing array of products and services for such an important segment of the economy.

The EBI MSME Unit is pleased to present the first study conducted on SMEs. This study is the first in a series of studies that will be published on a regular basis to provide MSME stakeholders with efficient information about this sector.

This study sheds lights on problems of access to finance that challenge SMEs. It is based on a number of individual interviews conducted on both the supply and demand side of the enterprise finance. While the study is based on a small sample, it offers some indications of the finance situation of SMEs.


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" PlaNet Finance, conducted interviews with SMEs and developed the report"

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الملخص:

تمثل المشروعات الصغيرة والمتوسطة العصب الرئيسي لاقتصاديات الدول النامية والمتقدمة لما تتميز به من قدره فائقة نحو إتاحة المزيد من فرص العمل للشباب ومكافحة البطالة، فضلا عن احتياجها لتكاليف استثمارية منخفضة تتواءم وإمكانات وطموحات الاقتصاد المصري لتحقيق أهداف خطط وبرامج التنمية الاقتصادية. وبالتالي بات من الضروري الاهتمام بتوفير البيئة المواتية منضمة تيسير التمويل ودعم وتطوير أداء تلك المشروعات كآلية فاعلة في منظومة التنمية المستدامة.

هذا وتهدف الدراسة إلي التعرف علي أهم التحديات والمشكلات التي تواجه قطاع المشروعات الصغيرة والمتوسطة في سبيل حصوله على التمويل الملائم لتلك المشروعات. وبالتالي تناولت الدراسة عرضا تحليليا لجانبي العرض والطلب متمثلا في الخدمات التمويلية من البنوك والمؤسسات المالية وكذا رؤية أصحاب المشروعات الصغيرة والمتوسطة في الحصول علي التمويل.

كما ناقشت الدراسة العديد من التحديات التي تواجهه تيسير التمويل، لعل من أبرزها، علي جانب الطلب، أن المشروعات الصغيرة والمتوسطة تفتقر إلى الكثير من المقومات التي تؤهلها للحصول على التمويل؛ كعدم توافر الضمانات الكافية والسجلات المالية المطلوبة، وكذلك عدم الإلمام بمتطلبات البنوك وكيفية إعداد دراسات الجدوى والخطط الإستراتيجية للمشروع. أما على جانب العرض، فتتلخص مجموعة التحديات في مطالبة البنوك للعديد من المستندات والضمانات التي لا تقوى تلك المشروعات على توفيرها، فضلا عن ارتفاع تكلفة التمويل وعدم توافر منتجات متنوعة تلائم طبيعة تلك المشروعات.

وقد أسفرت النتائج النهائية للدراسة إلي ضرورة وأهمية تنظيم حملات وبرامج تدريبية لرفع الوعي لدى أصحاب المشروعات الصغيرة والمتوسطة وإمدادهم بالمهارات اللازمة للتعامل بفعالية مع البنوك، وذلك بهدف سد الفجوة القائمة بين البنوك وأصحاب المشروعات الصغيرة والمتوسطة. هذا بالإضافة إلي أهمية تدريبهم علي كيفية إعداد دراسات الجدوى وخطط العمل وإعداد القوائم المالية البسيطة حتى يتسنى توفير الضمانات الكافية للحصول علي التمويل.

كما أفادت الدراسة بأهمية زيادة الوعي لدي البنوك بخصائص ومتطلبات المشروعات الصغيرة والمتوسطة ووضع الاستراتيجيات والسياسات الخاصة لتيسير التمويل لذلك القطاع، وكذا تقديم حزم متكاملة من الخدمات المصرفية تتلاءم وطبيعة تلك المشروعات.

Table of Contents

Table of Charts	7
Abbreviations and Acronyms	8
Executive Summary	9
Survey Objectives	10
Main findings	10
Main conclusions and recommendations	11
1. Introduction	13
1.1 Context of the study and expected outcomes	13
1.2 Methodology	13
1.3 Limitation of the Study	14
2. SMEs & Banks Profiles	15
3. Demand highlights	15
3.1 Purpose & Main Source of Financing	15
3.2 Access to Finance from other Sources	16
3.3 Use of Profits and Savings	17
3.4 Plans for Business Expansion	17
4. Thematic Issues	17
4.1 Financing Requirements and SME Qualifications	18
4.1.1 Banks' Requirements for Financing SMEs	18
4.1.2 SME Qualifications	18
4.2 Market Channels of Communication	19
4.2.1 Promotion of Banks' Products & Services to SMEs	19
4.2.2 SMEs Knowledge of Banks' products	19
4.3 Standardization & SMEs Desired Loan Features	19
4.3.1 Banks Standardization of SMEs Products	19
4.4 Loan Application & Rejection	20
4.4.1 SMEs Applying for Loans from Banks & Reasons for not Applying	20
4.4.2 Loan Application & Rejection by Banks	21
4.5 Banks' Products and SMEs Preferred Financial Services	21
4.5.1 Banks' Products & Services to SMEs	21
4.5.2 Preferred Type of Financing	22
4.5.3 Interests in Deposits, Saving, and other Investment Accounts	23
4.5.4 Interest in other Financial Services	24
4.6 Achieving SMEs' Growth Plans	24
4.6.1 SMEs' Perspectives on the Elements that Best Contribute to Achieving Growth Plans	24
4.6.2 Banks' Perspective on the Element that Best Contributes to the Growth of SMEs	25
4.7 Attitude & Relationship with Banks	25

4.7.1 SMEs' Access to Finance Compared to Micro and Larger Businesses	25
4.7.2 Banks' Preception of SMEs' Risk	26
4.7.3 Relationship Between SMEs & Bankers	26
4.8 SMEs' Views	27
4.8.1 Banks' Perspective	27
4.9 Information Needs	28
4.9.1 Information Needed by SMEs	28
4.9.2 Information that Banks should provide to SMEs	28
4.10 Additional Comments by Bankers	29
Conclusion	30
Policy implications and recommendations towards enhancing SMEs access to finance	33
Appendix	34
a) SME Profile	34
b) Banks Profile	37

Table of Charts

Chart #	Description	Page
Chart 1	Purpose of Financing	13
Chart 2	Liabilities and Fixed Assets	14
Chart 3	Willingness to Pledge Assets as Collaterals	14
Chart 4	Plans for Business Expansion	15
Chart 5	Bank Requirements	15
Chart 6	Sales & Profits	16
Chart 7	Promotion of Banks' Products to SMEs	17
Chart 8	SME Knowledge of Banks' Products	17
Chart 9	Standardization of Products to SME	17
Chart 10	Applying for Loans in the Past 5 Years	18
Chart 11	Loan Acceptance	18
Chart 12	Reasons for not Applying for Loans	19
Chart 13	Loan Application & Rejection	19
Chart 14	Reasons of Rejection	19
Chart 15	Products & Services to SMEs	20
Chart 16	Preferred Type of Financing – Bank Perspective	21
Chart 17	Interests in Deposits, Saving, and other Investment Accounts	21
Chart 18	Deposits, Savings, Investment offered by Banks	21
Chart 19	Interests in other Financial Services	22
Chart 20	Other Services offered by Banks	22
Chart 21	Ranking of Elements that Contribute to Achieving Growth Plan	23
Chart 22	Element that contribute to the Growth of SMEs –Bank views	23
Chart 23	Encouraging SMEs to Deal with Banks – SMEs Views	24
Chart 24	Encouraging SMEs to Deal with Banks – Bank Views	25
Chart 25	Age Distribution	29
Chart 26	Educational Status	29
Chart 27	Training Acquired	29
Chart 28	Experience in Business	30
Chart 29	Legal Structure	30
Chart 30	Family Partners	30
Chart 31	Profit Trends	31
Chart 32	Reasons for Increased Profits	31
Chart 33	Reasons for Decreased Profits	32
Chart 34	Size and Prospects of SME Lending Market	32
Chart 35	Existence of SME Unit	33
Chart 36	Drivers of Banks Involvement with SMEs	33
Chart 37	Obstacles of Banks Involvement with SMEs	34
Chart 38	SME Involvement with Banks	34
Chart 39	Risk Management Practices	35

Abbreviations and Acronyms

GTZ	German Development Cooperation
PSDP	Egyptian-German Private Sector Development Programme
EBI	Egyptian Banking Institute
PF	PlaNet Finance
FIs	Financial Institutions
SMEs	Small and Medium Enterprises
SFD	Social Fund for Development

Executive Summary

Survey Objectives

The main goal of this study has been to further investigate the difficulties that a significant number of Small and Medium Enterprises (SMEs)¹ claim having in accessing finance from banks. The key question at the core of this study is whether SMEs are experiencing difficulties in accessing bank finance due to issues related to the demand side and those related to the supply side. The research aims at providing a preliminary insight into the demand and supply-side processes related to SME bank financing in Egypt.

The survey is based on the outputs of interviews conducted by PlaNet Finance (PF) in collaboration with the Egyptian Banking Institute (EBI). It comprises of:

- 12 interviews with SMEs selected by GTZ
- 10 interviews with Egyptian Banks selected by EBI

Main findings

The main findings from the preliminary study on SMEs' access to finance can be summarized as follows:

1.0 SMEs Profile and Source of Financing

Interviewed SMEs are managed by highly educated and experienced entrepreneurs. The companies are formal institutions. The main purpose of financing for the majority of them is to strengthen their working capital. They prefer equity financing over debt financing.

Many of the interviewed SMEs did not use any form of leveraging through debt financing. Even for those leveraged businesses, the value of liabilities compared to their fixed assets can be as low as 7%; which indicates that the main source of financing for those SMEs is through equity. This can be justified as being due to the fact that SMEs believe that the cost of credit from formal institutions is too high. However, interviewed SMEs do not seek funding from sources other than banks. In an effort to secure their financial needs, SMEs re-invest the business profits as well as saving back into their businesses.

2.0 SMEs Growth Plans and Relation between Access to Finance and Profits

All of the interviewed SMEs have ambitious ideas about expansion. Ideas include: increased marketing, machinery upgrading, increasing production capacity and quality, innovation, land and building acquisition, and exporting. SMEs believe that the existence of supportive regulations is crucial to the success of their ideas for expansion. Moreover, the vast majority of SMEs believe that access to easier means of financing from banks will contribute significantly to improving their businesses. However, there was evidence that interviewed SMEs do not make a strong correlation

¹ More than 95% of all establishments in Egypt are SMEs. The definition of an SME in Egypt according to the **Law on Development of Small Enterprises** is as follows:

Article I: In the context of application of the provisions hereof, by a **small enterprise** shall be meant every company or sole proprietorship practicing an economic activity, whether productive, service-rendering or commercial in which the paid-up capital shall not be less than 50.000 L.E. and shall not exceed 1 Mio. L.E. and in which the number of employees shall not be more than 50 employees.

Article II: In the context of application of the provisions hereof, by a **very small enterprise** shall be meant every company or sole partnership practicing an economic activity, whether productive, service-rendering or commercial whose paid-up capital shall be less than 50.000 L.E.

The full text can be found at: <http://www.sfdegypt.org/law.asp>

between access to finance and profits. With regards to reasons of increased profit, access to more credit came in third after higher sales volume and new market opportunities. From the SMEs' perspectives, higher sales are driven by demand from the end consumer and not from acquisition of additional finance. None of the interviewed SMEs who reported decline in their profits associated it with lack of funding; instead they indicated that the decrease was mainly due to increases in input costs.

3.0 Banks' Requirements for Financing and SMEs Qualifications

Financing decisions made by interviewed banks rely on basic documents more than SME growth potential. 6 out of 10 banks indicated that 'existence of basic documents' (such as registration, license, tax card etc), as well as 'financial performance' of the businesses are the main requirements for financing SMEs. Only one bank highlighted the importance of the existence of 'business plans'. On the other hand, interviewed SMEs lack the existence of strong accounting systems. 100% of the interviewed SMEs have some form of accounting systems. However, these systems are very basic and produce unreliable financial statements, all of which reduce SMEs' abilities to meet the banks' requirements for financing. Also, declared profit margins of the interviewed SMEs are very low. The average profit margin (net after tax income / revenues) equals 8% and could go as low as 2% for some of the interviewed SMEs. This low level of profit margin provides a negative indicator regarding the efficiency of operations and can cause serious issues that will hinder their abilities to obtain finance from formal sources. Additionally, the majority of SMEs (75%) do not have business plans or feasibility studies; hence reducing their abilities to obtain finance from some formal institutions that require the existence of such documents.

4.0 SMEs Access to Credit

More than half of the interviewed SMEs did not apply for any loans over the past five years whilst a substantial minority did apply for loans and other financing facilities (mainly overdrafts). The rejection rate — reported by the interviewed SMEs — for those who applied was quite low and amounted for 20%. The reasons reported by the SMEs pointed towards the banks' policies. In some cases, the size of the loan requested was not approved or the SMEs did not have sufficient collateral to support the loan. Furthermore, the main reason for not applying for loans, according to the SMEs, was high interest rates and cost of credit. Also, according to a substantial minority of the respondents (40%), the loan terms were overall dissatisfying and there was often difficulties faced when dealing with the banks.

On the other hand, the average rejection rate—reported by banks—of SME loan applications was quite high: 66% of applications were rejected by banks during the last year. In one case, the rejection rate reached 98%. Weaknesses in management and the financial state of SMEs were among the main reasons of rejection according to 70% of bankers. Other reasons were bad credit history, lack of business plans and insufficient collaterals.

5.0 Banks' Products offered to SMEs

There are substantial numbers of banks that do not offer products that best fit the varying needs of SMEs. Half of the interviewed bankers indicated that the products they offer to SMEs are mostly standardized. However, almost one third indicated that they offer tailored, yet not diversified, products. The average desired loan amount for SMEs is a little more than 1.5 million L.E with SMEs preferring to pay off their debts rapidly; the average desired pay-back term is 3 years.

6.0 SMEs' Financial Services Needs

Interviewed SMEs are interested in a wide variety of financing options. The types of financing that attract the interest of most SMEs include venture capital, which was selected by 11 SMEs mainly because they welcome financing options based on sharing of gains or losses. The greater majority of SMEs also prefer trade finance, line of credits and overdrafts, leasing, working capital

loans, and letters of credit. Half of the SMEs prefer medium term loans, and a substantial minority prefers short and long term loans, factoring, business credit card, and bridge financing. With regards to other financial services, the majority indicated an interest in money transfer services and health insurance. Some are interested in property insurance and collection of receivables, credit insurance, wages and supplier payment, internet banking, and payment of taxes. In general, all banks offer the majority of the preferred types of financing to the SMEs in a standardized form with the exception of venture capital, which is offered only by one bank from the sample.

7.0 SMEs and Banks Perception regarding Financing SMEs

There is a wide spread belief among SMEs that it is more difficult for them to obtain financing from banks than smaller or larger size businesses. SME respondents indicated that banks are very difficult to deal with. However, one third of the respondents still have confidence in the ability of banks to serve their financial needs. Over 90% of the SMEs believe that banks are more risk averse towards SMEs. In their (SMEs) opinion, banks do not have a good understanding of the nature of SMEs' activities and their needs. Similarly, 9 banks agreed that it is easier to finance microenterprises or larger businesses rather than SMEs. In their point of view, larger businesses are more stable and less risky, with a sufficient availability of reliable, clearly structured and easily accessible information.

8.0 Banks' Perception of the SMEs Lending Market

Interviewed banks have mixed understandings of the SME market characteristics, which indicate that there is lack of a common understanding on the nature of the market. Consequently, this draws mixed policies from banks. Bankers indicated that factors (high risk and inefficient management) internal to SMEs remain the main obstacle to banks' involvement with the sector. Bankers admit that there are other factors—external to SMEs—that also discourages them from strengthening their involvement with SMEs such as: bank regulations that SMEs do not adhere to, SME lending technology and other bank specific factors. SMEs are mainly classified among the basic clients of banks, with the greater majority of respondents indicating that at least 75% of their SME clients are basic clients (using 1 to 3 products).

9.0 SMEs and Banks Perception of Closing the Gap

To encourage accessing financing from banks, SMEs are mostly interested in lower interest rates, less demanding guarantee requirements and simpler procedures for granting loans. The interviewed banks believe that SME development is linked to the regulatory environment more than facilitating access to finance. 70% of the respondents indicated that 'supportive regulations' is by far the most important factor in achieving the growth of SMEs. Only one bank indicated that it is actually 'access to easier means of finance from bank' that can contribute significantly to the growth of SMEs.

Main conclusions and recommendations

The above mentioned findings indicate that there are several issues at both the demand (SMEs) and the supply sides (banks) with regards to access to finance. While SMEs believe that they can further develop their businesses through easier access to finance, their preferred choice remains leveraging (through debt finance) as they believe that the cost of debt finance through banks is quite high. On the other hand, although banks clearly understand the importance of the SME sector as a profitable market, they lack strong understanding as to the true nature of the sector particularly with regards to the varying needs of SMEs. Moreover, in many cases, SMEs encounter difficulties in obtaining finance through the current schemes of the financial institutions due to the rigidity of these schemes in part and also because the SMEs lack the qualifications required by banks; such as reliable financial statement and efficient management.

In order to close the gap between the two sides, SMEs should start deploying sound management practices, developing strong accounting systems that produce reliable financial statements, and present the status of their businesses in a clearer manner. On the other hand, banks should get more information about the SME sector in an effort to understand the varying needs of SMEs and also set up the necessary infrastructure required to downscale their activities to be able to better serve this crucial sector. Additionally, improving the communications between the two sides of the SMEs' lending market is crucial to address the issues of access to finance; efforts should be made to bring the two sides together and provide them with information that will help each of them to better understand how to close business deals in an efficient and effective way.

1. Introduction

1.1 Context of the study and expected outcomes

Within its scope, the Egyptian-German Private Sector Development Programme (PSDP) does not provide financing to its target group, the private sector enterprises or the Small and Medium Enterprises (SMEs). However, the programme acknowledges the importance of access to finance for any successful venture. This preliminary study was developed by PlaNet Finance under the joint agreement between the PSDP and the SME Unit of the Egyptian Banking Institute (EBI). This study aims at providing an overview as to why companies in Egypt claim to lack access to finance.

The main goal of this study has been to further investigate the difficulties that a significant number of SMEs claim to have in accessing finance from banks. The fundamental question at the core of this study is whether SMEs are experiencing difficulties in accessing bank finance due to demand related issues or supply related ones. The research aims at providing preliminary insight into the demand and supply-side processes related to SME bank financing in Egypt.

Improving the access to finance of SMEs is extremely important in promoting entrepreneurship and innovation as well as improving the state of the national economy in Egypt. The ability of SMEs to more easily access suitable and sufficient means of finance has always been considered a major obstacle facing many SMEs in Egypt. Such financing is required to maintain growth and further support the activities of the SMEs. The majority of banks are becoming more risk averse towards SMEs, especially due to a wide spread notion that financing SMEs is risky and that serving them requires high transaction costs which makes them less profitable than the corporate sector.

The main underlying assumptions with regards to the issues on the demand side of finance provisions to Egyptian enterprises are: (1) companies lack information on available financial products, and (2) companies lack capabilities in assembling appropriate applications to financing. The study examines both the demand (SMEs) and the supply side-Financial Institutions (FIs). These were mainly the banks providing financing products and services to the SMEs that were interviewed. On the demand side, in-depth interviews with 12 SMEs were conducted. Also 10 other interviewed were conducted with selected banks.

1.2 Methodology

This study is preliminary in nature and was designed to provide a snapshot on issues related to SMEs' access to finance. It has applied PlaNet Finance's (PF) **Impact-Knowledge-Market (IKM) methodology**. This methodology is a training and action-research program methodology that uses qualitative and quantitative methods as part of a participative and multidisciplinary approach to identify the characteristics of the demand and supply sides of SMEs' finance.

PF developed structured questionnaires that combine a significant number of close-ended questions with a few open-ended questions. The in-depth interviews with the financial institutions were carried out by EBI; utilizing guidelines that were developed by PF. The in-depth interviews with SMEs were carried out by PF.

PF carried out 12 interviews based on a standardized questionnaire provided to select SMEs in Greater Cairo and Alexandria. Participants were selected by PSDP.

EBI carried out 10 interviews with Banks²

² 3 interviews with other FIs (Mortgage, Leasing, and Factoring).were conducted by EBI, but have been excluded from the analysis because of the quality of the information.

1.3 Limitation of the Study

Due the small sample size, the results of this study may be inconclusive. However, it provides useful information and initial indicators regarding issues related to SMEs' access to finance from banks, with an opportunity to be further examined in a more detailed study.

2. SMEs & Banks Profiles

In order to clearly understand the issues related to SMEs' access to finance, we need to have a better understanding of both the demand and the supply side. This section briefly discusses the main characteristics of SMEs—owners and business profiles— and gives an overview of the bank's perception regarding the SMEs market³.

The Interviewed SMEs are managed by highly educated and experienced entrepreneurs. Overall, the interviewed SMEs are very experienced in their fields with 10 out of 12 having at least 10 years of experience; and in some cases the experience extends to 30 years. On average, 75% of the interviewed businesses employ between 11 and 40 employees—excluding the seasonality factor. Over the past three years, the interviewed SMEs have witnessed an increase in the number of employees (except for one enterprise), suggesting that they have enjoyed growth during this period.

Interviewed SMEs are formal institutions: 100% of the interviewed SMEs are formal businesses and are registered entities with tax cards. The legal structure of one third of them is sole proprietorship and the other two thirds are basic partnerships in which family members are partners in 75% of the cases.

Banks that were interviewed have a diverse understanding of the characteristics of SMEs, which indicates that there is lack of a common understanding with regards to the nature of the market. This consequently draws mixed policies at the bank level. However, the vast majority of bankers (80%) believe that the market is quite large and holds good prospects.

Bankers indicated that factors internal to the SMEs (high risk and inefficient management) remain the main obstacle to banks' involvement with this sector. Bankers admit that there are other factors, external to SMEs, which impede banks from strengthening their involvement with the sector such as: bank regulations that SMEs do not adhere to, SME lending technology and other bank specific factors. SMEs are mainly classified as basic clients of banks; the greater majority of bank respondents indicated that at least 75% of their SME clients are basic clients (using 1 to 3 products).

3. Demand Highlights

This section illustrates some of the main demand side aspects of the access to finance equation. These include: the clarification of the main purpose and role of financing for SMEs and their preference regarding the source of finance (whether through equity or leveraging). This section also discusses ways in which SMEs use their profits and savings as well as their plans for business expansion.

3.1 Purpose & Main Source of Financing

The main purpose of financing for SMEs is to strengthen their working capital; 100% of them indicated that they use loans or other financing tools to finance their operating activities. Besides working

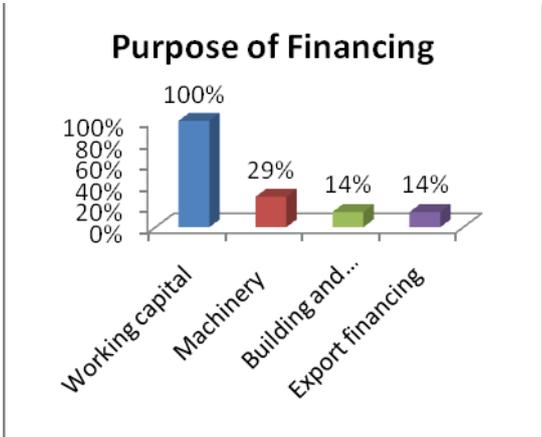


Chart 1: Purpose of Financing

³ More information regarding SMEs and Banks profiles can be obtained from the appendix.

capital, a noted minority of SMEs indicated that the purpose of financing is to upgrade their machinery and equipments, building land acquisition, and to finance their export activities.

SMEs Liabilities, Fixed Assets and Collaterals

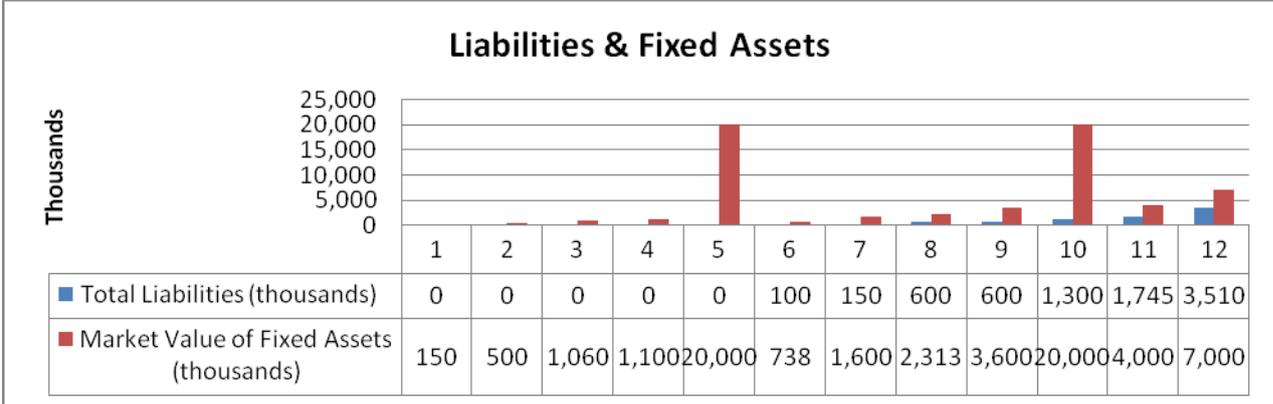


Chart 2: Liabilities and Fixed Assets

Five SMEs are not leveraged at all with zero liabilities. The range of liabilities varies between 0 and 3,510,000 L.E. and the average is 667,000 L.E. On the other hand, the overall range of the market value of the fixed assets ranges between 150,000 L.E. and 20,000,000 L.E. and the average is 5,172,000 L.E.

Although 7 of the interviewed SMEs reported that they have liabilities in their accounts, the amount of liabilities compared to the market value of the fixed assets varies between 7% and 50%, with most of them below 25%; all of which indicates that the main source of finance relies on equity instead of debt financing.

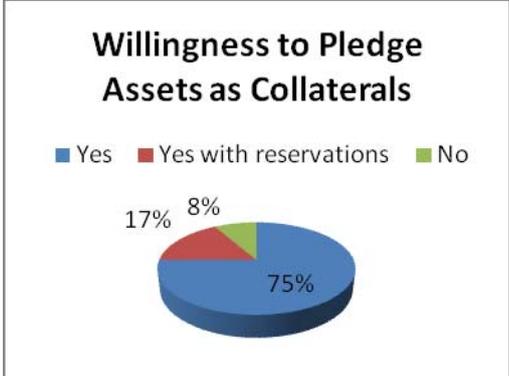


Chart 3: Willingness to Pledge Assets as Collaterals

75% of SMEs reported that they are willing to pledge their assets as collateral. Only one SME indicated that it would not be willing to do so and the remaining indicated that they were willing to pledge their assets as collateral but with some reservations regarding the banks’ requirements.

3.2 Access to Finance from other Sources

One quarter of respondents reported that they have accessed finance from sources other than banks (mainly private investors), who are usually friends or individuals from within their network. Even though the interest rate could go up to as high as 30%, the respondents still preferred this means of financing due to the agreeableness flexibility in the manner of the transactions. 2 of the SME respondents indicated that they prefer to deal with the Social Fund for Development (SFD), however, due to the tax benefits provided in the start-up phase.

3.3 Use of Profits and Savings

A great majority of SMEs indicated that they mainly re-invest their business profits as well as their savings back into their businesses in an effort to secure their financial needs. The remaining SMEs indicated that they also use the business profits for family or house expenses, or as dividends distribution.

3.4 Plans for Business Expansion

Improving marketing activities was noted to be the top priority for a substantial number of SMEs with regards to purposes of expanding their businesses.

A considerable amount of respondents highlighted this need as a prerequisite for growth.

About one third of the respondents believe that they need new machines to upgrade their production lines, whilst another 25% plan to increase their production capacity and acquire land and new buildings.

The remaining SMEs focus on innovation and on reaching the consumer as well as competing at both the local and international levels. Only one SME owner prioritizes quality, outsourcing, and an increase in the value added of local production as a growth factor.

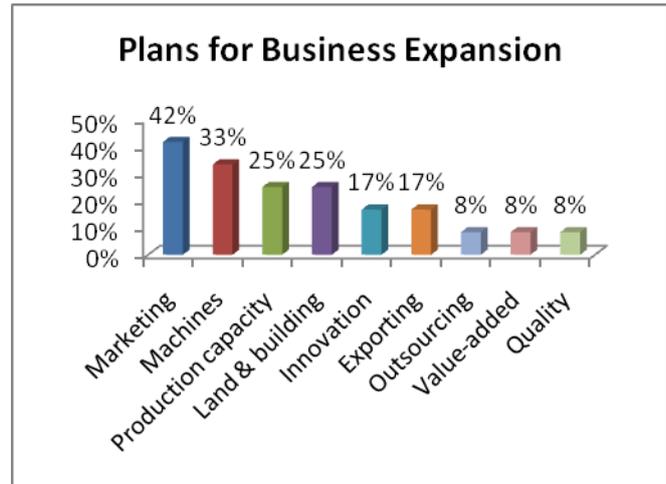


Chart 4: Plans for Business Expansion

4. Thematic Issues

This section provides a deeper analysis of the access to finance related issues from a thematic point of view; where different aspects of both the demand and supply sides are examined for each particular subject matter. Highlighted themes include:

- Financing requirements and SME qualifications
- Market channels of communications
- Banks' standardizations and SMEs' desired loan features
- Loan application and rejection
- Banks' products and SME preferred financial services
- Achieving SME growth plans
- Attitudes and relationship between SMEs and banks
- How to encourage SMEs to deal with banks
- Information needs

4.1 Financing Requirements and SME Qualifications

4.1.1 Banks Requirements for Financing SMEs

Six banks indicated that the ‘existence of basic documents’ (such as registration, license, and tax cards) and the reliability of financial statements, as well as the ‘financial performance’ of the business are among the main requirements for financing SMEs. Four banks indicated that ‘2-3 years of existence’ is a prerequisite for approving loans and 2 banks indicated that ‘potential market growth’ and ‘efficient management’ are important factors in the approval decision. Only one bank highlighted the importance of the existence of a ‘business plan’. The rigidity of these requirements may result in rejecting good business cases that are both feasible and have high potential. This is a significant issue for the industry regarding the success of the SME financing market.

4.1.2 SME Qualifications

Accounting Systems and Financial Statements

75% of SME respondents indicated that they maintain both manual and automated accounting systems; these automated accounting systems are either specialized accounting software or in the form of an MS Excel Sheet. The financial statements of the majority of SMEs were made for tax purposes and do not clearly represent the financial status of the business, which reduces SMEs’ abilities to meet bank requirements for financing.

Sales & Profits

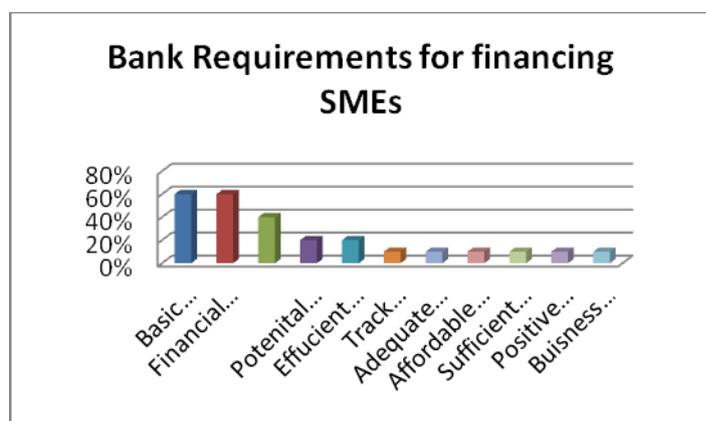


Chart 5: Bank Requirements

Reported declared sales of SMEs range from 400,000 L.E up to 15,168,000 L.E. On the other hand, reported declared profits are relatively low; the profit margins are as low as 2% and the maximum reported level is 19%; the average profit margin is 8% which does not reflect the relative risk of doing business. These figures have been prepared by businesses for the tax authorities in order to reduce their dues (graph below):

Existence of Business Plans & Feasibility Studies

Only 25% of SME respondents confirmed the existence of a business plan and feasibility studies, while the majority (75%) indicated that they do not have such documents. Those who do not have business plans or feasibility studies realize the importance of

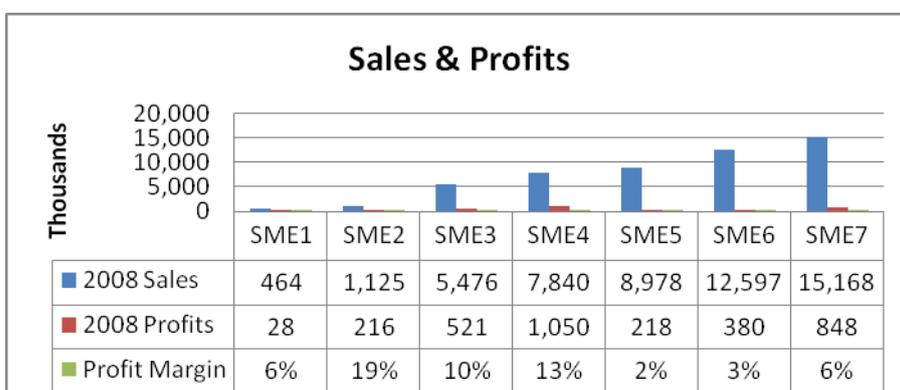


Chart 6: Sales & Profits

such documents; however, they indicated that they do not have the time to develop them.

4.2 Market Channels of Communication

4.2.1 Promotion of Banks' Products & Services to SMEs

8 banks indicated that 'word of mouth' as well as 'brochures' is among the most important means of promoting banks' products. Also, 7 banks indicated that, other means such as direct interaction (when client visits the bank) and the 'bank's website' are very important in educating SMEs regarding the different products and services offered by the bank. Half of the respondents indicated that 'advertisement' and a 'bank representative' are among the most important means to promote the bank's products as well.



Chart 7: Promotion of Banks' Products to SMEs

4.2.2 SMEs Knowledge of Banks' products

Most of the SME respondents indicated that the main channels of information with regards to the different products offered by banks are provided through visiting bank branches; 11 out of 12 SMEs reported that it is their preferred method. One third of the respondents indicated that they also rely on 'word of mouth' and 'bank representatives' to get information about banks' products.

Only one SME owner referred to the use of brochures and bank advertising when they needed information about the bank products.

This result has been confirmed by the respondents when asked about the most effective means to learn about the banks' products; where two thirds of respondents chose 'visits to bank' and 25% chose 'word of mouth'. All of the respondents did not trust 'banks' advertisements' or 'banks' websites'.

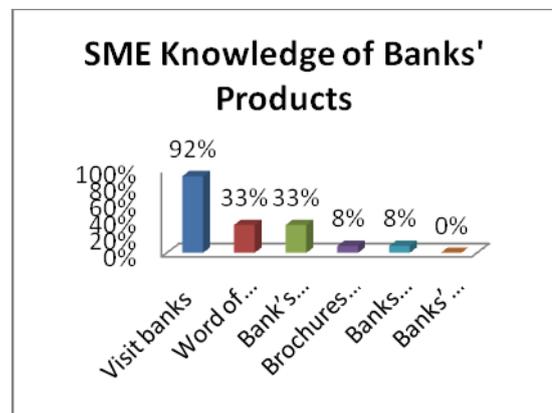


Chart 8: SME Knowledge of Banks' Products

4.3 Standardization & SMEs Desired Loan Features

4.3.1 Banks Standardization of SMEs Products

Only 3 banks indicated that their products to SMEs are tailored to meet the needs of the SMEs. On the other hand, 50% of respondents indicated that their products to SMEs are mostly standardized. While this will achieve a certain degree of efficiency in operations, it does not guarantee the fulfilment of the different needs of SMEs. The remaining banks indicated that they have a similar proportion of standard and tailored products.

4.3.2 Desired Loan Features

The range of the desired loan indicated by the SME respondents varies from 250,000 L.E. to 10,000,000 L.E. The average desired loan amount for SMEs is a little more than 1.5 million L.E. In general, SMEs would rather pay off their debts rapidly with the average desired term being 3 years. With regards to the loan terms, almost equal portions of SME respondents prefer the following options:

- Short term loans for less than one year,
- Two year term loans,
- Three years term loans, and
- Long term loans over five years.

Half of the SME respondents would rather pay their loan on a monthly instalment basis, one third of them would rather pay bi-annually, and one quarter would like quarterly instalments. The preferred frequency of instalments would vary according to the size of the requested loan and the loan term.

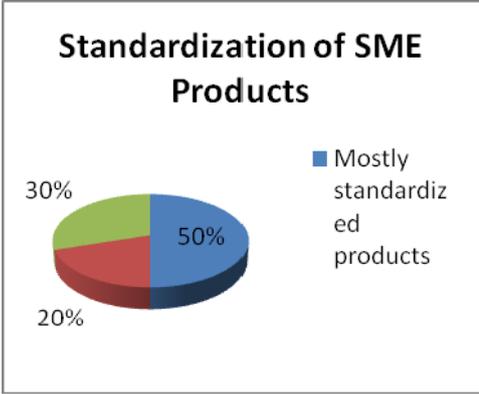


Chart 9: Standardization of Products to SME

4.4 Loan Application & Rejection

4.4.1 SMEs Applying for Loans from Banks & Reasons for not Applying

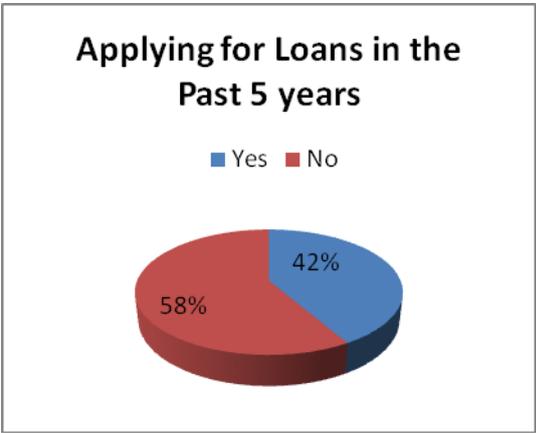


Chart 10: Applying for Loans in the Past 5 Years



Chart 11: Loan Acceptance

More than half of the SME respondents have not applied for any loans over the past five years. This indicates that many SMEs have navigated away from requesting finances from banks. The acceptance rate of the loan application was quite high in the sample, where 80% of the applications were accepted by banks and only 20% were rejected. The respondents who got their application rejected indicated that it was due to the banks’ policy—basically not meeting the requirement of the banks. The average size of obtained loans was 462,000 L.E and the average interest rate was 12%.

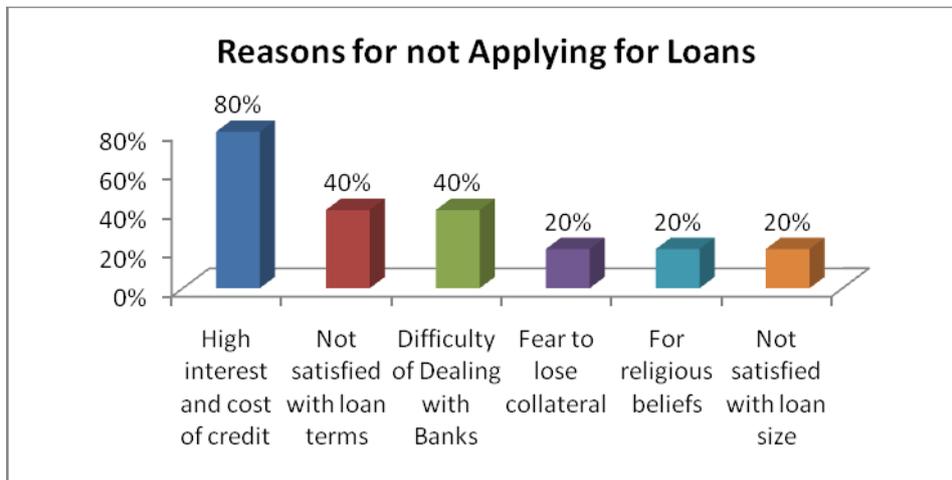


Chart 12: Reasons for not Applying for Loans

When investigating the reasons for not applying for loans from banks, the vast majority of respondents indicated that the main reason is due to the high interest rates and cost of credit from banks. A substantial minority of the respondents indicated that they were not satisfied with loan terms offered by the banks and also commented on the difficulty of dealing with banks in general. Other reasons such as ‘fear to lose collaterals’, ‘religious beliefs’, and ‘not satisfied with the loan size’ were reported by a minority of the respondents.

4.4.2 Loan Application & Rejection by Banks

Only 7 banks gave information regarding the loan applications and rejection rates for the SMEs’ applications. The rejection rate was as high as 98% and the average rejection rate was 66% which still can be considered as a high rate. For the accepted applications, the average Interest rate was 13% and the average loan term was 2 years.

70% of the respondents indicated that ‘weakness of management and financial state of the SMEs’ were among the main reasons for rejecting the SMEs’ loan applications. Half of the banks indicated that the rejection is also related to ‘bad credit history’. A substantial minority explained that the rejection is due to the lack of ‘business plan’ or ‘insufficient collateral’, and only two banks indicated that the ‘size of loan requested was too high’ or there was ‘no guarantor’.

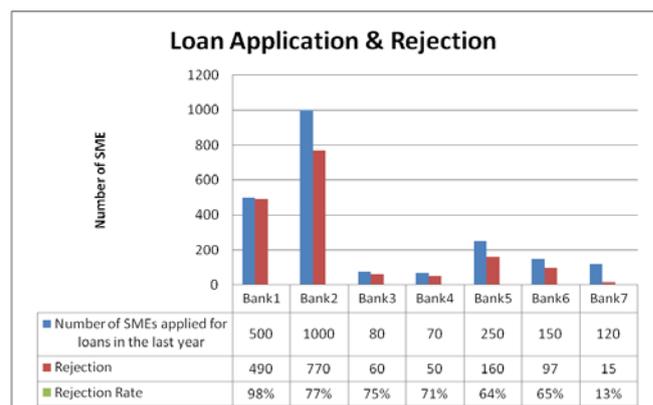


Chart 13: Loan Application & Rejection

4.5 Banks’ Products and SMEs Preferred Financial Services

4.5.1 Banks’ Products & Services to SMEs

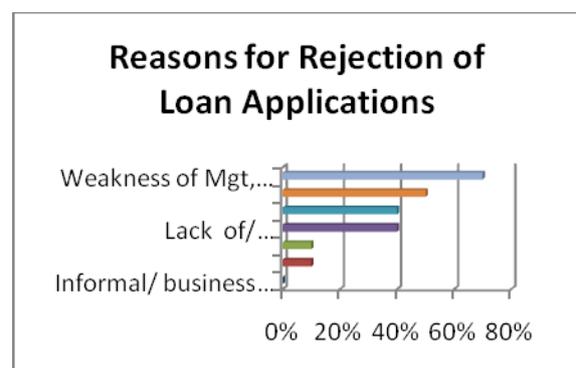


Chart 14: Reasons of Rejection

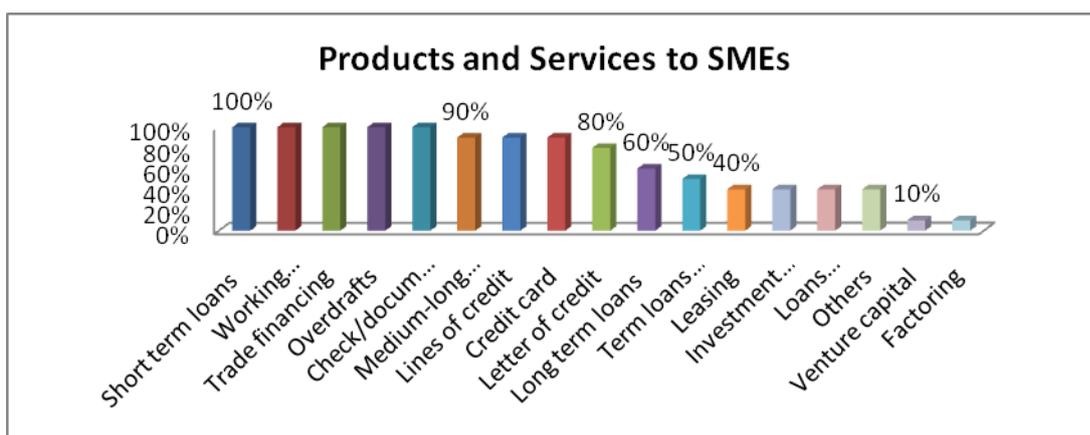


Chart 15: Products & Services to SMEs

100% of banks indicated that they offer the following services to SMEs:

- Short term loans
- Working capital loans
- Trade financing
- Overdrafts
- Check/document discounting

90% offer the following services:

- Medium-long term loans
- Lines of credit
- Credit card

80% offer letter of credits, 60% offer long term loans, 40% offer leasing, and only 10% offer venture capital and factoring.

4.5.2 Preferred Type of Financing

SMEs' Preferred Type of Financing

This table illustrates the preferred type of financing by SMEs. As listed, over 90% prefer a venture capital scheme (even though it is not common in the Egyptian money market). They believe that access to finance in a form that resembles a partnership is cheaper than loans, which are usually expensive from their perspectives. 75% prefer trade financing facilities because they have interests in exporting activities. Two thirds of the respondents have a special interest in overdrafts, but they do not rely on them heavily.

Preferred type of financing	SMEs %
Venture capital	92%
Trade financing	75%
Lines of credit	67%
Overdrafts	67%
Leasing	58%
Working capital loans	58%
Letter of credit	58%
Medium-long term loans	50%
Short term loans	42%
Long term loans	42%
Term loans with fixed asset guarantees	25%
Factoring	25%
Business Credit card	25%
Investment loans	17%
Loans supported by public programs or guarantees	8%
Bridge Financing	8%

Preferred Type of Financing by SMEs from Banks' Perspective

50% of banks indicated that one of the main preferred types of financing by SMEs is overdrafts. A minority reported that short, medium, long term loans, line of credit and discounting are among the most preferred types of financing for SMEs.

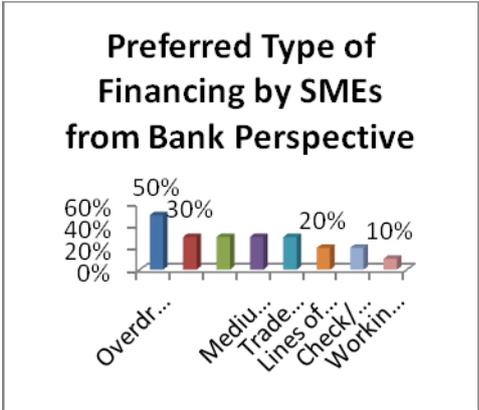


Chart 16: Preferred type of Financing – Bank Perspective

4.5.3 Interests in Deposits, Saving, and other Investment Accounts

SMEs' Interests in Deposits, Saving, and other Investment Accounts

There is a common consensus among the SME respondents with regards to their needs to current accounts. 100% of them are interested in current accounts, which is justified by their need for quick cash to finance their activities, while 50% are interested in saving accounts. A minority of the SME respondents is interested in short term deposits and other investment products.



Chart 17: Interests in Deposits, Saving, and other Investment Accounts

Deposit, Savings, and Investment Products offered by banks

100% of banks indicated that their banks offer current, savings, and term deposit services. 70% of banks have mutual funds; the remaining banks have other investment products and call deposit services.

Current and savings rank the highest in the preferred types of deposit and saving services by SMEs—from the banks' perspective—with 70% and 40% respectively.



Chart 18: Deposits, Savings, Investment offered by Banks

4.5.4 Interest in other Financial Services

SMEs’ Interest in other Financial Services

A majority of the SMEs indicated that they are interested in money transfer services mainly due to their export activities. Also, half of them indicated that they are interested in health insurance services, property insurance and collection of receivables. One third of the respondents indicated that they are interested in credit insurance, payment of wages or suppliers, or taxes through a third party.

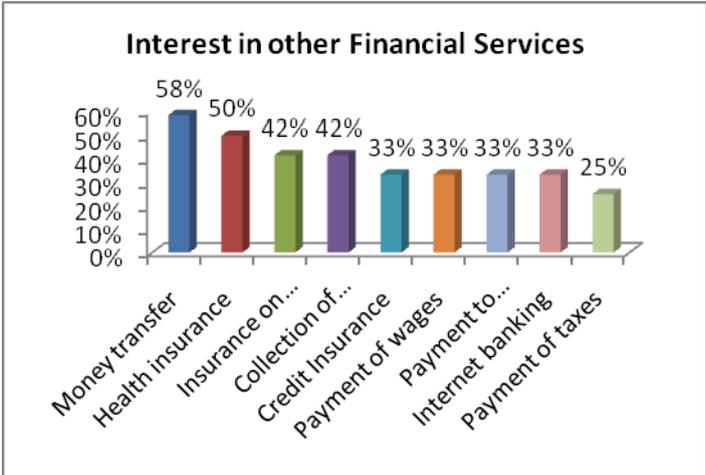


Chart 19: Interests in other Financial Services

Most of the respondents indicated that they are willing to get these services through banks if they were offered at a reasonable price.

Other Services Offered by Banks

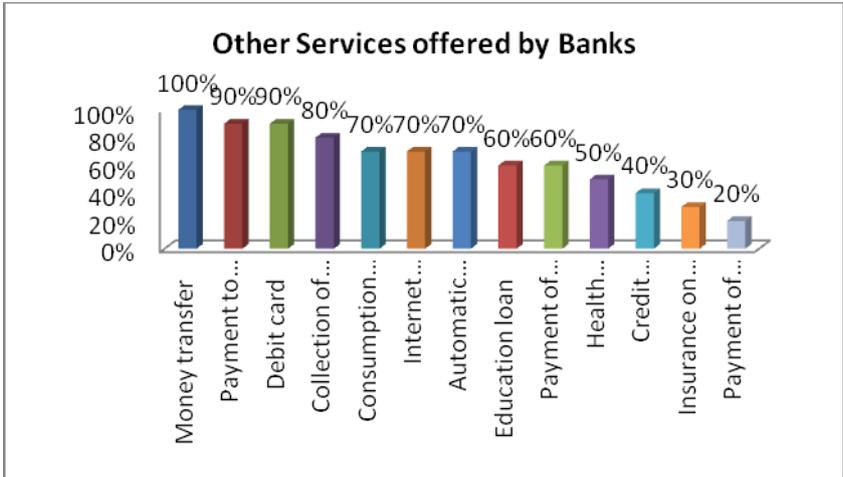


Chart 20: Other Services offered by Banks

4.6 Achieving SMEs’ Growth Plans

4.6.1 SMEs’ Perspectives on the elements that best contribute to achieving growth plans

75% of respondents perceive ‘easier access to financial means from banks’ as either their number one priority (58% which is the highest number one priority) or their number two priority (17%) with regards to achieving their growth plan.

100% of respondents, however, perceive the existence of ‘supportive regulations’ to SMEs as either their top priority (33%) or their second highest priority (67%) with regards to achieving their growth plan.

The lowest priority for the respondents is improved supply chains.

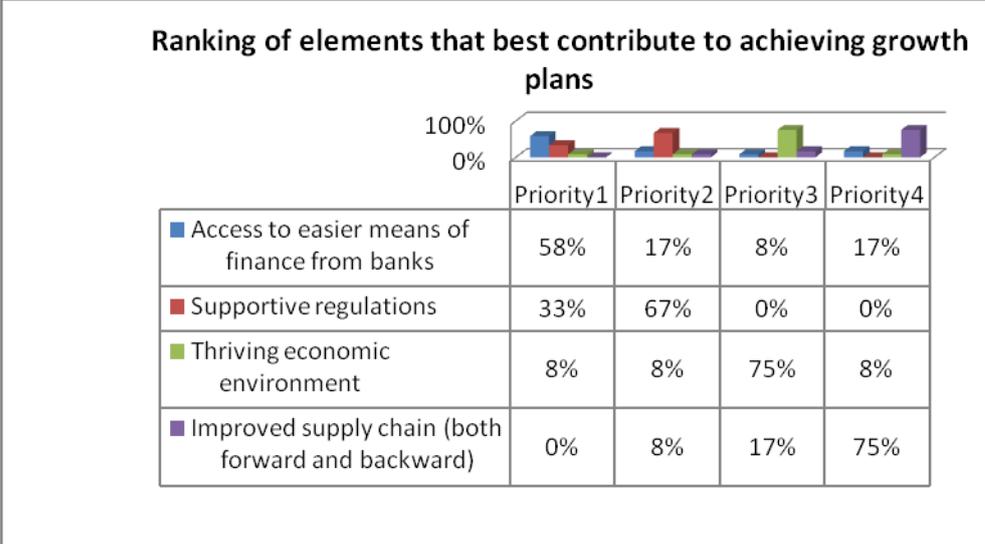


Chart 21: Ranking of elements that contribute to achieving growth plan

4.6.2 Banks’ Perspective on the Element that Best Contributes to the Growth of SMEs

7 of the interviewed bankers indicated that ‘supportive regulations’ is by far the most important factor in achieving the growth of SMEs. Only one bank indicated that it is actually ‘easier access to finance from banks’ that can contribute significantly to the growth of SMEs.

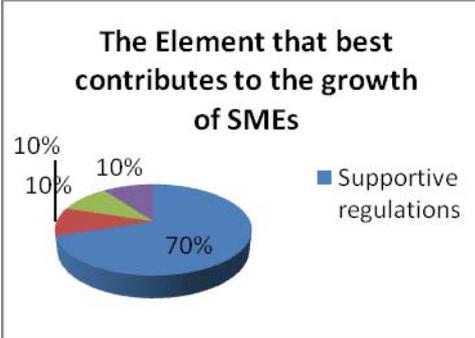


Chart 22: Element that contribute to the Growth of SMEs –Bank views

4.7 Attitude & Relationship with Banks

4.7.1 SMEs’ Access to Finance Compared to Micro and Larger Businesses

SMEs’ Perception

There is a wide spread belief among respondents that it is more difficult for SMEs to obtain financing from banks; 100% of the sample reported that it is much easier for both smaller and larger size businesses to get finance from banks than SMEs. The respondents indicated that the government and international development communities are focusing more on micro businesses, whilst the larger ones do not need any help and can obtain financial services easily; the main reason being that banks prefer to deal with them over dealing with SMEs. This leaves the SMEs to get ‘stuck in the middle’. Two thirds of the respondents indicated that banks are very difficult to deal with and they believe that obtaining financial services from other sources is much easier than from

banks. However, one third of the respondents still have confidence in the ability of banks to serve their financial needs and believe that getting financial services from banks is much better and much more trust worthy than obtaining it from other sources.

Banks' Perception

90% of respondents believe that it is easier to finance microenterprises or larger business than SMEs; in their point of view, larger businesses are more stable, less prone to risk, and have available records and information that is clearly structured and easier to access. Additionally, the required level of effort to deal with corporate enterprises is the same but with more profits.

4.7.2 Banks' Preception of SMEs' Risk

Banks' Perception Regarding SMEs' Risk

90% respondents believe that banks are more risk averse towards SMEs; they justified this belief by stating that SMEs are very risky and the economic environment is not pro SMEs. They are considered a 'new market' that is not fully developed, and there is a lack of information about its nature, activities, and characteristics. There is also a lack of regulations as well as a lack of experience on dealing with SMEs.

SMEs Views regarding Banks' Preception of their Risk

Over 90% of the respondents believe that banks are more risk averse towards SMEs. In their opinion, banks do not have a good understanding of the nature of SMEs' activities and their needs.

4.7.3 Relationship Between SMEs & Bankers

A great majority of SME respondents indicated that they have good relations with bankers in general and they do not have any issues with regards to the banks' customer services. The issues are mainly connected with banks' policies however. From the banks' perspective, the majority of banks indicated that they get along with SMEs in general while a substantial minority of banks do not hold the same view. Those who have good relations with SMEs indicated that banks should build the relationship with SMEs because they represent potential markets. On the other hand, those who do not have good relation with SMEs indicated that SMEs present a high risk and that the banking culture perceives the corporate sector as safer and more profitable choice than SMEs.

4.8 SMEs' Views

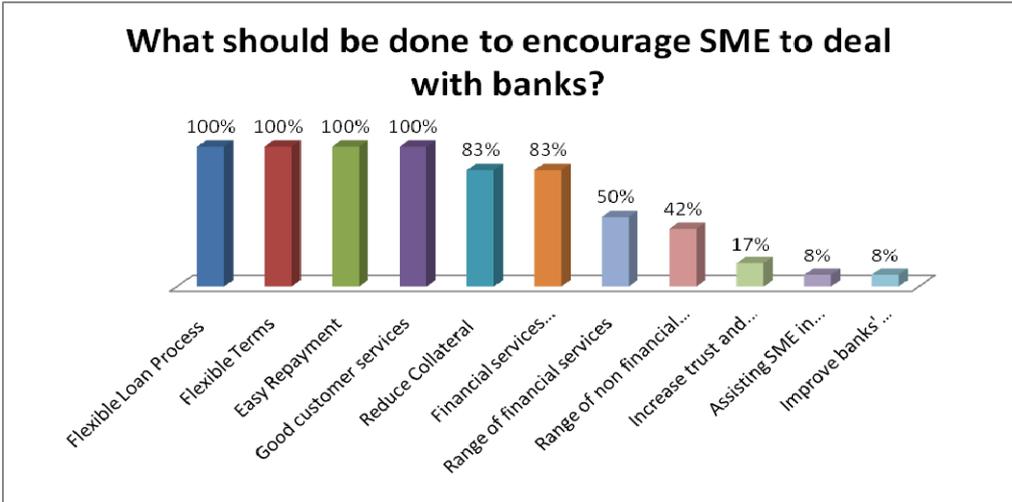


Chart 23: Encouraging SMEs to Deal with Banks – SMEs Views

100% of the respondents indicated that in order to encourage SMEs to deal with banks the following must be done:

- Flexibility in loan processing
- Flexible terms and conditions
- Easy repayment schedule
- Good customer services

A vast majority of SMEs also believe that the solution should focus on reducing collateral and improving the awareness of SMEs regarding the different financial services offered by banks.

50% indicated that banks should offer a wide range of financial services suitable to the needs of SMEs, and a significant minority indicated that banks should also offer a wide range of non financial services; all at reasonable costs. A minority of SMEs also emphasized the need for increasing trust and transparency between banks and SMEs, and only one SME indicated that banks should have a deeper understanding of SMEs and assist them in developing business plans and feasibility studies.

4.8.1 Banks' Perspective

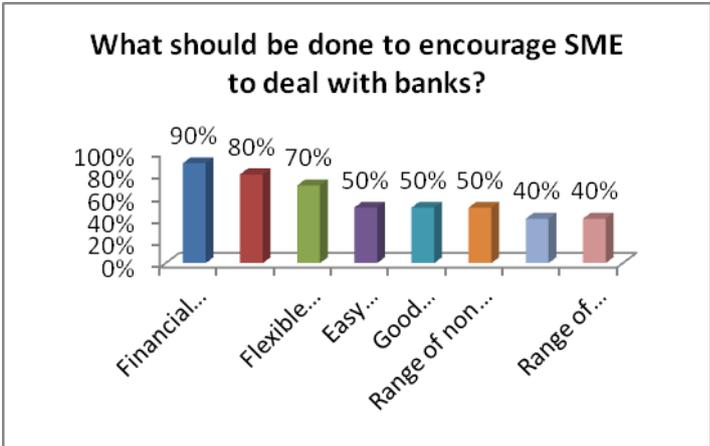


Chart 24: Encouraging SMEs to Deal with Banks – Bank Views

9 banks indicated that increasing SMEs' awareness of the different financial services offered by them is among the key elements to encourage SMEs to deal with banks. A vast majority also highlighted the importance of developing new schemes that facilitate the loan process in order to best fit the needs of SMEs. As well as improving the loans terms and conditions, an increase in flexibility is needed to be able to respond to the varying needs of SMEs. Additionally, half of the banks indicated that the loan repayment schedules should be more convenient and in line with the SMEs' cash flow. The same percentage of respondents stressed the issue of good customer services to attract SMEs as well as the need to offer a wider range of non financial services. A significant minority indicated that banks should reduce collateral requirements and offer a wider range of financial services.

4.9 Information Needs

4.9.1 Information Needed by SMEs

The respondents indicated that they wish to have a compilation of information regarding the supply side (mainly banks) of SMEs' financing market. Below is a summary of the respondents' inputs with regards to that:

- Information about banks' rating
- Information about different banks and their services
- Banks' loan forms with clear and simple procedures
- Simple indicative table for loan amounts and instalments
- Indication of required time to get finance
- Loan requirements
- How to finance exports
- Information about credit facilities and not loans
- Work schedule
- Bridge financing criteria
- Simple indicative table for loan amounts and instalments

4.9.2 Information that Banks should provide to SMEs

The respondents highlighted the following elements that need to be communicated to SMEs in a clear and precise manner:

- Pricing
- Payment terms
- Contacts
- Product features
- Collaterals
- Targeted segment
- Branches networks
- Non financial services
- Required documents

4.10 Additional Comments by Bankers

Some of the respondents indicated that in order to bridge the gap of SMEs' financing, there is a need for:

- More flexible and clear regulations from the central bank to support SMEs
- Well trained staff in SME's unit at banks
- Unified definition of SMEs
- Standardized level of SMEs within banks
- EBI can provide more awareness to SME's units at banks through conducting more periodical meetings through which experience is shared and demand information is exchanged.

Conclusion

As indicated earlier, the ultimate purpose of this study has been to identify issues internal to the SMEs that affect their ability to access finance from banks. It has also addressed those issues that are internal to banks that reduce their involvement in the SMEs financing market. Through the analysis of both the demand and supply sides of SMEs' financing markets, conclusions can be drawn to address the core question of this preliminary study which is related to assessing whether there is an initial evidence for failure in the market. The study did not indicate any strong evidence of a market failure; instead there are several issues on both the demand and supply side:

Demand Side Issues:

- Interviewed SMEs lack the existence of strong accounting systems.
- Debt financing is not the preferred method of finance for interviewed SMEs.
- Declared profit margins of the interviewed SMEs are very low.
- Interviewed SMEs do not make strong linkages between access to finance and profits or losses.
- Print media is not the most preferred method used by the interviewed SMEs to know about banks' products. 11 out of 112 SMEs report that they prefer visiting the bank branches to find out more on offered products.
- Interviewed SMEs believe that the cost of credit is too high.
- On average, interviewed SMEs do not seek funding from sources other than banks,
- In general, a majority of SMEs (75%) do not have business plans or feasibility studies,
- There is a wide spread belief amongst respondents that it is more difficult for SMEs to obtain financing from banks.
- Two thirds of the respondents indicated that banks are very difficult to deal with.
- Over 90% of the respondents believe that banks are more risk averse towards SMEs.

Supply Side Issues:

- Bankers indicated that factors internal to the SMEs (mainly management and financial status) remain the main obstacle to banks' involvement with the sector.
- There is a substantial amount of banks that do not offer products that best fit the varying needs of the SMEs.
- SMEs are mainly classified among the basic clients of banks
- Financing decisions made by interviewed banks rely mainly on the existence of basic documents within the enterprise rather than its growth potential.
- The average rejection rate of SME loan applications was quite high (66%).
- Interviewed banks believe that SME development is related to improving the regulatory environment more than facilitating access to finance.
- The majority of interviewed bankers are risk averse towards SMEs; 90% of them believe that it is easier to finance microenterprises or larger business than SMEs

The careful analysis of the interviewed SMEs indicates that the profile of owners is very good in terms of educational background, experience in business, and professional training. However, the demand side challenges related to SMEs must be addressed in order to strengthen the feasibility of their business cases submitted to banks for the purpose of accessing finance. On the other hand, the supply side issues at the bank level should also be addressed to close the gap with SMEs access to finance.

In general, the interviewed SMEs prefer equity financing to debt financing. They perceive the debt financing from banks to be very expensive, although the prevailing interest rate is quite reasonable. SMEs need to be more aware of the importance of leverage through debt financing for the growth and success of their businesses. Most of the SMEs in the sample did not apply for loans over the past five years due to the wide spread perception among them that the main hindrances to their abilities to access finance from banks are not internal to them, but are, rather internal to the banks. Those who applied for loans and got their applications rejected (20%) by the banks claimed that their business cases are always suitable but it is the banks that employ rigid policies which are not suitable to the SMEs.

The study revealed that the accounting systems of the majority of interviewed businesses are quite basic and their financial statements are produced mainly for tax purposes and not for the proper management of the enterprise. Therefore, these systems may not present the real financial state of the business and, in many cases; the financial statements indicate that these businesses are not efficient because their profit margins are very low.

Moreover, the majority of the interviewed businesses do not have business plans or feasibility studies and there is no indication that such important documents will be developed in the near future. The existence of a business plan is among the requirements for financing from some banks. The limited accounting system and lack of business plans will result in having financing applications to banks being turned down.

On the other hand, banks believe that the problems are mostly related to SMEs, and the majority of banks are risk averse towards SMEs. This was typified by the high average rejection rate of 66% (from the banks side). Many of the interviewed banks indicated that the main obstacles they face when dealing with SMEs are internal to those, specifically with regards to their management practices - which are deemed inefficient - and their unreliable financial statements. While the main banks' requirements for financing SMEs include basic standard documents and analysis of the business case, many banks remain more focused on the existence of the basic documents than on business cases which often results in the rejection of good business cases; sometimes just because of one missing basic document. Additionally, many of banks offer standardized products that may not be suitable for the needs of SMEs, which often have diversified needs that vary greatly from one SME to another. In order to serve SMEs effectively, banks need to offer more tailored products and services that are suitable to SMEs.

SMEs believe that they represent the 'missing middle' and it is more difficult for them to obtain finance from banks than it for micro-enterprises or larger businesses. They believe that banks are more risk averse to SMEs. There is evidence that the banks concur with this view regarding SMEs and that they prefer dealing with larger businesses. In order to strengthen the suitability of SMEs' cases to banks, they—SMEs—should improve their financial and accounting systems and develop sound and reliable financial statements to clearly represent their real situation and provide strong evidences for their growth potential. SMEs will also need to develop business plans and continually update them. On the other hand, banks need to have a better understanding of the special characteristics of SMEs and develop the infrastructure and systems required to serve them more effectively.

Clearly, there is a lack of communication and misunderstanding at both sides. There is a need for more enhanced communication between them. A 'Financing Forum' or an 'Awareness Campaign' could be good ideas to bring the two sides together so that each can deepen its understanding of the others' specific characteristics. This would then help to trigger the correct responses and requirements that would enable effective business transactions and the consequent reduction in the access to finance gap.

Finally, the consultant (responsible person from PlaNet finance) suggests conducting a detailed study on a much wider scale to further examine the findings of this initial study as well as to discover more informative ways to bridge the gap between banks and SMEs. Moreover, a detailed study that takes into consideration the various stakeholders (enterprise value chain represented by SMEs as well as larger and smaller size businesses, financial institutions, relevant government entities, donor agencies, NGOs, chambers of commerce, etc.) can contribute to developing a more conducive environment for the success of the SMEs sector.

Policy Implications & Recommendations towards Enhancing SMEs Access to Finance:

- Financial literacy has to be taken into account as one of the main pillars to encourage saving and investment; by designing and launching a financial education campaign targeting SMEs as well as the Egyptian education system in different levels.
- Improving the awareness of SMEs regarding the different financial services and products offered by banks and other financial institutions.
- Prepare and organize a complete set of training activities to enhance the capabilities of the entrepreneurs in developing business plans, feasibility studies and reliable financial statements.
- Banks need to better understand the special characteristics of SMEs and develop the infrastructure and systems required to serve them more effectively, as well as developing a full range of tailored products that accommodate their needs.
- Establish a certified consultative roster to deal with capacity building of SMEs, in order to strengthen the suitability of their cases to banks; by improving their financial and accounting systems, on the one hand, and developing sound and reliable financial statements, on the other; in order to clearly represent their real situation and provide strong evidences for their growth potential.
- Developing new schemes that facilitate loan process, in order to best fit the needs of SMEs, as well as increasing flexibility of loan terms and conditions, so that it responds to the varying needs of SMEs.
- Establishing SMEs database with a supportive website including up-to-date data, as well as valuable and reliable information to banks, policy makers, planners and entrepreneurs.
- Encourage more credit guarantee schemes to mitigate risk and provide enabling environment for SMEs access to finance.
- Augment the dialogue among banks and SMEs to identify potentials and constraints regarding access to finance through conducting various gatherings with respect to various sectors.
- Downscaling and up-scaling are quite needed at banks to change the mindset of top management to extend finance to the SME sector.
- Non-financial services have to take the same attention of the financial services in terms of banks' capacity building through training and technical assistance, applied researches, supportive publications, and reliable data and information.
- A National SMEs strategy has to be formulated with a clear vision, mission, strategic objectives and business plan.
- An official body has to be established by the Government to be responsible for planning as well as coordinating all of the stakeholders' efforts.

Appendix

a) SME Profile

1. SME Age Distribution

The age range of respondents was between 38 and 72 years old. The average age was 53.

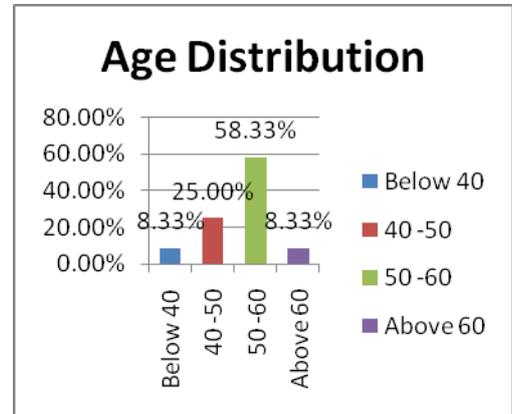


Chart 25: Age Distribution

2. SME Educational Status

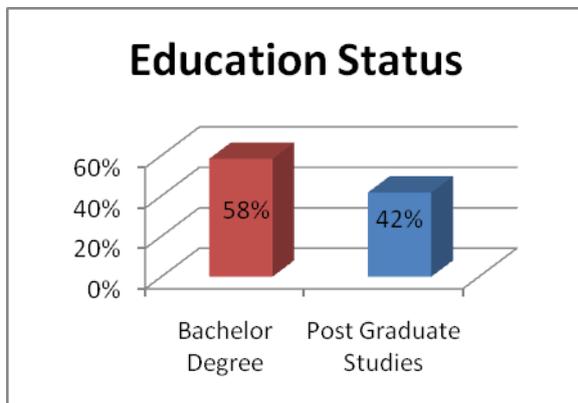


Chart 26: Educational Status

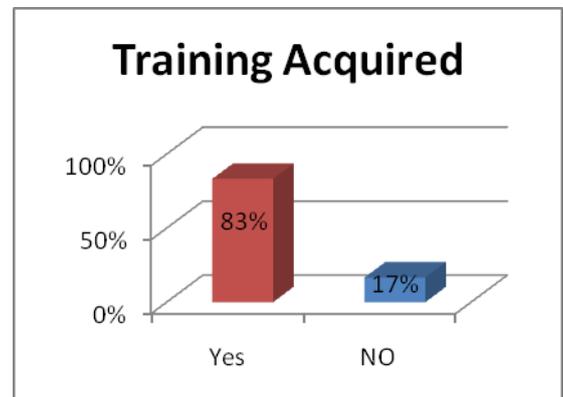


Chart 27: Training Acquired

When examining the educational background of the respondents, it was clear that 100% of them are highly educated. The majority obtained a university degree (bachelor's degree), and the remaining had completed post graduate studies—mainly PhDs. Moreover, a vast majority of respondents have received additional trainings mainly in effective management practices with some technical training in their respective fields.

3. SME Experiences in Business

Overall, 75% of respondents have experiences that range between 10 to 30 years in their primary business; one SME owner exceeds 30 years of experience and the remaining have at least 7 years of experience.

We can conclude that interviewed SMEs are managed by experienced entrepreneurs.

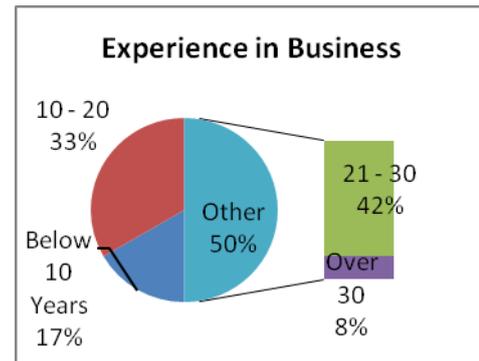


Chart 28: Experience in Business

4. SME Number of Employees

The average number of employees per enterprise for 2009, 2008, and 2007 was 27, 22, and 20 respectively.

The increasing number of employees over time (with the exception of one enterprise) suggests that the interviewed SME have enjoyed growth over the past three years.

	3 year average	2009 Only	2008	2007
SME1	72	85	70	60
SME2	55	62	58	45
SME3	21	34	15	15
SME4	29	30	28	30
SME5	25	25	25	25
SME6	16	16	16	16
SME7	16	12	17	20
SME8	11	12	12	10
SME9	11	11	11	11
SME10	8	11	7	6
SME11	4	11	0	0
SME12	6	6	6	6
Average	22.89	26.25	22	20
Median	16.17	14	16	16

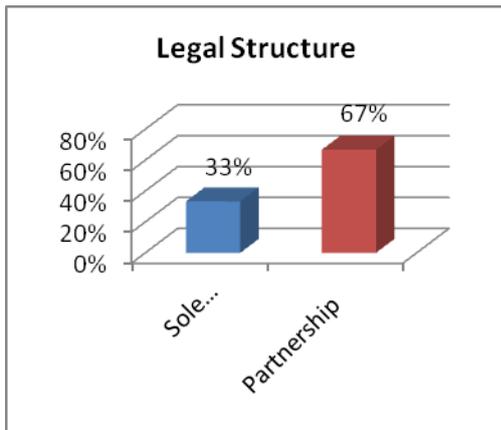


Chart 29: Legal Structure

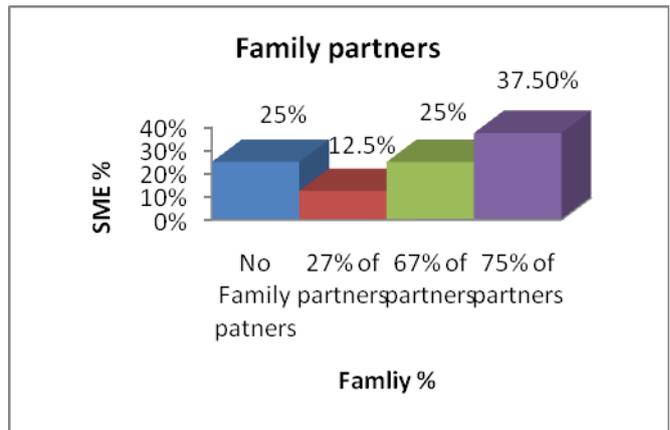


Chart 30: Family Partners

5. SME Legal Structure & % of Family Partners

One third of the sample is classified as sole proprietorships and the other two thirds are simple partnerships. The number of partners range from 3 to 22 partners and the average is 6,75% of the businesses which are classified as partnerships have members of their immediate family as partners; the level of family membership varies from 27% to 75% of the total number of partners.

6. Additional Work for SME Owners

50% of respondents indicated they have additional work apart from their primary core business. This is mainly another self-owned business which in some cases may represent a completely different business line then that of the core business.

7. SME Profit Trends

In general, when asked about the profit trend over the past three years, exactly 50% of the respondents indicated that their profits increased; 25% of SMEs said they enjoyed a 'strong' increase in profits. 25% of the SMEs alternatively reported decreases in their profits and the remaining 25% stayed constant.

The reasons for increasing profits reported by the SMEs were:

- higher sales volume
- new market opportunity
- more access to credit
- decrease in fixed costs
- decrease in input costs

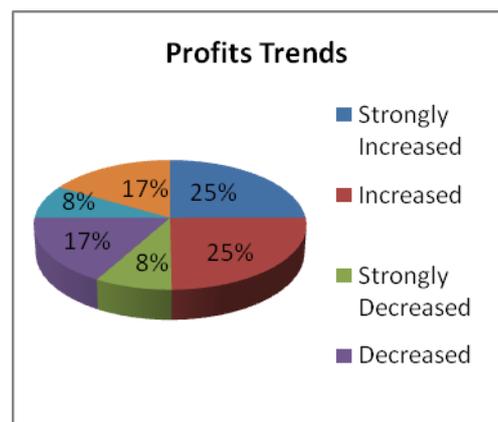


Chart 31: Profit Trends

- got a new contract

The higher sales volume was the reason selected by two thirds of the respondents to explain the increase in their profits. Half of the respondents also selected the new market opportunity factor as being the reason for increased profits. More access to credit, decrease in fixed costs, decrease in inputs' costs, and winning of a new contract were selected by a small percentage of the respondents.

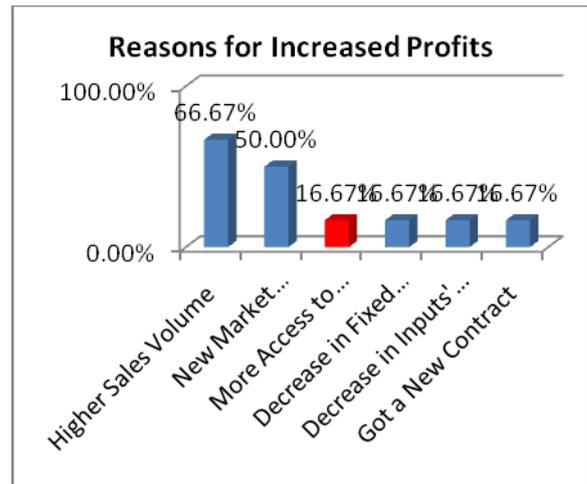


Chart 32: Reasons for Increased Profits

Respondents were asked to choose from the following list to justify the reasons for their decreased profits:

- Increase in inputs' costs
- Loss of sales contract
- Increase in fixed costs
- Not enough funding
- No access to funding
- No access to raw material
- Not enough employees
- Weakness of sales
- Higher competition
- Production's difficulties
- Health problem



Chart 33: Reasons for Decreased Profits

Only increase in inputs' costs and loss of sales contracts were selected by 67% and 33% of respondents respectively. None of the other options were selected, especially the 'Not enough funding' and 'No access to funding' options.

b) Banks Profile

1. Banks' perception about SME financing market

1.1 Main Actors of SME Financing

Interviewed bankers were asked about their views regarding the main actors of the SME financing market and were given different choices to select from. The ranking of the main actors in SME financing from the point of view of respondents was as follow: 'public banks' (government owned) was selected by 100% of the respondents as the one main actor in SME financing, 'larger

banks' was selected by 6 out of the 10 respondents, 'other FIs' was selected by two out of the 10 respondents and 'private banks' was selected by only one bank.

1.2 Extent of Competition in the SME Lending Market

Half of the respondents believe that the SME lending market is competitive but not saturated yet, which indicates that this portion of respondents are aware of the unmet financial services' demands of the SMEs, but that there is competition from other banks. However, about one third believe that the SME lending market is not competitive and has weak entry barriers, suggesting that there is a big unmet demand especially considering the existence of weak entry barriers from the supply side. One bank respondent believes that the market is not competitive but has strong entry barriers whilst the remaining respondents see the market as competitive and saturated.

1.3 Size and Prospects of the SME Lending Market

The vast majority of bank respondents (80%) believe that the market is large with good prospects. Another respondent believes that it is a small market but with good prospects, and the remaining believe that the market is small with a marginal imperative.

2. Banks Focus on SMEs

50% of respondents indicated that their banks have a sector specific focus in dealing with SMEs and the other 50% reported that there is no sector specific focus when dealing with SMEs; those tend to focus on industrial sectors in general.

A vast majority of banks indicated that they have a specific geographic focus when dealing with SMEs. This focus tends to be associated with the banks' branches in general. The remaining respondents indicated that their banks do not have any specific geographic focus.

90% of respondents indicated that specialized units to manage SMEs exist in their banks, with

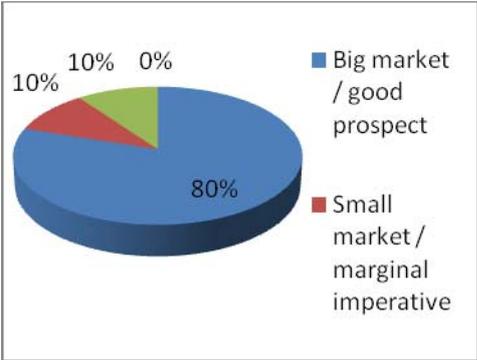


Chart 34: Size and Prospects of SME Lending Market

the exception of one bank that does not have such units, and man

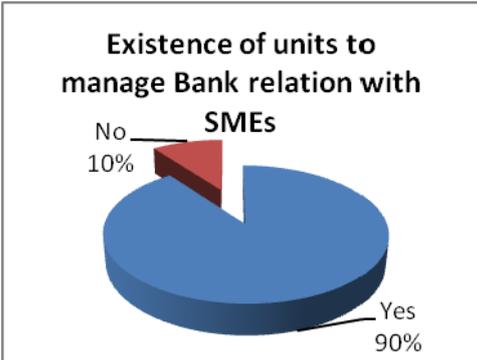


Chart 35: Existence of SME Unit

ages the SME accounts under the corporate department.

3. Drivers of Banks' Involvement with SMEs

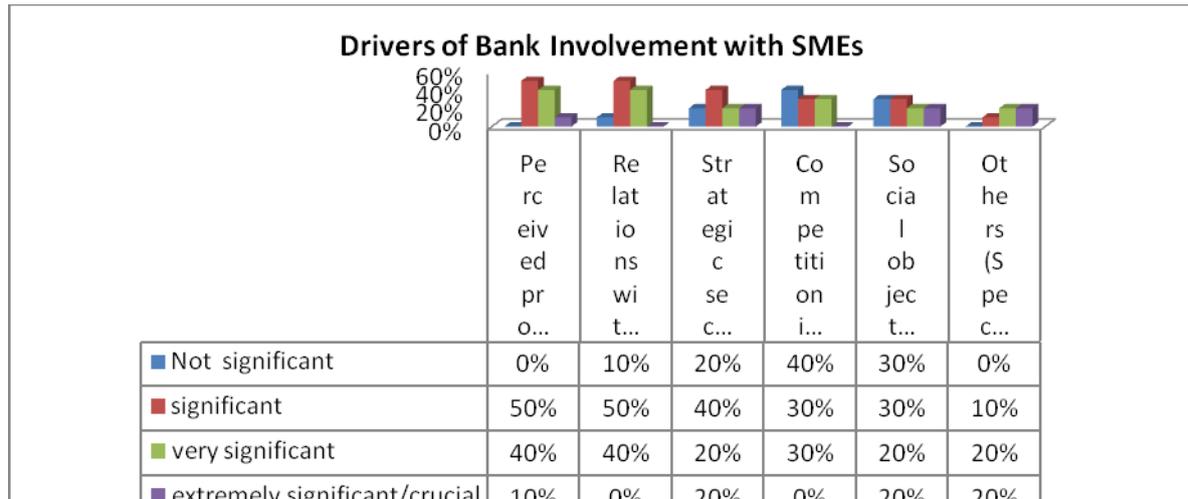


Chart 36: Drivers of Banks Involvement with SMEs

100% of respondents' perceptions about profitability as one of the main drivers for banks' involvement with the SME sector measured at 50% significant, 40% very significant and 10% extremely significant. Similarly, 90% believe that another main driver is related to building relations with a larger number of clients. 80% believe that the SME sector as a strategic sector is one of the main drivers. 60% believe that competition in other sectors forces banks to deal with the SME sector. 70% believe that the social mandate of the banks can be considered as one of the main drivers for banks involvement with SMEs.

Other main drivers were reported as significant by 50% of respondents:

- Economic development
- Risk mitigation
- Reputation
- Cross selling
- SME responsiveness to banks' requests

4. Obstacles of Banks' Involvement with SMEs

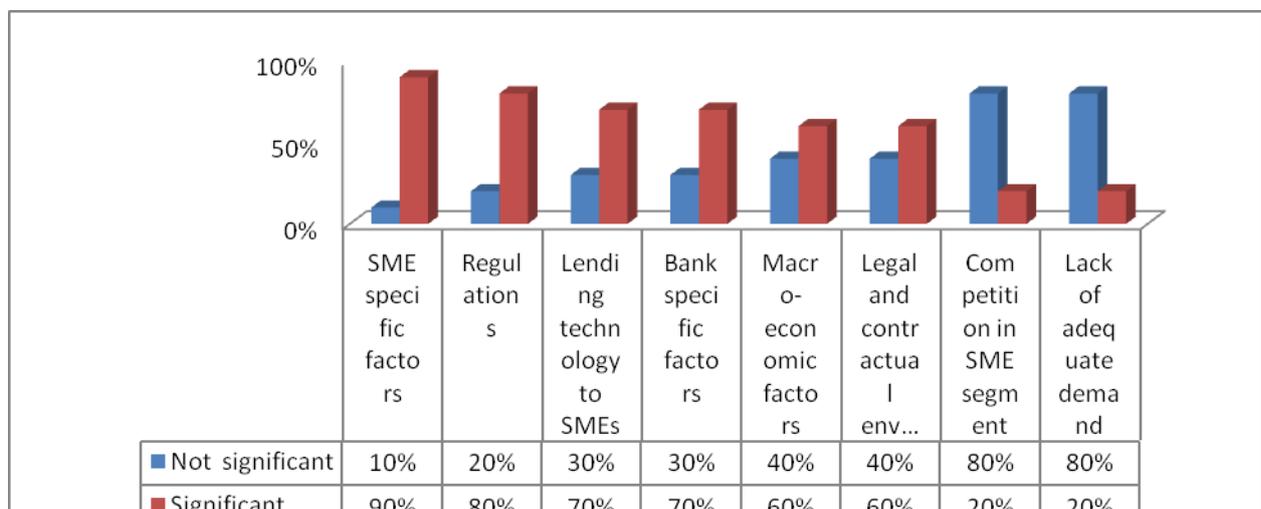


Chart 37: Obstacles of Banks Involvement with SMEs

90% of respondents believe that one of the main obstacles of banks' involvement with SMEs relates to SME specific factors; stressing on issues internal to the SMEs and the demand side in general. 80% believe that another important obstacle is related to the regulatory environment and they would like to have more support and guidance from the central bank with regards to this issue. 70% believe that other main issues include lending technology to SMEs as the banks lack the expertise to deal with SMEs.

5. SMEs' Involvement with Banks

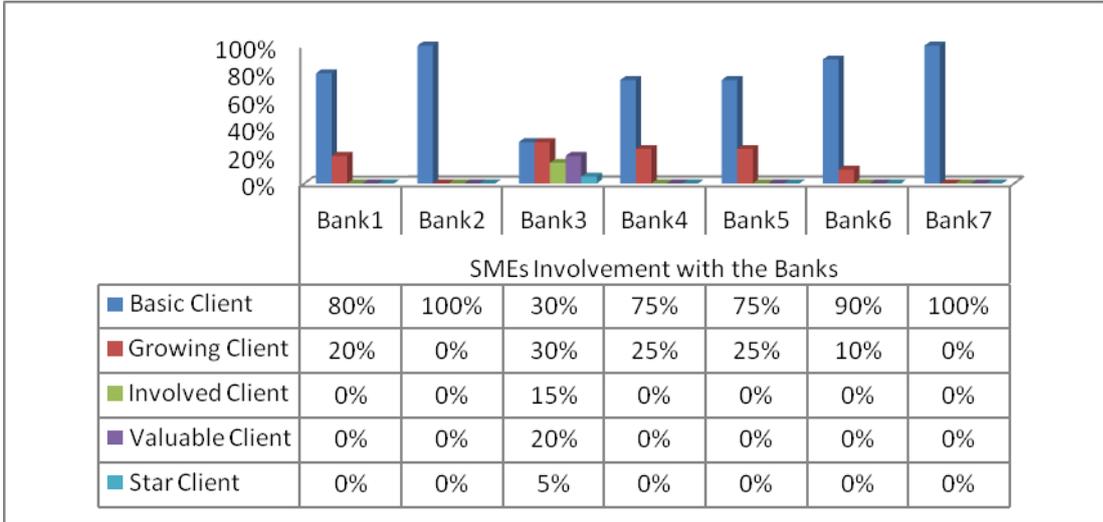


Chart 38: SME Involvement with Banks

As indicated in chart 38, only 7 banks reported information about the classification of their SME client base; respondents were asked to indicate the percentage of their SME clients at each of the following levels:

- "Basic Client" - SME that uses 1 to 3 banking products or services
- "Growing Client" - SME that uses between 4 and 6 products/services
- "Involved Client" - SME that uses 7 to 8 products/services.
- "Valuable Client" - SME that uses 9 to 10 products/services,
- "Star Client" - SME that uses more than 10 products or services

The majority of respondents indicated that at least 75% of their SME clients are "Basic Clients".

6. Risk Management Practices

While a large majority of respondents reported that the risk management practices are not automated, a minority of them reported that these practices are automated. Almost all of them indicated that it is usually conducted by a credit analyst. 7 banks indicated that it is separate from sales and 6 banks indicated that it is centralized at the Headquarter.

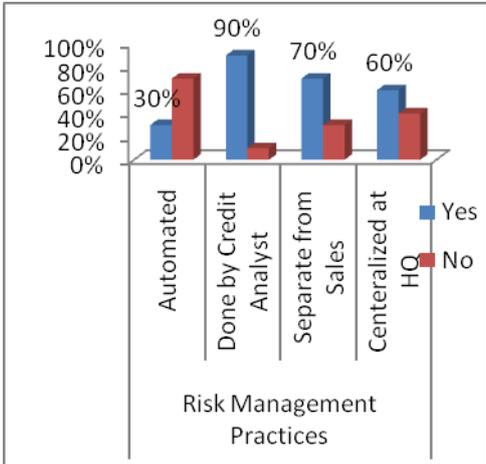


Chart 39: Risk Management Practices