

Policy Position Paper By
the Egyptian Junior Business Association on

FINANCING MICRO, SMALL, & MEDIUM-SIZED ENTERPRISES

June 2020



AVAILABLE SOURCES OF FINANCING FOR MSMES

1. The banking sector
2. The Micro, Small and Medium-Sized Enterprises Development Agency (MSMEDA)
3. Private finance firms including micro financing and factoring finance firms
4. Non-governmental organizations
5. Venture capital firms
6. Financial leasing firms
7. NILEX, the Egyptian Exchange SME platform

RESPONSIBLE ENTITIES:

- * The House of Representatives
- * The Cabinet
- * The Central Bank of Egypt
- * The Egyptian Financial Regulatory Authority
- * The Federation of Egyptian Banks
- * The Micro, Small and Medium-Sized Enterprises Development Agency (MSMEDA)

** This paper includes the key points and takeaways from the Egyptian Junior Business Association (EJB) meeting on May 19, 2020*

MSME FINANCE CHALLENGE: REASONS AND IMPACT

- * Investment portfolios are directed towards low-risk investment options, such as treasury bills and government bonds.
- * The expansion of banks' consumer lending, which is viewed as more profitable because of the high-interest rates associated with it. Due to this unbalanced allocation of resources, productive sectors are suffering from a significant decrease in bank lending opportunities, which could have assisted in creating jobs and expanding export capacities.
- * Banks exaggerate in their collateral requirements for small and medium-sized enterprises (SMEs). In some instances, banks require borrowers to sign a personal guarantee on a loan and provide signed postdated checks. In the case of default, a business owner may lose his personal wealth and be subjected to legal actions resulting in sanctions and imprisonment.

- * Banks subject SMEs to the same procedures and loan documentation prescribed for large enterprises; these requirements are unreasonable and create an unlevel playing field for SMEs, which limits their access to finance.
- * The absence of the concept of “crowdfunding” and the lack of a legal framework to regulate it limit the opportunities available for startup entrepreneurs to finance innovative ideas.
- * Banks and financial institutions fail to provide adequate credit to finance exports at preferential interest rates, which are low compared to prevailing interest rates; this is inconsistent with practices in many developing countries. This shortcoming ultimately reduces the competitiveness of Egyptian products such as cotton and textiles.
- * The high-interest rates and various expenses and commissions drive up the cost of financial services; this cost may reach more than 5% above the average interest rate (Corridor).
- * Bank approvals take a long time, sometimes extending for over a year, after the submission of all required documents.
- * Banking institutions refrain from financing capital assets or working capital and are more inclined to provide loans for commercial operations due to the shorter repayment period associated with commercial operations loans; the entire burden of financing production lines is thus placed on business owners.
- * Poor communication between banks and the target groups; loan processing procedures often lack clarity.
- * The absence of an umbrella body that provides administrative, organizational, and legal support services to SMEs to assist with their development and thus, improving their access to bank and non-bank finance with favorable terms.
- * Despite the issuance of the Bankruptcy Law No. 11 of 2018, its implementation on the ground is still limited. The prevailing culture in financial institutions regarding bankruptcy remains unchanged; bankrupt businesses continue to be treated in the same old manner, which destroys business owners, prevents them from carrying on, and does not allow them the opportunity to set up new enterprises.

RECOMMENDATIONS

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- * The Central Bank of Egypt should issue mandatory guidance to banks requiring them to diversify their credit portfolios, such that the largest share of their credit flows be directed to productive activities across the various economic sectors. The guidance should also specify credit targets for priority productive sectors that Egypt needs to realize economic advancement and improve its global competitiveness.
 - * Eliminate unfair requirements related to personal guarantees and postdated checks. The decision to provide financing should be primarily based on the type of business model adopted and its success.
 - * Allow the establishment and licensing of second-tier banks that specialize in dealing with SMEs in a manner that is appropriate to their size and nature; SMEs should not be continually subjected to the same set of standards and procedures applicable to large enterprises, which is the current practice.

- * Issue a law to regulate crowdfunding so that startups can easily access finance from investors who are enthusiastic and eager to support creative ideas.
- * The banking sector should support business incubators to provide consultancy services to small and medium businesses which need administrative and organizational support to qualify them to obtain institutional financing and reduce the period of obtaining credit approvals.
- * Reformulate the procedures and requirements related to the export sectors in a manner that increases the availability of funding at reasonable costs; reforming procedures will lower the burden on exporters and raise the competitiveness of Egyptian products in international markets.
- * Improve the marketing policies of banks and financing institutions so that they strategically reach the intended target groups; banks should also specify the set of documents required for obtaining a loan and post the documents on their websites, additionally, telephone customer service should be well-equipped and prepared to communicate adequately with those seeking financing, and able to clarify loan application procedures and conditions.
- * Establish a specified period of time within which banks must provide their approval or disapproval of loan applications; all studies, inquiries, and administrative work must be completed in a period not to exceed three months.
- * The Central Bank of Egypt must develop a specific mechanism for financing distressed enterprises, as well as monitor its implementation and encourage banks to rescue these enterprises.
- * The Central Bank of Egypt to penalize banks which do not comply with the guidelines on the percentage of credit allocated to financing small and medium enterprises.
- * Extend the period of repaying medium and long-term loans to ten years.
- * Rather than resorting to liquidating distressed businesses, take advantage of the Bankruptcy Law No. 11 of 2018 to restructure them, and provide distressed investors with the opportunity to establish a new enterprise and successfully manage them.
- * To encourage investment and support businesses, interest rates on bank deposits must be tied to inflation rates in a manner consistent with international.
- * Strengthen the capacity of the Credit Guarantee Corporation to broaden its credit portfolio to serve small and medium enterprises.
- * Oblige investment funds to invest a minimum of 5% of its assets in companies listed in NILEX Stock exchange.



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