Middle East and North Africa Region

SMEs for Job Creation in the Arab World

SME Access to Financial Services

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Sahar Nasr and Douglas Pearce

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# EXECUTIVE SUMMARY

**Foreword** vii

**Acknowledgments** ix

**Abbreviations and Acronyms** xi

I. Introduction 1

II. SME Prospects in MENA 5
   A. SMEs Contribution to Job Creation 5
   B. Innovation and Growth of SMEs 7

III. SME Access to Finance 11
   A. Financial Intermediation for SMEs 11
   B. SME Financial Products 16
   C. Recent Policy and Program Interventions 21

IV. Challenges to SME Development 23
   A. Legal and Regulatory Framework 24
   B. Financial Institutional Infrastructure 25
   C. Financial Intermediaries Capacities–Banks and NBFIs 27
   D. Enterprises Skills 29

V. An Agenda for an Inclusive Financial System in MENA 33
   A. Bank SME Finance Models 33
   B. The State as Regulator and Enabler–Providing an Enabling Environment 34
   C. Innovative Financial Products 37
   D. Guarantees and Risk Sharing 39
   E. Equity Finance 40
   F. Capacity Building for SMEs 43

VI. Concluding Remarks 47

Annexes 51

Annex 1: SME Definitions 51
Annex 2: SME Access to Finance 52
Annex 3: Enabling Environment for SME Finance 58

Bibliography 59
Figures

2.1 SMEs as Employers in Selected MENA Countries 6
2.2 SMEs Employment as a Percentage of Total Private Employment, by Region 6
2.3 Innovation Indicators for MENA and Comparator Regions 8
2.4 SME Managers Spending More of Their Time Dealing with Regulation 8
2.5 SMEs Reporting That Informal Payments are Made to “Get Things Done” 8
3.1 Percentage of Firms with a Line of Credit 11
3.2 Percentage of Investment Finance by Banks 11
3.3 Percentage of Firms with a Bank Account by Size for Selected Countries 14
3.4 Percentage of Firms with a Loan for Selected Countries 14
3.5 SME Loans-to-Total Loans Ratio and SME Lending Targets 15
3.6 Products and Services Offered to SMEs 16
3.7 SME Lifecycle-Financing Needs 17
3.8 MENA Leasing Penetration Rates 17
3.9 Factoring Penetration Rates by Region 19
4.1 Proportion of MENA Banks Responding that Obstacle is Very Important or Important for SME Financing 24
4.2 Proportion of MENA Banks Using Selected Risk Techniques for SME Lending 26
4.3 Collateral Value as a Proportion of Loan Value by Size of Firm 28

Boxes

3.1 Gender Disparities–Women Economic Empowerment 13
3.2 NILEX SME Exchange, Egypt 20
4.1 Islamic Finance for SMEs 29
5.1 Reverse Factoring: The Case of NAFIN, Mexico 38
5.2 Jordan–Expanding SMEs Access to Finance 41
5.3 Inovar Program, Brazil 42
5.4 Emerging Arab Diaspora links to SME Innovation in MENA 43
5.5 Key Findings from CGAP’s Global Study on Microfinance Apex Institutions 45

Tables

2.1 SMEs as a Proportion of Total Enterprises 7
4.1 Loan Portfolio Concentration 25
The Arab Spring in the Middle East and North Africa (MENA) region has brought to the forefront, key challenges as well as prospects. It has highlighted the need to create job opportunities, equal access, a level playing field, governance, transparency and accountability, as well as a fair and competitive environment to accelerate inclusive growth. It is also a time of change—the recent political and economic developments in the region, enhanced prospects for change, and an appetite for reforms. It is essential to address the challenges and build on the opportunities at this historical time.

Small and medium enterprises (SMEs) are the main source of private sector jobs in MENA. Despite the important role SMEs play in the economy, they are still confronted with several obstacles. Key constraints, include, financial institution lending capacity, enterprises' creditworthiness, liquidity of the financial intermediaries, and the availability of risk-sharing instruments. Among the major challenges also facing the sector are non-conducive legal and regulatory frameworks, as well as, poor financial infrastructure, information asymmetry, and a weak judicial and legal system. Moreover, there are non-financial challenges, including lack of adequate business development services, enterprises managerial and marketing skills, advanced technology, and skilled labor. All this hinders the development of the SME sector in the MENA region.

The progress and pace of some of the reforms undertaken in the region to develop SMEs, and improve their access to finance, have been commendable. However, there remains much to be done to ensure better financial intermediation, allowing businesses to capitalize on their growth potential and operate on a
larger scale, turning initiatives and ideas into employment opportunities. The recent Arab uprisings have revealed the shared aspirations of the people who want to see their countries rise to their potential. Growth in MENA has failed to generate enough employment, for both women and a rapidly growing and increasingly youthful population, and did not address regional disparities. Overall growth in the Arab World was not inclusive. Financial inclusion is one key avenue to broadening and increasing the benefits of market economies.

This report comes at a critical time, and we hope that the findings and recommendations will assist in the ongoing endeavors to meet these challenges. It was initiated in order to gain a better overall understanding of how SMEs operate in the MENA region, and to identify constraints to their development. The report provides a comprehensive assessment and evaluation of the supply and demand of financial services to SMEs, as well as the regulatory, institutional and policy environment. The report concludes with policy recommendations and measures that would enhance the role of SMEs in job creation, and in contributing to overall economic growth in the MENA region. It presents an approach of how to do things differently.

The MENA countries are committed in achieving the aspirations of its people. Attaining sustainable and inclusive development by expanding private-led jobs and creating entrepreneurship opportunities has become increasingly urgent especially among youth, women and people in marginalized regions. This calls for all stakeholders—the government, the private sector, the civil society and development partners to join forces to support the once underserved and unserved segments of society. While work should commence on a broad range of issues, some key decisions need to be taken immediately, while others may be implemented over the medium and long term. Most important is that we need to move forward now. There is a momentum for change and reform that needs to be taken advantage of.

Inger Andersen
Vice President
Middle East and North Africa
The World Bank
This Innovative SMEs Development for Job Creation Post Arab Spring: Access to Financial Services report was written by Sahar Nasr, Lead Financial Economist, Finance and Private Sector Development Group, MENA, World Bank; and Douglas Pearce, Financial Inclusion Practice Manager, Financial Inclusion Global Practice, World Bank.

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The summary findings of the report were presented to various audiences during a series of consultations. These consultations included private sector representatives, government officials, civil society representatives and members of academia, as well as staff from international organizations—USAID, the African Development Bank, the Organization of Islamic Conference, the European Union, and the Organization for Economic Cooperation and Development. All participants in these consultations are hereby gratefully acknowledged for their useful feedback and suggestions.

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The findings, interpretations, and conclusions of this policy research report are those of the authors and do not necessarily reflect the views of the World Bank, its executive directors, or the countries they represent.
**Abbreviations and Acronyms**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AFESD</td>
<td>Arab Fund for Economic and Social Development</td>
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<td>AMF</td>
<td>Arab Monetary Fund</td>
</tr>
<tr>
<td>BFPME</td>
<td>Banque de Financement des Petites Moyennes Enterprises</td>
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<tr>
<td>CAPMAS</td>
<td>Central Agency for Public Mobilization and Statistics</td>
</tr>
<tr>
<td>CBE</td>
<td>Central Bank of Egypt</td>
</tr>
<tr>
<td>CCG</td>
<td>Caisse Centrale de Garantie</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
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<tr>
<td>EAP</td>
<td>East Asia Pacific</td>
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<tr>
<td>EBI</td>
<td>Egyptian Banking Institute</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ECA</td>
<td>Europe and Central Asia</td>
</tr>
<tr>
<td>EPCGF</td>
<td>European Palestinian Credit Guarantee Fund</td>
</tr>
<tr>
<td>FORPROD</td>
<td>Fonds de Promotion et de Decentralisation Industrielles</td>
</tr>
<tr>
<td>GCC</td>
<td>Gulf Cooperation Council</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GTIP</td>
<td>Global Technology and Innovations Partner</td>
</tr>
<tr>
<td>ICICI</td>
<td>Industrial Credit and Investment Corporation of India</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>ILO</td>
<td>International Labour Organization</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>JEDCO</td>
<td>Jordan Enterprise Development Corporation</td>
</tr>
<tr>
<td>LAC</td>
<td>Latin America and Caribbean</td>
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<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
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<tr>
<td>MFI</td>
<td>Micro Finance Institution</td>
</tr>
<tr>
<td>NAFIN</td>
<td>Nacional Financiera</td>
</tr>
<tr>
<td>NBFI</td>
<td>Non-Bank Financial Institutions</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-Governmental Organization</td>
</tr>
<tr>
<td>NILEX</td>
<td>Nile Stock Exchange</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
</tr>
<tr>
<td>SA</td>
<td>South Asia</td>
</tr>
<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SOTUGA</td>
<td>La Société Tunisienne de Garantie</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>UAB</td>
<td>Union of Arab Banks</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>WBI</td>
<td>World Bank Institute</td>
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</table>
I. Introduction

The Arab Spring in the Middle East and North Africa (MENA) region has brought to the forefront key challenges: the need to create job opportunities, equal access, a level playing field, transparency and accountability, and a fair and competitive environment. Crony capitalism—the privileged access of certain elites to favorable legal and regulatory treatment, access to markets, and the coincidence of political and economic power—was a major concern contributing to the uprising. Many saw privilege and corruption as the source of unemployment and inequality, effectively raising barriers to entry and growth for the majority of entrepreneurs. At the same time, practices such as connected lending and preferential land allocations, contributed to poor performance of key institutions, underpinning the market economy. It is critical for the MENA countries to achieve the aspirations of their people and attain sustainable and inclusive development by expanding private-led employment and creating entrepreneurship opportunities.

The Arab Spring has highlighted a challenge shared across the region of generating job opportunities, promoting inclusive growth, and improving competitiveness. It has revealed the unified and common demands of the people who want to see their countries live up to their potential. Although growth in MENA has accelerated over the past decade, averaging 4.7 percent, it still lags behind other developing regions’ average of 6 percent, and more important is that it was not inclusive. Growth has been below its full potential and has failed to generate enough employment. The MENA region has been unable to make substantial progress in reducing persistently high unemployment rates, especially among youth and women, and addressing, regional disparities. The private sector falls short of creating sufficient jobs for young entrants into the market while public sector jobs are
prevalent, creating distortions in the market and contributing to long unemployment spells.

A critical challenge in the MENA region is high unemployment rates, which has been aggravated by the recent slowdown in economic growth and calls for an increase in job creation. The demographic transformation of the region has led to an abundance of young working-age adults. MENA countries face a rising labor supply that has outstripped demand, leading to stubbornly high unemployment rates of 10 percent with even higher female unemployment rates of 16 percent. The aggregate rates for female unemployment in most countries are high with the rate at 23 percent in Egypt, 17 percent in Tunisia, and 10 percent in Morocco. As a result, the informal economy has expanded and absorbed a large number of both unskilled as well as discouraged educated workers. This has affected mostly women who have not been able to find job opportunities in the formal sector. The problem of unemployment has been sharply exasperated, especially among youth and women, with the recent slowdown in economic growth and on-going demonstration and unrest in some of the MENA countries. Broad-based growth is essential, and hence the need to boost employment and improve productivity.

Recent political and economic developments in the region raise various challenges but also enhance prospects for change and an appetite for reforms. Addressing these challenges and building on the opportunities at this critical time is essential. SMEs are the main source of private sector jobs in MENA. Developing this sector has become an even higher priority for development partners since the Arab Spring. This will entail leveling the playing field so that once-marginalized enterprises can compete fairly with privileged large enterprises. With huge popular expectations and an uncertain transition, the authorities are keen on finding best practice solutions to the substantial challenges facing regional economies. Newly elected leaders will need to proceed with designing reforms to meet the demands for expanded opportunity. There is a momentum for change and reform that needs to be taken advantage of.

SMEs contribute significantly to Gross Domestic Product (GDP) and to private sector employment in the MENA region, yet often lack access to the type of investment and financial services that they need to start-up, operate and grow. Access to employment and income earning opportunities through participation in SMEs, whether as owners or employees, is a topical and prominent issue in the MENA region. New research by Ayyagari, Demirguc-Kunt and Maksimovic (2011) confirms that small firms are important contributors to total employment and job creation, but suggests that their productivity and growth is held back by SME-specific constraints. There is a raised awareness in MENA that difficulty of entry into relatively closed private sector networks, and a lack of access to finance and to markets, holds back the growth and competitiveness of SMEs. Policymakers are looking for effective tools and levers to stimulate SME development in response, including through improving SME access to finance.

A small proportion of high performing SMEs have the potential to grow into internationally competitive companies, generating significant economic benefits through raised productivity, employment, and economic stability.
However, this potential is constrained by entrepreneurs not being able to access start-up or growth capital and associated business mentoring. SMEs may be denied credit despite having sufficient cash flow or purchase orders, due to collateral requirements. SMEs may only be able to access short-term credit facilities and not the type of financial products they need (such as factoring, leasing, or longer tenor loans). Certain segments of the population, such as women, may be excluded from business activity and from finance, for example because they traditionally do not own land, which is often still the preferred collateral for SME loans.

This report assesses the supply and demand of financial services to SMEs in the MENA region, as well as the regulatory, institutional and policy environment that determines the cost, risk, and scale of SME finance. Emerging and promising SME finance models for banks, investors, government and regulators are outlined. These could significantly improve the outreach, viability, risk management, and development impacts of SME finance in the MENA region. SMEs need access to longer term credit products and equity, in addition to working capital loans and trade finance. They also need payment and card services, deposit facilities, liquidity management, risk management tools and insurance. The principal role of the state is as an enabler and regulator, providing the financial infrastructure, and legal and policy frameworks that financial institutions need to be able to meet the range of SME financial needs profitably. All this will contribute to attaining a more sustainable and inclusive system that can play a more important role in economic growth, and the regions prosperity.
Job Creation in the Arab World
II. SME Prospects in MENA

SMEs in MENA are a significant employer and contributor to GDP. Recent work on SMEs globally has confirmed their importance in job creation. A recent World Bank analysis of 99 countries shows that firms with less than a hundred employees account for the lion’s share of employment creation (Ayyagari, Demirguc-Kunt, and Maksimovic 2011). A growing literature on the vital role of fast-growing SMEs (“gazelles”) in employment creation has focused attention on the characteristics of high-growth firms, highlighting the importance of building their capacities and skills, while reducing constraints to their entry and operation. Further reforms are needed to develop the SME sector in the MENA region.

A. SMEs Contribution to Job Creation

SMEs account for the majority of enterprises and private sector employment opportunity, but they have been marginalized. SMEs represent between 80 percent and 90 percent of all formal sector enterprises, and an even higher proportion if informal enterprises are taken into account. SMEs typically account for 20 percent to 40 percent of all private sector employment in MENA (Figure 2.1). Accordingly, the number would rise particularly in countries with large informal sectors. Employment in SMEs is likely to be significantly under-counted in official records due to imprecise records on the informal sector.

1 The definition of SME still varies widely by bank, regulator, ministry, and country. The SMEs are typically defined by employees (the minimum threshold in MENA can be 5–10 for small enterprises, 20–25 for medium enterprises, and 100–200 for large enterprises, though this varies widely by institution and country), turnover, and capital. Examples of definitions are presented in Annex I.
SMEs are typically responsible on average for more than 30 percent of all private sector employment in MENA (Figure 2.2), and between 4 percent and 16 percent of total employment, including public sector and non-governmental organizations (NGOs) employment. Employment in SMEs is likely to be under-counted in official records due to informality, for example under-reporting of employment for tax reasons, or enterprises not being registered. The typical non-Gulf Cooperation Council (GCC) MENA country is estimated to employ as much as 67 percent of its labor force informally, although only 6 percent of GCC labor is informal (Loayza and Wada 2010). It is worth noting that the level of recorded employment in SMEs is lower as a percentage of total employment in the MENA region than other regions. As the MENA region does not seem to have a high level of informal business, this suggests that SMEs (and microenterprises) are operating below their employment generating potential there.

The majority of enterprises in many MENA countries are microenterprises, rather than SMEs. The proportion of SMEs to total enterprises is less than four percent in Egypt, Morocco, Lebanon and Yemen (Table 2.1). For micro, small and medium enterprises together the proportion rises to between 86 and 97 percent for the same countries. In Saudi Arabia, SMEs are the majority, making up 79 percent of all enterprises, while the United Arab Emirates enterprise sector is more balanced between microenterprises and SMEs. GCC countries tend to be more dominated by large corporates than non-GCC countries (related to the importance of oil and gas), which may reduce the number of microenterprises, although another explanation is possible under-recording of informal small and micro enterprises.

Table 2.1: SMEs as a Proportion of Total Enterprises (Formal Sector)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>Small Enterprises (percent)</th>
<th>Medium Enterprises (percent)</th>
<th>SMEs (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Egypt</td>
<td>2006</td>
<td>1.7</td>
<td>0.1</td>
<td>1.8</td>
</tr>
<tr>
<td>Morocco</td>
<td>2002</td>
<td>1.9</td>
<td>0.3</td>
<td>2.2</td>
</tr>
<tr>
<td>Lebanon</td>
<td>2004</td>
<td>2.3</td>
<td>0.2</td>
<td>2.5</td>
</tr>
<tr>
<td>Yemen</td>
<td>2004</td>
<td>3.4</td>
<td>0.2</td>
<td>3.6</td>
</tr>
<tr>
<td>Jordan</td>
<td>2007</td>
<td>9.2</td>
<td>1.6</td>
<td>10.8</td>
</tr>
<tr>
<td>Oman</td>
<td>2007</td>
<td>12.6</td>
<td>6.1</td>
<td>18.7</td>
</tr>
<tr>
<td>Bahrain</td>
<td>2006</td>
<td>13.0</td>
<td>8.7</td>
<td>21.7</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>2005</td>
<td>37.5</td>
<td>3.4</td>
<td>40.9</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>2008</td>
<td>48.5</td>
<td>30.9</td>
<td>79.4</td>
</tr>
</tbody>
</table>

Sources: Government databases; World Development Indicators.

B. Innovation and Growth of SMEs

Fast-growing SMEs are essential generators of new employment in developing economies. Innovation in the private sector could be one of the key means of generating middle-income level jobs. In MENA, high SME growth and innovation are linked to workers’ education, firms offering formal training, firms’ quality certification and firms’ email or Website use (Figure 2.3). This underscores the importance of policy and institutional reforms to strengthen these factors. Innovation is also linked to competitive pressure, whether local or international, which underscores the importance of integrated competition policy to facilitate market dynamism. In order to respond to the urgent needs of the MENA countries, it is important to support reforms that would enhance the development of innovative SMEs, creating job opportunities and sustainable economic development.
Furthermore, because SMEs suffer more than large firms from many policy and institutional constraints arising from imperfect markets, they benefit disproportionately from reforms.\(^2\) Small firms in particular significantly stand out in the degree to which they identify regulatory policy uncertainty, corruption, access to land, taxation, access to finance, and electricity as serious constraints. For example, senior managers of SMEs spend a higher percentage of their time dealing with bureaucracy and are more likely to report that informal payments to officials are needed “to get things done” (Figure 2.4 and Figure 2.5).

\(^2\) Small firms not only suffer more from market frictions such as transaction costs and information assymetries than large firms, but these market frictions have a disproportionatly larger effect on small firms in nations with less developed institutions.” See Beck and Demirguc-Kunt, 2006.
A World Bank report on SMEs noted, “The role of the State is mainly to provide an enabling business environment that opens access to markets and reduces policy-induced biases against small firms” (Halberg 2000). To further enhance innovation, experience suggests not only a supportive investment climate and business regulations that encourage ease of exit, entry and competition; but also a potential role for innovative finance, quality certification, mentoring and incubating, and effective competition policy (Bell 2011).

SMEs are responsible for a large part of employment and are disproportionately important in employment growth. Equally important, is the presence of a vibrant SME sector (as opposed to a “missing middle” between micro and large firms) is understood to be a key indicator of economic dynamism and a source of new ideas and competitive pressure that spur innovation. SMEs play a key role in the economic “turbulence” (entry and exit) that is a necessary part of rapid growth. In a healthy economy with competitive markets, new firms constantly enter the market, but most will exit again within five years. Better performing firms become large. Thus large firms (survivors) are the most productive and long-lived. However, there is no optimal size of firms (Klein and Hajimichael 2003). Optimal size, whether small, medium, or large, depends on the sector, technology and country conditions. Healthy markets with undistorted incentives select more productive firms. In MENA, innovative SMEs tend to generate more employment than do others. Size-neutral policies that enhance the environment for competition and innovation are both good for growth and good for SMEs.
III. SMEs Access to Finance

A. Financial Intermediation for SMEs

SMEs have a low level of access to finance, which could worsen with the recent economic and political developments in the MENA region. In fact, MENA has the lowest levels of usage of bank loans of all regions except sub-Saharan Africa, according to the World Bank enterprise and bank surveys (World Bank 2011a). Only 20 percent of SMEs in MENA have a loan or line of credit and the average share of SME lending on total loans is only eight percent in MENA, which is the lowest ratio among all the regions (Figure 3.1 and Figure 3.2).

MENA also lags behind most regions in access to finance indicators of deposit and loan accounts per population, with only 24.5 percent of adults having a loan account. Bank lending tends to be directed to large, corporate customers, and many banks still prefer to utilize excess liquidity to finance the government’s deficit or the activities of large established corporations. High potential and start-up SMEs face significant constraints in accessing growth capital (angel finance and venture capital), from more specialized investors and funds.

Recent estimates conducted by McKinsey for the IFC-led G20 Experts Group on SME Finance suggest that there is a considerable financing gap for SME lending in MENA, totaling US$ 2.26 billion for Egypt, Jordan, Morocco, Tunisia, and Lebanon alone. The estimated SME credit gap is US$ 1.05 billion, then US$ 547 million, US$ 497 million, US$ 247 million, and US$ 26 million respectively. According to McKinsey, SME lending would have to increase by 125 to 150 percent in the MENA region in order to meet demand, that is more than double, which is the second highest regional percentage increase projected, after sub-Saharan Africa (Stein, Goland, and Schiff 2010).

SME finance in the MENA region is dominated by banks, with capital markets and non-bank financial institutions (NBFIs) being less significant financing sources for SMEs as compared to other regions. Bank lending to SMEs varies significantly by product, size of loan and client, and lending technology used. The majority of MENA banks already provide SME finance: 92 percent of MENA banks already have SMEs as clients. Around 70 percent of banks have SME units focused on SME finance. However the average share of MENA bank portfolios made up of SME lending is only 7.6 percent. Certain segments of the population, such as women, may be excluded from business activity and from finance, for example because they traditionally do not own land, which is often still the preferred collateral for SME lending (Box 3.1).

SMEs have low rates of credit usage in MENA, although they are better served with bank accounts. SME use of credit from financial institutions in MENA is at a lower level than any other region except sub-Saharan Africa. A notably higher proportion of MENA SMEs however, can potentially access deposit, cash management and payments services through bank accounts. At the country level, SMEs have high levels of access to bank accounts in Morocco, Lebanon, Jordan, Syria, and Saudi Arabia, ranging from 86 percent to 95 percent. SMEs in Yemen and Egypt have relatively ever less access, with 53 percent and 69 percent respectively. SME usage of bank accounts is not notably lower than for large enterprises in a number of MENA countries (Figure 3.3). Of the subset of countries mapped in the Figure, only in Egypt and Yemen is the difference a significant one. MENA still has room to improve SME usage of bank accounts relative to other regions though.

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3 These market gap figures are calculated on the basis of enterprise demand or need for credit, compared to the existing supply.
Box 3.1: Gender Disparities–Women Economic Empowerment

Female SME owners can face gender-related barriers that affect their access to finance. These barriers tend to vary by country and household. Women suffer more from constrained access to finance compared to men, whether in terms of the cost of finance, ability to gain approval for financing, or legal disputes and conflict resolution in case of bankruptcy. In addition, banks request more strict collateral requirements when dealing with women investors.

Although the law gives women ownership rights, they often have less productive assets and lack independence in managing these assets (being under the guardianship of their brother, husband, or even son), they often lack independence necessary to manage these assets. In many cases they are prevented from using their property as collateral for loans, limiting their ability to participate as independent agents in private-sector activity. The allocation of resources within the family is greatly influenced by the perception of roles, where the men are seen as the main, if not the sole bread-earner (even in the cases when they are not).

Broader constraints include women’s limited mobility due to socio-cultural reasons. Social traditions reduce women’s flexibility to leave the house, reach out to financial institutions, and deal with strangers. As a result, women rely more on the informal financial market, compared to men. They are also more likely to draw on funds from family and friends. In Egypt, few women entrepreneurs use commercial banks for credit (around 20 percent), but those who do are confronted with higher rejection rates (6 percent compared to 4.5 percent for men). The proportion of Egyptian women who complained about collateral requirements was double that of men (Nasr 2011).

The financial sector in MENA in general does not systematically collect gender-disaggregated portfolio information and so does not have a good understanding of the needs of women SME owners as potential customers. Less than a third of loan officers in MENA banks are female (31 percent, according to the 2010 World Bank and Union of Arab Banks survey, 2010), although banks estimate that women account for only 10 to 25 percent of bank clients.

There is no evidence that women SME owners and managers are riskier clients than men, but there is plenty of anecdotal evidence that they are served less. Serving a greater proportion of women-headed SMEs is therefore a market opportunity for banks, and an access to finance challenge. Standard Chartered have developed a ‘Women in Business’ line, and conducted extensive research using their existing loan portfolio and borrower records. Standard Chartered found that female-headed SMEs have even poorer financial transparency than male-headed SMEs, with three times as many women not having adequate financial statements as men.

Women cited the cost of having accounts audited as a major reason for not doing so. Importantly though, Standard Chartered found that gender does not affect risk (for probability of default), and have developed a product for female-headed SMEs that provides: (i) access to banking services through an operating account; (ii) access to a partially-secured overdraft facility; (iii) convenient access through Internet and doorstep banking; (iv) account fee discounts; and (v) an improved credit score over time as women build up a credit history with the bank. This links to what is calls “enablers”, including accounting firms (to make audits more accessible), and its Women in Business online resource center, to assist women become better customers and access more financial services. The Women in Business resource center provides educational modules in financial, marketing, strategy and soft management skills.
Small enterprises have notably lower rates of usage of credit services than medium and large companies. Less than half the proportion of SMEs as compared to large enterprises use credit from financial institutions in MENA (Figure 3.4), which again is lower than all regions except Africa. Many SMEs prefer to finance longer-term, more risky, investments from internal funds, which are the dominant source of financing for MENA SMEs. According to World Bank enterprise surveys, this has been the case more for SMEs than for large enterprises, in all seven MENA countries where data has been gathered.4

Greater bank involvement in SME finance in the Moroccan and Lebanese markets is reflected by the much larger percentage of SME borrowing from banks than in the other MENA countries, which suggests that usage does increase with access. When credit is available on sufficiently attractive terms and forms, a higher proportion of SMEs do borrow. Therefore countries with very low percentages (less than 10 percent) for SME borrowing from banks, such as Saudi Arabia, Egypt and Yemen, have SMEs that are credit constrained, and not only SMEs that choose not to borrow.

4 This type of funding holds true except for working capital financing in Morocco (where SMEs seem to have better access to supply chain credit), and Syria (where “moneylenders and others” is a greater source for SMEs as compared to large enterprises), and investment financing in Lebanon, where non-bank financial institutions (NBFIs) are accessed by a greater proportion of SMEs than large enterprises.
SME lending targets are less than half in the GCC than in the non-GCC countries in MENA, at 12 percent and 27 percent respectively, and the actual proportion of lending in non-GCC countries is even lower as a portion of total bank lending (only one sixth). This illustrates the relative lack of focus of GCC banks on SME lending. State-owned banks have an average share of SME loans of 9 percent of total lending, as compared to 11 percent for private banks (Figure 3.5). State and private banks also have almost identical long-run targets for SME lending in the future.

Figure 3.5: SME Loans-to-Total Loans Ratio and SME Lending Targets

The potential returns from SME lending are the principal reason why MENA banks are interested in such lending. Private banks are also motivated by the potential for cross-selling a range of financial products to SMEs, and by a desire to maintain a diversified portfolio and manage risks. State-owned banks on the other hand are also motivated by diversification and by competition in other market segments.

Overall, SME access to finance is constrained by various challenges. SMEs have relatively good access to bank accounts, but their access to credit, growth capital, and some other financial services is more constrained. Moreover, banks are the principal source of SME finance, but they operate at well below the SME market potential. SMEs finance primarily from non-financial sector sources, including trade credit, start-up and growth capital is in short supply.

Governments and regulators have introduced reforms to expand and strengthen SME finance, but policies, regulatory frameworks and financial infrastructure need much greater attention. Financial institutions can expand SME finance prudently through transaction-based lending techniques, packaging a bundle of products to clients, and effectively serving female-owned SMEs. At the same time financial product diversification is needed to improve the viability and outreach of SME finance in MENA, with NBIFs playing a greater role. SME creditworthiness can be improved through better information provision, more appropriate reporting and auditing standards, and improved access to business services.
B. SME Financial Products

Most of the financial products offered to SMEs are through the banking sector, rather than from NBFIs. Banks offer a range of financial services to SMEs, primarily credit (including trade finance and overdraft facilities), deposits and cash management, and payments and transfer services. Insurance, pensions, leasing and equity finance are much less widely offered (Figure 3.6). Insurance and leasing are offered only by 28 percent of MENA banks, often through wholly owned subsidiaries.

Figure 3.6: Products and Services Offered to SMEs


Banks often offer a narrow range of credit products to SMEs, with many enterprises not seeing banks as relevant to their financing needs beyond overdraft facilities or occasional working capital loans. Due to collateral requirements by banks, SMEs may be denied credit despite having sufficient cash flow or purchase orders. Or SMEs may be able to access only short-term credit facilities and not the type of financial products they need. The range of products offered to SMEs is narrow, and equity finance, leasing, factoring, and longer-tenor loans are not widely offered. Only 10 percent of their investment expenditures are financed by a bank loan, a share that is higher only to that of sub-Saharan Africa.

The range of credit products needed by enterprises does not match the available financial products. There is a lack of longer-term, more substantial investment from private equity providers or through lease arrangements (Figure 3.7). While not all SMEs will utilize credit products in a particular month or year, virtually all SMEs need deposit and payment services provided through bank accounts (and cards linked to accounts) and access to insurance or other risk-management services.
Leasing. Leasing is present in 13 MENA countries, with an estimated 109 lessors in operation, although often only at a limited scale (Al-Sugheyer and Sultanov 2010). Leasing in much of MENA is relatively underdeveloped (Figure 3.8, and Figure A2.6 and Figure A2.7 in Annex 2). The most active and developed leasing markets in the region are in Tunisia, Kuwait and the UAE, but even these are characterized as “emerging” and not yet “developed”. Leasing has been increasing significantly in recent years in the nascent leasing markets of Morocco, Egypt and Jordan. The primary form of leasing is “full-payout” for vehicles, equipment and machinery, which is similar in nature to asset financing through loans.

A penetration rate of less than five percent would indicate that the leasing market is nascent, a penetration rate between 5-10 percent indicates an emerging market, and a rate above 10 percent is an evidence of a developed market. Penetration rate is the annual leasing volume divided by the gross fixed capital formation.
Leasing is primarily provided by banks or bank subsidiaries, as they can access term deposits and relatively cheap financing as compared to stand-alone leasing companies in MENA, which are reliant on more costly equity investments or longer-term loans (if available). In a number of MENA countries such as Lebanon and Tunisia leasing is allowed only by banks and bank affiliates. Around 28 percent of MENA banks offer leasing, according to the 2010 World Bank and Union of Arab Banks survey.

The legal framework for leasing in MENA is either absent or ineffective, which has hampered the growth of the industry in the region. Only five countries have special leasing laws, or in other words, specialized leasing legislation is absent in 80 percent of MENA’s countries. While some of these specialized leasing laws are considered progressive, such as those in Jordan and Yemen, others fall short of addressing the vital legal issues for leasing which makes these laws ineffective (Al-Sugheyer and Sultanov 2010). Effective repossession and court systems are lacking in many MENA countries, with only Jordan, Yemen and Egypt offering non-judicial repossession. Cumbersome and lengthy repossession procedures increase the credit and liquidity risks for lessors, as well as their costs, and weaken their position as creditors. Enforcement of contractual and proprietary rights is inefficient in much of the region, with systematic delays in court proceedings and in registering property titles.

**Factoring.** Factoring is a transaction-based lending technique and a form of structured finance, used by banks and NBFIs. Factoring is also a type of supplier financing, whereby firms sell their creditworthy accounts receivable at a discount (generally equal to interest plus service fees) and receive immediate cash. Factoring is not a loan and there are no additional liabilities on the firm’s balance sheet, although it provides working capital financing. Nevertheless, many MENA countries have technological, regulatory, and judicial barriers to the expansion of factoring, as well as a shortage of information about SMEs that may be involved in such a transaction.

Factoring penetration in the MENA is the lowest among the world’s regions, reaching only two percent of GDP in Lebanon, and is virtually nonexistent in the rest of the region except for Tunisia, Morocco and Egypt (Figure 3.9). Tunisia is a positive regional example of growth from a low base, with US$ 352 million of invoices purchased in 2008, up 10.4 percent from 2007, involving 511 firms and 24,156 buyers. Tunisia Factoring is the first independent factoring company in the local market, with 13 years of experience. It maintains 65 percent of the market share. In 2009, Tunisia Factoring turnover amounted to €250 million. Fitch has rated Tunisia Factoring at BBB. The total turnover of factoring in Morocco amounted to €910 million, equivalent to 1.46 percent of GDP, out of which €160 million were part of foreign transactions. The government of Egypt has recently implemented reforms to foster the factoring industry, including the amendment of the Executive Regulation of the Investment Law, setting main rules and

6 For cross-country and region comparisons for factoring penetration see Annex 2, Figure A2.8.
7 The leading factoring companies that provide financing in Morocco are Standard Bank Factors, Nedbank Factors, RSA factors, Capital Bancorp, Summit Finance, Ventures and Trust Limited, and First Industrial Factoring House. Only Standard Bank Factor accepts bad debt risk; other factoring houses insist on recourse to the customers.
regulations governing factoring activities, licensing, registration requirements, and procedures and establishing surveillance that includes financial adequacy, credit risk protection, receivables book-keeping, and collection services.

**Figure 3.9: Factoring Penetration Rates by Region (factoring as a percent of GDP)**

![Bar chart showing factoring penetration rates by region](chart.png)

*Source: Factors Chain International (2011).*

**Insurance.** A well-functioning insurance sector can enable the range of loan tenors to be lengthened, and help manage the risk of financing SME investments. Insurance other than life insurance appears to be important at all stages of development, while life insurance becomes a growth driver for transition in developed countries. With a few exceptions, the MENA insurance sector is dominated by the non-life sector. On the basis of the ratio between actual insurance penetration or density and the value predicted by GDP per capita, MENA performs poorly relative to all other regions. MENA is the only region that has penetration ratios of less than 100 percent for both life and non-life. Three countries, Morocco, Lebanon, and Egypt, have a life density ratio at or above 100 percent, with Jordan approaching the 100 percent mark. All of these countries have tapped into growing middle class investors and retail credit markets through banc-assurance.

**Trade credit.** “Trade credit” or “supplier credit” from other firms, such as firms that supply production or service inputs, is a common source of finance for SMEs globally, and can be more prevalent where SMEs lack the alternative of bank credit (IFC 2010). Trade credit, or supplier credit enables SMEs to manage their cash flow by delaying payment for goods and services purchased, and are typically used to meet short-term working capital needs. Trade credit is in some ways the other side of the coin to factoring, as it is based on accounts payable rather than accounts receivable.

Where SMEs are unable to access sufficient financing from the banking system, or only at a high cost, as is the case of much of the MENA region, trade credit can give SMEs access to finance through their trade relationships with large firms that have access to (lower priced) domestic and foreign bank
financing. SMEs often depend on their large customers and suppliers to provide them with working capital financing. This may be in the form of 30 day credit from suppliers—which is repaid when the final goods are sold—or cash advances from customers—which is settled when the final goods are delivered. Demirguc-Kunt and Maksimovic (2001) find that in 39 countries around the world, trade credit use is higher relative to bank credit in countries with weak legal environments, which make bank contracts more difficult to write. Fisman and Love (2002) highlight the impact of inter-firm financing by showing that industries with higher dependence on trade credit financing exhibit higher rates of growth, in countries with relatively weak financial institutions.

**Capital markets, private equity.** MENA equity markets tend to be relatively large in terms of market capitalization to GDP but are not yet accessible to SMEs. They tend to function more as a club for corporate insiders and venue for weakly informed speculation as opposed to a dynamic mechanism for SME equity finance, corporate restructuring, corporate oversight, and price discovery. SMEs in MENA, like their counterparts elsewhere in the world, face a number of challenges when trying to access local or international capital markets. The cost of raising capital tends to be considerably higher for SMEs as a result of the perceived greater risk associated with investment in such enterprises as well as the smaller relative amount of financing SMEs require to fund their growth. Furthermore, SMEs find it almost impossible to satisfy the strict issuance eligibility criteria and listing conditions required by capital market regulators.

**Box 3.2: NILEX SME Exchange, Egypt**

In order to facilitate SME access to equity capital and encourage initial private offerings, in 2007 the Egyptian government began efforts to establish a separate and distinct board for SME listing: NILEX. Like their SME market counterparts elsewhere around the world, NILEX rules provide greater flexibility for SMEs with regard to capital structure, disclosure, and financial history as well as significantly lower listing costs. Companies wishing to list on NILEX are required to have an Egyptian Financial Supervisory Authority (EFSA) approved advisor to assist the company in meeting its initial listing and ongoing disclosure requirements for at least two years. As of the end of 2011, only twelve firms had listed on NILEX and only limited trial trading sessions had occurred. Factors such as poor market conditions, attitudes of family-owned firms toward disclosure and public scrutiny, or NILEX’s own rules, may account for the modest initial development of NILEX.

To address these concerns both Egypt (NILEX) and Tunisia (Marché alternatif) have opted to establish dedicated stock exchanges exclusively for the SME sector, with the aim of facilitating access through less stringent eligibility criteria and a lower all-in cost (Box 3.2). While promising initiatives, neither market is yet particularly active. A lack of options for exits, therefore constrains investment in SMEs. Private equity funds are active throughout the region, including venture capital funds (there are at least 40 venture
capital funds operating in Tunisia), but they tend to lack SME investment expertise and market knowledge, or are put off by the lack of exit options given capital market constraints. There are government-and donor-funded schemes to facilitate access to venture capital for high growth companies, for example FOPRODI in Tunisia and recent EU and USAID-supported SME fund initiatives in Jordan, but private sector venture capital fund investments in SMEs are still limited.

The availability of risk capital for SMEs and start-ups is increasing in some MENA countries outside of the GCC, with wealthy individuals, banks, and investment funds setting up a small number of risk capital funds. The acquisition in 2009 of Maktoob.com, a Jordanian Internet firm and online community, sparked great interest in Jordan’s active information and communication technology sector, for example, several private equity investors have since set-up SME and start-up funds for Jordan, including Abraaj Capital. However, there is reportedly still a shortage of early stage venture capital in the range of US$ 50,000 to US$ 200,000 relative to larger second stage investments of US$ 1 million to US$ 2 million.

C. Recent Policy and Program Interventions

The recent political and economical developments that have swept through the MENA region during the past two years have shaped and prepared the region for serious challenges, and also, prospects and opportunities. Taking advantage of the opportunities and addressing the challenges throughout this critical transition period is essential in order to ensure a smooth transition to success on many different levels. SMEs play a large role in private sector employment and also contribute significantly to GDP. Developing the SME sector and fully utilizing it towards its full potential has become an even higher priority for development partners since the uprisings that took place during 2011. Both political and economical developments have brought about the prospect of change, however there are uncertainties but what remains true is the importance of developing the SME sector for the creation of sustainable jobs, catering to a large number of the population especially youth, women and marginalized groups, and has the potential to hugely improve the economic well-being of many.

Governments are committed to SME development and see SMEs as the engine of development and job-creation. Governments are increasingly promoting a more balanced and equitable growth model. Banks are also seeking to grow their SME portfolio. SMEs are perceived as a large untapped market segment, more diversified and less exposed to political risks than large connected corporations. All this highlights the need to support the development of the SME sector in MENA, which can play an important role in job creation—a major challenge the region faces. The MENA countries are undergoing a major transformation post the Arab Spring.

Several reforms have been undertaken in order to improve the SME business environment. Measures undertaken include building the capacity of
banks to improve access to finance for SMEs in order to attain an inclusive system, focusing on youth, women and regional disparities. This was especially critical for state-owned banks that have the largest branch network and can reach out to the poor villages where most of the disadvantaged groups are located. This entailed emphasis on strengthening risk management and corporate governance practices. Moreover, work has been done on supporting enterprises through entrepreneur networks, mentoring, and business incubator-type services. This included broadening the range of business development services in the region in order to facilitate linkages with investors, new markets and technologies, as well as scaling up incubator operations to reach a larger number of entrepreneurs.

MENA governments and regulators have been undertaking reforms and providing positive signals to the private sector to expand SME finance and address market failures. Central banks across the region have stepped up efforts to encourage SME finance, including in Egypt, Morocco, and Lebanon (regional leaders in SME finance), and Jordan, West Bank and Gaza. The Central Bank of Egypt (CBE), for example, introduced measures to introduce data (a nationwide SME census to build a comprehensive SME database), and bank SME lending capacity (by establishing a specialized SME unit at the Egyptian Banking Institute). The CBE also hopes to stimulate SME lending by waiving the 14 percent reserve requirement on loans to SMEs, on deposits equal to the amount of SME lending. The Egyptian Banking Institute has assisted several banks in setting up SME units, primarily with training.

SMEs benefit disproportionately from reforms because they suffer more than large firms from many policies and institutional constraints arising from imperfect markets. Small firms not only suffer more from market frictions such as transaction costs and information asymmetries than large firms, but these market frictions have a disproportionately larger effect on small firms in nations with less developed institutions. Small firms in particular significantly stand out in the degree to which they identify regulatory policy uncertainty, corruption, access to land, taxation, access to finance, and electricity as serious constraints. Moreover, over the past decades it was mainly the large and connected firms that benefited most from the regulatory reforms that took place, leaving the SMEs at a disadvantage, underserved, and often unserved.
IV. Challenges to SME Development

Despite the important role SMEs play in the economy, they are confronted with key obstacles, which have constrained their development, and hindered their potentials to create private-sector jobs and entrepreneurship opportunities. SMEs access to finance is limited, and their potential to grow is constrained by entrepreneurs not being able to access start-up or growth capital. Although SMEs contribute significantly to GDP and to private sector employment in the MENA region, they often lack access to the type of investment and financial services that they need to start-up, operate and grow. Access to employment and income-earning opportunities through participation in SMEs, whether as owners or employees, is a topical and prominent issue in the MENA region. Research by Ayyagari, Demirguc-Kunt and Maksimovic (2011) confirms that small firms are important contributors to total employment and job creation, but suggests that their productivity and growth is held back by SME-specific constraints.

Key constraints include the regulatory and supervisory framework, financial infrastructure, and financial intermediaries lending capacity, as well as enterprise management skills and capabilities. Enterprise creditworthiness, liquidity of the financial intermediaries, and the availability of risk-sharing instruments, also raise key constraints. Several MENA countries suffer from government-enforced interest rates caps, lack of consumer protection policies, the absence of national microfinance strategies, the scarcity of credit information and scoring system, and lack of integration of microfinance credit information into public credit registries or private credit bureaus (Figure 4.1). MENA banks cite a lack of enterprise transparency, difficulties in using collateral, and uncertainty over creditor rights as primary barriers to their greater involvement in finance. There is a raised awareness in MENA that
difficulty of entry into relatively closed private sector networks, and a lack of access to finance and to markets, holds back the growth and competitiveness of SMEs. Policymakers are looking for effective tools and levers to stimulate SME development in response, including through improving SME access to finance.

Figure 4.1: Proportion of MENA Banks Responding that Obstacle is Very Important or Important for SME Financing


A. Legal and Regulatory Framework

Among the major constraints facing the sector are non-conducive legal and regulatory frameworks as well as weak judicial and legal systems. Most MENA countries suffer from a weak supervisory and regulatory environment, government-enforced interest rates caps and a lack of effective and well enforced consumer protection policies. MENA ranked last in the legal rights index in the World Bank’s Getting Credit Doing Business report for 2011. Deficient legal and judicial frameworks for secured transactions are the second set of constraints cited by banks (registration and enforcement of movable collateral and creditor rights).

MENA governments and regulators have introduced a range of regulatory reforms to stimulate SME finance, but many lack appropriate and timely information to effectively supervise and support it. Regulators have strengthened legal and judicial frameworks for secured transactions, introduced legal frameworks intended to support the growth of NBFIs and investors, and provided exemptions on reserve requirements for an equivalent amount to SME lending. Only just under half of the 11 regulators that responded to the 2010 CGAP survey said that they regularly monitored levels of SME lending by regulated institutions, (CGAP and World Bank, Financial Access 2010). This suggests that regulators may not have sufficient information on SME financial services and portfolios to effectively conduct
supervision of SME finance, and to ensure that access to finance for SMEs is increasing, and in a prudent manner.

B. Financial Institutional Infrastructure

Although credit information and reporting systems are developing fast in some MENA countries, they are held back in others by a lack of a legal framework for their establishment and operation, limited availability of positive credit data, lender reluctance to share data, technology differences between different types of lenders, and a predominance of credit registries as compared to credit bureaus. Banks in MENA cite a lack of SME transparency and weak financial infrastructure (weak credit information, weak creditor rights, and collateral infrastructure) as the main reasons why SME lending constitutes only eight percent of their total loan portfolio, as opposed to the 21 percent that they say is their goal for SME lending (World Bank 2011a).

Credit registries are typically operated by central banks to provide information needed for their supervision of lending (with the exception of the Palestinian Registry, which also operates as a credit bureau), while credit bureaus are designed to collect—and make available—information useful for potential lenders. Credit bureaus can also include non-regulated entities, such as telecom companies, microfinance institutions, retailers, and utilities, thus improving the comprehensiveness and value of borrower information.

Over the past three years, several MENA countries have developed their credit bureaus. Only six MENA countries have operational credit bureaus, with the oldest established in Kuwait in 2002. Three countries, namely, Morocco, Egypt, and the UAE, have recently established private credit bureaus. Two-thirds of MENA countries still entirely rely on credit registries—a higher percentage than in all other regions except for sub-Saharan Africa. Three countries rely entirely on credit bureaus (Saudi Arabia, Bahrain, and Kuwait); while the other three maintain both, credit bureaus as well as credit registries (Egypt, UAE, and Morocco). Numerous new credit reporting systems are either underway, planned, or under refurbishment including in Algeria, Djibouti, Jordan, Lebanon, Syria, and Yemen.

A lack of widely available and comprehensive credit information limits the use of external credit scoring for SMEs, and asset-based lending is limited by collateral execution issues. Credit bureaus are a relatively new phenomena in much of the region and initially focus on individual scoring rather than more complex small business scoring.

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<th>Country</th>
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<td>Bahrain</td>
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<td>Egypt</td>
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<td>Jordan</td>
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<td>Saudi Arabia</td>
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<td>UAE</td>
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* 20 largest corporate exposures.
Source: Standard and Poor’s (2010).
business scoring. Banks in MENA therefore rely on internal rating and scoring systems, which can have a much weaker predictive power than scoring systems operated by credit bureaus with access to a wider set of borrower information, and therefore restrict the degree to which banks can extend lending to a new set of clients while managing risks.

Almost all of the 130 surveyed banks in the region use an internal rating system for SME lending (93 percent), while almost half use an internal credit scoring system. The kind of low cost, automated, transaction-lending techniques based on SME credit scores that have been used in the United States since the mid-1990s (when the largest external provider of scores, Fair, Isaac and Company, introduced its first small business model) are not yet widely applied in MENA. Less than a quarter of MENA banks make use of external credit scoring or automated application processing (Figure 4.2).

![Figure 4.2: Proportion of MENA Banks Using Selected Risk Techniques for SME Lending](image)

**Source:** World Bank and Union of Arab Banks banks survey.

MENA has the lowest score on the 2011 Doing Business Legal Rights Index for getting credit, which assesses the use of movable assets as collateral, the strength of creditor rights, and the availability of out-of-court enforcement mechanisms. Banks face higher costs of overcoming information asymmetries and higher levels of credit and default risk for micro lending, and have not yet directly entered the low income consumer or microenterprise market at any great scale. Small enterprises are often not able to provide adequate collateral for loans. Also, the costs to banks of registering and executing collateral for small loans can be disproportionate. Over two-thirds (69 percent) of MENA banks report significant problems selling movable collateral, and 57 percent enforcing movable collateral. No MENA country scores above four out of 10 on this index (see Annex 3 for regional and country comparisons). Banks, as a result, in many cases do not extend lending further into the micro and small enterprise sector.

Banking sector concentration may merit more of a focus in the region in the context of SME finance. Concentration at a portfolio level is evident in much of the region, and particularly in Egypt and Saudi Arabia, as seen in
Table 4.1 which shows the 20 largest corporate exposures as a percentage of gross loan portfolios. Concentration is also a feature of MENA banking systems, and can act as a disincentive to banks to improve their SME finance products, systems and technology, and to expand competitively into the SME market. Bank competition in MENA was found to be lower relative to other regions and linked to the relatively weak credit information environment as well as to lower market contestability.

C. Financial Intermediaries Capacities–Banks and NBFIs

Financial intermediaries often lack the capacity to lend to SMEs, with high administrative costs for small-scale lending, as well as inadequate banking skills for dealing with SMEs. Most banks have outdated SME lending technologies and are not able to expand SME lending significantly while also managing costs and risks. Many MENA banks have deficient credit technology and skills for efficient and prudent SME lending. Too often banks try to apply lending technologies designed for large corporations that rely on audited financial statements and immovable collateral such as land. Unsurprisingly, this leads to unviable lending and sometimes to poor portfolio quality, with banks frustrated that SMEs do not fit with their methodology. Banks therefore prefer to lend to large well-established firms or to buy government bonds and treasury bills. In some cases, there is reluctance to tap into financing that is considered non-compliant with *Shari'a*–religious considerations.

State-owned banks in MENA tend to have less developed risk management mechanisms than private commercial banks, as they are less selective in their strategies to target SMEs, have a lower ratio of collateralized loans to SMEs, and yet have a higher share of investment loans (typically longer-term and more risky than working capital lending) in total SME lending. A lower share of state-owned banks has dedicated SME units, makes use of credit scoring, and conducts stress tests. Nevertheless, state-owned banks in MENA have an average share of SME lending that is almost identical to that of private banks.

Nevertheless, several MENA countries have state-owned banks that have recently been increasing interest in supporting SMEs. For example, in Tunisia the Banque de Financement des Petites et Moyennes Entreprises (BFPME) is a state-owned bank that provides consulting, monitoring and financing activities geared toward SMEs. Its aim is to facilitate access to financing for the creation and expansion of SMEs. It promotes SME lending through co-financing with banks and leasing companies, equity stakes in start-ups, and risk sharing. In Egypt, the National Bank of Egypt and Banque Misr are state-owned banks that expanded into SME finance reaching out to various governorates.

In the MENA region the adoption of efficient transaction lending techniques to lower the cost and risk of SME lending has been relatively slow. This is linked to the deficient financial infrastructure, legal frameworks, court systems, and bank reporting systems and skills. Transactions technologies used by banks for SME lending includes financial statement lending, small
business credit scoring and asset-based lending (Berger and Udell, 2006). These can enable banks to expand SME lending while managing credit risk and cost per loan, as compared to the more time-intensive relationship-based lending approach. MENA banks tend to require higher collateral values as a ratio to loan value for SME loans, (Figure 4.3). Around 78 percent of GCC banks and 48 percent of non-GCC banks say they have higher collateral requirements for SMEs as compared to corporates.

Figure 4.3: Collateral Value as a Proportion of Loan Value by Size of Firm

Banking sector competition in MENA is weaker than in other regions, with lower market contestability. This dilutes the incentives for banks to expand SME finance and develop products and delivery mechanisms for smaller firms and to serve the range of enterprise financial needs. H-statistic and Lerner index analysis by Anzoategui, et al (2010) suggests that banking sectors in MENA operate under monopolistic conditions. Regulator measures to ease bank entry and to improve the availability of credit information environment would address this lack of competition, as would regulatory, policy and institutional reforms to support the development of NBFI intermediaries (stock markets, pension funds, mutual funds, and insurance companies).

The “crowding-out” effect—whereby government borrowing can reduce bank lending to the private sector, is a concern. Some countries in the region have tried to reduce this effect by borrowing externally rather than domestically. Increased demand from governments led to banks and other financiers having a reduced appetite for overall lending, especially to SMEs that are considered more risky. It is important for governments to minimize this “crowding-out” effect. Banks in the MENA region have not fully emerged from a reliance on lending to governments and a narrow set of well established corporates.
Box 4.1: Islamic Finance for SMEs

Islamic Finance has become an increasingly integrated part of the global financial system. Since the development of the modern Islamic finance in the 1960s, the Islamic finance has evolved from fringe industry that catered to specific banking requirements of the Muslim community to a global industry encompassing banking, insurance and capital market. The Islamic financial landscape has now been dramatically transformed with more diverse players with an extensive range of financial products and services.

The global Islamic finance industry continues its quest to boost international competitiveness and to build a sustainably profitable business model. Islamic finance assets around the world are expected to climb 33 percent from their 2010 levels boosted by the aftermath of the Arab Spring uprisings and dissatisfaction with conventional finance in the wake of the global debt crisis. Islamic banking is a growing worldwide phenomenon. The number of Islamic financial institutions has increased significantly in the Arab Countries. There are now around one hundred Islamic banks and financial institutions working in the private sector.

Less than half of MENA banks report that they offer SME Shari’a-compliant products (41 percent), although the percentage is much higher in Saudi Arabia (100 percent), and Qatar (78 percent). The low uptake levels may indicate a lack of familiarity on the part of both SMEs and credit staff with Shari’a-compliant products. All banks offering Shari’a-compliant products offer murabaha (cost plus) financing, which is more typically used for working capital. Ijara, which is similar to leasing, is the next most prevalent financing product offered. The supply of Islamic finance products is increasing, with a further 28 percent of MENA banks planning to offer Islamic products in the coming period.

Egypt has the longest experience of Islamic finance since it started in 1960s, yet it is underdeveloped compared to GCC countries, Iran and Malaysia. Given the longest period of Islamic finance in Egypt, compared to that of global Islamic finance experiences, the rules and regulations governing Islamic banking remain inadequate. Political factors have been unhelpful for Islamic finance where it was seen at being associated with banned Islamists. The recent political and economical development along with the appointment of the Islamist dominated parliament, has brought to the forefront the need in developing Islamic finance and Shari’a compliant financial products. The development of the Islamic banking in Egypt after the Egyptian revolution of 2011 and the remarkable winning of the Islamists parties in the parliament are likely to have positive impact on Islamic finance in Egypt. Egypt is viewed as a promising market of Islamic finance due to its large population and proven interest in Islamic finance.

The recent economic and political developments in the MENA region, have flagged the need and importance of Islamic finance in general, and Islamic financial products for SMEs. This calls for legal and regulatory reforms which includes Shari’a compliant financial services for the SME sector. Development partners are working with the new leaders and stakeholders in responding to these demands.

D. Enterprises Skills

MENA SMEs suffer from various deficiencies and face problems limiting their development. These problems include the SMEs lack of capacity to prepare a business plan and loan application, opaque or non-existent financial statements, and insufficient collateral. SMEs also face non-financial issues including a cumbersome legal and regulatory framework as well as
a highly bureaucratic system. They suffer from a lack of adequate business development services, adequate information, advanced technology, and skilled labor. Moreover, there are also gender related constraints in terms of access to finance; these include higher costs of finance, difficulties in gaining approval for financing and stricter collateral requirements. These problems complicate lending to SMEs by NGOs and explain the low level of bank finance to them.

MENA banks cite a lack of enterprise transparency, difficulties in using collateral, and uncertainty over creditor rights as primary barriers to their greater involvement in finance. Poor quality financial statements, informality, and lack of business skills of enterprises are key aspects of lack of transparency and information asymmetry. Information asymmetry as a constraint on SME finance has not yet been effectively addressed in the MENA region. The Basel II framework further increased the need for good quality SME information, given its emphasis on ratings-based approaches for risk and capital adequacy assessment. Although the intention to make lending decisions and capital adequacy assessment more risk sensitive and contingent on the individual quality of borrowers is important, its application can in practice be a constraint on broadening SME access to finance.

An SME that does not have the required quality and availability of information can be avoided by a lender irrespective of the strength of its cashflow or its competitiveness and market performance. An SME’s ability to provide relevant quantitative and qualitative information for ratings assessments increasingly determines its access to finance, and the cost and terms of that finance. Probability of default is also calculated in part based on past credit history. Credit bureaus are therefore a critical part of the financial infrastructure for SME finance, although SMEs that have not previously borrowed from banks will be picked up only by credit bureaus that also include NBFI lenders, including retailers and finance companies.

Reporting and audit requirements for SMEs, whether regulatory or simply required by banks as a consideration for accessing credit, sometimes act as a barrier to SME finance and to SME growth. External audits can be costly and difficult to justify, as SME accounting is usually straightforward, relying on historical cost-based, rather than fair value, measurement. They may also act as an incentive to stay disengaged from the formal sector and full regulatory compliance. For example, CBE requires banks to have three years of audited statements. In West Bank and Gaza, all companies with limited liability, including SMEs, are required to undergo an annual independent audit, which can act as an indirect barrier to SME finance. This can also act as an incentive to enterprises operating informally and therefore less transparently.

Such requirements particularly affect smaller enterprises, which may not keep standardized financial statements in line with bank or auditor expectations. In some cases, enterprise owners may even keep more than one version of financial records for instance, if they do not present all relevant information to tax authorities. Smaller enterprises also rely on retail banks, leasing companies

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8 Basel III builds on rather than replaces Basel II. The key provisions in this area remain in place.
and similar financial institutions for debt capital; these are often privy to internal information and often obtain personal guarantees from owner-managers as additional security for their lending.

In addition to financial access, SMEs are also constrained by financial or management skills and by a lack of access to information about markets, product standards, and buyer trends. Excessive bureaucratic requirements for audits, enterprise registration, and payment of fees and taxes can also act as a disincentive to enterprises operating in the formal sector, which would further exclude enterprises from many market opportunities. SME owners may lack the range of skills needed to successfully run a business as it grows and becomes more complex, and tend to place insufficient importance on financial management and accounting.
Sme S for Job Creation in the Arab World
V. An Agenda for an Inclusive Financial System in MENA

A small proportion of high-performing SMEs have the potential to grow into internationally competitive companies, generating significant economic benefits through raised productivity, employment, and economic stability.

A. Bank SME Finance Models

There is a need to build the capacity of financial intermediaries in MENA, especially banks, the dominant financial institution. This will encompass developing market segmentation strategies, tailoring lending products, marketing, screening SMEs, developing growth strategies and portfolio risk management, and downscaling programs. A large proportion of SMEs in MENA have bank accounts, which potentially gives them access to cash management, deposits, payments and other financial services. State-owned banks, with the largest branch network in MENA and the biggest outreach, should be given special focus in the effort to support SMEs. State-owned banks are almost the only banks with branches in poor, disadvantaged villages with marginalized populations. The support needed by banks goes beyond training. It includes advisory services and hands-on assistance on issues such as the design of new products, such as Shari’a compliant ones. The banks need help to turn around SME loans, develop risk management, improve governance, improve the credit information system, and reform loan officer compensation.

A move away from collateral-based lending and toward transaction lending techniques could improve the viability and scale of SME lending and lower risk, at least for smaller enterprises. Banks that have been successful in growing a strong SME business globally have gone beyond the important first step of setting up a dedicated SME unit. They have invested in improving
their understanding of the SME market and in developing a range of products that address SME financial service needs, beyond only credit. They may sub-segment the SME market so that products can be tailored to needs, as medium enterprises may require more of a corporate banking approach while small enterprises may merit mass market approaches that are closer to retail banking. While financial infrastructure (for example, credit reporting systems to underpin the use of transaction lending techniques) is less critical for relationship-based lending to well-known and well-collateralized larger enterprises, but it is increasingly important as enterprise size decreases.

It is important to follow a more innovative approach and identify new products that would be more suitable to SMEs. Developing non-credit as well as credit products, and taking advantage of improvements to payment systems and electronic payments technology, will need to be a priority for MENA banks. Leading banks serving SMEs globally have found that credit accounts for less than half of the share of revenues from SME clients, with account-management-related activities, deposits, payments, and other financial services as important contributors to revenues.

Banks that plan to serve SMEs need to package financial products with business development services. First, banks should ‘bundle’ products to SME clients, with the goal of bringing all of their business to that bank. Second, banks need to ensure that the bundle of products is profitable by improving cost and revenue monitoring (which requires disaggregated data by product) and by understanding which products are most attractive to SME clients. Third, banks need to develop new products with lower costs and risk, in order to expand lending and other products to new SME clients. SME products with standardized features (such as terms and pricing) and with more automated approval processes may be needed to ensure that small business lending is viable.

B. The State as Regulator and Enabler–Providing an Enabling Environment

The role of the state in expanding access to finance for SMEs is primarily as a regulator and an enabler. Many banks would like to expand SME finance, as they recognize that it is a potentially profitable and large market segment, but they face considerable constraints in doing so. In order to support improved access to financial services for SMEs while protecting the stability of the financial system and the rights of SMEs, governments can:

- Invest in improving financial infrastructure.
- Reform the regulatory framework.
- Enhance data availability.
- Support product diversification.
- Increase the capacity of regulators to monitor SME finance providers.
- Strengthen consumer protection (including disclosure) legal and enforcement frameworks.

Fostering greater access to financial services for SMEs requires improving financial infrastructure and ensuring a regulatory and
supervisory framework that supports financial intermediation. Additional policy and program interventions are widely used to try and accelerate the supply and demand side response to these measures and to compensate for remaining deficiencies in these frameworks. Financial infrastructure includes accounting and auditing standards, credit reporting systems (credit registries and bureaus), collateral and insolvency regimes, and payment and settlement systems.

The regulatory and supervisory framework for SME finance, including elements of banking, insurance, leasing, factoring, and security laws need to be more conducive for SMEs. Effective legal and regulatory frameworks promote access to finance while preserving financial stability. This is achieved by expanding the range of financial institutions and instruments and promoting market development and competition, while subjecting financial institutions and agents to sound prudential rules as well as rules of conduct. Policy and program interventions can include loan guarantee schemes, state provision of financial services, for example, through public banks, exemptions on reserve requirements, interest rate subsidies, and credit lines to banks.

Improved regulatory frameworks and financial infrastructure are priorities for MENA authorities. This entails expanding the range of movable assets that can be used as collateral, improving registries for movables, improving enforcement and sales procedures for both fixed and movable assets, and offering out-of-court enforcement mechanisms. It also involves upgrading public credit registries and introducing private credit bureaus capable of expanding coverage and the depth of credit information. With these infrastructure improvements, banks will be able to employ lower cost technologies for SME lending and better manage credit risks, progressing from name-based lending to a narrow set of enterprise clients to transaction lending techniques that open up access for many more SMEs.

**Secured transactions framework.** A sound institutional infrastructure is needed to underpin the effective use of movable assets as collateral, so that registration and execution (collection) of collateral is more expeditious and also more predictable in terms of outcome. Modern secured transactions systems allow the use of movable assets (both tangible and intangible) such as equipment, inventory, accounts receivable, cash flows, livestock, crops, and others as collateral for loans. Economic analysis also suggests that SMEs in countries that have stronger secured transactions laws and registries have greater access to credit, better ratings of financial system stability, lower rates of non-performing loans, and a lower cost of credit (Alvarez de la Campa 2010). Enforcement for fixed assets and both registration and enforcement for moveable assets were highlighted by MENA banks as problematic.

Increasing the protection of creditors’ rights and enforcement mechanisms can boost access to finance and increase private sector credit relative to GDP (Alvarez de la Campa 2010). Legal and judicial frameworks for secured transactions need to be strengthened, and asset registries need to be consolidated and made easier to use. In their absence, entrepreneurs are unable to leverage
current assets into capital for investment. Movable assets, including inventory, should be a particular focus, given that small enterprises tend to be better placed to offer movable assets as collateral than (often larger and indivisible) immovable assets. Quality of collateral affects loan pricing, and the expected recovery rate, which partly determines credit risk assessment under Basel II.

Out-of-court enforcement mechanisms are needed to provide faster, more effective, and less expensive means for realizing security interests. Ideally, the enforcement law should allow the secured party to the security agreement to perform enforcement without court assistance. Under this procedure the secured creditor takes the property from the debtor without the assistance of the execution office. The creditor should have access through the law to speedy seizure procedures. The timing for removing the property from the control of the defaulting person is critical, as property can be relocated, hidden or damaged. Delays in the process of enforcement can cause depreciation of property value (Alvarez de la Campa 2010).

**Credit reporting systems.** Supporting the development of credit reporting systems should be a priority. Credit reporting systems are an important basis from which lenders can introduce more efficient lending and effective risk management technologies. Full credit reporting can reduce collateral needs by providing “reputational collateral”, and it can allow lenders to avoid non-payers while expanding lending to include new clients (Madeddu 2010). Borrowers would have a stronger incentive to repay, and interest rates could be tailored to individual risk profiles. While credit reporting has improved considerably in recent years in MENA, the region is not yet exploiting its potential for SME finance. Small business credit scoring is needed, not only consumer scoring. Berger & Udell (2006) note that small business credit scoring appears to have been associated with an increase in lending to opaque SMEs in the US market.

**Responsible finance.** Regulatory and supervisory frameworks should promote access to finance that is predicated on effective risk management and ‘responsible finance’ principles, in order to ensure prudent growth in SME finance that benefits these enterprises. A focus on promoting competition and product diversification is recommended to improve access to finance for SMEs in MENA, in addition to the collateral and credit information-related measures outlined above. In some countries, central banks regulations hinder the growth of SMEs.

In some countries, central bank regulations hinder the growth of SMEs. For example, the requirement of having at least three audited financial statements is a constraint for many entrepreneurs, especially small ones, for whom having an audited financial statement would be costly.

**State-ownership of banks.** is still significant in a number of MENA countries (most notably Algeria, Libya, Syria), and state-owned banks may play a counter-cyclical role in providing credit during financial sector contractions, and in temporarily compensating for market failures. But the opportunity cost to taxpayers of maintaining inefficient and often non-transparent financial
intermediation mechanisms with poorer performing loan portfolios than private banks on average is not clearly outweighed by any benefits in the longer-term. Partial credit guarantee funds, if carefully designed, can play a more positive market development role in stimulating sustainable SME finance.

**Risk-weighting of SME loans.** Countries should keep in mind the findings of the Basel committee that adapted the initial Basel II framework to avoid penalizing SME finance as follows: (i) at a given probability of default, exposures to SMEs require relatively less capital than larger firms in risk-weighting calculations; (ii) SME exposures classified as retail have a specific risk weight curve; (iii) the risk weight for non-mortgage retail exposures was reduced under the standardized approach; and (iv) credit risk mitigants such as collateral and guarantees were better recognized. The design of specific risk-weighting formulas for SMEs was justified on the basis that SME and retail portfolios exhibit lower asset correlations compared to large firms (IFC 2010). Smaller SME loans can potentially benefit from a lower risk weighting (75 percent)—if classified as retail—than for corporate loans (100 percent), although other factors affect that weighting, including quality of collateral.

**C. Innovative Financial Products**

Developing innovative financial products will enhance competition and off better quality services to SMEs. There is significant potential for growth of MENA’s leasing industry, with an estimated market penetration in MENA of only 4.2 percent (Al-Sugheyer and Murat, 2010). Leasing is particularly advantageous for SMEs in the MENA region given its limited collateral requirements and its perceived Islamic compliance. There is scope for an expansion of leasing into operational leasing as well as financial, to include sales and leaseback, leases with options to buy, and other forms of operational leases, and into immovable assets. While leasing is in principle well suited to countries with weak collateral regimes, in practice weak protection of ownership rights and contract enforcement dilute or even eliminate their supposed advantages. Its potential has yet to be realized as a result of a variety of market constraints, which include the absence of an effective legal framework in many countries, limited access to long-term funding, and the ambiguous treatment of leasing for taxation purposes.

Governments first need to strengthen and clarify the legislative framework governing leasing operations. This should include a definition of leasing transactions, appropriate rights for lessors to repossess assets, and clarification of tax treatment of leasing as a financing mechanism (Al-Sugheyer and Murat, 2010). Tax treatment of leasing is a major driver of its growth as a sector. Where financial leasing is treated as a financial instrument, tax treatment is more favorable and attractive. However in much of the MENA region tax legislative frameworks were enacted before leasing was commonplace, and so they do not address how to treat financial leasing transactions in terms of income tax, sales tax, value added tax, and customs duties. As a result leasing is more costly and less attractive in MENA than it might otherwise be.
There may be a greater reliance since the global financial crisis on factoring in MENA, due to constrained access for SMEs to finance. Factoring can be an effective way of reducing costs and risks for banks in financing SMEs, if banks have the capacity to effectively monitor and collect on accounts receivable, if required, at a low cost. Factoring can be done without recourse; in other words, the factor that purchases the receivables assumes the credit risk for the buyer’s ability to pay. Factoring can therefore be an important source of financing in jurisdictions with inefficient insolvency regimes, as borrower assets would not be subject to bankruptcy proceedings (OECD 2004).

“Reverse factoring” allows SMEs to receive more financing at lower cost. The lender purchases accounts receivables only from specific high-quality buyers and the factor only needs to collect credit information and calculate the credit risk for selected buyers. Reverse factoring has the potential to be an important source of working capital financing for exporters in countries with poor credit information. In particular, factoring is an ideal source of financing in countries with small, risky suppliers and large foreign buyers. Whereas ordinary factoring requires lenders to have timely and comprehensive credit information, reverse factoring requires complete credit information on only one or more creditworthy firms. A successful example of reverse factoring is the Nafin factoring program in Mexico, which highlights how the use of electronic channels and a supportive legal and regulatory environment can cut costs and provide greater financing opportunities for exporters and SMEs in emerging markets (Box 5.1).

**Box 5.1: Reverse Factoring: The Case of NAFIN, Mexico**

Nafin has succeeded in providing financial services to Mexican SMEs. It relies on the creditworthiness of large buyers rather than that of the SMEs. All factoring is done on a non-recourse basis, which lets small firms increase their cash holdings and improve their balance sheets. Nafin has a multi-bank approach, which allows lenders to compete to factor suppliers’ receivables. As of mid-2004, Nafin had established productive chains with 190 big buyers (about 45 percent in the private sector) and more than 70,000 SMEs (out of a total of about 150,000 participating suppliers). About 20 domestic lenders participate, including banks and independent finance companies. Since the program’s inception in September 2001, Nafin has brokered ever 11 million transactions—98 percent by SMEs—at a rate of about 4,000 operations per day.

NAFIN uses an electronic platform that provides on-line factoring services, which further reduces costs and improves security. Over 98 percent of all services are provided electronically, which reduces time and labor costs and allows all commercial banks to participate in the program. Many suppliers that participate in the Nafin program have no other sources of financing. Many had no access to external financing before receiving financing from Nafin and depended on internal funds and credit from their own suppliers. Suppliers view Nafin financing as preferable to bank financing, since banks are seen as slow to make credit decisions and as charging higher rates.

The Nafin program depends on the existence of electronic signature and security laws. The Nafin platform helps prevent fraud, which can be present in the factoring business in developed countries. Since only large buyers are able to enter new receivables, sellers cannot submit fraudulent receivables. Moreover, since the bank is paid directly by the buyer, suppliers cannot embezzle the proceeds.

D. Guarantees and Risk-Sharing

Partial credit guarantee schemes and other risk-sharing facilities can play a positive role but may need reform to ensure additionality and to increase their attractiveness to financial institutions.

In an attempt to facilitate access to finance for SMEs, a number of countries in the MENA region support partial credit guarantee schemes (PCGs). When well designed, PCG schemes support banks in expanding their SME loan portfolios through lending to SMEs that they do not currently lend to: for example, an otherwise creditworthy SME that lacks the collateral required by the bank in the absence of sufficient credit history.

While the average size of guarantee schemes in MENA is in line with the international average, there are major differences among countries in the region, and in a number of MENA countries schemes are far too small to create a sizable impact. In comparison with international averages, the number of guarantees issued per year (scaled by population) is low in MENA while the average value of guarantees is relatively large. On average, MENA schemes issued only 80 guarantees per million people in 2009. Guarantees are concentrated in a limited segment of firms in MENA, and do not yet reach a significant number of smaller firms. Kafalat in Lebanon is innovating further, through its plans to also provide partial equity guarantees for selected start-up SMEs that can demonstrate the potential to create commercial value added through innovation.

The European Union has a similar equity guarantee facility for participating countries operated by the European Investment Fund. The European Palestinian Credit Guarantee Fund (EPCGF) was established in 2005 for West Bank and Gaza and has partnership agreements with seven banks. EPCGF is a promising model as it not only provides guarantees but also helps partner banks establish specialized departments for SME lending and to develop more appropriate lending technologies (such as cash flow lending) and portfolio management tools. EPCGF developed a risk-rating system to help banks mitigate the risks and better manage the SME portfolio. The Tunisian government has created the Tunisian Guarantee Company (SOTUGAR), a public interest company, which provides, among other things, guarantees for certain categories of loans granted by the credit institutions to SMEs.

It is not clear the extent to which PCG schemes in MENA are achieving that objective, and a number of those schemes, including those in, Jordan, UAE, and Syria, have much broader objectives, also covering housing loans, exports, or even consumer loans, thus diluting their focus, their ability to benchmark performance with peers, and potentially also their impact.

The Kafalat scheme in Lebanon has achieved the largest coverage of SME loans of any MENA scheme, with 292 guarantees per million people issued in 2009, followed by the West Bank and Gaza scheme with 128 (2010) Kafalat provides credit guarantees to SMEs for loans in industry, agriculture, tourism, traditional crafts, or high technology.
The Moroccan Caisse Centrale de Garantie (CCG) is an example of a regional reform that has provided clearer incentives for banks to maintain prudent risk management, in order to improve its additionality. The CCG now has access to the databases of the credit bureau and is able to screen new applicants, and banks receive only 50 percent of the guaranteed amount upon default (rather than 100 percent), with the remaining 50 percent after three years or earlier upon proven efforts to recover the delinquent loan. The amount of lending guaranteed is up notably as a result, and this volume increase is expected to be accompanied by an increase in efficiency, due to a greater focus on SMEs, better lifecycle support, and improved incentives at loan origination.

E. Equity Finance

High potential SMEs with the potential to grow require equity investment as well as credit and other financial services. Improved access to equity finance could also improve SME creditworthiness under Basel II-related assessment criteria. While banks may lack the expertise and systems to make such equity investments, they are increasingly setting up equity fund subsidiaries or partnerships with fund managers to meet this business need and market opportunity. For example, ICICI Bank (India) set-up ICICI Venture to provide equity and quasi-equity (mezzanine debt) to growth-oriented medium businesses, and Capital Bank in Jordan has set-up Capital Investments. Private investors in MENA are also starting to provide both investment and non-financial support to promising start-ups in a less ad hoc way. For example, the Oasis 500 early stage and seed investment network offers small amounts of start-up capital linked to intensive mentoring and business incubator support, while the US$ 500 million (target size) RED Growth Capital Fund set-up by Abraaj Capital is complemented by mentoring, networking and informational support to high-potential-growth SMEs.

In Jordan, the government and donors have introduced funds and support services for SMEs that seek also to stimulate private sector investment. The Jordanian authority is assisting enterprises in modernizing and becoming more competitive in domestic and foreign markets, through providing capability and capacity-building services to SMEs (Box 5.2). EU-supported funds offer grants for export development and upgrading. USAID is supporting the development of an “angels” network in Jordan to try and stimulate the provision of early stage VC for startups, and is funding a research and development fund and incubators.
SMEs are major contributors to the Jordanian economy, and to its competitiveness, and employment potentials. Although SMEs play an important role in Jordan’s economy, they make up only 10.8 percent of firms (around 9,000 enterprises). Empirical evidence has shown that smaller firms in Jordan grow at faster rates in comparison with their large counterparts. On average SMEs in Jordan create 2–5 jobs annually as opposed to 8–12 jobs by the large corporate. Nevertheless, SMEs have limited access to finance. Banks are the principal source of external finance for SMEs, however, only 11 percent of bank lending goes to SMEs, compared to 25 percent in emerging markets. SMEs are undercapitalized and predominantly financed through internal funds, as well as, informal sources.

The growth of the SME sector in Jordan is constrained by various factors. On the supply side, SME lending is hampered by an inadequate legal and institutional framework for secured transactions and insolvency, lack of credit reporting and information, and weak regulatory and supervision of financial services. Banks cite SMEs lack of reliable or available information as the primary reason for high loan-to-collateral requirements for SMEs. Most banks in Jordan try to stretch corporate lending techniques to also cover SMEs, to the extent that they can finance them. In many cases banks rely primarily on collateral-based lending. In order for banks to expand access, appropriate techniques and risk management capacities are required.

On the demand side, the SMEs skills and capacity holds back their access to finance. Enterprises often lack transparency, and do not have audited financial statements. SMEs are perceived as less stable, and lack competent management, and hence considered more risky. SMEs often refrain from applying for bank loans due to their disbelief in interest-based borrowing. The recent World Bank enterprises survey reveals that more than 14 percent of the small enterprises and six percent of the medium enterprises did not apply for a loan for this reason. In general, there has been a growing demand for Islamic Shari’a compliant financial products in Jordan.

The Jordanian authorities have recently made significant strides in improving the enabling environment for the SME sector. Key steps have been taken to enable financial institutions to support these enterprises in contributing to economic development and job creation. The government is committed to the creation of private sector jobs through developing the sector. The Ministry of Planning and International Cooperation have finalized a partial guarantee scheme, OPIC, which would significantly help in improving access to finance for medium and large corporate in Jordan, and is currently working on drafting a National SME Strategy and an SME Law. Numerous efforts have been made by the Jordan Enterprise Development Corporation (JEDCO) to improve the business environment for SMEs, especially fast-growing innovative ones. Another major step taken by the government was the approval of basic mobile phone payments, and the enactment of its guidelines. The Jordanian government is currently working on adopting a comprehensive secured transactions law and development of a collateral registry.

The Central Bank of Jordan (CBJ) has taken a number of key measures to improve SMEs access to finance. It has strengthened the financial institutional infrastructure, including, lowering the threshold for reporting to public credit registry. CBJ has also supported the establishment of the first private credit bureau, which would help in improving access to finance and in enhancing competition. Moreover, the central bank is working on modernizing the reporting and monitoring system for banks. At the same time, several banks are currently working on increasing their share of lending to this segment through adopting more advanced transaction-lending techniques. New branches have been opened in Governorates that were underserved, and new Islamic banks have been licensed. As a result, a more positive enabling environment is starting to emerge, which should help enterprises in contributing to job creation, and overall economic growth.
Where there are market failures in the provision of venture capital to high-potential-growth SMEs, and to innovation-based start-ups, governments may have a role to play in leveraging private sector investment and knowhow, particularly for early stage start-ups. The IFC has invested over US$ 80 million in recent years in seven MENA equity funds (mostly private equity) to support SME investment, including Beltone and Sphinx in Egypt, AlterMed in Morocco, AlterMed in Tunisia, and three regional funds. The Inovar program in Brazil (Box 5.3) is a promising example of a government initiative to foster the creation of an SME venture capital market in Brazil.

**Box 5.3: Inovar Program, Brazil**

The objective of the program is to support the development of new, technology-based SMEs through the establishment of a venture capital (VC) market and to enhance private investment in technology businesses.

To achieve this, Inovar created a research/knowledge and information dissemination platform and develops managerial capacity for channeling and accelerating VC investments in small-company funds in Brazil. The program created a VC portal with information on how to register for different program components, with over 2,650 registered entrepreneurs, and over 200 investors. It established a technology investment facility where investors can perform joint analyses and due diligence on VC funds, which resulted in over 50 joint due diligences with approximately US$ 165 million committed/approved in 15 VC funds. The program has also established 20 venture forums for SMEs to interact with potential investors and present business plans, resulting in 45 SMEs receiving over US$ 1 billion in VC/Private Equity (PE) investments.

A key success factor was gaining engagement and support from the private sector, especially local and international fund managers, who value the initial investment facilitated by the Inovar Program and the assistance it provides to SMEs.

Many MENA markets may lack the scale needed for the development of vibrant venture capital markets, however. Regional funds can to a degree compensate for that. The Maghreb Invest Private Equity Fund II LP was established as a 10-year private equity fund for equity and quasi-equity investments in diversified local companies (mainly SMEs) in Morocco, Algeria, Tunisia, and Libya. The fund is managed by local fund manager Tuninvest, which had an established SME-related track record of over 12 years. The fund was established with US$ 76.3 million in capital commitments and reached a final closing value of US$ 170 million in April 2008. (An interesting geographically targeted fund that taps the Arab diaspora is outlined in Box 5.4).
Global Technology and Innovation Partners (GTIP) is a partnership of successful Arab diaspora entrepreneurs based in Silicon Valley that targets investments across the Middle East, North Africa, and South Asia regions (MENASA). GTIP has recently established the Rising Tide Venture Capital Fund (US$ 250 million being raised) that will focus on building local entrepreneurial ecosystems and provide seed, early, and growth stage capital for innovative ventures in MENASA countries. To help ensure the development and acceleration of successful and innovative start-ups in the region, GTIP intends to pool their staff, partners and other successful entrepreneurs from Silicon Valley, and elsewhere in the United States to provide companies in MENA with continuous mentorship and expertise. GTIP has two key partners to help transfer support and provide mentorship: Plug and Play Technology Center (PnP), which is a technology incubator based in Silicon Valley, and the Tech Wadi networking association, which allows GTIP to tap into the Arab diaspora to provide mentorship and advice to MENA entrepreneurs.

Setting up SME stock exchanges or junior markets can further improve the supply of equity investment to SMEs, although these have not yet been successful in this region. As demonstrated by the lack of activity on such exchanges in Egypt and Tunisia, simply establishing one and equipping it with modern systems and infrastructure is in itself no guarantee of success. Improvements to the wider enabling environment for capital markets are needed. The SME exchanges that have succeeded globally are those where:

- The underlying legal and capital market regulatory frameworks are reasonably well-developed, robust and, above all, trusted by investors.
- Access to credible corporate information on SMEs is widely and readily available.
- A reasonably broad spectrum of early-stage equity capital is available from angel, venture capital, and private equity investors.
- The size of both the private sector and the qualified institutional investor community is sufficiently large to support the growth of the market generally (Mako 2010).

Options that the Egyptian and Tunisia stock exchanges might consider to make NILEX more attractive to potential investors include requiring a two-year lock-up period for all major shareholders, a higher upper limit on the size of companies eligible for listing, and the promotion of a new small-cap index fund and encouragement of small-cap equity investment fund.

F. Capacity Building for SMEs

SMEs need to better understand the importance of financial and enterprise information for banks in their lending decisions. This will help the SMEs play their part in overcoming information asymmetry. Companies that provided timely, relevant (for lenders), and precise information, and that have an equity base; will be able to obtain a better rating and therefore better credit.
conditions. Banks could therefore be required to explicitly share information requirements and ratings criteria with SME loan applicants, as well as how ratings impact their credit terms. This could enhance the quality of information received by banks from SMEs and help overcome the severe mismatch between bank information requirements and the information that they are often provided by smaller enterprises. SME capacity to produce financial statements and business plans needs to be supported or better recognized in lending requirements. A non-legislative code of conduct between banks and SMEs could establish a framework that sets out the principles for rating-process disclosure for banking and SME associations.

Instead of requiring SMEs to have complex financial statements, regulators and banks should focus on ratings and scoring systems, and promote credit bureaus and other sources of borrower information. Accounting by SMEs is usually straightforward and does not merit extensive disclosure requirements. SMEs could be exempt from the same audit requirements that are applied to large companies (Cairns, 2010). Otherwise smaller and newer enterprises may be excluded from bank borrowing, or at the very least discouraged from applying for loans.

The new International Financial Reporting Standards (IFRS) for SMEs (published in 2009) would better fit medium enterprises, while waivers could be introduced for smaller enterprises (as in the EU). IFRS for SMEs are being considered for adoption in Egypt and other MENA countries, as well as globally. However, they may be too complex and costly for smaller enterprises, which rely on internal funds and their immediate families for equity capital. These insiders have access to financial information about the entity. Many of the disclosures aimed at public shareholders and lenders are unnecessary, as are external independent audits. In Germany, where SME owners might be expected to be widely financially literate, it was decided that IFRS for SMEs would be excessive, and they were not adopted. In the United Kingdom, small enterprises are required only to use the simpler “Financial Reporting Standard for Small Entities”, in place of the more complex United Kingdom accounting standards or even IFRS for SMEs. A waiver for small companies may therefore be merited in MENA jurisdictions lacking the resources to develop a more tailored set of reporting standards.

Enterprises need institutional capacity building to become more innovative and be able to compete in local as well as international markets. This includes education, worker training, country quality systems, and conformity assessment. Training is a good example where smaller firms, confronted by skills deficiencies of workers, may under-invest due to lack of knowledge of its benefits or available providers, financial market failures that limit potentially profitable investments in training, and problems of staff turnover that prevent them from capturing the full benefits (Tan and Batra 1995). There is also a need for a telecommunications policy supporting email and Internet use. Formal training for employees and international certification for firms are areas needing improvement. Both national policy frameworks and institutional arrangements may need strengthening to improve firm-level practice. In addition, the analysis suggests the importance of an integrated competition
policy, involving a combination of trade, investment, and regulatory policies that encourage flexible operation and ease of entry and exit, with an active competition authority empowered to address anti-competitive behavior.

Wholesale lending mechanisms, or ‘apexes’, are present in many MENA countries. NBFIs set-up with public sector support (such as JAIDA in Morocco and the Development Employment Fund in Jordan) can also play an apex role. At their most effective, apexes can play a role in raising performance and reporting standards and accelerate the uptake of SME lending technologies, although apexes often do not achieve such positive results due to capacity constraints and political influence (Box 5.5).

**Box 5.5: Key Findings from CGAP’s Global Study on Microfinance Apex Institutions**

The purpose of the CGAP study was to examine the performance and future role of apex institutions in advancing microfinance development based on a global survey and six case studies, including Social Fund for Development (SFD), Egypt. The paper identifies critical success factors and lessons learned aimed at helping funders, governments, and apex managers improve the design and operations of apex institutions. Key findings include the following:

- The design of an apex institution is fundamental to its effectiveness. Experience shows that apexes that are designed or structured poorly also perform poorly. Institutional structuring involves a range of tasks, including agreeing on the legal form of the apex, its mission, products and services, governance, staffing structure, policies and procedures, performance metrics, and financing model.

- The apex mission and objectives should be defined clearly with a focus on building strong, sustainable and responsible microfinance institutions, not just loan disbursements and outreach entities. This requires a long-term, institution-building perspective.

- Stakeholders should focus on putting in place good governance, capable management and an appropriate organizational structure. The most effective apexes are those that are politically independent, with professional, effective boards and capable management. Boards typically include representation of stakeholders such as microfinance institutions (MFIs) and the banking sector. Apex staff need to be appropriately qualified and receive ongoing training and professional development in order to keep up to date with the latest developments in the microfinance field and build and sharpen professional skills.

- The most effective apexes in terms of scale of operations and efficiency are those that separate their wholesale funding activity from other activities, including having separate management, staff, and financial accounts.

- Apexes need robust selection criteria and appraisal procedures and should focus, not on the number of the MFIs they fund, but the quality of those MFIs as sound institutions. The apexes most successful in supporting the growth of microfinance typically have a large proportion of their funds invested in the largest, fastest growing MFIs. In India, for example, the apex Small Industries Development Bank of India (SIDBI’s) top 15 MFIs account for 90 percent of its loan portfolio. Most apexes also fund promising, small, less-developed MFIs as a way to increase outreach in under-served areas.

- Products developed should respond to market conditions and the stage of development of MFIs. Apex loans should be tailored to the cash flow patterns and planning needs of MFIs. For more mature, high-growth MFIs, apexes might want to broaden their product range to include quasi-equity and equity to strengthen MFIs balance sheet and support sound growth.
Relevant training and advisory services may therefore also be required for SMEs, whether from banks, service firms, or from industry associations. At the same time, administrative and legal barriers to enterprise registration, growth and innovation should be removed. SME development agencies, SME associations, and chambers of commerce can play a role in this regard, while private sector service provision can be stimulated through output-based aid approaches that link subsidies to performance. The emergence of networks of entrepreneurs and angel finance investors in MENA noted in this paper, as mentors and sources of market information, business advice, and finance, is a very promising development for improved SME creditworthiness and competitiveness.

Overall, the public sector initiatives to support SME finance should be evidence-based, with progress monitored over time so that initiatives can be redesigned, dropped, or expanded based on impact and cost effectiveness. In addition to regular monitoring of SME lending by regulators of all financial institutions (not only banks), annual or bi-annual enterprise and bank surveys can be used to provide evidence of improvements in access and to provide feedback and ideas. Performance indicators can be agreed at design stage and then monitored during implementation.

There is a need for a level playing field, where all enterprises without discrimination by size, gender, or regional location have access to opportunity. Subjective discretion and interference in applying the rules should be reduced, and, where it persists, it should be made more transparent through such means as mandatory disclosure. This agenda demands reducing conflicts of interest between civil servants and private interests—key sources of privilege. A supportive regulatory and institutional environment is critical for the development of SMEs in the MENA region.
VI. Concluding Remarks

A momentum is building in the region as the Arab Spring generates an appetite for reform, providing new opportunities for SMEs. Attaining an inclusive system through fair opportunities, equal access to markets and a level playing field is critical. Numerous Arab governments are already moving forcefully in that direction; they are committed to improving the enabling environment and increasing access to finance for SMEs. The majority of SMEs in the MENA region have been marginalized and underserved, and more efforts are needed to ensure that they have access to finance given their instrumental role in the creation of private sector jobs.

Governments are committed to SME development and see SMEs as the engine of development and job-creation. Governments are increasingly promoting a more balanced and equitable growth model. Banks are also seeking to grow their SME portfolio. SMEs are perceived as a large untapped market segment, more diversified and less exposed to political risks than large connected corporations. All this highlights the need to support the development of the SME sector in MENA, which can play an important role in job creation—a major challenge the region faces. The MENA countries are undergoing a major transformation post the Arab Spring.

The route to sustained, private-led growth and job creation requires improving the credibility of reforms, the effectiveness of policies, and their equitable enforcement. In that context, it is important to remove constraints to competition and entry, enabling a new generation of entrepreneurs to emerge, oriented toward competing in global and domestic markets based on their firms’ performance, not on privilege. For this to happen, business-friendly policy reforms will need to level the playing field and remove traditional sources of rent and privilege.
There is huge potential for SMEs in the MENA region as SMEs have the ability to solve problems facing a vast majority of developing countries. The promotion and enhancement of SMEs is essential given their instrumental role in increasing employment. Small firms are important contributors to total employment and job creation, but suggests that their productivity and growth is held back by SME-specific constraints.

Governments can play an important role in enhancing access to finance for SMEs as regulators and enablers. Governments in the MENA region remain committed in supporting the sustainable growth of SMEs, however much can still be done to develop the SME sector. Investing in improving the financial infrastructure, reforming the regulatory framework, enhancing the data available, and supporting product diversification is critical. Increasing the capacity of regulators to monitor SME finance providers, and strengthening consumer protection are all important steps that need to be taken by states if they wish to see the SME sector flourish.

Improving the legal and regulatory framework as well as the financial institutional infrastructure is critical for SME development. The regulatory framework for SME finance needs to be more conducive, this can be achieved by expanding the range of financial institutions and instruments and promoting market development and competition while subjecting financial institutions and agents to sound prudential rules as well as rules of conduct. A sound institutional infrastructure is needed to underpin the effective use of movable assets as collateral, this can be achieved by increasing the protection of creditors rights and enforcement mechanisms which will in turn boost access to finance and increase private sector credit. Out of court enforcement mechanisms are also crucial in order to provide faster, more effective and less expensive means for realizing security interests. Furthermore, an essential challenge that needs to be addressed is the development of credit reporting systems as well as credit scoring. This can be tackled by offering support and training to SMEs on how to develop their credit reporting and how to keep their financial statements in order as well as strengthening and supporting private credit bureaus. Also the promotion of competition and product diversification are priorities in order to improve access to finance for SMEs in the Arab World.

Banks and regulators should focus more on ratings and scoring systems instead of requiring SMEs to have complex financial statements. SMEs should become exempt from the same audit requirements that are applied to large corporations, otherwise smaller and newer enterprises may be excluded from bank borrowing, and even discouraged from applying for loans.

Banks can play an essential role in the growth of SMEs. Setting up a dedicated SME unit is the first step that banks should be taking in enhancing access to finance for SMEs. This should be based on their understanding of the needs and wants of the SME market and in developing a wide range of products that are specifically SME targeted other than credit lending. In doing so, banks can begin to deal with different sized enterprises rather than grouping SMEs and hence embark on creating products that are tailored to the specific needs of different sized projects. A more innovative approach and
identifying new products that would be more suitable to SMEs are important to their development. Also the creation of non-credit as well as credit products, and taking advantage of improvements in payment systems and electronic technology will need to become a priority for MENA banks.

Developing NBFIs can also enhance competition in the financial sector, and improve the provision of financial services to SMEs. There is significant potential for growth in MENA’s leasing industry. Given its limited collateral requirements and its perceived Islamic compliance, leasing is particularly beneficial for SMEs in the region. Leasing could be expanded to operational and financial in order to include sales and leaseback; however its potential has yet to be reached due to a variety of market constraints such as the absence of an effective legal framework, limited access to long-term funding, and the ambiguous treatment of leasing for taxation purposes. In order for leasing to reach its full potential, governments need to strengthen and clarify the legislative framework governing leasing options.

On the other hand, there has been greater reliance on factoring in the MENA region since the global financial crisis due to constrained access for SME finance. “Reverse Factoring” has been used successfully in several emerging economies, and could be used in the MENA region as an important source of working capital, especially in countries with poor credit information. It has the ability to provide SMEs with fast cash, and helps them avoid dealing with debts.

SMEs also need to play their own role when it comes to growth. They need a better understanding of the importance of financial and enterprise information for banks in their lending decisions. This will assist SMEs in playing their part when it comes to information asymmetry when approaching banks. Accordingly, banks could be required to openly share information requirements and ratings criteria with SME loan applicants, as well as how ratings impact their credit terms. In doing so, there would be more cohesion and understanding between banks and SMEs, establishing a framework that sets out the principles for rating-process disclosure for banking and SME association.

Training and advisory services are also required for SMEs, whether it be from banks, service firms, or from industry associations. At the same time, administrative and legal barriers to enterprise registration, growth and innovation should be removed. SME development agencies, SME associations, and chambers of commerce can play a role in this regard, while private sector service provision can be stimulated through output-based aid approaches that link subsidies to performance. The emergence of networks of entrepreneurs and angel finance investors in MENA noted in this paper, as mentors and sources of market information, business advice, and finance, is a very promising development for improved SME creditworthiness and competitiveness.

To further enhance innovation, experience suggests not only a supportive investment climate and business regulations that encourage ease of exit, entry and competition; but also a potential role for innovative finance, quality certification, mentoring and incubating, and effective competition policy. Innovative SMEs can make a substantial contribution to economic growth,
job creation and economic restructuring. For these SMEs financial issues are compounded by the technological and market risks associated with innovation. Innovative SMEs may find it particularly difficult to present a robust business case to potential finance providers with acceptable levels of investment risk. Guarantee schemes can increase lender confidence in making innovation-enabling investments by supporting either debt or equity finance.

Expectations are extremely high, especially among the youth. At the same time, the hostility towards those who benefited improperly from preference under the old system should not yield a universal condemnation of market mechanisms, and private sector-led growth. Instead it should be directed towards a fairer and more competitive economy that utilizes market mechanisms to generate equal opportunities and create jobs, bolstered by building the capacity of institutions, and developing the skills of the market players. Experience has shown that high-growth countries were able to rely on strong, rule-bound institutions to reduce discretion and create dependable incentives for rapid private-led economic growth. Key to this is the strengthening of institutions to implement private sector policies equitably and consistently.
Annex 1: SME Definitions

Table A1.1: Thresholds for SMEs, GCC banks, Non-GCC banks and the EU

<table>
<thead>
<tr>
<th>Turnover – Thousands of US Dollars</th>
<th>Minimum Small</th>
<th>Maximum Small</th>
<th>Maximum Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCC</td>
<td>365</td>
<td>5,456</td>
<td>18,390</td>
</tr>
<tr>
<td>Non-GCC</td>
<td>61</td>
<td>897</td>
<td>4,757</td>
</tr>
<tr>
<td>EU</td>
<td>2,816</td>
<td>14,085</td>
<td>70,422</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Turnover – Multiples of Per Capita Income</th>
<th>Minimum Small</th>
<th>Maximum Small</th>
<th>Maximum Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCC</td>
<td>8</td>
<td>144</td>
<td>601</td>
</tr>
<tr>
<td>Non-GCC</td>
<td>26</td>
<td>342</td>
<td>1,719</td>
</tr>
<tr>
<td>EU</td>
<td>85</td>
<td>427</td>
<td>2,134</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Minimum Small</th>
<th>Maximum Small</th>
<th>Maximum Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>GCC</td>
<td>3</td>
<td>24</td>
<td>90</td>
</tr>
<tr>
<td>Non-GCC</td>
<td>4</td>
<td>17</td>
<td>58</td>
</tr>
<tr>
<td>EU</td>
<td>20</td>
<td>50</td>
<td>250</td>
</tr>
</tbody>
</table>

* GCC and Non-GCC: Average of individual bank thresholds. EU: Official definitions.

Source: Rocha et al. (2010).

Table A1.2: Country Examples

<table>
<thead>
<tr>
<th>Country</th>
<th>Employees</th>
<th>Annual Sales (Revenues)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>10 to 250</td>
<td>&lt;CAD 50 million</td>
</tr>
<tr>
<td>Mexico</td>
<td>&lt;500 in manufacturing, &lt;50 in services</td>
<td></td>
</tr>
<tr>
<td>South Africa</td>
<td>10-20 to 100-200 depending on industry</td>
<td>ZAR 200-300,000 to ZAR 4-50 million, depending on industry</td>
</tr>
<tr>
<td>Thailand</td>
<td>&lt;200 in labor intensive industries, &lt;100 in capital intensive industries</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>10 to 250</td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td>5-200</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Small: &lt;60, Medium: 60-99</td>
<td></td>
</tr>
<tr>
<td>UAE</td>
<td>Small: &lt;USD10 million</td>
<td>Medium: USD10-25 million</td>
</tr>
</tbody>
</table>


Table A1.3: SME Definitions in Egypt**

<table>
<thead>
<tr>
<th></th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees</td>
<td>CAPMAS, CBE: up to 5</td>
<td>CAPMAS, CBE, Law 141: up to 50</td>
<td>CAPMAS: 50+</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>CBE: 50-99</td>
</tr>
<tr>
<td>Paid-up Capital</td>
<td>Law 141: &lt;LE 50,000</td>
<td>Law 141: LE50,000-LE 1 million</td>
<td></td>
</tr>
<tr>
<td>Annual Sales</td>
<td>CBE (for SMEs): LE 1 million–LE 20 million</td>
<td>CBE (for SMEs): LE 250,000–LE 5 million</td>
<td></td>
</tr>
<tr>
<td>Turnover</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


* In Morocco and Lebanon microenterprises are defined as having fewer than 10 employees, while in Egypt the definition used here is fewer than 5 employees.

** Relatively low definition thresholds may be appropriate for non-GCC MENA countries, which may have smaller enterprise sizes at all levels. Egypt definitions are set out in Table A1.3 as a MENA example that illustrates the variation in definition even within institutions at country level. The Egyptian Small Enterprise Law 141 of 2004 defined micro enterprises as companies or sole partnerships with paid-up capital of less than LE50,000, and small enterprises as companies or sole proprietors with paid-up capital between LE50,000 and LE 1 million, and with 6 to 50 employees. The Central Agency for Public Mobilization and Statistics (CAPMAS) acknowledges this definition, but in practice uses number of employees, defining micro-enterprises as having up to 5 employees, small enterprises as up to 50 employees, and medium and large enterprise as having over 50 employees. The central bank groups SMEs together for definitional purposes and focuses on paid-up capital and sales turnover.
Annex 2: SME Access to Finance

A2.1: Constraints in Selected MENA Countries by Size of Firm

![Bar chart showing constraints in selected MENA countries by size of firm.](chart1)

*Source:* World Bank Enterprise Surveys.

A2.2: Percent of SME's with Overdraft Facilities and Loans

![Bar chart showing percent of SME's with overdraw facilities and loans.](chart2)

*Source:* World Bank Enterprise Surveys.
A2.3: Percentage of Firms with a Loan by Size of Firm


A2.4: How MENA Enterprises Finance Working Capital Needs

A2.5: How MENA Enterprises Finance New Investments


A2.6: Leasing as a Percentage of GDP

A2.7: Leasing as a Percentage of GDP

*Penetration rate is the annual leasing volume divided by the gross fixed capital formation.


A2.8: Factoring as a Percentage of GDP, by Country and Region

A2.9: SMEs with a Bank Account by Region


A2.10: Constraints to MENA Enterprises by Firms Prior Year’s Growth Level

A2.11: Firms Offering Training Are More Likely to Innovate

A2.12: Larger firms Are More Likely to Employ University-educated Workers
## Annex 3: Enabling Environment for SME Finance

### A3.1: Financial Infrastructure: Creditor Protection, Credit Information Sharing

<table>
<thead>
<tr>
<th>Region/Country</th>
<th>Getting Credit</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Strength of</td>
<td>Depth of credit</td>
<td>Public registry</td>
<td>Private bureau</td>
</tr>
<tr>
<td></td>
<td>legal rights</td>
<td>information</td>
<td>coverage (percent of</td>
<td>coverage (percent of</td>
</tr>
<tr>
<td></td>
<td>index (0-10)</td>
<td>index (0-6)</td>
<td>adults)</td>
<td>adults)</td>
</tr>
<tr>
<td>MENA</td>
<td>3.3</td>
<td>3.4</td>
<td>5.0</td>
<td>11.3</td>
</tr>
<tr>
<td>EAP</td>
<td>6.1</td>
<td>2.1</td>
<td>8.2</td>
<td>17.3</td>
</tr>
<tr>
<td>ECA</td>
<td>6.6</td>
<td>3.9</td>
<td>12.3</td>
<td>23.1</td>
</tr>
<tr>
<td>LAC</td>
<td>5.5</td>
<td>3.3</td>
<td>10.1</td>
<td>31.5</td>
</tr>
<tr>
<td>SA</td>
<td>5.4</td>
<td>2.1</td>
<td>0.8</td>
<td>3.8</td>
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<tr>
<td>SSA</td>
<td>4.6</td>
<td>1.7</td>
<td>2.7</td>
<td>4.9</td>
</tr>
<tr>
<td>OECD</td>
<td>6.9</td>
<td>4.9</td>
<td>8.8</td>
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</tr>
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<td>0.0</td>
<td>35.9</td>
</tr>
<tr>
<td>Saudi Arabia</td>
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<td>6.0</td>
<td>0.0</td>
<td>18.0</td>
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<td>5.0</td>
<td>22.9</td>
<td>0.0</td>
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<td>Morocco</td>
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<td>5.0</td>
<td>0.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Kuwait</td>
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<td>4.0</td>
<td>0.0</td>
<td>29.6</td>
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<tr>
<td>Qatar</td>
<td>3.0</td>
<td>2.0</td>
<td>0.1</td>
<td>0.0</td>
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<tr>
<td>Algeria</td>
<td>3.0</td>
<td>2.0</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Oman</td>
<td>4.0</td>
<td>2.0</td>
<td>19.6</td>
<td>0.0</td>
</tr>
<tr>
<td>Egypt, Arab Rep.</td>
<td>3.0</td>
<td>6.0</td>
<td>2.9</td>
<td>10.3</td>
</tr>
<tr>
<td>Lebanon</td>
<td>3.0</td>
<td>5.0</td>
<td>8.7</td>
<td>0.0</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>4.0</td>
<td>5.0</td>
<td>8.4</td>
<td>17.7</td>
</tr>
<tr>
<td>Iran, Islamic Rep.</td>
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<td>4.0</td>
<td>22.7</td>
<td>4.5</td>
</tr>
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<td>Jordan</td>
<td>4.0</td>
<td>2.0</td>
<td>1.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Yemen, Rep.</td>
<td>2.0</td>
<td>2.0</td>
<td>0.3</td>
<td>0.0</td>
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<tr>
<td>Syrian Arab Republic</td>
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<td>2.0</td>
<td>2.2</td>
<td>0.0</td>
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<tr>
<td>Djibouti</td>
<td>1.0</td>
<td>1.0</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Iraq</td>
<td>3.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>West Bank and Gaza</td>
<td>0.0</td>
<td>3.0</td>
<td>5.6</td>
<td>0.0</td>
</tr>
</tbody>
</table>


Sme S for Job Creation in the Arab World
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