

# Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance

**Qamar Saleem**  
**Senior SME Banking Specialist MENA, IFC**



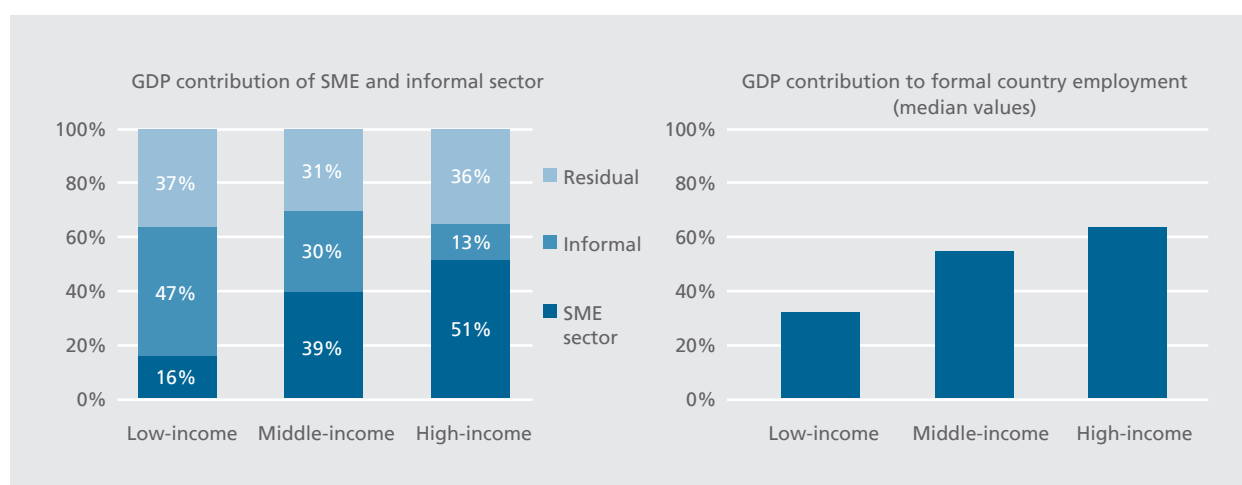
**IFC**

**International  
Finance Corporation**  
World Bank Group

# Overcoming Constraints to SME Development in MENA Countries and Enhancing Access to Finance

The role of the Micro, Small and Medium Enterprises (MSME) sector cannot be over emphasized in terms of its contribution to GDP and employment generation, particularly in emerging economies. Studies indicate that formal SMEs contribute up to 45 percent of employment and up to 33 percent of GDP in developing economies (IFC: Scaling-Up SME Access to Financial Services in the Developing World 2010). These numbers are significantly higher when taking into account the estimated contributions of SMEs operating in the informal sector. In high income countries, SMEs contribute nearly 64 percent to the GDP and 62 percent to employment (Figure 1).

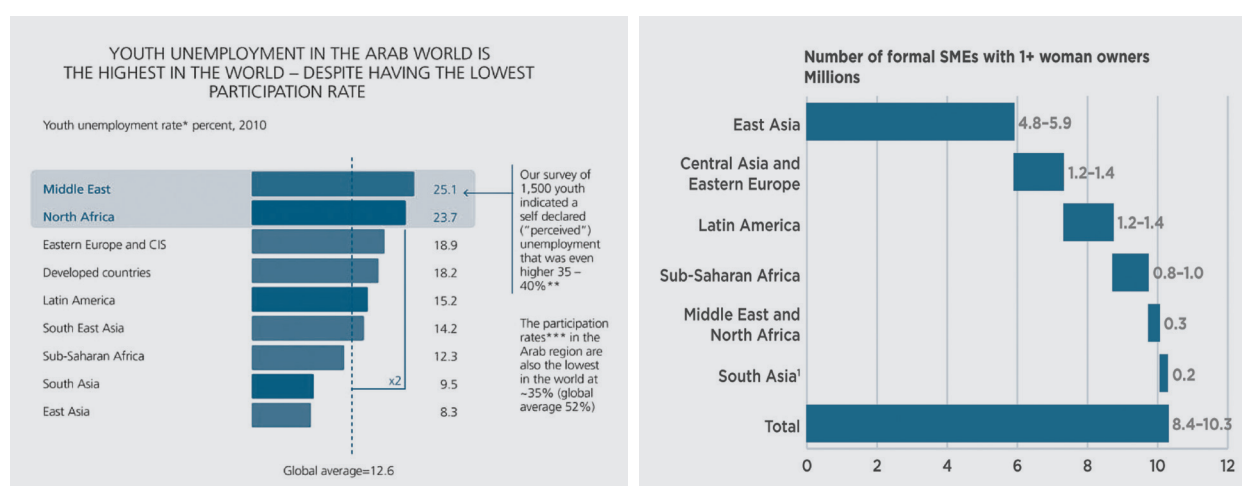
**Figure 1: SME Sector's Contributions to GDP and Employment, a Comparison**



**Source:** IFC SME Banking Knowledge guide 2010; Ayyagari, Beck, and Demirgüç-Kunt (2003)

Youth unemployment of 25.1 percent for the Middle East and 23.7 percent for North Africa—versus a global average of 12.6 percent—and female-entrepreneurship levels of 12 to 15 percent—versus a global average of 31 to 38 percent—severely affect economic growth (Figure 2). Creating jobs for young entrepreneurs and fostering female-entrepreneurship remains a key challenge.

**Figure 2: Youth Unemployment and Women Entrepreneurship in MENA versus Regions**



**Source:** IFC, Education for Employment Report; IFC, Strengthening Access to Finance for Women-Owned SMEs

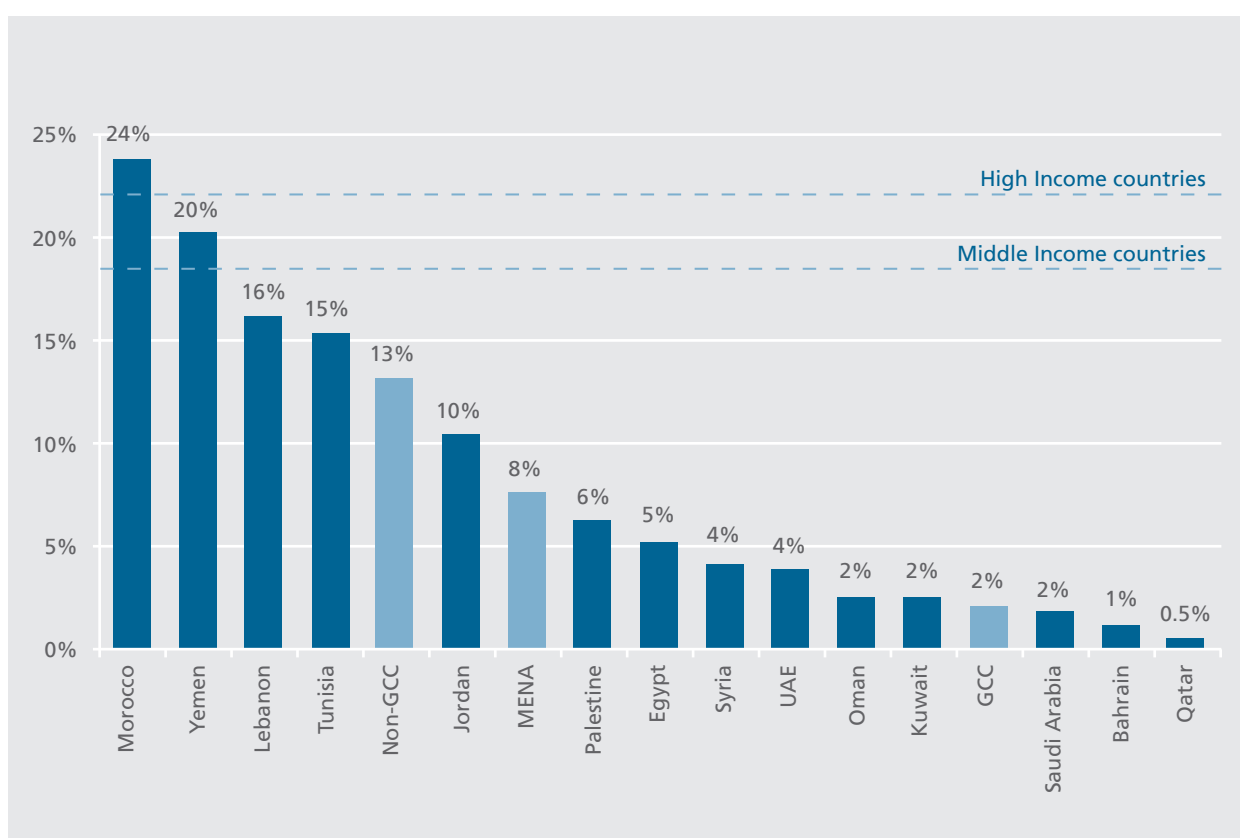
## SME Landscape in MENA Region

MSMEs account for a very high share of private sector employment in the Middle East and North Africa (MENA), particularly in countries with large informal sectors. According to official statistics, MSMEs typically account for 10 to 40 percent of all employment in MENA. However, employment in MSMEs is likely to be significantly underestimated in official records. The typical non-GCC MENA country is estimated to employ as much as 67 percent of labor informally, although only 6 percent of GCC labor is informal (Loayza & Wada, 2010).

The majority of enterprises in MENA are MSMEs, estimated at 19-23 million (formal and informal) in number and comprising 80-90 percent of total businesses in most countries. Access to finance is one of the greatest challenges facing MSMEs across the globe, and particularly for MENA where nearly 63 percent of the MSMEs do not have access to finance. The total financing gap for MSMEs in MENA is estimated at \$210 to \$240 billion (of which formal MSME finance gap is estimated at \$160-180 billion).

A recent World Bank/Union of Arab Banks survey of over 130 MENA banks shows that only 8 percent of lending goes to SMEs across MENA, and even less in GCC countries at 2 percent. This is substantially lower when compared to the middle income countries lending average of 18 percent and high-income countries average of 22 percent (Figure 3).

**Figure 3: MSME Lending Benchmarking in MENA Region**



**Source:** Union of Arab Banks/World Bank Financial Flagship Report 2011

SME finance in MENA is restricted by the lack of an enabling environment. Regulations are insufficient, financial infrastructure is inadequate, lending capacity and tools are lacking, SME management skills need to be improved, financial transparency needs to be encouraged, and the availability of collateral is scarce. Banks and Financial institutions in MENA are also not equipped to offer sustainable and profitable SME banking products.

## Creating Enabling Environment and Leading Practices

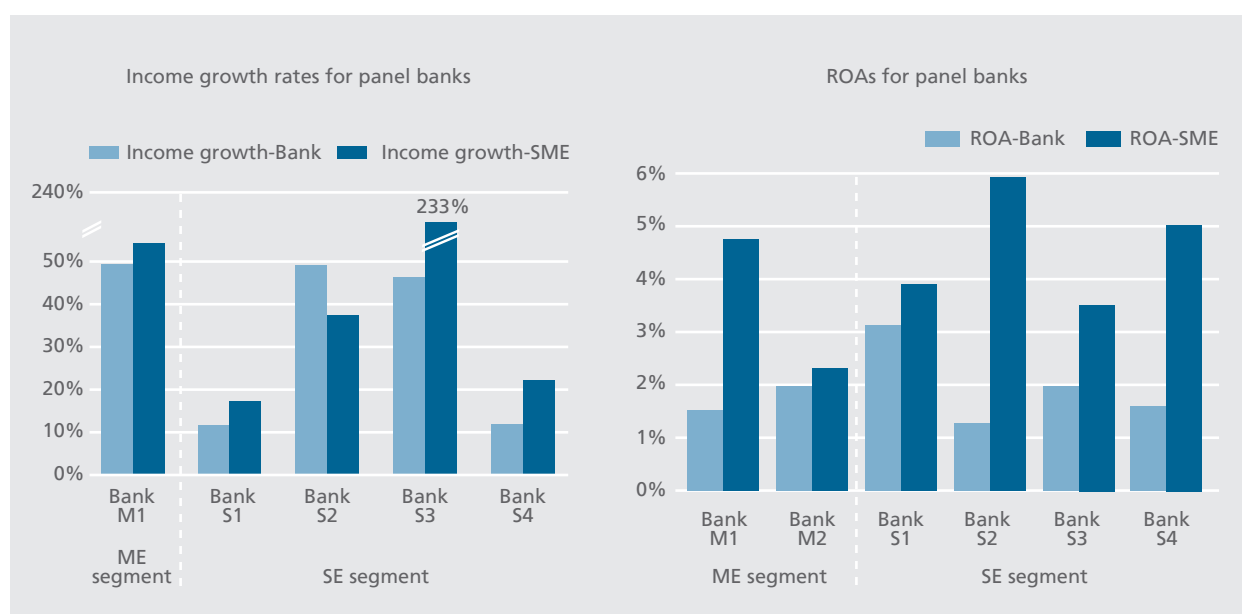
IFC has recently completed a review of leading SME finance practices and models as part of work with the G20. Key recommendations and a collection of best practices from the G20 Sub-Group in creating an enabling environment are as follows:

- **Developing country specific strategies:** The development of an effective SME finance strategy for an individual country should ideally be based on a comprehensive diagnostic of its SME finance gap and the quality of its SME finance architecture.
- **Developing a supporting legal and regulatory framework:** An effective legal and regulatory framework promotes competition by avoiding overly restrictive licensing requirements and allows international and regional banks with better SME lending tools to enter the market. Competition among financial sector players can be promoted further by introducing technological platforms in key areas, facilitating a variety of financial products and services, driving down the costs of financial access, and reaching previously untapped markets. Mexico's platform for reverse factoring and Brazil's information platform for venture capital are good examples of government interventions that can mobilize private resources for SME finance.
- **Strengthening the financial infrastructure:** Establishing a solid financial infrastructure (auditing and accounting standards, credit registries/bureaus, collateral, and insolvency regimes) should be a priority in financial development. The aim should be to develop a comprehensive credit reporting system that covers both personal and commercial credit information, and can cover MSMEs and help lenders better manage credit risk and extend access to credit. Some countries, such as India, have introduced SME rating agencies as an additional institution designed to provide more information to prospective lenders. Moreover, a well-functioning collateral regime characterized by a wide range of allowable collaterals (immovables and movables), the establishment of clear priority rankings of claims over collateral, efficient collateral registries making priority interests publicly known, and effective enforcement of collateral in the case of default can further enhance risk acceptability of SME customers for financial institutions.
- **Effective government support mechanisms:** In all cases, government interventions should be carefully designed and better evaluated with a view to accurately measure their achievements in terms of outreach and leverage. Partial credit guarantee schemes should remain an important form of intervention. Key guiding principles on such schemes should contain guidelines on eligibility criteria, coverage ratios, scalable credit approval mechanism, fees, payment rules, use of collateral/down-payment, and equity ratios, among other parameters. The Chilean FOGAPE guarantee fund and Small Business Finance Program in Canada are two good examples. There are multiple partial credit guarantee schemes in the region but market penetration remains concentrated on 'Medium' enterprise. The maximum outreach has been achieved by Kafalat program in Lebanon for the MENA region. Another important stimulus can be government procurement linked to the SME supply chain.
- **Building reliable data sources for SME finance:** An effective data collection framework at the national level should include efforts to standardize the definition of SMEs, centralize the collection of supply-side data by the central bank/banking supervisors and other financial supervisors, and survey SMEs in order to identify and quantify underserved SME segments. Demographic data on SMEs by number of employees, turnover, and asset size should be available and help normalize access to data. Computerized business registries would further facilitate the data gathering process and would serve as an important first step for firms joining the formal sector. Annual business and financial reports can provide important measures over time on the size and trends of the SME sector.
- **Address specific market niches:** Promoting female entrepreneurship and enhancing sustainable energy finance is crucial. Experience across different developed markets has shown that women have a better repayment record and yield a higher cross sell ratio for financial institutions. Women Entrepreneur Package by Garanti Bank in Turkey and M-Power Package by Access Bank in Nigeria are good examples of how outreach was increased to women in business. In addition, sustainable energy finance provides opportunities for SMEs to reduce costs as well as increase environmentally friendly operations. Erste in Czech Republic and eight banks in Russia (in particular Bank-Center Invest) have successfully built profitable portfolios in this sector.

## Institutional Capacity Building

SME Banking can be a very profitable business. Returns are often some of the best on a risk-return basis with attractive yields (Figure 4). And according to McKinsey SME banking revenue in MENA should grow by 18 percent per year to reach \$15 billion by 2015.

**Figure 4: Profitability Benchmarking of SME Business versus Overall Bank Performance**



**Source:** IFC, *Benchmarking SME Banking Practices in OECD and Emerging Markets*, 2007

Specific strategies and business model design can help build a strong and sustainable SME business. The below strategies and recommendations are based on IFC's 15 years of experience advising banks in building and scaling up SME businesses across emerging markets.

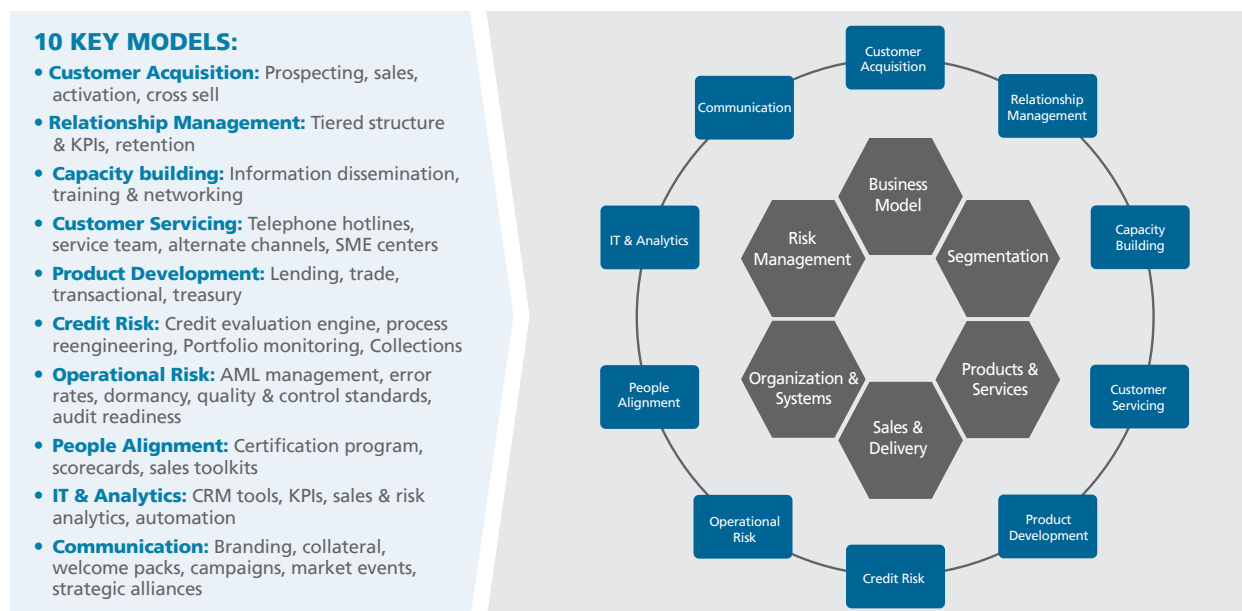
SME banking is much more than SME lending. A focus on loans does not allow financial institutions to really look at the client's needs and design a suitable proposition. SME customer needs are primarily deposit, transactional, and credit based. While credit needs (loans, overdrafts, trade finance, receivable finance etc.) are usually focused on, deposit (operating accounts, term deposits, investment options) and transactional banking (internet banking, phone banking, mobile banking, transfers, debit cards, foreign exchange etc.) contributions can represent between 50-60 percent of best practice SME business profitability and demand greater attention.

Proposition, People and Process are three key building blocks of the SME business within a financial institution. The proposition requires building a servicing model, transactional and deposit products, credit and financing programs and simple treasury products. The people are seen as key enablers in terms of SME senior management and staff. The importance of well defined processes cannot be emphasized enough, the front-end and support infrastructure, business and credit processes, and customer relationship management tools are paramount.

SME business set-up and growth within a financial institution also faces significant internal and external challenges. The key internal factors are strategic intent, finding the best organizational fit, investment capacity in early years of launch, change readiness levels within key stakeholders and the significance of the SME initiative within the overall strategic direction. The external factors influencing the initiative are mainly the size of the revenue pool, the financial institution's positioning strategy, the suitability of the economic environment, maturity of the regulatory framework and the focus of the government. New and growing SME businesses within a financial institution require deep engagement, commitment and discipline.

In order to be successful in SME Banking, proficiency across six core areas and 10 enabling business models is required (Figure 5):

**Figure 5: Proficiency Requirements for a Successful SME Business**



- **Business Model:** A dedicated business model and appropriate organization fit is required. Various business model options, which are not mutually exclusive, include retail-based for mass market, advisory differentiated, segment-based, supply chain linked, mobile money-based, niche markets positioned (e.g. women in business), and alternate financing models.
- **Segmentation:** Specific value propositions are essential to target specific sub-segments. Typical approaches to segmentation are industry led, sales turnover, profitability, geography or customer need based, and gender; these not being mutually exclusive. A powerful segmentation can help define a bank's participation model and help optimize costs.
- **Products and Services:** Financial and non financial products and a differentiated servicing model are required. These include heavy customization of products, Islamic and non-Islamic banking provision, non-financial advisory provision (e.g. training), and information dissemination. Moreover a strong cross-sell focus and bundling of products. Also customer value proposition aligned branding, campaign and communication strategy is needed.
- **Sales and Delivery:** Tiered sales and service focusing on higher valued customers, branch-based models for small SME volumes, and investment in alternative channels not only enhance customer experience but also help reduce operating costs. Specific customer acquisition, activation, retention and churn policies are required.
- **Organization and Systems:** Dedicated organization structure for SME focus, separation of acquiring/retention/remedial activities, strong relationships across bank, dedicated training and certification programs are necessary. In addition upgrading of IT platform for achieving scale, investment in loan origination platform, credit scoring, credit approval factory, data warehousing, loan management systems, CRM, analytics etc.
- **Risk Management:** Pricing needs to incorporate data driven risk scoring, development of statistical application and behavioral scoring, strong portfolio management, operational risk management, strong collections framework, and participation in risk sharing facilities driven by government entities etc.



## IFC Services

IFC provides a combination of Investment and Advisory Services for optimal results. The services can be summarized as follows:

### Investment Services:

- Equity investments in financial institutions/equity funds for SMEs
- Funded lines to expand investment and working capital lines especially in illiquid markets
- Blended finance options for selected projects, to support the expansion of IFC's risk appetite (e.g. grace periods, performance based pricing, subordination, higher risk/lower security or in limited cases, local currency positions)
- Focus on underserved segments, such as women, conflict zones, agriculture, and climate
- Risk sharing facilities/partial credit guarantees to enhance risk taking capacity and provide capital relief via low risk weightings; avoid foreign exchange mismatches and encourage domestic resources for SME financing

### Advisory Services:

- Build capacity of financial institutions in strategy, market segmentation, credit risk management, and product development through new approaches and systems to scale up their financing for SMEs on a sustainable basis
- Promote sub-sector focus such as female owned SMEs, sustainable energy SME projects, agriculture SMEs, and leasing
- Raise awareness on best practices in the SME finance space
- Develop credit reporting infrastructure based on country needs
- Support development of secured transactions, collateral registries, legal and regulatory framework
- Build capacity of public/private stakeholders through advice and training

### Advisory services are supported by the following innovative tools:

- **SME Banking Knowledge Guide:** Outlines leading practices and success factors for profitable SME banking operations. The guide has been translated into Arabic, Chinese, French, Russian and Spanish.
- **SME Banking Training Program:** IFC offers two courses, an introduction or scaling up course. The three day course consists of modules, case studies and exercises covering the following areas: business models for SME banking, identifying market opportunities, customer management, products and services, sales, credit risk management, IT and MIS.
- **Customer Management Best Practice Guide:** The guide outlines key success factors in better serving SME clients and allowing banks to maximize revenue opportunity. It is primarily a technical publication, intended for bank directors and managers interested in acquiring the key capabilities to enhance growth and revenue.
- **Customer Management Tools:** Provision of du pont model and revenue projection models for the SME segment.
- **SME Banking CHECK Diagnostic Tool:** A guide to assess SME banking operations and design relevant advisory services projects.
- **SME Banking Benchmarking:** An online SME Benchmarking Survey that automatically benchmarks SME banking practices.
- **Market Segmentation Tool:** Generates information that can be used by a bank to decide whether to invest in developing SME operations, identify target SME segments, and decide how to target them, design and sell products.
- **Assessing and Mapping the Global Gap in SME Finance:** A joint IFC and McKinsey report that assesses and maps the global gap in SME finance, including the number of enterprises by region, size and formality, as well as SME's access to credit and value of the credit gap.

