Shaping the Future through Innovation and Entrepreneurship

Overcoming Challenges to Enterprise Financing in the MENA Region

Alissa Koldertsova,
MENA-OECD Investment Programme
Organisation for Economic Cooperation and Development
Enterprise financing - a challenge in MENA and OECD countries

- Financing difficulties can be due to a range of issues related to the depth of the financial system, regulatory or legal gaps or asymmetric information
- Enterprise financing, particularly to SMEs, problematic not only in MENA but also in OECD member countries
- 2006 OECD study findings:
  - No generalised “financing gap” in OECD countries
  - Shortage of SME financing in non-OECD countries
  - Perception that lack of financing hinders SMEs
  - Governments convinced that market failure justifies some intervention
- Marginalisation of SMEs in emerging economies
  - SMEs and informal enterprises account for 60% GDP, 70% employment
  - Macroeconomic imbalances
  - Larger informal sector
- MENA region not ‘extraordinary’ in this sense but extent of the problem varies by country
  - Legal system, liquidity in the economy, corporate governance standards, banking and capital markets development
Distinctive challenges of SME financing

- Difficulty distinguishing financial situation of the firm from owners
- Monitoring more demanding
- Wide variance of profitability and growth
- Relationship between firms and stakeholders personal
- Good corporate governance principles difficult to enforce in family enterprises
- Asymmetric information
- Structural rigidities and distortions
  - Domestic savings-investment imbalance
  - Legal, institutional and regulatory framework
  - Structure of the financial system
- Result: high collateral requirements, high rejection rates, informal finance, particular problems for enterprises with intangible assets
Enterprise financing obstacles vary by country…

- Sources of finance to emerging enterprises particularly weak in Egypt, Morocco, Tunisia, Jordan
- Lebanon and Palestine present a particular challenge because of high demand of SME support and guarantees
- Tunisia, Morocco, Syria - private sector risk averse, awaits public lead
- Algeria and Syria - banking sector still state dominated
- High urban rural divide in many countries - micro credit as solution?
- Development of capital markets highly variable, obstacles to IPOs
- Several instruments of enterprise financing such as trade credit, leasing, VC at early stages of development
- Other parameters such as insolvency legislation, monetary policy, credit registry, lack of definitions play an important role
Enterprise financing inevitably tied to financial sector development…

- SMEs suffer in particular due to lack of depth in financial sector…
- Bank financing limited and on specific terms
- Capital markets remain a source only for larger enterprises
- Weak bond markets, absence of long term government yield curve
- Regulatory requirements impact bank financing
- Private equity/venture capital fundraising somewhat limited to the Gulf
- Rapid raise of Islamic Finance and particularly the sukuk market
- Factors to consider:
  - Launch of new financial centers (Bahrain Financial Harbour, King Abdullah Financial District, etc)
  - Dismantling investment restrictions for FDI and portfolio investment
  - On the demand side, financial education key ingredient to use of available financial products
Overview of the ‘Financing Gap’ in the MENA region

- Rising oil prices leading to increased liquidity in the Gulf, moderate affect through investment on other MENA countries
- Private liquidity in the Gulf grown in excess of $2.3 trillion, $1.5 billion in Gulf (UNIDO)
- Specialised funds (Venture Capital Bank) and state guarantee programmes (BFPME, Kafalat) for SMEs

However:
- Continued trend by local investors to seek greater international diversification of assets (latest IIF report)
- Private investment in the region as a share of total investment 40-45% (UNIDO)

Therefore:
- Enterprise financing remains a serious issue, particularly for countries outside the Gulf region and early financing stages
- Governments in the region seeking creative solutions
Solutions to ‘close the gap’

Area of significant action by MENA governments:
- Morocco: second tier capital market, SME agency, venture capital law to stimulate finance to SMEs
- Tunisia: state owned SME bank (BFPME), alternative market
- Lebanon: loan guarantee programme (Kafalat)
- Palestinian Authority: various donor programmes on SME financing
- Egypt: SME unit in the Ministry of Finance

• Attempt to streamline and simplify administrative and financial obstacles
  - Doing Business 2008 shows large improvements in administrative simplification
  - Minimum capital requirements still high in some cases

• Private sector response as well:
  - Islamic SME PE fund
  - Bahrain: venture capital associations
  - Microcredit institutions being set up
  - Foreign government credit lines
MENA-OECD Investment Programme: focus on financial sector development

- Regional Working Groups on Policies for Financial Sector Development and on Corporate Governance
- Current focus on corporate governance of banks and insolvency Legislation
- Enterprise Policy Index for MEDA countries
  - Encourage a holistic evaluation of SME policy
  - Combination of self-assessment and independent verification
- Business Climate Development Strategy implemented with the WB
  - Chapter on financial sector development
- Support for financial sector reform programmes in MENA countries
  - Egypt: development of derivatives and other financial instruments
  - Morocco: evaluation of VC regulation
  - Lebanon: evaluation of SME financing schemes
  - Jordan: development of the VC sector
- Various OECD studies and instruments can be extended to the region
Case study 1: Evaluation of the VC legislation in Morocco

- Requested by the Moroccan government to evaluate law regulating VC investment funds (loi relative aux organises de placement de capital-risque 41-05)
- Prior the sector completely unregulated
- Objective of the law to encourage VC funds to invest in certain categories of SMEs
- Part of the overall government strategy to make SMEs an engine of growth (ANPME)
- Law tied to Charte de PME which provides specific definition for SMEs (revenue, age, etc.)
- In the context of relative underperformance of other government programmes to provide credit for young entrepreneurs
- Little interest by VC companies in investment incentives under the law
- Establishment of a VC association and greater organisation of the industry
Case study 2: Access to credit by Lebanese SMEs

- Conducted an assessment of access to credit and VC in Lebanon in 2006
- Traditional ratios of banking sector development Lebanon stands positively
- Liberal banking sector, high foreign bank penetration
- Some crowding out of private sector lending by public
- 95% of Lebanese companies SMEs, 90% have less than 5 employees, 1% over 1000 employees
- 3% of beneficiaries account for 75% of private sector credit
- Voluntary CG covering SMEs
- PE investment in Lebanon represents 5% of total in MENA
- Kafalat provides loan guarantees, operates through Lebanese banks
- SME support unit in Ministry of Economy and Trade
- Challenge to deal with explosion of financing demand following the war
Solving the Equity Gap: MENA-OECD Enterprise Financing Network

• The MENA-OECD Enterprise Financing Network aims to improve the regulatory conditions for financing entrepreneurship using the MENA-OECD Investment Programme as a forum for exchange of good practice between MENA and OECD business and government representatives.

• The Network aims to foster entrepreneurship in the region by:
  – Creating a platform to connect entrepreneurs, financiers and government regulators
  – Providing avenues for private sector participants to effectively input into key investment policy reforms relevant to financing of entrepreneurship.

• The Network was launched in Manama in 2006 and a meeting hosted by the Dubai International Financial Center was held in 2007.

• The Enterprise Financing Network is open for membership and sponsorship of activities.
The Dubai Declaration

- Dubai Declaration adopted at the last EFN Meeting calls for:
  - Conduct survey of framework conditions relating to the operation of private equity and venture capital in MENA countries
  - The establishment of a MENA Institute for entrepreneurial finance and to provide training/advice
  - Support the establishment and use of business incubators in order to assist the commercialisation of early-stage enterprises;
  - Foster linkages between universities, R&D centers, science and technology parks, business incubators and entrepreneurs.
  - Survey framework conditions relating to the operation of private equity and venture capital in the MENA countries and develop recommendations;
  - Develop a blueprint for successful enterprise funds drawing on best practice from MENA and OECD countries;

- Enterprise funds experience can be implemented in the MENA region
- Polish Experience with Enterprise Funds in 1998-2002
THANK YOU

Alissa Koldertsova,
+ 33 1 45 24 83 05
alissa.koldertsova@oecd.org