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PREPARING SMES FOR ACCESS TO FINANCE: CHALLENGES **IN SEMED COUNTRIES**

Access to finance for small businesses continues to be a top priority for economic policy-makers across European countries and emerging markets. The financing gap between the resources available to small businesses and the funds they need to expand is large and growing. At the EBRD, we have a powerful toolkit to help fill this gap, including a wide array of financial instruments, such as factoring, which is discussed in this journal. Providing small and medium-sized enterprises (SMEs) with the know-how they need to improve their performance and boost growth is another important instrument in the EBRD's toolkit.

Finance alone often cannot meet the challenges faced by SMEs. Companies encounter a variety of problems that need to be addressed before they can even consider seeking external financing. These include a lack of reliable information on their operations, the need for a state-of-the-art, customised management information system and trained staff to use it to full effect. With this information available to SMEs, management can see where they can most profitably allocate resources and where they may need to cut back. Typically, a firm that installs a basic management information system soon sees the benefit of further advice in areas such as enterprise resource planning, human resources management, accounting, and so on.

SMEs also face other problems which are more complex. For example, family-owned firms may need modern corporate structures with formalised roles and responsibilities, or they may need to ensure their manufacturing facilities meet good manufacturing practices in order to sell their products in the European Union or other international markets. To assist them with this, we offer many complex services and types of advice. Without such support, many firms stand little chance of qualifying for financing. However, with good advice from local consultants or international experts, SMEs can become more competitive and have a better chance of qualifying for financing, whether from local commercial banks, a private equity fund or the EBRD itself.

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The EBRD has been helping small and medium-sized enterprises access advice since 1993 through its Small Business Support (SBS) team and has assisted some 15,000 enterprises in over 30 countries. Currently operating in 25 countries in which the EBRD works, the SBS programme is funded by a wide range of donors and delivered on a cost-sharing basis to SMEs. Our advice is tailored to the specific problems faced by the enterprises with which we work. Advice is provided either through local consultants, which are trained and screened by the SBS team to ensure they are capable of delivering the advice needed, or through international experts with many years of experience in the same industry as the client company. In order to ensure that the quality of local advice is comparable, whether delivered in the Kyrgyz Republic or Romania, we have developed a suite of training courses for local consultants to build a sustainable network of support for SMEs on the ground in each country.

One year after completing each project, we return to measure changes in the client's business performance. Results show that within a year of a project ending:

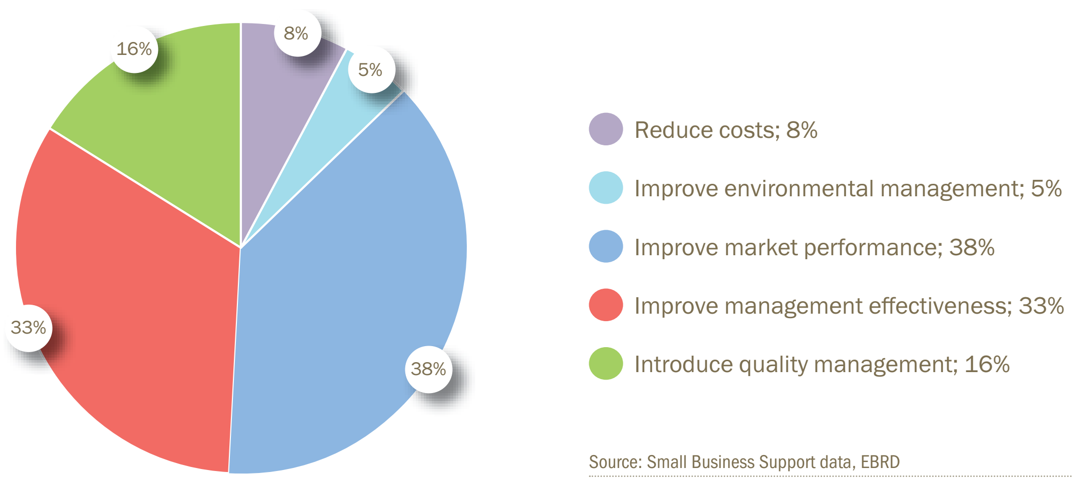
- 77 per cent of our clients increase their turnover by an average of 23 per cent and improve their productivity by an average of 8 per cent
- 57 per cent create new jobs, increasing their employee numbers by an average of 14 per cent (in 2013 alone, our clients created nearly 10,000 jobs)
- 17 per cent secure external financing.

Clearly, advice has a positive impact on enterprise performance. In order to achieve these results, the Bank starts by performing integrity checks and due diligence on the clients before each project is undertaken. We have well-tested monitoring and evaluation procedures. From the outset, we are clear about the results expected from each project, which is carried out with carefully prepared terms of reference and monitored closely to ensure that we are on track to deliver the anticipated results. We then benchmark our projects against industry trends and market developments to ensure that our advice is getting results consistent with global best practices, and adapt them if they are not.

As shown in Chart 1, over one-third of the EBRD's advisory project portfolio has been aimed at improving market performance. This is explained by the fact that smaller businesses operating in a competitive environment have to invest a lot of effort towards improving their marketing strategy, finding new business partners and searching for viable investment opportunities before they can apply for finance.

About 33 per cent of projects aim to improve management effectiveness. Many growing businesses acknowledge that they need advice on how to improve their organisation to be able to deal with the challenges of further growth. Greater employee numbers and increased output levels complicate resource management and supervision, which creates the need to introduce automated

CHART 1 ADVISORY PROJECTS BY OBJECTIVE



Source: Small Business Support data, EBRD financial and management information systems that will also provide accurate financial information to potential financiers.

Local companies show a high interest in quality management systems and certification, which is mainly motivated by the pressure they face to seek new markets in countries where product certification is expected and to comply with the requirements of clients, partners and suppliers. At the same time, businesses that implement quality systems are driven by the need to improve their organisational structures and to reassure clients of their ability to consistently provide high-quality products or services. Any bank will appreciate seeing this trait in a borrower.

Cost-reduction studies make up the fourth largest group of SBS advisory projects. Obsolete and deteriorating SME production facilities are low in efficiency and hence do not generate a high return on assets. Capital expenditure funding (following advisory projects focused on manufacturing automation, business process optimisation and engineering solutions) generally leads to increased operational efficiency and turnover.

The smallest share of SBS advisory projects (5 per cent) focuses on improvements in environmental management. Such projects range from performing environmental audits and impact assessments to implementing sophisticated environmental management or engineering solutions, and they demonstrate the increasing importance that these considerations have in the business environment.

As illustrated below in the Healthy Mushrooms case study, external advice positively affects sales, productivity and ultimately profitability in a number of ways. Market research and branding open up new markets and help to increase sales. Feasibility studies and business plans prepared by industry experts ensure that the goals are realistic and achievable, so that associated investments are successful. Energy and other resource efficiency projects save money, while environmental projects reduce waste disposal costs. A successful strategy provides a clear roadmap for day-to-day operations to avoid wasting resources on business areas that have not been vetted and agreed upon.

A case in point is Aroghj Sunk (translated as "Healthy Mushrooms"), an Armenian mushroom production company founded in 2004. The business has three mushroom farms producing around 200 tonnes of fresh mushrooms monthly, which are delivered to stores, supermarkets and restaurants across Armenia. The EBRD's first engagement with the company was through a marketing project with a local consultant in 2008. The project aimed to develop a corporate identity and brand to help the company compete in a market dominated by imports. A year after the project ended, turnover had increased by about 64 per cent and the company began exporting to Georgia.

As the company continued to grow, they realised they needed to upgrade their internal management systems. An international adviser and agribusiness specialist from Ireland designed and helped the company install a management information system, and also developed a marketing and sales promotion plan to increase exports and foster foreign match-making. After this engagement, Aroghj Sunk applied for a loan from the EBRD's Medium-Sized Co-Financing Facility, through a credit line with HSBC. The company already produced its own compost for growing mushrooms and wanted to expand this production by building a new production site. To access the loan, they needed to bring their financial statements in line with international financial reporting standards. The SBS team helped them work with a local audit firm to accomplish this task. The company received a loan for €8.6 million and is currently working on a second project with an international adviser from Italy to upgrade its new production facility to international standards, thereby raising the quality of their product and increasing their output capacity. In total, since the first project in 2008, turnover and gross profits have risen by approximately 438 per cent and 171 per cent, respectively. Their exports have also increased by €1.72 million, and through import substitution the company has gained an impressive market share.

For firms, successfully engaging external advice also shows important qualities to future financial investors – that this is a firm managed by people who are serious about its future, who invest time and money to improve operations and who are willing to make important changes to their business.

External advice takes many forms. While contemplating granting a loan to Borges, a major olive oil producer in Tunisia, the EBRD helped the company to work with an international expert that trained Borges' suppliers in agricultural best practices, enabling the company to better ensure high-quality olives and higher-quality oil. By improving machine maintenance and quality controls for temperature and product integrity, the company was able to guarantee the colour and texture of its olive oil, thereby increasing its competitiveness.

While the operational results from advisory projects are very strong, statistics show that the impact of Small Business Support advisory assignments on access to finance is less dramatic. This is, in part, the result of the short period (one year) between the completion of the advisory project and its evaluation. Anecdotal evidence among the firms financed directly by the EBRD shows that getting external financing takes time. Many of the firms that have been financed by the EBRD in Central Asia, eastern Europe and the Western Balkans had their first advisory assignment 3-5 years prior to receiving financing.

This may also relate to the difficulties SMEs face in accessing finance in the traditional EBRD region.[1] Since 2008 finance in commercial banks has been tight and economic growth has been subdued in much of the region compared with the previous period (2003-08). Many small firms have delayed investment due to economic uncertainties. Of those that are investing, many rely on their own internally generated resources to grow their businesses.

In the southern and eastern Mediterranean (SEMED) countries, the situation for SMEs wishing to access finance is even more challenging. The EBRD started working in Egypt, Jordan, Morocco and Tunisia in 2012. Advisory programmes were also introduced in the four countries that same year. While the SEMED region already had a rich tapestry of assistance programmes for SMEs, there was clearly a need for an efficiently delivered and tailor-made approach. The Bank also put a special emphasis on Advice for Agribusiness, a programme that aims to provide advisory services to help local agribusiness companies prepare to access finance directly from the Bank. Overall, the EBRD's advice for small and medium-sized businesses has been met with substantial demand from the start.

There are a few significant differences in the SEMED markets compared with those in the EBRD's traditional region. According to the 2012 Business Environment and Enterprise Performance Survey (BEEPS V),[2] 36 per cent of small businesses in Jordan perceive access to finance as a major or very severe obstacle to their operations. In Egypt this figure is slightly lower at 30 per cent; however, only 11 per cent of small businesses have a line of credit or a loan from a financial institution, whereas in Jordan this figure is 22 per cent. Across all the countries in the traditional EBRD region, the percentage of businesses with credit or loans from financial institutions is significantly higher, at 35 per cent on average.

Informality in the SEMED region is an even bigger concern compared with the countries in which the Bank has been working for more than 20 years. Until firms register formally, pay their taxes and account for all of their employees, it will be very challenging for them to gain access to finance. Of those firms operating in the formal sector, it is a very common practice for firm owners to diversify their risks and opportunities by establishing new companies for different (but often related) lines of business. This makes it difficult for any financial partners to be sure that money provided to one company will not be transferred to another firm with the same owner. Transfer pricing and overall lack of transparency reduces the chance that such firms will qualify for bank loans or gain the interest of a private equity firm.

Financial institutions are generally more risk-averse than in south-eastern and eastern Europe, where collateral requirements for SMEs are often in the range of 300 per cent. In addition, long-term investment loans are difficult to obtain. Sometimes the terms and conditions of working capital loans are not sufficiently attractive, leading firms to approach the EBRD for a range of financial products.

A key issue on the supply side is that the banking sector remains highly concentrated and banks have few incentives to tailor financial and lending products to SME needs. The reason that nearly 20 per cent of small businesses in Jordan have not applied for new financing is due to complex application procedures or unfavourable interest rates. In Egypt 16 per cent of SMEs reported similar issues.[3] Indeed, according to the Organisation for Economic Co-operation and Development,[4] credit guarantee schemes and other sources of financing, which can play important roles in easing access to bank lending, remain insufficient and have been constrained by political instability across the region.

For the company Pharaoh-Tech, an Egyptian electrical engineering systems producer (air conditioning, security and fire-safety systems), accessing finance presented a great challenge. The company, which has around 40 employees, was looking to expand by producing their own parts rather than sourcing them externally. An advisory project to develop a feasibility study was a great step forward as it reaffirmed the market demand and confirmed the viability of the project, but that alone was not enough to attract financing in a difficult banking environment.

In Morocco we helped Citruma, a leading juice producer known for its widely recognised brand name, Marrakech, to obtain a €3.6 million mezzanine loan from the EBRD in November 2013. The mezzanine structure provided long-term resources and the flexibility needed to support the firm's objectives. However, before the investment took place, an advisory project was carried out to help Citruma's management improve their product development process, engage with new foreign customers and suppliers, and improve management effectiveness. This helped the company become a more credible banking client.

Citruma is a medium-sized company with annual sales expected to reach €11 million in 2014. However, at the other end of the spectrum are the micro and small firms that are wary of approaching financial institutions. Since it starting investing in SEMED, the EBRD has made a number of loans to financial intermediaries in the region. Among these are the National Bank of Egypt (NBE) and the Microfund for Women (MFW) in Jordan.

The MFW was established as a non-governmental organisation and is now the largest microfinance institution in the country as measured by number of clients (30 per cent of market share) and the second largest by gross loan portfolio (13 per cent of market share), with total assets worth US$ 47.3 million. The MFW reached 100,000 clients in 2013 and has received a US$ 4 million loan from the EBRD to enable it to better finance its client base, which has grown beyond the micro segment. Enterprises seeking loans above €10,000 but below €70,000 face difficulties in accessing finance from banks that impose excessive collateral and burdensome lending procedures. The Jordanian Department of Statistics estimated that, in 2010, 83 per cent of SMEs in Jordan were in the trade and services sectors, and only 14 per cent were in the industry sector. Service sector enterprises often lack real estate and other tangible collateral that banks seek when extending loans. This is even truer for women entrepreneurs and means that access to physical assets, which serve as a basis for loan assessment, is limited. In contrast, the Microfund for Women relies on client knowledge, lending methods based on cash flow and a fast response time, which SMEs need.

The EBRD disbursed a €50 million loan to the National Bank of Egypt, a state-owned commercial bank, for on-lending to SMEs. The NBE has also taken out a further loan for on-lending to women-led businesses, which the EBRD is providing as part of a Women-in-Business package combining finance and advice for women. This product has been developed over the course of 2014 and involves donor funds to compensate for the lack of collateral that is often a barrier to women-led businesses gaining access to finance. Together with a loan from the EBRD and advice for women entrepreneurs, the programmes will provide a suite of training courses (covering financial literacy, leadership skills, online marketing, and so on), as well as access to mentoring, networking, and for those identified as high-potentials, coaching opportunities. In addition, advisory services through local consultants and international experts will be made available. The National Bank of Egypt is an important first mover among commercially operated financial institutions in this field.

At present, the Bank is already offering similar assistance to women-led enterprises in cooperation with the Social Fund for Development in Egypt. Under this programme, the Bank is working with the Egyptian Business Women's Association and the Arab Women Investors Union on networking. In the past 14 months, some 133 women entrepreneurs in Cairo, the Nile Delta and Upper Egypt have attended awareness-raising events, where they have benefited from business diagnostics and have been given advice on areas where their businesses need improvement. Over the same period, the Bank completed projects to help about 35 of those entrepreneurs advance their businesses. One of these firms, Dallah Misr, is a table oil manufacturing company owned and managed by a woman. The Bank assisted the firm in implementing a computerised financial control system, making the flow of information easier and more accurate, thereby enabling management to take a strategic decision on the expansion of the company's operations.

NOTES

1 These countries include all of the Western Balkans, central and eastern Europe, and Central Asia.

2 BEEPS are implemented in all Mediterranean and North African (MENA) countries. Currently, data are only available for Egypt and Jordan.

3 EBRD-World Bank (2012), Business Environment and Enterprise Performance Survey (BEEPS V), EBRD-World Bank-EIB, Middle East and North Africa Enterprise Surveys (MENA ES).

4 OECD (2014), *Financing SMEs and Entrepreneurs 2014: An OECD Scoreboard,* Paris.

5 International Finance Corporation (2012), *Why Banks in Emerging Markets are Increasingly Providing Non-Financial Services to Small and Medium Enterprises*, Washington, D.C.

The Bank has had to overcome some critical challenges to bring this work to fruition. SME owners in general, and specifically women-led enterprises in remote regions, are not often aware of the importance of business advisory services to grow their companies. As such, the Bank has held a number of small, carefully targeted visibility events and meetings to raise awareness on the benefits of accessing the know-how companies need in order to grow. As a result, half of the projects in Egypt are with enterprises based outside of Cairo.

According to a 2012 study conducted by the International Finance Corporation,[5] "such [advisory] services have the potential to help SMEs become more bankable, increase their ability to repay loans and improve their business practices to grow their enterprises".

A common issue for the EBRD – not in any way unique to Egypt or SEMED – is the lack of qualified local consultants in some countries and in many provincial regions. To address this, the EBRD has developed the Grow Your Consulting Business training series, a set of six courses which offer local consultants the opportunity to develop their skills. The courses cover a range of critical skills for consultants and offer those with better established practices the opportunity to develop their project management, diagnostic or marketing skills. The courses are offered in all of the countries where the EBRD gives advice to small businesses. Consultants participate on a cost-sharing basis and the courses are presented in the local language wherever possible. In addition, we have developed courses to help consultants learn specialised skills, such as offering export promotion advice and conducting energy audits (which requires engineering skills to participate).

By transferring this important knowledge, the EBRD is building the skills base required for SMEs to access quality local advice. In addition, we are working with local organisations to improve their capacity to manage programmes similar to those offered by the Bank's Small Business Support team. In Croatia the Bank has been working alongside HAMAG Invest to share information about best practices for advising small businesses. After a year of collaborating with the Bank, HAMAG Invest will continue to offer advice to small businesses while the Bank will concentrate on offering advice for women in business. Naturally, an exit strategy like this requires strong local administrative capacity and well-developed local skills. Over time, the Bank anticipates providing similar capacity-building support to ensure that this advice is sustainable in other markets, while also focusing its attention on the countries in which skills need further improvement.

Based on our activity in the SEMED region over the past couple of years, it is clear that the gap in access to finance for SMEs is significant and that the need for advice is equally substantial. Hence, the Small Business Support team intends to be active in the region for quite some time to come.