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An Analysis of Access to Finance by Micro, Small and Medium Enterprises (MSMEs) in Egypt

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Executive Summary

A well-functioning financial sector that can provide financing to MSMEs is very important. This study presents the access to finance by Micro, Small and Medium Enterprises (MSMEs) in Egypt, where MSMEs account for more than 99% of all non-agricultural private enterprises. The paper reviews the supply of finance covering credit, microcredit and equity finance: venture capital (VC), angel investors and crowdfunding; the demand for finance (i.e. MSMEs) and the regulatory framework.

On the supply side of credit, banks, the Social Fund for Development (SFD) and microfinance institutions (MFIs) are the primary sources of credit for MSMEs in Egypt. The commercial banking sector has experienced a very considerable growth in the last 10 years and remains the most important source of credit in the country. Between 2005 and 2010, Egypt's banking system witnessed significant increases in deposits and loans and the borrowers' base, alongside increased levels of liquidity. Banks' liquidity ratios show that during the global financial downturn of the late 2000s', the main suppliers of credit to MSMEs adopted more conservative lending practices, which translated into a relative contraction of the credit supply.

Private commercial banks admit being reluctant to making efforts towards the MSME sector, and consider investments in MSMEs too risky and better suited for NGOs and public sector banks. Banks tend to have limited involvement in microfinance, although recent joint initiatives between banks and MFIs would seem to indicate the trend may be changing: the four licensed banks providing microcredit in Egypt have been able to reach 15% of potential microcredit clients.

The SFD is a quasi-governmental organization supported by the government that mobilises resources to finance activities through the provision of loans and other pre-loan financial services to MSMEs. However, the global financial crisis, continuing political and security instability in the country have probably impacted the capacity of the SFD to mobilize more resources.

Other sources of finance have progressively become more important to MSMEs. The case of MFIs is remarkable: despite the great difficulties they have in mobilizing resources (they cannot offer deposit accounts) MFIs have become a very solid source of credit, especially for micro-enterprises. Thanks to sound management practices, MFIs have grown considerably and often represent a true alternative to banks' credit, which is making the line between banking and

microfinance blurry. The growing importance of MFIs in Egypt is interesting given the sector's large size. There are 1.4 million active micro-enterprise borrowers, making the country the largest microfinance market in the Arab region in terms of outreach. The MFI sector consists mainly of NGOs, both non-profit and profit-seeking, which contribute to financial inclusion as they target micro-enterprises and actors in the lowest-income segments of the population, such as female-headed households or youth wishing to start their own businesses.

With regards to equity, until 2008 VC saw considerable growth in the country. However, the volume of investments seems to have stagnated thereafter. Conversely, new types of finance have recently started to appear in the country's investment landscape. Most notably, new networks of angel investors have emerged in the last two-three years. Their business models are yet to be tested, but high growth potential is one of their key targets.

Similarly, crowdfunding seems to be taking off. While it is not exactly a new type of finance, its distribution channel (i.e. the internet) makes crowdfunding quite innovative and has shown in other countries, e.g. the United States, to have an immense capacity to mobilize funds for investment in MSMEs with innovative projects and ideas.

To assess the creditworthiness of the demand side, the study considers key characteristics of entrepreneurship and the financial characteristics of corporate borrowers. MSMEs' creditworthiness has suffered since the onset of the global financial downturn, as many long-standing entrepreneurs went out of business and it was difficult for nascent entrepreneurs to start new ventures. The main sources of funds to finance investments by MSMEs are internal re-absorption of profits, equity sales, banks' credit and suppliers' credit. In terms of financial characteristics, Egypt's private sector companies perform better than those in the region on a number of accounts. For instance, they are considerably more likely to have a checking or savings account than those in other Arab countries.

Whereas for large companies the reduction of credit of the late 2000s implied not having as much credit as they would have liked, MSMEs (with lower credit volumes) saw higher screening by credit suppliers, which meant a higher likelihood of being left out of the market. It is therefore not surprising that many MSMEs be willing to consider VC as an option.

Under a more holistic approach it is worth noting that, although the lack of credit is a sizeable constraint, it is merely one of the obstacles MSMEs face. Informal practices, the tax system, access to an educated workforce and corruption are other, more important hindrances which ought to be tackled.

The Egyptian government's legal, regulatory and institutional framework in relation to MSME finance includes among others an SME law, the development of a National SME Strategy or the establishment of an SME Development Unit, institutions geared towards the consolidation of a policy environment whereby SMEs work under the umbrella of the formal sector.

The country has room to make its regulatory framework more conducive in channelling finance to MSMEs, both in the form of credit and equity. The judicial system is large and complex, suffers from backlogs, and has insufficient legal provisions for the rights of borrowers and lenders with regards to collateral and bankruptcy laws, resulting in lenders who are not fully empowered to lend.

Although insufficient credit information inhibits access to credit, the creation of the private credit bureau I-Score is a very positive experience, as it has greatly expanded data records: I-Score now holds data pertaining to over 4 million SMEs and consumer borrowers.

In order to address the shortcomings noted, the paper outlines some key policy measures to consider and analyse in depth. Regarding the supply of credit, banks should adopt lending systems better suited to the nature and characteristics of MSMEs (versus the one-size-fits-all-clients approach). Some initiatives could be the training of line management and senior management on MSME lending, the introduction of policies targeting MSMEs (e.g. a share of portfolio loans dedicated to MSMEs), innovative procedures to assess MSMEs' creditworthiness (e.g. scoring systems) and especially their growth prospects. In particular, the supply of credit could widen the range of products offered to better adapt to MSMEs and contribute to their success. For instance, banks could contribute to their clients' success by setting up business development services that support MSMEs capacity on financial statements, accounting standards, business planning, market research, etc.

Besides banks, it is necessary to provide the appropriate infrastructure to allow NGOs involved in microfinance (NGO-MFIs) become commercially autonomous. They could benefit from a regulatory framework better suited to micro financing activities. Allowing NGO-MFIs to offer saving products under specific conditions would facilitate an easier financial position for them and spur competition in the financial sector, which is essential to improving access to finance for MSMEs.

Regarding equity, an in-depth analysis of VC and innovative sources of funding such as angel investors and crowdfunding is advisable. An assessment of their practices would serve to publicize these new options vis-à-vis MSMEs, as well as to preclude potential frauds in the future.

Recommendations to support MSMEs include simplifying and streamlining procedures to start a business, with a one-stop shop that is simple and avoids duplication. The current efforts undertaken by the Egyptian Banking Institute with regards to financial education and entrepreneurs' awareness are in the right direction and should be strengthened.

With regards to the regulatory financial infrastructure, the laws regarding collateral, secured transactions and bankruptcy should be revised with a view to expand the pool of assets that can be used efficiently as collateral. This would involve actions such as clarifying property rights, improving owners' ability to document those rights, improving collateral registries, improving the efficiency with which lenders can take possession of and sell assets serving as collateral, and prompting development of more-liquid markets for such assets, so that the prospects for realizing their value is improved. The back log of court cases should be cleared, for which a possibility could be the establishment of courts dealing specifically with financial affairs, at least on a pilot basis.

Access to credit information should be more equitable, especially for MFIs who deal with lower loan volumes. A possibility is that I-Score stakeholders contribute proportionally to their Gross Loan Portfolio (GLP) per borrower. Furthermore, the public sector registry should improve its data coverage and depth.

Finally, the country should analyze in detail how to increase the incentives offered for financial institutions to lend to MSMEs. For instance, the Central Bank of Egypt could encourage banks to direct funds to MSMEs through preferential interest rates. Similarly, credit guarantee companies could be encouraged to play a more active role that would favour higher MSME lending by financial institutions.

1. Introduction

Micro, Small and Medium Enterprises (MSME)[1] are vital to the economy, as they account for a large share of countries' GDP and employment. This pattern sees no exception in the Arab region: for instance, SMEs in Kuwait constitute about 90% of the private workforce, and in Lebanon SMEs constitute more than 95% of all enterprises and contribute about 90% of the jobs.[2] This study focuses on Egypt, a country where SMEs constitute more than 99% of all non-agricultural private enterprises in the country.[3]

When it comes to promoting MSMEs, the overarching necessary factor is a sound investment climate, which involves a variety of aspects such as the legal framework, qualified human resources and access to finance, among others. While keeping in mind such holistic approach, this paper focuses primarily on access to finance, vital for MSMEs to finance their working capital and invest in their future operations. Two basic types of finance can be accessed: debt (e.g. loans, credit lines) and equity (e.g. venture capital, private equity). While the first type has to be repaid under specific conditions, the second typically involves some type of shareholding whereby the investor becomes co-owner of the MSME under specific conditions.

A well-functioning financial sector that can provide credit to MSMEs is vital for any country. Its main function is to channel funds from those agents that have an excess of funds (or savings) to those agents that require funds (investors), thereby facilitating the process of investment, capital accumulation and wealth-generation. One of the determinants of MSMEs' accessing credit is the amount of savings that credit institutions are able to collect and channel for investment. This ability to collect savings is linked to financial penetration, associated with indicators such as the number of people that have a bank account. The second determinant is how 'easy' the credit-granting process is, which involves aspects such as e.g. banks' policies to assess

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[1] The paper refers to MSMEs in a generic way for three reasons: first, definitions of MSME vary; second, data are very scarce (particularly for the micro segment); and finally, some of the sources consulted refer to MSMEs while others relate to SMEs. To provide a benchmark definition, the World Bank uses the following criterion to classy of enterprises: micro (1-4 employees), small (5-9), medium (20-99), and large (>100). Thus, in the passages where the acronym SME is explicit, the reason could be because i) micro-enterprises are excluded, or ii) it is the name of a specific program.

[2] Elasrag, H. (2011).

[3] Ibid.

loan applications, central banks' reserve requirements, etc. Finally, the third key variable is how risky those MSMEs applying for loans are in terms of creditworthiness.

Financial penetration in the Arab region remains low relative to other regions of the world.[4] Indeed, the financial sectors of Arab countries are generally less developed than those in other regions, and MSMEs face more difficulties in accessing credit than MSMEs in other parts of the world.[5] However, the pattern is very uneven and differences between the 'more diversified economies' (MDE) and the Gulf Cooperation Countries (GCC) are very marked. In Egypt, financial penetration is low even when compared to the other Arab countries. For instance, the number of deposits held by Egyptian commercial banks per 1,000 people in 2010 was the second lowest in the region after Yemen.[6]

To better understand the credit market for MSMEs in Egypt and subsequently recommend measures to stimulate it, this paper presents its overall performance. The analysis is comprised of the supply of credit (e.g. credit-granting organisations), the demand (MSMEs) and the financial regulatory infrastructure.

The paper is in line with other works aimed at analysing and providing policy recommendations to stimulate the credit market in the Arab region.[7] The structure of the paper is as follows: sections two and three present in detail the supply and demand of credit, while section four discusses aspects relating to the regulatory framework. Finally, section five concludes and presents policy recommendations to promote the development of the MSME credit market in Egypt.

[4] IMF (2012).

[5] IFC (2012).

[6] Countries with data available: Algeria, Egypt, Jordan, Kuwait, Lebanon, Morocco, Oman, Saudi Arabia, United Arab Emirates, Palestine and Yemen.

[7] See e.g. Rocha et al. (2011).

2. The Supply of Finance for SMEs in Egypt

This chapter depicts the main actors that supply finance to MSMEs in Egypt. The nature of this supply is somewhat associated with the lifecycle of an enterprise: "At the very beginning, entrepreneurs often turn to their family and friends for support, an option recently expanded by 'crowdfunding'. Assistance can also come from risk capital firms, which are firms that support promising projects in exchange of a share in the company. In a similar fashion, but 'favouring larger projects at later stages in the lifecycle' venture capital firms also support MSMEs. When MSMEs are consolidated, it is much easier for them to access credit through microfinance institutions (MFIs) or commercial banks".[8]

This section will cover the following actors: banks, the Social Fund for Development (SFD), MFIs, Venture & Risk Capital (VRC) and Angel Investors. Each sub-section will illustrate the main actors, available data on performance indicators, and the importance for MSMEs credit.[9]

2.1. Banks

This subsection starts by introducing the structure of the Egyptian banking sector. Next, the sector is assessed with regard to the two characteristics already noted: its ability to collect savings (for which financial penetration in the country is considered) and the ease with which banks' collected savings can be channelled towards MSMEs (which is reflected in the indicators of access to credit by MSMEs). For the period with available data (2006-2010) the market is considered as in equilibrium, and therefore there is no presumption that banks should have lent more to MSMEs. The analysis explores whether banks have the margin to increase credit to MSMEs, and if that is the case, what are the main obstacles they face. The combination of these factors gives a picture of how well Egypt's financial sector functioned vis-à-vis the country's economy.[10]

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[8] Pedrosa-Garcia, J.A. (2013).

[9] Data are not available on all the categories.

[10] Note that beyond the financial sector undertaking its function inclusion is vital. For instance, suppose the financial sector was financing only the Government's deficits. In this case the financial sector would be doing its function, but how much wealth it would create is a controversial question. The figures of how much credit has gone to the public sector in Egypt are given below.

Table 2.1 below gives an overall image of Egypt's banking sector and its evolution between 2004 and 2010. This seven-year period saw a process of consolidation in the commercial banking sector: in 2010 there were 15 banks less than in 2004 (column a). At the same time, banks' access points increased considerably, both in terms of their number of branches (b) and ATMs (c), representing a growth of 41% and 274%, respectively. This growth in absolute numbers is reflected in the density of branches and ATMs, both from a geographical (d, f) and demographic perspective (e, g).

TABLE 2.1. BANKING SECTOR SELECTED INDICATORS

Concept	Unit	2004	2005	2006	2007	2008	2009	2010
(a) Commercial banks	Number	54	45	41	41	39	39	39
(b) Commercial banks: Number of Branches	Number	1,795	1,859	1,966	2,167	2,347	2,466	2,533
(c) Number of ATMs	Number	1,288	1,670	2,271	2,841	3,465	4,203	4,821
(d) Commercial bank branches per 1,000 km^2	Number	1.857	1.913	2.016	2.218	2.397	2.516	2.584
(e) Commercial bank branches per 100,000 adults	Number	3.820	3.833	3.944	4.240	4.483	4.607	4.631
(f) ATMs per 1,000 km2	Number	1.294	1.678	2.281	2.854	3.481	4.222	4.843
(g) ATMs per 100,000 adults	Number	2.661	3.362	4.462	5.456	6.510	7.729	8.680

Source: IMF (2012).

Next, table 2.2 below shows selected indicators relating to banks' collected savings. The total number of deposits grew by 7.6% between 2006 and 2010 (a), while household deposit accounts grew by 7.9% (b). Therefore, not only did financial inclusion increase, but considering the banks' base of clients, households grew in importance: 97.4% of the outstanding deposits belonged to households in 2006, while in 2010 that figure was 97.7%.[11]

However, growth in the number of household deposits was not accompanied by a similar increase in the volume in those deposits. Of the 568,841 million Egyptian pounds (EGP) held in bank deposits in 2006, 66.8% belonged to households.[12] Despite growing to 574,717 million

[11] Ratio (b)/(a).

[12] Ratio (d)/(c).

EGP in 2010, household deposits as a share of total deposits remained relatively unchanged at 64.4%.[13]

The number of deposit accounts at commercial banks per 1,000 people grew from 2006 until 2008, decreasing thereafter (g). Relative to the population, of all deposit accounts in 2006, 97.3% belonged to households while in 2010 that figure was 97.8%.[14] The volume per deposit account rose from 29,963 to 43,673 EGP (e), entailing a growth of 45.7%. Considering households only, the volume per deposit account rose from 20,552 to 28,775 EGP (f), which yields a growth rate of 40%. This difference implies that the volume per deposit account held by actors other than households, i.e. organisations (which accounted for 2.2% of all accounts in 2010[15]) grew 139%.[16]

Despite the growth in total and average volumes of deposit accounts (for all types of holders), the weight of the deposits relative to the Egyptian economy decreased considerably, both in general (i) and for households only (j), which means that the economy must have grown more than deposit volumes, i.e. the ability of commercial banks to collect savings decreased relative to the economy.

TABLE 2.2. SELECTED INDICATORS OF EGYPT'S BANKING DEPOSITS

Concept	Unit	2006	2007	2008	2009	2010
(a) Commercial banks: Deposit Accounts	Number	18,984,872	19,617,000	20,553,088	20,465,560	20,435,595
(b) Commercial banks: of which: Household deposit accounts	Number	18,496,868	19,175,202	20,061,898	19,983,148	19,972,523
(c) Commercial banks: Outstanding Deposits	Million EGP	568,841	649,953	747,199	809,694	892,492
(d) Commercial banks: Outstanding Deposits, households only	Million EGP	380,147	420,124	447,772	513,768	574,717
(e) Commercial banks: Deposit balance per account	EGP	29,963	33,132	36,355	39,564	43,673

[13] Ratio (d)/(c).

[14] Ratio (h)/(g).

[15] 1-((h)/(g)).

[16] Calculations not shown.

(f) Commercial banks: Deposit balance per account, households only	EGP	20,552	21,910	22,320	25,710	28,775
(g) Deposit accounts with commercial banks per 1,000 adults	Number	373	377	386	376	368
(h) Household deposit accounts with commercial banks per 1,000 adults	Number	363	368	377	367	360
(i) Outstanding deposits with commercial banks, relative to GDP	Percent	92	87	83	78	74
(j) Outstanding household deposits with commercial banks, relative to GDP	Percent	62	56	50	49	48

Source: IMF (2012) and own calculations based on IMF (2012) data.

Next, table 2.3 presents selected indicators of Egypt's access to credit. The number of borrowers increased very considerably between 2005 and 2010, both considering all clients (a) and households only (b), which yields growth rates of 125% and 131%, respectively. The overall volume of outstanding loans rose from 324,041 million EGP to 465,990 million EGP in only five years (c), representing a growth of 43.8%, while for households only the volume of outstanding loans grew 74.5% (d). In 2006, 94.1% of all loans belonged to households[17] although the volume of those household loans represented only 16.4% of the total.[18] By 2010, the number of household loans rose to 96.5% of all loans, accounting for 19.9% of the total.[19] This pattern led to lower average loans: the outstanding loans' volume per borrower (e) in 2010 was 107,074 EGP, down from 167,626 EGP in 2006, entailing a decrease of 36.1%. Similarly, outstanding loan per household borrower decreased from 29,285 EGP in 2006 to 22,082 EGP in 2010 (f), which shows a decrease of 24.6%.

Relative to the population, the overall number of borrowers (g) roughly doubled between 2006 and 2010, while households saw slightly higher growth at 111% (h). Finally, relative to Egypt's GDP, overall banking credit decreased considerably from 52% to 39% (i), although for households it remained relatively stable (j). We can see once again that, since outstanding loans and clients grew very substantially, GDP must have grown even higher (which could have been facilitated e.g. by credit from other suppliers).

[17] Ratio (b)/(a).

[18] Ratio (d)/(c).

[19] Ratios (b)/(a) and (d)/(c).

TABLE 2.3. SELECTED INDICATORS OF EGYPT'S ACCESS TO CREDIT

Concept	Unit	2006	2007	2008	2009	2010
(a) Commercial banks: Borrowers	Number	1,933,118	2,731,376	3,643,602	3,805,916	4,352,049
(b) Commercial banks: of which: Household borrowers	Number	1,815,747	2,606,620	3,527,643	3,666,048	4,202,120
(c) Commercial banks: Outstanding Loans	Million EGP	324,041	353,746	401,425	429,957	465,990
(d) Commercial banks: of which: Household Outstanding Loans	Million EGP	53,174	59,938	78,332	84,588	92,793
(e) Commercial banks: Outstanding loan per borrower	EGP	167,626	129,512	110,173	112,971	107,074
(f) Commercial banks: Household Outstanding loan per borrower	EGP	29,285	22,995	22,205	23,073	22,082
(g) Borrowers from commercial banks per 1,000 adults	Number	38	52	68	70	78
(h) Household borrowers from commercial banks per 1,000 adults	Number	36	50	66	67	76
(i) Outstanding loans from commercial banks, relative to GDP	Percent	52	47	45	41	39
(j) Outstanding household loans from commercial banks, relative to GDP	Percent	9	8	9	8	8

Source: IMF (2012) and own calculations based on IMF (2012) data.

A question that remains is how much of the lending was dedicated to finance public institutions: in 2005, lending to the public sector represented 46.8% of total lending, peaked at 59.6% in 2011 and decreased slightly to 58.9% in 2012.[20] Such levels are relatively high and can be better understood in light of the high budget deficits the country has had in recent years, averaging -8.4% of GDP between 2005 and 2012.

To summarize, between 2005 and 2010 Egypt's banking system saw a significant increase in deposits and loans. While deposits per account increased, however, loan volumes per borrower decreased. This pattern seems explained by a very large expansion in the borrowers' base, i.e. many more loans were granted, but of smaller volume. Indeed, while banking deposits were

[20] Economist Intelligence Unit (2013).

driven mainly by institutions, banking credit disproportionately favoured households (who borrow smaller amounts) over institutions. The year 2008 seems to have marked an inflexion point, as from there onwards some key variables decreased (e.g. deposit accounts per 1,000 adults) or began to grow at a slower pace (e.g. borrowers per 1,000 adults). These two facts may indicate that the global financial crisis undermined firms' investment projects.

The impact of the financial crisis may have affected the country's credit market, but could banks have increased the supply of credit? Admittedly, answering this question without considering the loan applications received by banks is very difficult. However, it is possible to make a conjecture on the banks' margin to lend by looking at their relative liquidity. Table 2.4 shows the ratio of average outstanding loan and average outstanding deposit, disaggregated by clients (all and only households). The figures can be interpreted as follows: in 2006, for every EGP deposited by "all clients", 5.6 were loaned, yielding a leverage of 17.8%.[21] This means that banks had relatively high liquidity levels.[22]

Looking at the evolution between 2006 and 2010 it appears that banks became much more liquid: the loan-to-deposit ratios increased consistently: from 17.8% to 40% (all clients) and from 71% to 125% (households). Hence, despite Egyptian banks having loan-to-deposit ratios in 2006 that were not high relative to other credit markets, banks followed a constant deleveraging strategy that increased their liquidity further. Supporting this, Egypt's index of banking sector risk decreased from 53 to 48 between 2005 and 2010 (though it went back up and reached 59 in 2011 and 2012).[23]

It may be argued that this rising aversion in lending was due to lower quality of banks' loan portfolios (i.e. higher probability of default) as a result of the global financial crisis. However, the trend started in 2006 (before the crisis) and Egypt's growth seems to have been immune to the crisis: between 2006 and 2010 the country's GDP grew an average 6.2% annually.

[21] The calculation is 1 / 5.6 = 17.8%.

[22] As a benchmark, in July 2013 the US Federal Reserve announced that the minimum Basel III leverage ratio would be 6%.

[23] The Banking Sector Risk ranges from 0 (low) to 100 (high), and assesses the risk of a systemic crisis whereby bank(s) holding 10% or more of total bank assets become insolvent and unable to discharge their obligations to depositors and/or creditors. Economist Intelligence Unit (2013).

TABLE 2.4. RATIO OF (AVERAGE OUTSTANDING LOAN / AVERAGE OUTSTANDING DEPOSIT) BY CLIENT

Year	2006	2007	2008	2009	2010
All clients	5.6	3.9	3.0	2.9	2.5
Only households	1.4	1.0	1.0	0.9	0.8

Source: Own calculations based on tables 2.2 and 2.3 above.

With regards to banks' services, the array of products offered is quite comprehensive, although standardized (and therefore not tailored to MSMEs).[24] At least 75% of the banks' MSME clients are simple clients in the sense that they only use one to three products offered by the bank.[25]

Banks see MSMEs as carrying extra risk: although banks understand the importance of MSMEs in terms of profitability, they lack a clear understanding of the nature of the sector, particularly with regards to MSMEs' needs.[26] Bankers justify this perception not only by MSME-internal factors (such as inefficient management practices), but also on factors external to MSMEs (such as the banks' MSME-lending technology or banks' regulations).[27] Furthermore, banks make their financing decisions based on basic present documents rather than on SME growth potential (e.g. the existence of business plans is not something banks usually care much about).[28] The main requirements for granting credit to MSMEs are usually basic documents, such as registration or license, as well as financial performance of the businesses.[29] Bankers' perception is reflected in a disconnection with their clients: during the credit-granting process, the loan application rejection rate reported by SMEs was 20%, whereas that reported by banks was 66%.[30]

[24] Egyptian Banking Institute (2009).

[25] Ibid.

[26] Ibid.

[27] Ibid.

[28] Ibid.

[29] Ibid.

[30] Ibid.

Main Actors

Due to their small size, most MSMEs often request microfinance products from banks (the smaller the size of the MSME, the more likely it is to do so). However, private commercial banks tend to have limited involvement in microfinance activities, as they consider investments in MSMEs either too risky or better suited for NGOs and public sector banks with a large infrastructure base.

There are four licensed banks providing microcredit in Egypt: Bank of Alexandria (BoA), Banque du Caire (BdC), National Bank for Development (NBD) and Banque Misr (BM). These four banks have been able to reach 15% of potential microcredit clients despite having branch networks with extensive geographical coverage and well trained professional staff.[31] As an illustration of banks' involvement in microfinance, the experiences of the NBD (privately owned) and BdC (state owned) are presented next:

Founded in 1980, in 1987 the NBD became the first commercial bank to start microfinance operations in Egypt through its SME division. The bank's original 13 branches have subsequently grown to 69 nationwide, and throughout its 30 years of operation, NBD has been involved in the setting up of more than 73 companies, with a total capital of 1.4 billion EGP.[32] NBD adopted a model for its operations inspired by Grameen Bank: it incorporates client servicing approaches comparable to those of NGOs with sound financial practices, pursuing sustainable lending.

The main objective of NBD's microfinance program is to provide microcredit to those existing SMEs that would otherwise not be eligible for conventional bank loans. The idea is that eventually, microcredit borrowers will become clients with access to conventional bank loans. Microloans are small loans with short maturities and no collateral required; approvals are based on information regarding the enterprise cash-flow cycle and viability. Typical interest rates hover around 30% and loan approvals require a period of around 2 weeks, following transparent scanning and assessment procedures. The program also provides life insurance coverage to all borrowers and a mandatory savings component that is held in an NBD interest-bearing account.

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[31] Sanabel (2010).

[32] Loutfy, N. (2010).

For considerably long periods of time, the NBD's SME program has proven profitable as evidenced by profit rates higher than those generated from conventional lending operations. This is further substantiated by the number of repeated borrowing, which exceeds 70% of the value of loans disbursed. The main challenges include: covering the costs associated with training and remunerating loan officers in lieu of the regular workforce, and assessing the loan charges that maintain profitability and ensure growth of the program over time.

In 2007, NBD was purchased by Abu Dhabi Islamic Bank (ADIB), an institution that operates according to Islamic Sharia. The micro financing element, counting 39 microfinance units across 21 governorates, was redesigned to be Sharia compliant. The new microfinance program was successfully implemented and showed tremendous growth in 2009.[33]

Banque du Caire (BdC) is a state-owned bank founded in 1950 and nationalized shortly after, which was reformed in 2000 to gain competitiveness. Today, the BdC is a leader in microfinance lending based on gross loan portfolio (GLP), number of active loans and portfolio at risk. Relative to other banks, BdC has a comparative advantage given its presence in low-income areas. The bank is endowed with excess liquidity and has funded its microloan portfolio from its own resources. The government encouraged the participation of BdC in microfinance through the removal of restrictions on interest rates and the promotion of a more efficient management style. For instance, BdC has a decentralized system that provides significant decision-making authority to branch managers.

BdC started its microfinance activities with a pilot phase from 2001 to 2002, which then expanded within its branch network between 2002 and 2004. The bank introduced microfinance operations into 25 of Egypt's 26 governorates and has penetrated approximately 40 percent of Egypt's local districts. Subsequently its microfinance operations have expanded further: 80 new specialized microfinance units were established in areas where BdC did not previously have existing branches. In 2007 BdC merged with Banque Misr, and the resulting organisation integrated their microfinance activities.

[33] Daily News Egypt (2010).

2.2. Social Fund for Development (SFD)

The SFD is a quasi-governmental organization mandated by the government to create jobs by providing institutional, financial and technical support to MSMEs. It was established in 1991 as part of Egypt's Economic Reform and Structural Adjustment Programme.[34] Since the beginning of its operations, the SFD has become a key institutional vehicle for channelling government and donor resources to MSMEs in Egypt.

The SFD mobilises national and international resources and then lends them to eligible microfinance NGOs and banks, which in turn lend them to MSMEs. The main sources of funds include: the Egyptian government, European Union (EU), IDA, Arab Fund, Kuwait Fund, German Development Bank (KfW) and UNDP.[35] Financing activities are operated mainly by two arms: the Small Enterprise Development Organization (SEDO) manages the provision of loans and other pre-loan financial services to MSMEs, while the Human Community Development group (HCDG) provides microcredit and other basic human services (e.g. health, education) to address the needs of the poor.

The SFD lending policy is in line with international best practices, and incorporates social and human development dimensions that favour outreach to marginalized groups. For instance, MSMEs located in marginalised geographic areas and run by specific social groups are favoured, and there is a quota whereby at least 25% of beneficiaries have to be women.[36]

Successive government and multi-donor reviews of SFD programs carried out in 1994, 2000 and 2004 have noted the effectiveness of the SFD, reflected in its quick, flexible, and transparent disbursement mechanism. In line with efforts to engage banks as intermediaries in loan disbursement to MSMEs, the SFD established the Cooperative Insurance Society (CIS) for MSMEs. The CIS provides credit guarantee services to enterprises borrowing SFD funds, whereby CIS covers 80% of the loan, SEDO an additional 10%, and the financial intermediary the remaining 10%.

Some other key indicators of the SFD are the following:

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[34] OECD (2010).

[35] Planet Rating (2004).

[36] Nasr, S. (2011).

- Until 2008, the SFD disbursed a total of USD 2.5 billion.[37]
- By the end of 2008, 767,000 permanent jobs and 230,000 temporary jobs in MSMEs were created, in addition to 675,000 jobs in micro enterprises.[38]
- The loan repayment rate from intermediaries was 100%.

[37] Abou-Ali et al., (2009).

[38] UNDP (2014).

2.3. Microfinance Institutions (MFIs)

Egypt is the largest microfinance market in the Arab region in terms of outreach. By the end of 2009 the total number of active borrowers exceeded 1.4 million. [39] In terms of portfolio size, Egypt's total portfolio reached 2.2 billion EGP in 2010,[40] ranking the country second after Morocco.[41]

Besides public and private banks, microfinance services can be offered by several categories of institutions: i) NGOs, which play a major role in the microfinance sector and account for more than 70% of the microcredit granted, ii) the National Postal Authority (NPA), and iii) informal institutions such as Rotating Savings and Credit Associations (RoSCAs).

i) **NGO-MFIs**

Given the high number of micro-enterprises in the country (2.5 million) and the contraction of banking credit relative to the country's GDP in the late 2000s, MFIs have risen as a vital actor in MSMEs' access to credit, especially for micro enterprises. Indeed, MFIs' importance is justified by evidence of cross-lending between the banking and MFI sectors, as well as (to a lesser degree) across MFIs.[42]

In 1988, USAID initiated the Small and Micro Enterprise Development Project. Its aim was to address the gap in financing MSMEs. With support from Environmental Quality International (EQI), the project succeeded in providing a microfinance model for businessmen associations registered as NGOs.

The Cairo Small Enterprise Development Foundation (ESED) and the Alexandria Business Associations (ABA) SME Project Unit were the first to be developed following best practices, and grew into financially self-sustainable institutions capable of providing both technical and financial services to SMEs. ABA is of particular interest due to its outstanding performance: it reached operational self-sufficiency[43] (OSS) in 2 years and showed a repayment rate of 99%.

[39] EFSA (2014).

[40] Ibid.

[41] Sanabel (2010).

[42] World Bank (2012).

[43] OSS is defined as: Revenue from operations / (Financial expense + Loan loss expense + Operating expense).

ABA's positive experience instigated the replication of the model in other organizations, namely the Assiut Businessmen's Association (ASBA), Sharkia Business Association for Community Development (SBACD), the Dakahleya Business Association for Investors and Community Development (DBACD) and LEAD (Lend, Empower, Advance, Develop) Foundation.

The above mentioned MFIs along with Al Tadamun, Coptic Evangelical Organization for Social Services (CEOSS) and First Micro Finance Foundation Egypt (FMF) are the largest MFIs in Egypt in terms of GLP. Six of these ranked among the top 100 performing MFIs in the world in 2009: LEAD (10th), ASBA (25th); AT (27th), DBACD (47th), ABA (56th) and CEOSS (74th).[44]

Table 2.4 below shows key indicators of outreach and lending volume pertaining to nine of the largest MFIs based on GLP. Between 2008 and 2011, the total number of borrowers increased by 6.8% while the GLP soared by 49.1%. This difference in growth rates implies a significant rise in the average GLP per borrower, which grew for all the MFIs considered.

GLP per borrower relative to GNI per capita is less than 20%, which confirms the commitment towards serving the poor.[45] This indicator, which is impressive when compared to other countries of the region, improved in terms of "poverty-friendliness" between 2008 and 2011: the ratio of GLP per borrower to GNI per capita decreased for all the MFIS considered, the only exception being ESED (for which it remained stable). These results confirm that MFIs contributed significantly to the credit expansion in Egypt during the late 2000s, complementing banks as suppliers of credit and focusing on the lowest-income segments of the population. A notable difference is that while bank's GLP per borrower decreased, it increased for MFIs, which translates into banks and MFIs 'converging'.

[44] According to the MIX composite indicator which incorporates outreach, efficiency and transparency (MIX, 2014).

[45] Sanabel (2010).

TABLE 2.4. SELECTED MFI INDICATORS

MFI\ Variable	Number of borrowers			Gross Loan Portfolio, GLP (EGP)			Average GLP per borrower (EGP)		Average GLP per borrower as % of GNI per capita	
	2008	2011	Change	2008	2011	Change	2008	2011	2008	2011
ASBA	219,662	225,289	2.6%	52,836,962	61,854,750	17.1%	240.5	274.6	13.4	11.4
LEAD	156,833	141,389	-9.8%	16,746,888	19,139,510	14.3%	106.8	135.4	5.9	5.6
ABA	100,807	187,955	86.5%	29,249,042	57,855,885	97.8%	290.1	307.8	16.1	12.7
ESED	98,035	70,640	-27.9%	16,818,754	16,300,861	-3.1%	171.6	230.8	9.5	9.5
DBACD	93,533	104,338	11.6%	19,825,148	25,202,335	27.1%	212.0	241.5	11.8	10
Al Tadamun	67,845	46,440	-31.5%	7,239,736	5,747,581	-20.6%	106.7	123.8	5.9	5.1
CEOSS	33,400	39,306	17.7%	4,857,277	6,307,898	29.9%	145.4	160.5	8.1	6.6
SBACD	29,734	39,216	31.9%	-10,858,451	12,266,056	-213%	-365.2	312.8	20.3	12.9
FMF	-	-	-	3,703,118	4,646,883	25.5%	-	-	-	11.3
Total	799,849	854,573	6.8%	140,418,474	209,321,759	49.1%	908	1,787	-	-

Source: The Mix data (2012) and own calculations.

MFIs generally have three main sources of funding: deposits, debt and equity. In Egypt, regulations prohibit NGOs from offering deposits to their clients.[46] As a result, NGOs involved in MFI can only access finance through debt or equity, and the main source of MFI funding has historically been donated equity. The majority of Egyptian MFIs rely on donors as their substantive source of financing for lending activities, thus complementing government programmes.[47]

In the last few years, however, the trend is shifting from equity to debt. A major change occurred in 2006, when DBACD became the first MFI to negotiate commercial debt financing. Subsequently, five additional MFIs in Egypt started to receive loans from banks.[48] As a consequence, their debt-to-equity ratios have increased.

Main Actors

Within the NGO-MFI category there are two types: those NGOS that are non-profit (e.g. ABA, ASBA) and those that do allow for profits (e.g. Reefy).

2.3.1. Not-for-Profit NGO-MFIs

[46] Ibid.

[47] OECD (2010).

[48] Sanabel (2010).

Most microcredit available in Egypt is provided by specialized NGO-MFIs, which are usually registered as business associations and act as intermediaries for disbursing and managing donors' funds to MSMEs. Table 2.5 below presents services and target beneficiaries offered by some of the most prominent MFI-NGOs in the country. Despite the considerable development MFIs have undergone, they are still primarily focused on supplying credit, which most often takes one of the following two forms:

- Group Lending: Introduced to Egypt in 1997 by SBACD, these programs usually adopt a "Solidarity Group" mechanism in loan extension, where individual loans are provided to each member of a group, who will undertake to guarantee loan repayment together. If one member of the group defaults, the other members are obligated to repay on her/his behalf. Group loans are often used for income generating activities of marginalized groups such as female-headed households in low-income categories.
- Loans disbursed based on a model which promotes clients from one program to another based on performance. For example, these loans can provide working capital for existing enterprises; if clients use the loans efficiently, are able to expand their business and demonstrate its sustainability, they can upgrade to the next category, and hence become eligible to bigger loans, etc.

TABLE 2.5. EXAMPLES OF PRODUCTS AND SERVICES OFFERED BY MFIS

Organization (year established)	Name of Service/Product	Year	Targeted Clients	Description
ABA[49] (1983)	Small and Micro credit program	1990	MSMEs	Individual loans
	Blossoms of Micro Enterprises	1999	Female-headed households in poor areas (group lending).	Credit and non-financial services.
	Towards Self-employment Program	2000	Very poor people who embark on an individual entrepreneurial initiative	Training and Seed Capital.
	Development Path	2006	Micro enterprises	Solidarity Group loans
	Step by Step Program		Youth who wish to start their own business	Training & loans to individuals with entrepreneurial skills.

[49] The Mix (2012a).

Lead Foundation-Egypt[50] (2003)	The Blossoms of Goodwill Group Lending (GL) Program		Female-headed households in poor areas	Financial services
	The Microenterprise Individual Lending Program		Entrepreneurs in need of small loans to enhance their growth potential	
The Dakahlya Businessmen' Association for Community Development[51] (1997)	Individual loan	1998	Working capital House improvements Vehicle maintenance	Financial and technical services
	Group loan (Bashayer)	2001	Female headed households in poor areas	
Al Tadamun[52] (2003)	Solidarity Group Loan Product		Groups of women micro entrepreneurs	Express loans
	Seasonal Loan Product		Groups of women micro-entrepreneurs	Small, individual, and multiple cycle working capital loans
Assiut Businessmen Association[53] (1995)	Individual loan	1996	MSMEs	
	Group (Bashayer) loan	1999		
Sharkia Businessmen's Association for Community development[54] (1996)	Individual loan		MSMEs	lending/technical assistance/training
	Group (Bashayer) loan			

Source: Own compilation based on available data

2.3.2. For-Profit NGO-MFIs

The for-profit service microfinance lender is a recently-emerged model.[55] They act as agents for local private sector banks that are interested in tapping into the microfinance market.[56] Reefy was the first of such for-profit MFIs, working with Commercial International Bank (CIB). Reefy sources clients, distributes loans and manages accounts, but CIB holds the loan-book portfolio because only banks are licensed to lend in Egypt. MFIs such as Reefy help MSMEs overcome obstacles in obtaining funds from banks, who perceive these MSMEs as having poor

50 The Lead Foundation (2014).

51 The Mix (2012b).

52 Al Tadamun Microfinance Foundation (2014).

53 The Mix (2012c).

54 Planet Rating (2004).

55 Halime, F. (2011).

56 The Mix, Sanabel (2014).

credit ratings. More recently another company, Tanmeyah, has adopted the same business model as Reefy. Tanmeyah works via the Egyptian private equity firm Citadel Capital's framework.[57]

Performance

Most Egyptian MFIs have achieved positive returns since their inception. Many of them managed to grow and reached profitability by the end of 2011: profitability ratios are high for the majority of the MFIs considered, ranging from 2% (ASBA) to 26% (Al Tadamun). In general Egyptian MFIs' rates of Return On Assets (ROA) are well above the Arab region (3.4%).[58] The secret to their good performance seems to be efficient management practices. Most MFIs are characterized by excellent loan portfolios and loan portfolio management systems, solid and loyal customers and financial management and accounting practices often better and more transparent than those in public banks. As a result, a number of MFIs are fully sustainable and others are close to achieving that goal. The MFIs considered in table 2.4 above had achieved 100% OSS, a high increase in the number of borrowers, 100% transparency and high levels of efficiency. They underwent scrutiny by international ratings agencies and earned marks ranging from B+ to A-.[59]

In terms of financial structure, most MFIs have debt-to-equity ratios below the usual benchmark for NGOs of 1:1.[60] This could be explained by MFIs' limited accessibility to debt for their portfolio finance. According to the Microfinance Information Exchange (MIX), a great constraint on Egyptian MFIs' growth is their limited access to commercial sources of funding, which is rooted in the restrictions on mobilizing deposits and involves low debt-to-equity ratios. Donations and subsidized funding from USAID and SFD represent the main source of funding for Egyptian MFIs. The great exception to this trend is the ASBA (with a debt ratio of 1:3.7), which has developed working relations with commercial banks to contribute to the funding of its lending operations.

[57] Halime, F. (2011).

[58] Ibid.

[59] OECD (2010).

[60] Debt-to-equity ratio is the key financial ratio used to express how much of the financing is from debt versus equity and reflects an institution's ability to repay its obligations. A debt to equity ratio of 1:1 is fairly typical of NGOs (FAO, Microfinance and forest based small scale enterprises. Rome 2005. Forestry paper 146). As NGO MFIs transform into regulated intermediaries debt/equity ratios typically rise rapidly, as MFIs are better able to access commercial sources of funds.

TABLE 2.6. GROSS PORTFOLIO TO ASSETS RATIO (%) FOR THE YEARS 2007 TO 2011

Year\MFI	ABA	ABWA	Al Tadamun	ASBA	CEOSS	DBACD	ESED	LEAD	SBACD	Mean[61]
2007	43.9%	71.7%	78.3%	59.0%	49.8%	63.0%	62.6%	43.8%	43.8%	57.3%
2008	52.2%	66.2%	84.2%	68.0%	81.9%	66.2%	54.9%	51.8%	67.6%	65.9%
2009	67.1%	73.4%	84.8%	56.9%	91.9%	67.5%	58.0%	58.2%	59.4%	68.6%
2010	76.6%	86.9%	82.8%	58.9%	92.0%	69.3%	59.0%	62.1%	67.7%	72.8%
2011	80.1%	97.4%	39.5%	49.7%	73.0%	66.3%	55.3%	56.0%	69.2%	64.7%

Source: MIX data

ii) **The National Postal Authority (NPA)**

The NPA is a key provider of micro saving services in Egypt, as NGOs are not allowed to collect savings and banks have little interest in developing savings' products for micro entrepreneurs. Since its establishment in 1865, the Egyptian Postal Authority has grown to include 3,700 branches and reach 17 million clients. The NPA offers a variety of products ranging from basic saving services, such as the saving passbook, to the more sophisticated electronic payment system. The savings accumulated in passbooks amounted to more than 41 billion EGP by 2009.[62]

iii) **The Rotating Savings and Credit Associations (RoSCAs)**

RoSCAs are a ubiquitous saving scheme that consists of a group of individuals who agree informally to save monthly amounts of funds, which are then disbursed to one of the participants. Participants enjoy the benefits of their savings sooner than if they had saved on their own. Interestingly, this model is popular among bank employees in Egypt, who consider savings from ROSCAs easier to manipulate than bank accounts.[63] ROSCAs are more useful for individuals than for SME (with micro enterprises being in-between).

Difficulties faced by NGO-MFIs

[61] Simple arithmetic average for all MFIs in a particular year.

[62] Sanabel (2010).

[63] Aliber, M. (2001).

Most MFIs in Egypt are linked to larger institutions such as NGOs or quasi-governmental organizations (e.g. SFD), an arrangement that may pose impediments to the development of microfinance activities within the host organization:

- The legal framework governing the operations of NGO-MFIs may not be well adapted to microfinance activities, which complicates access of NGOs to bank loans (e.g. excessive collateral requested).
- National regulations inhibit NGOs from offering micro savings services to their clients, which is a limitation to both NGOs and depositors because micro-savings generate micro-assets, provide a cushion against shocks and engage clients in the culture of regular payments.
- NGO board members have well defined roles that may not have the capacity to manage a microfinance dimension.
- The Ministry of Social Affairs (MoSA) is mandated to inspect NGOs on a regular basis, although it may not necessarily have the expertise to supervise the quality of NGOs' microfinance activities.[64]
- A lack of identity for the microfinance arm of these organizations might eventually send conflicting messages to clients.[65]
- Internal rules and regulations of both the host organization and the MFI might give rise to inconsistencies and conflicts.[66]
- The current laws give the government of Egypt the authority to dissolve NGOs, which creates uncertainty about the future and thereby limits investments in NGOs. In turn, such lack of incentives may represent an incentive for NGOs not to build sound financial management practices.[67]

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[64] Planet Rating (2004).

[65] Brandsma, J. and Hart, L. (2008).

[66] Ibid.

[67] Kharas, H. and Abdou, E. D. (2012).

2.4. Venture Capital and Angel Investors

This section refers to Venture Capital (VC), broadly understood as those early-stage investments in innovative start-ups whereby the investor provides finance to MSMEs and owns a share of the MSME (thereby sharing the business or project risk). Similar concepts such as Angel Investors (highlighted due to their recent rise), Risk Capital or Private Equity are also comprised in this category.[68]

In 2012 the number of venture capital (VC) companies in Egypt was 16, of which nine were listed in the stock market.[69] In some cases these companies are securities companies that included venture capital among their activities to obtain tax advantages.[70] Although the total investment increased from 2002 to 2008, it seems to have stagnated and even decreased thereafter.[71] By the end of 2008 the total amount invested by VC companies was EGP 386.5 million.[72]

The Egyptian VC sector is relatively small, although potentially very important for MSMEs. Research has shown that the majority of Egyptian MSMEs are willing to consider VC to finance their operations, which is associated with the size of the company: the smaller the enterprise, the more likely it is to be open to VC.[73] The availability of VC is perceived as incommensurate with the needs of new and growing firms especially given the difficulties these businesses face when approaching conventional funding institutions.[74] Also, the lack of a healthy venture capitalist community is considered a severe limitation to entrepreneurial innovation.[75]

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[68] The differences between Venture Capital, Risk Capital and Private Equity are not always clear as they vary across sources. For instance, angel investors may refer to donations (i.e. money is given in exchange of nothing), which happens mostly in the context of families and in terms of volume is marginal. For instance, according to other sources "Angels step in when a start-up is in most dire need of capital and help. Angels do faster due diligence, negotiate less onerous terms, take more risk, and rarely seek majority. This makes them very attractive to entrepreneurs as an early stage option for raising capital" (Cairo Angels, 2014).

[69] Kenawy, E. M., Abd-el Ghany, M. F. (2012).

[70] Ibid.

[71] Ibid.

[72] Ibid.

[73] El Kabbani, R. N., Kalhoefer, C. (2011).

[74] Hattab H., (2009).

[75] Daily News Egypt (2011).

There are several reasons why Egypt does not have a strong VC market. It is contended that government involvement in organizational and managerial matters is undermining the efficient operation of VC companies.[76] Another reason is the lack of expertise to identify and select initiatives in which it is worth investing.[77] More awareness of the VC sector would also help, as would the dissemination of stories where VC played an instrumental role in initiating and developing successful MSMEs. Finally, it has been argued that most shareholders in the VC market are involved in the restructuring and reform of existing companies to enhance their performance with the ultimate aim of reselling them in the stock market. However, due to the current instability in Egypt such operations are very difficult.[78]

Main Actors

Some of the companies identified in the VC sector are the Cairo National Co for Investment and Securities, International Trade Company for Investment, Al Ahli for Development and Investment, National Youth Company for Investment and Development, Misr Exterior, Gulf Company for Financial Investments or the American-Saudi Company for Financial Investments.[79] While a complete list of the companies involved in VC and a full description of their activities goes beyond the scope of this paper, next we present some of the key companies and their business models based on a listing from Wamda.com.[80]

Founded in January 2011 by Ahmed Alfi and Hany Sonbaty, Sawari Ventures is perceived as the foundation for Egypt's new investment community specializing in technology.[81] Sawari launched the Flat6 entrepreneurship lab at the American University in Cairo, which provides specialized services including seed funding and mentorship. If companies manage to survive and reach more developed stages, they become eligible for further funding from Sawari, typical investments ranging from $250,000 to $2 million.[82]

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[76] Ortmans, J. (2014)

[77] Kenawy, E., Abd-el Ghany, M. (2012).

[78] Ibid.

[79] Ibid.

[80] Aysha, O. (2013).

[81] Ibid.

[82] Daily News Egypt (2011).

Ideavelopers is a VC firm responsible for the management of the Technology Development Fund (TDF). TDF is the only government-backed fund with a total value of 50 USD million to support Egyptian innovation and entrepreneurship, and focuses on early-stage ICT companies. Over half of the total allocated amount has been invested in 17 companies operating inside and outside Egypt.[83] The company pools VC from several investors to fund selected start-ups. Support is complemented by another company that provides strategic services at the pre-investment stage through strategic planning, business models, financial structure, and human resources, sales and marketing. On average, each company receives about EGP 4 million in funding and investors are expected to recover their investments in 3 to 5 years.[84]

Founded in 2010, Innoventures is one of the most recent companies established to support creative start-ups in becoming businesses eligible for VC. Innoventures focuses on clean technology, ICT, electronics, media, market intelligence and inclusive businesses fields.[85] The efforts of the company consist of a six-month duration incubation program which includes seed funding, customized business training and access to partner networks. In exchange for its services, Innoventures imposes a minority equity stake in the incubated ventures. The Innoventures business model "innovation venture management" differs from traditional VC models in that it provides more support to creative ideas with no business expertise than traditional VC companies.[86]

Aside from VC companies, some investors present themselves as "Angel Investors".[87] One of them is Cairo Angels, a network that invests in start-ups and early-stage companies using a high-risk, high-return matrix. Since its inception in early 2012 Cairo Angels has invested EGP 1.1 million in 4 companies, and made binding offers of EGP 1 million to two more companies.[88]

Cairo Angels is made up of around 50 individual members, almost all Egyptian, of whom 20% are women and more than half are founders of highly recognized brands. The network does not include companies, institutions or funds: angels invest their personal money and leverage

[83] Ideavelopers (2014).

[84] Balancing Act (2014).

[85] VC4AFRICA (2013).

[86] Innoventures (2014).

[87] As noted above, the differences in the business model are blurry.

[88] Cairo Angels (2014).

their experience and network to benefit the business in return for an equity stake in the business.[89] Targeted companies are those with the potential to return 3 to 5 times the investment in a timeframe of 3 to 5 years.[90]

Although most of its investments to date have been in the technological domain, Cairo Angels' aim is to invest across all sectors with a particular appetite for export oriented products and services.[91] Thus, Cairo Angels are especially interested in businesses from the agricultural, logistics and energy sectors, and encourage women entrepreneurs' applications. Cairo Angels are open to regional start-ups applying for funding as well.[92]

Finally, private sector companies can also access financing in the form of equity through the Egyptian exchange market (Nilex), where companies can access long term capital at a low cost for the expansion of their businesses. Since the Nilex is usually focused on larger size companies, however, an analysis of equity provided through the Nilex goes beyond the scope of this paper.

2.5. Crowdfunding

The JOBS Act (2012) in the United States of America fostered a phenomenon known as "crowdfunding", whereby businesses can accept small contributions from private investors without making an Initial Public Offering (IPO).[93] These contributions can be made as donations or in exchange for equity. The internet allows entrepreneurs who have good project ideas to receive support through online platforms such as kickstarter.com, indiegogo.com or fundable.co, and raise funds in small quantities from a large number of investors.

Since these operations take place on the internet, traditional country boundaries do not necessarily apply. However, some of the websites operating in the Arab region, and in Egypt in particular, are aflamnah.com, zoomaal.com or yomken.com.[94] While it may still be early to

[89] Ibid.

[90] Ibid.

[91] Ibid.

[92] Ibid.

[93] Pedrosa-Garcia, J.A., (2013).

[94] Sometimes the difference between business angels and crowdfunding is also very blurry. For instance, shekra.com is a crowdfunding platform that has a closed network of investors such as Cairo Angels.

consider crowdfunding as a significant source of finance for entrepreneurs, yomken.com is described next to exemplify this new business model.

Yomken is an online crowdfunding platform with its headquarters in Cairo.[95] It claims to be the first open-innovation and crowdfunding platform in the Arab world to bridge the gap between the challenges faced by MSMEs working mainly in low-tech and informal manufacturing industries, and the innovative ideas and skills of potential problem solvers (e.g. engineers, designers or researchers).[96] The rationale for such mechanism is to capitalize on the 'wisdom of the crowd'.

Subsequently, a group of volunteer experts review the proposed solutions to choose the best suited for implementation.[97] These volunteers started supporting more than 60 workshops in Manshiet Nasser, Cairo's 800,000-residents slum, in fields such as toy making, souvenirs, plastic gadgets and handmade furniture.[98] The crowdfunding works as follows: buyers pre-pay for products from their e-wallet and once the target amount is pledged (which includes costs and a profit margin), the workshop owner and the innovator can initiate production of the products.[99] Funders can track the use of their contribution during the production process, and even the social impact of the project (e.g. number of jobs created or increased income of the workshop owner).[100]

The Yomken initiative received seed funding from the World Bank's Youth Innovation Fund and is being implemented in partnership with the Istebdaa' Initiative for Innovation in Low-Tech Industry (a registered Egyptian non-profit company)".[101]

3. The Demand for Finance by SMEs in Egypt

This section describes the demand for finance in Egypt within the SME sector, some of its main features being: most SMEs are geographically concentrated in only three governorates (out

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[95] Wamda (2012).

[96] Ibid.

[97] Ibid.

[98] Ibid.

[99] Ibid.

[100] Ibid.

[101] Yomken (2014).

of Egypt's 27), SMEs are mainly operating in manufacturing and trade, very few of them export and very few deal with banks.[102]

The ideal scenario would require an assessment of those loan applications submitted by Egyptian MSMEs. Since those idea data are not available, data on the SMEs' characteristics are used as a proxy. Three specific aspects are of interest: i) basic indicators of entrepreneurship (e.g. the motives that led the entrepreneur to start a business), ii) the characteristics of SMEs' operations (e.g. informality), and iii) the financial characteristics of SMEs (e.g. having a bank account). These features are complemented with firms' opinions on the main obstacles they face when doing business.

Available data allow for a comparison of Egypt's private sector with the overall MENA region, but evolution over time can only be traced between 2007 and 2008 (the latest year with data available). Most data disaggregate by size (Small, Medium and Large), which permits an insightful cross-sectional picture of how private sector features would evolve as firms increase in size. The main inconveniences are that data do not include micro enterprises, and the time series component is only two years.

3.1. Entrepreneurship

In 2009 Egypt saw the birth of 6,308 new limited liability companies and the country's new business density was 0.13, which represents the 3rd lowest figure compared to available data for the Middle East and North Africa region.[103]

Annex table 3.1 shows relevant data on Egypt's entrepreneurship. Entrepreneurship is socially well regarded in Egypt (although between 2008 and 2012 the fear of failure grew considerably), and most people believe they have the required skills to start a business. Usually MSMEs have ambitious ideas for expanding, despite their low average profit margins (from 8% to 2%).[104] The perception of business opportunities grew from 2008 onwards, despite the fact that customers from other countries decreased dramatically between 2008 and 2012 (the number of foreign tourists dropped drastically in recent years).

[102] El-Said, H. et al. (2011).

[103] Countries considered: Algeria, Egypt, Iraq, Jordan, Malta, Morocco, Oman, Syria, Tunisia and the United Arab Emirates. Source: http://www.doingbusiness.org/data/exploretopics/entrepreneurship.

[104] Egyptian Banking Institute (2009).

Overall it is clear that entrepreneurial activity decreased: between 2008 and 2012 the percentage of entrepreneurs in business for less than 3 months, from 3 to 42 months and for more than 42 months all decreased or were stable. It is noteworthy that the biggest decreases occurred in the first two years: between 2008 and 2010 many long-established entrepreneurs (>42 months) went out of business, while the percentage of nascent entrepreneurs (<3 months) shrank to a third of the initial level. Similarly, the percentage of entrepreneurs that are in business because they did not have any other options grew from 19 to 53 between 2008 and 2010. From then on, however, some indicators improved somewhat: the share of forced entrepreneurs declined to 34 in 2012, and by 2012 the rates of nascent entrepreneurs had started to grow again.

3.2. Basic characteristics

According to the Central Agency for Public Mobilisation and Statistics (CAPMAS), in 2006 there were 2.5 million SMEs in Egypt, of which 92% were microenterprises with 1-4 employees. SMEs represent nearly 99 percent of total private enterprises and about 80 percent of total employment, with average assets valued at EGP 30,000 (some $5,000) and an average of 2.2 employees.

As can be seen in Annex table 4.1, SMEs are on average about 22 years old. Although the emphasis of this analysis is not a comparison between Egypt and the rest of the region, it is remarkable that Egyptian private sector companies in general (including SMEs) are considerably older than others in the region. SMEs are mostly owned by private domestic stakeholders. However, as the size of firms goes up, the openness to ownership by foreigners and public authorities increases, and the ownership of companies is less concentrated. In terms of legal status, small companies rely mostly on “sole proprietorship”, a pattern that increased between 2007 and 2008. On the other hand, large companies are more likely to be publicly listed companies, a legal status form that grew between 2007 and 2008 at the expense of Limited Liability Company (LLC), sole proprietorship and partnership. Medium enterprises are clearly less likely to be an LLC, and have a roughly similar probability of being publicly listed, a sole proprietorship, a partnership or a limited partnership.

Table 4.2 in the Annex shows key selected characteristics with regards to human resources. Although half of all firms consider the workforce to be inadequately educated, larger firms are more likely to train their employees. Labour regulations are seen as a stronger constraint by smaller companies, who are less likely to have female participation both in their ownership and workforce.

Table 4.3 in the Annex shows key selected characteristics relating to innovation. While quality certifications are very rare among small (4.3%) and medium (14.3%) enterprises, they are very common among large companies (50%). The pattern is similar when it comes to using technology licensed from foreign countries, although the differences are not so large. Similarly, SMEs are less likely to have their own website and are less likely to use email for their interaction with clients and suppliers. It is remarkable, however, that across the size range a majority of enterprises have annual financial statements reviewed by financial auditors. This counters one of the typical claims of banks: that SMEs don't have proper financial accounts.

Annex Table 4.4 shows key selected characteristics of access to, and quality of infrastructure. For instance, electricity is not necessarily seen as a major constraint: 15.5% and 14% of small and medium-sized companies, respectively, identified it as a problem. Transportation is seen as a bigger constraint.

Table 4.5 in the Annex shows key selected characteristics related to crime. On average, between 6.4% and 7.9% of SMEs identify crime, theft and disorder as a major constraint. When firms pay for security, it costs small companies almost 3% of their annual sales, a much bigger burden for small companies than for medium and large enterprises. In the instances were losses occurred, theft and vandalism cost small companies 9.4% of their annual sales. With the Arab Spring uprisings in the country it is expected that these indicators would have deteriorated.

Table 4.6 in the Annex shows key selected characteristics with regards to corruption. Almost half of all enterprises identify corruption as a major constraint to running a business, and this perception is more prevalent among smaller firms.

In line with this perception, a survey on corruption found that in 2009 paying bribes in Egypt was pervasive: 42% and 29% MSMEs declared they were obliged to offer bribes to obtain the license necessary for their business / operate their businesses.[105] Gifts are expected by a large percentage of companies to get things done, e.g. a construction permit, an electrical or a water connection. On the other hand, the average expected value of the gifts to secure a government

[105] Centre for International Private Enterprise (2009).

contract is minimal. For more important things such as securing a contract with the government, the percentage improved very considerably between 2007 and 2008.

Annex table 4.7 shows key selected characteristics relating to informality and performance. SMEs are more likely to be competing against informal firms, which would be consistent with smaller companies being informal. However, a comparably high percentage of large companies also declare they are competing against informal firms. Small firms are more likely to have registered when they started operating but at the same time, when larger firms are not registered they are more likely to remain informal for a long time, which could reflect their 'growth' period. Hence, the link between informal practices and firms' size is not clear, which points at informality as a widespread feature of Egypt's business world. Finally, in terms of performance, large companies tend to use a higher percentage of their production capacity, which may be interpreted as an indicator of higher efficiency.

3.3. Financial Characteristics

This subsection describes key financial characteristics of Egypt's private sector based on Annex table 4.8, differentiating where possible between small, medium and large enterprises. For the majority of SMEs, the main purpose of accessing finance is to strengthen their working capital.[106] MSMEs have very little financial leverage through debt financing and hence, it is not surprising that they reinvest their business profits, as well as savings, back into their businesses.[107]

Egypt's private sector companies are considerably more likely to have a checking or savings account than those in the rest of the Arab region. Approximately 50% of small companies have at least one of those two types of accounts. And as firms increase in size, so does the probability of having such accounts. However, even when companies are large it is not guaranteed that they will have an account: about 5% of all large companies in Egypt did not have one in 2008, which is surprising.

In terms of financing, Egyptian enterprises are three times more likely to have access to credit than companies in the region, but within the country there is great inequality in regard to

[106] Egyptian Banking Institute (2009).

[107] Ibid.

firms' size. Approximately 5% of small companies had access to credit in 2008, while 13.8% and 36.1% of medium and large companies did. Such figures show positive growth between 2007 and 2008 for all three categories.

In order to access credit, 100% of the loans granted to small companies in 2008 required collateral, a percentage that decreases as the size of the enterprises goes up. The reason for this pattern is that credit-granting institutions consider smaller companies as riskier. Beyond having to provide collateral, the value of the collateral is vital. Smaller companies are required higher collaterals than larger ones, a gap that decreased substantially between 2007 and 2008. In 2008, small companies had to provide collateral for 87.6% of the value loan, while medium-sized enterprises had to guarantee 83.5% of their loans. This relation is not linear with firms' size, however, as large companies were required to provide collateral for a higher percentage than medium-size companies: 86%. The large discrepancy between Egypt's average value of collateral required as percentage of a loan (85.5%) and average values of collateral required in the MENA region (200.8%) is striking. Indeed, Egyptian MSMEs that do not apply for bank loans argue that the conditions are not satisfactory and that dealing with banks is difficult.[108]

Between 3-4% of SMEs used banks to finance their investments in 2008, a percentage that was much higher for large companies. However, a large decrease was experienced between 2007 and 2008 with medium and large firms taking the biggest reductions. This pattern translated into a convergence in the rates of firms accessing banking credit to finance their investments. The financial crisis, to which bigger companies would be more exposed in terms of volume of credit, would have contributed to this phenomenon.

Not only did banks finance less firm investments in 2008, but they also financed a lower share of those investments. Indeed, in 2008 banks financed just 1.5% and 2.7% of the value invested by small and medium enterprises, respectively, compared to 3.3% and 10% a year before. In response, firms were more likely to finance their investments internally in 2008 than in 2007. Overall, the main source of funds to finance investments by SMEs was internal financing, followed by equity sales (2.3% to 2.5%), banks financing (1.5% to 2.7%) and supplier credit (0.2%).

[108] Egyptian Banking Institute (2009).

In terms of financing working capital, only 2% of small enterprises and 6.5% of medium-size ones accessed banking credit, which is in sharp contrast to large firms' 15.4%. Furthermore, banks financed very low shares of that working capital: 0.8%, 2.9% and 5.6% for small, medium and large enterprises, respectively. It is interesting that, while banks in Egypt are less likely to finance working capital than in the rest of the MENA region (0.4% vs. 8.3%), the value of working capital financed is much higher than in the region (2.5% vs. 0.6%). This suggests that Egyptian banks may be more wary of adverse selection. By way of stricter screening of loan applications, banks raise the cost of financing working capital and exclude potential borrowers from the market. Once they have been screened, however, banks are more willing to trust them. Despite the low involvement of banks in financing working capital they are still the main source of finance in this regard, as supplier credit is an even smaller source of financing.

During the course of a survey undertaken by the Egyptian Banking Institute, interviewed MSMEs declared their preference for finance in the form of venture capital, although trade finance, lines of credit and overdrafts, leasing, working capital loans and letters of credit were also appreciated.[109] Other financial products that SMEs are interested in are property insurance and collection of receivables, credit insurance, wages and supplier payment, internet banking, and payment of taxes. [110] With regards to credit, MSMEs are interested in lower interest rates, less demanding guarantee requirements and simpler procedures for granting loans.[111] The average loan amount desired by MSMEs is a little more than 1.5 M EGP, with MSMEs preferring to pay off their debts rapidly (although the average desired payback term is 3 years).[112]

Data in Annex table 4.8 also shows the response of firms who identified access to finance as a major constraint. In 2007, almost a quarter of all small firms considered it a concern. This percentage nearly doubled in 2008 with almost half of all small firms identifying access to finance as a major constraint, a perception that decreases as firms gain size. This would be consistent with the fact that, as the financial crisis kicked in, credit-granting institutions became more risk-averse and preferred to concentrate on larger firms. Other research has shown that

[109] Egyptian Banking Institute (2009).

[110] Ibid.

[111] Ibid.

[112] Ibid.

access to finance is more likely to be identified as a major obstacle for SMEs operating in services or trade, and less so for those operating in manufacturing or construction.[113]

To conclude this subsection, Annex table 4.9 shows the obstacles to run a business as identified by the private sector. In 2008, the biggest problems for small companies were informal sector practices, an inadequately educated workforce and the tax system; political instability and criminality were their least of the concerns. Medium and large companies showed the same pattern: the biggest problem was informal sector practices, followed by an insufficiently skilled workforce and tax rates.

It is noteworthy that political instability, criminality and the courts system were considered as negligible, although larger firms started to worry about criminality in 2008. These factors are likely to have increased in importance in recent years due to the global financial downturn and, especially, to the Arab Spring.

It is interesting to see that relative to all the other factors considered, access to finance was not one of the major obstacles to run a business. For instance, in 2008 it ranked as the 6th cause of concern. Even more interestingly, large companies were the most highly concerned, although the percentage of small enterprises worried about access to finance doubled between 2007 and 2008.

When asked, in a different survey, about the factors that determine MSMEs' ability to achieve growth beyond access to finance from banks, the main answers were supportive regulations, a thriving economic environment and access to an improved supply chain (forward and backward).[114]

4. Regulatory Framework

This chapter outlines the key legal, regulatory and institutional mandates, activities and structures that impact the access to credit by MSMEs. The existence of an enabling policy and regulatory framework should have two goals: first, to enable the transformation of the MSME sector from low added-value to high added-value activities. And second, to minimize negative

[113] El Kabbani, R. N. and Kalhoefer, C. (2011).

[114] Egyptian Banking Institute (2009).

effects such as moral hazard and adverse selection, thereby make the financial system more efficient.

The Egyptian Government has previously made policy and regulatory statements regarding the importance of MSMEs to the country's development. Its 2004 Poverty Reduction Strategy reinforced the importance of job creation along with its commitment to MSME development. This commitment was translated into key policy initiatives such as the passage of the SME law 141 and the development of the National SME Strategy.[115] Box 1 outlines legislation related to MSMEs in Egypt.

Box 1. Key legislation regulating and promoting MSMES in Egypt

- Law No. 141 of 2004 concerning Micro and Small Enterprise Development;
- Prime Minister's Decree No. 1241 of 2004 issuing the executive regulations for Micro and Small Enterprise Development Law;
- Minister of Finance's Decree No. 54 of 2012 concerning rules and principles of Tax Accounting for Small Businesses and procedures to collect the tax on profits.

The 2004 SME Law was the first law in the country's history to specifically target the MSMEs sector. It defines (i) micro and small enterprises, (ii) the role of the Social Development Fund, and (iii) facilities granted to SMEs.

In addition to the laws outlined in Box 1, Egypt's Ministry of Finance (MoF) established an SME Development Unit in 2004 to develop "an appropriate fiscal policy environment that enables SMEs to work and grow under the umbrella of the formal sector".[116]

The MoF undertakes a dual approach of short-term policy development and longer-term capacity building to support a policy development process conducive to MSMEs' development. A key contribution to policy development of SMEs was provided through the Small and Medium Enterprises Policy Development Project (SMEPOL), an initiative jointly implemented by the MoF and the Canadian International Development Agency (CIDA) between 2004 and 2008. A significant output of SMEPOL was the "Enhancing Competitiveness for SMEs in Egypt – General Framework and Action Plan" (2004). The objective of this policy framework was to

[115] Canadian International Development Agency (2006).

[116] Egypt's Ministry of Finance (2014).

identify, address and remove the main constraints SMEs face, obstacles that hinder their engagement within the formal sector.[117] The Action Plan included a set of tasks related to improving the operation of financial services to ensure that they were better able to offer the necessary capital and services to SMEs. Examples of such tasks include setting principles for bank lending to SMEs, increasing the profitability of banks' lending to SMEs and the privileges they receive, amending Law 95/1995 on leasing to provide incentives to leasing companies so that SMEs can be better served, streamlining mortgage procedures and reducing their steps by establishing an assets registry for land and buildings, establishing new credit guarantee companies and enhancing credit provision procedures through the establishment of specialized information agencies.[118] Furthermore, actions and reforms were proposed for the improvement of SME products' quality in order to meet wider government goals on export and marketing capabilities, raising SME contributions to GDP, increasing foreign currency yields and correcting the deficit in the trade balance. An independent evaluation of SMEPOL found that it achieved its primary objectives of policy development but also highlighted limitations, including policy influence being mostly achieved at the Ministerial level and not across the government, as well as little change in the actual operation environment for SMEs.[119]

In addition, the Ministry of Investment's General Authority for Investment (GAFI) launched the Small & Medium Investment (SMI) Strategy in 2008. The strategy included as one of its pillars the aim of improving MSME's access to finance by setting up sector-specific SMI funds in cooperation with international donors, so as to mobilize conventional and non-conventional financing.[120]

Also at an institutional level, the Central Bank of Egypt (CBE) has attempted to stimulate access to finance by SMEs by waiving its 14 percent reserve requirement on loans to SMEs, in favour of an amount equal to the SME lending of each bank.[121]

[117] Egypt's Ministry of Finance (2004).

[118] Ibid.

[119] ODI (2006).

[120] OECD (2010), page 14.

[121] GPFI & IFC (2011).

Financial Sector

Banks in Egypt operate under the supervision of the CBE and are regulated and supervised by the CBE's Law No. 88 'The Banking Sector and Money' (2003). There is no explicit legal requirement to obtain permission to lend. However, only banks are permitted to collect savings and mobilize deposits via deposit accounts as defined by Law No. 88.[122] The CBE regulates banks and regulates and licenses private sector credit bureaus according to Regulations of the Credit Bureaus and Information and Data Sharing Systems. In contrast, NGO-MFIs are regulated by the Ministry of Social Solidarity (MSS).

Operating under the auspices of the CBE since 1991, the Egyptian Banking Institute (EBI) is a non-profit organization that works to enhance the country's financial sector through the provision of financial education, research and entrepreneurs awareness.[123]

The Egyptian Financial Services Authority (EFSA) was created in 2009 under the Law of Regulation of Non-Banking Financial Markets and Instruments (the Single Rule Law) and regulates securities markets and non-bank financial institutions. The EFSA is responsible for, and has the authority to issue rules to oversee the efficiency of the non-banking financial sector, as well as to apply necessary consumer protection rules to ensure transparency and limit market manipulation and fraud.

With regards to VC, the Egyptian regulatory framework starts with the issuance of the money market law no. 95 in the year 1992, which organizes the activity of companies working in the field.[124] That legislation is complemented by the ministerial decree no. 935 in 1996, which adds investment funds to the activity field of venture capital.[125]

Egypt does not currently have an institutional infrastructure that enables a sound and efficient financial system, but efforts have been exerted to improve the infrastructure and institutional environment for efficient intermediation. These include improving and strengthening the legal, regulatory and supervisory framework, information infrastructure, financial reporting, the payments system, and entry and existing policies.[126] The complexity and

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[122] USAID (2009).

[123] Egyptian Banking Institute (2014).

[124] Kenawy, E. M. et al. (2012).

[125] Ibid.

[126] Nasr, S. (2008).

multiplicity of the legal framework has resulted in a slow and cumbersome loan recovery process that can drag on for years. In addition, and with important relevance to credit information, Law No. 88 required all banks, real estate finance companies, financial lease companies and inquiry and credit rating companies to preserve the secrecy of their clients' information and to disclose to their clients the true and complete interest rates and service fees. Major constraints to accessing finance in Egypt for MSMEs include:

- Complexity of laws on secured transactions, the enforcement of which are time consuming (notification, attachment, and sale by public auction), and the inability for private sale and strict foreclosure under the law;
- A court system (Civil and Commercial Courts) that suffers from backlog and delays, lack of specialized courts for financial institutions and a lack of specialized judges with adequate knowledge of financial market risks;
- Complex bankruptcy laws (more than 200 Articles) that are multi-layered and time-consuming;
- The inability of MSMEs to use land assets as collateral (to gain access to credit) due to difficulties in property rights registration / titling.[127]

The country ranks 83rd out of the 185 states considered in the *Doing Business 2013 Report*: Getting Credit classifications highlight the continuing need for greater access to credit in Egypt.[128] Indeed, the legal framework in Egypt suffers from a number of structural and operational drawbacks that have negatively impacted the cost and terms of credit for MSMEs. Egypt's ranking of 3 (out of 10) in the Strength of Legal Rights Index[129] of the *Doing Business 2013 Report* highlights the damaging impact of these constraints on access to finance for MSMEs in the country (table 4.1).

[127] Ibid.

[128] Getting Credit Indicators: (i) Strength of legal rights – protection of rights of borrowers and lenders through collateral laws & protection of secured creditors' rights through bankruptcy laws, (ii) Depth of credit information index - scope and accessibility of information distributed through public credit registries and private credit bureaus, (iii) Public credit registry coverage – number of individuals and firms listed in public credit registry as percentage of adult population, and (iv) Private credit bureau coverage – number of individuals and firms listed in largest private credit bureau as a percentage of adult population (World Bank 2013a).

[129] The strength of legal rights index measures the degree to which collateral and bankruptcy laws protect the rights of borrowers and lenders and thus facilitate lending (World Bank 2013a).

A ranking of 3 out of 10 on the Strength of Legal Rights Index in Table 4.1 highlights the lack of sufficient legal provisions for the rights of borrowers and lenders with regards to collateral and bankruptcy laws. The consequence is that, without sufficient legal guarantees for the recovery of their loans in case of default or insolvency, lenders are not empowered to lend

TABLE 4.1. STRENGTH OF LEGAL RIGHTS INDEX (0-10)[130]

Can any business use movable assets as collateral while keeping possession of the assets; and any financial institution accept such assets as collateral?	Yes
Does the law allow businesses to grant a non-possessory security right in a single category of movable assets, without requiring a specific description of collateral?	No
Does the law allow businesses to grant a non-possessory security right in substantially all of its assets, without requiring a specific description of collateral?	Yes
May a security right extend to future or after-acquired assets, and may it extend automatically to the products, proceeds or replacements of the original assets?	No
Is a general description of debts and obligations permitted in collateral agreements; can all types of debts and obligations be secured between parties; and can the collateral agreement include a maximum amount for which the assets are encumbered?	Yes
Is a collateral registry in operation, that is unified geographically and by asset type, with an electronic database indexed by debtor's names?	No
Are secured creditors paid first (i.e. before general tax claims and employee claims) when a debtor defaults outside an insolvency procedure?	No
Are secured creditors paid first (i.e. before general tax claims and employee claims) when a business is liquidated?	No
Are secured creditors either not subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure, or does the law provide secured creditors with grounds for relief from an automatic stay or sets a time limit to it?	No
Does the law allow parties to agree in a collateral agreement that the lender may enforce its security right out of court, at the time a security interest is created?	No
Score (number of "yes" responses)	**3**

Potential lenders face difficulties when making loaning decisions due to lack of information about the creditworthiness of the borrower (MSMEs), and the result is inhibited credit granting. Insufficient credit information can be rooted in two issues: the 'shallowness' of the data (relating to its depth) and the very lack of information (relating to its coverage). Table 4.2 shows key indicators relating to the depth of credit information. Egypt's score of 6 (out of 6) is remarkable, although the result is driven by the private credit bureau. The information of the public credit registry, as evidenced by the table, is very incomplete.

[130] World Bank (2013a).

TABLE 4.2. DEPTH OF CREDIT INFORMATION INDEX (0-6)[131]

	Private credit bureau	Public credit registry	Score
Are data on both firms and individuals distributed?	Yes	Yes	1
Are both positive and negative data distributed?	Yes	No	1
Does the registry distribute credit information from retailers, trade creditors or utility companies as well as financial institutions?	Yes	No	1
Are more than 2 years of historical credit information distributed?	Yes	No	1
Is data on all loans below 1% of income per capita distributed?	Yes	No	1
Is it guaranteed by law that borrowers can inspect their data in the largest credit registry?	Yes	No	1
Score ("yes" to either public bureau or private registry)			**6**

In terms of the coverage of credit information, Egypt still has significant progress to make. For instance, the public credit registry only covers 4.3% of the population, although the private credit bureau I-Score does much better at 16.4% (table 4.3).[132]

TABLE 4.3. COVERAGE OF CREDIT INFORMATION[133]

	Private credit bureau	Public credit registry
Number of individuals	8,532,921	2,159,173
Number of firms	91,085	81,064
Percent of total	**16.4**	**4.3**

The country has improved very positively in just a few years. Until the creation and feeding of I-Score, the only source of credit information was the Public Credit Registry of the CBE. The Public Credit Registry's information is only available to banks (mortgage and leasing companies are excluded). Preventing access to information of clients' creditworthiness also inhibits the development of non-bank financial institutions that could be an important source of finance for SMEs.[134] Although I-Score is providing greater credit information, the cost of the

131 World Bank (2013a).

132 This indicator reflects the number of individuals and firms listed in a registry (private or public) with information on their borrowing history from the past five years.

133 World Bank (2013a).

134 Ibid, page 86.

credit reports it issues is perceived by the large NGO-MFIs in Egypt to be high, relative to the average volume of the loans they grant.[135]

Box 2. Private sector bureau[136]

The first private credit bureau in Egypt – "I-Score" was established in 2005 and became operational in 2008. Its objective is to provide information services and credit classifications to enable access to credit for individuals and SMEs. I-Score's shareholders consist of 25 banks and the SFD. Its role is to provide Egyptian facility guarantors with accurate, factual information relevant to the history and payment habits of their existing or prospective clients, enabling them to better assess their clients' creditworthiness. I-Score also aims to educate the general public of the values, benefits, and consequences of owning a good credit file.

Prior to the establishment of I-Score, data secrecy laws posed a major obstacle to the establishment of a private credit-reporting infrastructure. The CBE was highly instrumental in creating a legislative framework conducive to the operations of a private credit bureau by undertaking reforms to the legal and regulatory framework governing the exchange of credit information. These allowed for the exchange of information among banks, mortgage finance and financial leasing companies, credit bureaus, and the central bank without the need to obtain individual borrower consent.

At present I-Score serves the credit information needs of 55 institutional subscribers, which include 44 banks, eight mortgage finance companies, four leasing companies, the SFD, and one retailer. It has managed to establish a transparent and advanced credit bureau that offers services in Arabic and English.

I-Score's stakeholders include banks, MFIs, individual borrowers and SMEs. Since the beginning of 2011, I-Score has been proactive in winning the confidence of MFIs and encouraging them to participate in the information-sharing scheme. Initially, Egypt's MFIs envisioned a separate credit bureau for microfinance clients. However, a study noted that much relevant borrower information would remain invisible to MFIs in a segmented credit information system. The leading MFIs decided to join I-Score instead. Including MFI clients in the credit reporting system prevents the negative effects of data fragmentation and enhances the use of credit bureau data for risk management and financial inclusion.

Since its inception, I-Score's data centre has been vastly expanded to include 14 million data records, a 13-fold increase from the baseline of 0.9 million records initially held by the CBE's Public Credit Registry. The data pertain to over 4 million SMEs and consumer borrowers.

5. Conclusion and Policy Recommendations

This study noted that lack of finance is a constraint to doing business in Egypt, and that this difficulty could be rooted in several factors: i) a low capacity of credit suppliers to mobilize resources, ii) the ease with which those suppliers channel their savings in the form of credit, iii) low creditworthiness of loan applicants (MSMEs), or iv) lack of equity finance.

The analysis has shown that although the lack of credit is certainly a sizeable constraint, it is merely one of the many obstacles MSMEs have to face. Informal practices, the tax system,

135 USAID (2009).

136 World Bank (2012).

lack of access to an educated workforce and corruption are other, more important hindrances that have to be tackled.

Furthermore it has become clear that three groups of factors contribute to the overall outcome. First, the capacity of credit suppliers to mobilize savings (using by financial penetration as proxy) is low (for banks) or inexistent (for MFIs). The case of MFIs is remarkable: despite the great difficulties they have to mobilize resources they have become a very solid source of credit, especially for micro enterprises. Furthermore, the boundaries between banks and MFIs have become blurrier, as banks' and MFIs' GLP per borrower have decreased and increased, respectively. This convergence in their lending patterns is corroborated by lending to the same clients and cross-lending between the two types of institutions. The very fact that banks and MFIs are now collaborating in a growing number of cases is proof that they can complement each other.

Secondly, the creditworthiness of MSMEs has suffered in recent years. Many the long-standing entrepreneurs went out of business and there were meagre numbers of nascent entrepreneurs, although by 2012 the birth rates of enterprises started to recover.

Thirdly, it is not easy for banks to channel the savings they collect towards MSME credit. Several factors contribute to this result: banks see MSMEs as riskier, which is due to a lack of knowledge of MSMEs and a lack of expertise in MSME lending. The financial crisis of the late 2000s led to a contraction of credit in the market. Large companies were affected by not getting as much credit as they would have liked, while small companies had to face higher screening by credit suppliers. The pattern is in sharp contrast with credit to households (often with a higher tendency to use loans for consumption instead of investment), who benefited disproportionately from access to credit (relative to their contribution into banks' collected savings). Hence, the crisis led to less opportunities for business (reflected in the entrepreneurship indicators), which was compounded by more conservative liquidity ratios by banks.

Finally, VC is a relatively new sector that seems to provide a limited source of finance for MSMEs: while it grew considerably between 2002 and 2008 it seems to have stagnated from that year onwards. Despite this stagnation, however, from 2011 onwards a number of investors have started rather innovative operations such as high-tech VC companies, networks of angel investors and crowdfunding.

Analysing the regulatory framework helps to complete the picture and better understand the roots of banks' conservative practices. The Egyptian justice system is complex and inefficient, and therefore not conducive to doing business. As most credit suppliers are interested in profits (e.g. banks) or at least self-sustainability (e.g. MFIs), MSMEs are considered riskier. In times of crisis, risk aversion increases and credit suppliers concentrate on the safest client profiles.

While the experience of the I-Score private credit bureau is exemplary, the information coverage of I-Score could still improve substantially. This would further lessen the phenomenon whereby insufficient credit information results in credit suppliers' not granting more loans.

In terms of policy recommendations it is clear that measures to stimulate the MSME credit market should be holistic and address the supply and demand of credit and the regulatory framework. While further analysis and consultation are advisable to tailor the specific measures, the main pillars of intervention should be the following:

Regarding the supply of credit, banks should adopt lending systems better suited for MSMEs. Some initiatives could be the introduction of a scoring system as an additional appraisal tool to assess MSMEs growth prospects, training of line management (e.g. loan officers) and senior management (credit committee members of financial institutions) on MSME lending, the introduction of policies of MSME credit targets, or manuals of procedures for lending specifically to MSMEs.[137]

Supply side solutions could also include expanding the range of products offered to better adapt to the demand of credit, by e.g. encouraging banks and MFIs to include more innovative products. Banks could contribute to their clients' success by setting up MSME development services to help borrowers in business planning, accounting standards or financial statements, among others.

It is also necessary to provide the appropriate infrastructure to encourage the development of NGO-MFIs involved in microfinance, so as to allow them to become commercially autonomous MFIs. NGO-MFIs would benefit from a regulatory framework better adapted to micro financing activities (e.g. micro savings). Allowing NGO-MFIs to offer saving products

[137] See e.g. Chironga et al. (2012).

would facilitate an easier financial position for them and would spur competition in the MSME finance sector, essential to improve access to finance by MSMEs.

The demand for credit can be stimulated simplifying the procedures to start a business (i.e. increasing the quantity of businesses) and/or the possibilities of survival of those business. A simplification of requirements and procedures would be appropriate. For instance, to avoid duplication of procedures it would be convenient to streamline a one-stop shop entity. Such an institution should have the required authority to consolidate all the relevant activities and responsibilities of different ministries and develop the MSME sector in Egypt.

To achieve higher creditworthiness of the demand, the strategy would consist of providing business support and training to current and potential start-up entrepreneurs. Often this approach is put in practice through business incubators, although other institutions (e.g. chambers of commerce, universities, etc.) have significant room for involvement as well. The current efforts undertaken by the Egyptian Banking Institute (Central Bank of Egypt) with regards to financial education and entrepreneurs' awareness are in the right direction and should be strengthened.

Within the regulatory financial infrastructure, the laws regarding collateral, secured transactions and bankruptcy should be revised. Efforts should be made towards expanding the pool of assets that can be used efficiently as collateral: clarifying property rights, improving owners' ability to document those rights, improving collateral registries, improving the efficiency with which lenders can take possession of and sell assets serving as collateral, and prompting development of more-liquid markets for such assets. The back log of court cases should be cleared, and a possibility for that could be the establishment of courts dealing specifically with financial affairs.

Access to credit information should be more equitable, especially for MFIs because they deal with lower volume loans. A possibility is that I-Score stakeholders contribute proportionally to their GLP per borrower. Furthermore, the public sector registry should improve both in terms of data coverage and depth.

At the level of the CBE, Egypt could encourage banks to direct funds to MSMEs by providing them with preferential interest rates. In a similar vein, the country could increase the incentives offered for financial institutions to lend to the MSME sector. Finally, it would also be appropriate to encourage credit guarantee companies to play a more active role, which is instrumental for financial institutions to grow their MSME lending activities.

6. Annexes

TABLE 3.1. SELECTED ENTREPRENEURSHIP INDICATORS IN EGYPT[138]

	2008	2010	2012
Percentage of 18-64 population who believe to have the required skills and knowledge to start a business	59	63	59
Percentage of 18-64 population who agree with the statement that in their country, successful entrepreneurs receive high status	84	89	87
Percentage of 18-64 population with positive perceived opportunities who indicate that fear of failure would prevent them from setting up a business	20	25	33
Percentage of 18-64 who see good opportunities to start a firm in the area where they live	35	39	54
Percentage of 18-64 population who personally know someone who started a business in the past two years	44	-	31
Percentage of TEA who expect to employ at least five employees five years from now	19	-	63
Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded) who intend to start a business within three years	34.5	24.3	42.3
Percentage of TEA who indicate that their product or service is new to at least some customers	28	-	28
Percentage of TEA[139] who indicate that at least 25% of the customers come from other countries	27	-	8
Percentage of 18-64 population who have personally provided funds for a new business, started by someone else, in the past three years	3.6	-	4.5
Percentage of 18-64 population who are currently a nascent entrepreneur, i.e., setting up or in a business < 3 months	7.9	2.1	3.1
Percentage of 18-64 population who are currently owner-manager of a business between 3 – 42 months	5.5	4.9	4.9
Percentage of 18-64 population who are currently owner-manager of an established business for > 42 months	8	4.5	4.1
Percentage of those involved in TEA who are involved in entrepreneurship because they had no other option for work	19	53	34

[138] GEM (2014)

[139] Total Early-stage Entrepreneurial Activity (TEA)

Table 4.1. Basic characteristics of SMEs[140]

Year	Subgroup	Age (years)	Proportion of private domestic ownership in a firm (%)	Proportion of private foreign ownership in a firm (%)	Proportion of government/state ownership in a firm (%)	Proportion of a firm held by the largest owner(s) (%)	Percent of firms with legal status of publicly listed company	Percent of firms with legal status of privately held Limited Liability Company	Percent of firms with legal status of Sole Proprietorship	Percent of firms with legal status of Partnership	Percent of firms with legal status of Limited Partnership
	Small	22.9	98.7	1.1	0.2	68.2	10.4	1.4	45.3	27.7	15.1
2007	Medium	22.7	95.8	2.4	1.7	64.0	25.9	2.0	27.9	20.3	22.6
	Large	25.7	83.2	4.7	10.6	59.2	53.0	3.7	9.5	10.4	13.4
	Small	21.6	97.0	0.4	0.5	75.0	6.2	1.5	51.2	26.6	13.9
2008	Medium	23.2	93.5	2.5	0.8	63.1	20.6	2.1	24.7	26.8	24.3
	Large	26.3	84.9	3.6	6.5	61.8	57.8	1.7	7.6	7.8	17.3
2008	Total	23.6	92.2	2.0	2.4	67.0	26.6	1.8	29.1	21.0	18.4
-	MENA	13.0	91.3	0.4	0.1	91.7	0.2	1.6	82.6	14.1	1.0

Table 4.2. Selected characteristics of SMEs relating to: workforce and gender[141]

Year	Subgroup	Years of the top manager's experience working in the firm's sector	Percent of firms identifying labour regulations as a major constraint	Percent of firms identifying an inadequately educated workforce as a major constraint	Percent of firms offering formal training	Percent of firms with female participation in ownership	Proportion of permanent full-time workers that are female (%)
	Small	16.3	27.9	31.4	10.1	19.2	13.2
2007	Medium	15.4	24.1	27.6	17.6	20.9	15.0
	Large	19.1	28.5	32.2	37.0	23.3	14.2
	Small	9.3	31.5	51.4	12.7	26.4	13.6
2008	Medium	9.3	28.4	51.2	19.6	38.0	17.7
	Large	13.2	20.0	47.5	34.9	40.9	16.9
2008	Total	10.4	27.0	50.1	21.7	34.0	16.1
-	MENA	14.4	17.8	29.3	9.9	6.6	6.9

140 World Bank (2013b)

141 World Bank (2013b)

Table 4.3. Selected characteristics of SMEs relating to: innovation[142]

Year	Subgroup	Percent of firms with an internationally-recognized quality certification	Percent of firms using technology licensed from foreign companies*	Percent of firms having their own Web site	Percent of firms using e-mail to interact with clients/suppliers	Percent of firms with an annual financial statement reviewed by external auditors
2007	Small	2.9	1.6	16.8	20.3	76.6
	Medium	12.4	6.5	32.0	42.9	92.5
	Large	48.3	16.5	66.4	76.6	94.8
2008	Small	4.3	5.4	15.6	18.3	71.0
	Medium	14.3	11.7	36.3	45.6	87.5
	Large	51.0	22.1	67.3	77.3	80.3
2008	Total	21.1	12.6	38.2	45.3	79.4
-	MENA	4.3	2.7	13.9	18.5	23.4

Table 4.4. Selected characteristics of SMEs relating to: infrastructure[143]

Year	Subgroup	If there were outages, average duration of a typical electrical outage (hours)	If there were outages, average losses due to electrical outages (% of annual sales)	Percent of firms owning or sharing a generator	If a generator is used, average proportion of electricity from a generator (%)	Days to obtain an electrical connection (upon application)	Percent of firms identifying electricity as a major constraint	Percent of firms identifying transportation as a major constraint
2007	Small	5.5	5.5	6.0	28.7	97.5	24.0	6.9
	Medium	4.9	5.9	13.1	16.2	184.5	19.9	4.2
	Large	4.9	2.8	52.3	13.6	107.7	15.1	3.9
2008	Small	2.0	3.6	4.7	19.4	45.4	15.5	15.7
	Medium	2.2	3.6	18.6	14.3	132.9	13.9	14.2
	Large	2.2	2.3	52.6	14.1	71.6	12.5	14.6
2008	Total	2.1	3.2	23.9	14.4	77.2	14.0	14.9
-	MENA	30.1	11.0	54.3	48.4	43.9	54.9	26.8

[142] World Bank (2013b)

[143] World Bank (2013b)

TABLE 4.5. SELECTED CHARACTERISTICS OF SMES RELATING TO: CRIME[144]

Year	Subgroup	Percent of firms identifying crime, theft and disorder as a major constraint	Percent of firms paying for security	If the establishment pays for security, average security costs (% of annual sales)	If there were losses, average losses due to theft and vandalism (% of annual sales)
	Small	6.4	6.9	2.9	9.4
2008	Medium	7.9	15.1	0.6	0.4
	Large	5.9	22.4	0.6	0.2
2008	Total	6.8	14.3	1.0	3.0
-	MENA	32.3	20.1	3.2	7.8

TABLE 4.6. SELECTED CHARACTERISTICS OF SMES RELATING TO: CORRUPTION[145]

Year	Subgroup	Percent of firms identifying corruption as a major constraint	Percent of firms expected to give gifts to secure government contract	Percent of firms expected to give gifts to get a construction permit	Percent of firms expected to give gifts to get an electrical connection	Percent of firms expected to give gifts to get a water connection	Value of gift expected to secure a government contract (% of contract value)
	Small	59.6	94.9	6.1	12.8	0.0	9.5
2007	Medium	57.0	92.9	2.9	7.9	11.4	7.6
	Large	60.8	89.5	8.3	17.8	14.3	10.1
	Small	47.9	39.4	50.0	15.4	36.4	1.2
2008	Medium	46.2	39.7	47.1	42.9	16.7	1.3
	Large	40.9	24.8	26.7	33.3	30.8	1.1
2008	Total	45.2	32.0	40.0	31.1	27.8	1.2
-	MENA	65.3	48.6	45.7	47.5	30.7	5.1

144 World Bank (2013b)

145 World Bank (2013b)

TABLE 4.7. SELECTED CHARACTERISTICS OF SMES RELATING TO: INFORMALITY AND PERFORMANCE[146]

Year	Subgroup	Percent of firms competing against unregistered or informal firms	Percent of firms formally registered when they started operations in the country	Number of years firm operated without formal registration	Percent of firms identifying practices of competitors in the informal sector as a major constraint	Capacity utilization (%)*
2007	Small	...	20.7	15.8	54.4	55.5
	Medium	...	17.9	16.4	54.3	67.0
	Large	...	14.9	19.5	56.3	78.2
2008	Small	50.5	...	...	63.3	58.4
	Medium	44.2	...	...	60.5	68.8
	Large	44.8	...	...	60.9	77.5
2008	Total	46.7	...	...	61.7	68.8
-	MENA	43.2	72.1	0.9	30.7	67.8

TABLE 4.8. CHARACTERISTICS OF SMES RELATING TO FINANCE AND ACCESS TO CREDIT[147]

Year	Subgroup	Percent of firms with a checking or savings account	Percent of firms with a bank loan/line of credit	Proportion of loans requiring collateral (%)	Value of collateral needed for a loan (% of the loan amount)	Percent of firms using banks to finance investments	Proportion of investments financed internally (%)	Proportion of investments financed by banks (%)	Proportion of investments financed by supplier credit (%)	Proportion of investments financed by equity or stock sales (%)	Percent of firms using banks to finance working capital	Proportion of working capital financed by banks (%)	Proportion of working capital financed by supplier credit (%)	Percent of firms identifying access to finance as a major constraint
2007	Small	50.3	4.5	86.4	156.0	2.1	90.0	3.3	0.0	0.2	3.5	1.0	1.0	23.3
	Medium	77.4	10.6	89.5	161.8	7.5	86.4	10.0	0.2	0.1	6.4	2.6	1.0	26.1
	Large	95.7	21.9	83.2	116.3	16.9	77.5	15.8	0.7	2.0	19.5	9.2	1.4	25.4
2008	Small	49.7	5.1	100.0	87.6	2.9	90.6	1.5	0.2	2.3	2.0	0.8	0.6	45.5
	Medium	82.1	13.8	86.5	83.5	4.1	89.9	2.7	0.2	2.5	6.5	2.9	1.2	27.9
	Large	94.8	36.1	79.8	86.0	10.4	84.4	6.8	0.7	2.8	15.4	5.6	2.5	20.9
2008	Total	74.3	17.4	84.5	85.5	...	...	5.6	88.5	3.5	0.4	2.5	7.5	3.0
-	MENA	37.2	5.9	74.4	200.8	20.8	28.5	3.5	85.6	1.9	8.3	0.6	5.3	1.6

[146] World Bank (2013b)

[147] World Bank (2013b)

TABLE 4.9. BIGGEST OBSTACLE TO RUN A BUSINESS IDENTIFIED BY SMES[148]

Year	Subgroup	Access to finance	Access to land	Business licensing and permits	Corruption	Courts	Crime, theft and disorder	Customs and trade regulations	Electricity	Inadequately educated workforce	Labour regulations	Political instability	Practices of the informal sector	Tax administration	Tax rates	Transportation
2007	Small	3.0	2.2	1.1	14.7	0.9	0.0	0.4	8.8	7.3	3.0	0.0	27.2	2.8	27.2	1.5
	Medium	6.5	3.5	3.8	16.2	0.7	0.0	2.4	7.6	10.0	3.8	0.0	20.0	4.5	20.7	0.3
	Large	12.1	4.1	2.3	13.9	1.6	0.0	4.9	3.6	9.3	7.2	0.0	27.6	2.1	10.3	1.0
2008	Small	6.5	7.1	2.3	6.9	0.4	0.0	1.0	4.6	19.2	3.5	0.0	25.6	2.1	17.9	2.9
	Medium	5.9	8.2	2.7	8.4	0.5	0.2	2.3	5.7	17.3	3.6	0.0	26.4	1.8	13.9	3.0
	Large	10.2	7.1	1.8	9.2	0.5	0.3	6.3	3.7	17.9	2.9	0.0	24.1	2.1	10.5	3.4
2008	Total	7.4	7.5	2.3	8.1	0.5	0.2	3.0	4.7	18.1	3.4	0.0	25.5	2.0	14.4	3.1
-	MENA	4.8	8.6	3.6	14.8	0.8	1.3	2.5	25.9	6.2	2.6	11.4	9.4	2.0	5.7	0.5

[148] World Bank (2013b).

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