Financial Reform for Small Business Development in Egypt

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PREFACE

This report is based on a study conducted by the Development Economic Policy Reform Analysis ("DEPRA") Project, under contract to the United States Agency for International Development, Office of Economic Policy and Analysis, Cairo, Egypt (USAID/Egypt) (Contract No. 263-C-00-96-00001-00, Task Order 15).

The DEPRA project is intended to encourage and support macroeconomic reform in Egypt through the provision of technical assistance and services to the Ministry of Economy, with particular focus on international trade and investment liberalization, deregulation and financial sector strengthening.

The study was conducted, and this report was authored by, a team of consultants comprised of Dr. Mayada M. Baydas, Team Leader and Microfinance Specialist, Mr. John M. Porges, Senior Banking Specialist, and Mr. Stephen P. Wade, Banking Specialist; and Dr. James L. Walker, Senior Economist and the DEPRA coordinator for the study. The team would like to express their special appreciation to Dr. Omar Salman, Helwan University, who provided instrumental support in interviewing managers of financial institutions and other establishments. The team would also like to express their gratitude and special thanks to Dr. Sarah Loza, SPAAC, and her team members who were extremely efficient and cooperative in conducting the survey of micro, small, and medium scale enterprises. The assistance of Drs. Alia Almahdi, Hoda El-Sharkawi, Khairy El-Giziry, and Salah Zein El-Din is well appreciated.

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Executive Summary

Egypt's financial sector has undergone extensive liberalization since 1991. Credit controls have been eliminated, interest rate and foreign exchange regimes have been liberalized, modern banking regulations and treasury bill auctions have been introduced and the stock market has been revitalized. However, the financial sector remains dominated by government institutions with very weak performance allocating an excessive portion of private saving to finance public sector debt. In addition, the bulk of formal sector credit is directed to large firms. Small and medium-scale enterprises (SMEs), including informal microenterprises, which generate most of the nation's value added and employment, are generally perceived to be excluded from formal financial institution financing and rely largely on informal and self financing. Donor-subsidized SME credit programs cover a fraction of the financial demand of these enterprises. Because this perceived shortfall in credit availability to the more dynamic section of Egypt's economy runs counter to the Government's priority of increasing the economy's growth rate and providing expanding employment, the Ministry of Economy (MOE) requested that this financial reform study be conducted to focus on making credit more readily available to SMEs.

The objective of this study is to determine the main constraints to greater availability of credit to micro, small, and medium scale enterprises (SMEs) that have potential to grow and provide employment in Egypt and to provide policy recommendations for increasing the availability of such credit. While emphasis is placed on small and medium scale enterprises with potential to grow, the study also assesses the financing situation of informal sector microenterprises with growth potential and the experience of and constraints facing banks and non-bank financial institutions regarding microfinancing, including special donor and the Government of Egypt (GOE) sponsored programs. Various financial products of actual or potential significance to SME financing are explored, including leasing and loan guarantees. These analyses provide the basis for recommendations regarding policy, legal and regulatory reforms, and special programs which would improve the availability of credit to the SME segment of the Egyptian economy.

The study primarily involved an examination of the supply of and demand for financial services in the SME sector in Egypt. This entailed, on the one hand, interviews with private and public sector financial institution managers that supply credit to SMEs. These interviews took place in Cairo, Alexandria, Port Said, Damietta, 6th October City, 10th of Ramadan City, and Fayoum, and included the Central Bank of Egypt, eleven commercial banks, three business and investment banks, two specialized banks and five non-bank financial institutions. On the other hand, the demand investigation involved interviews with 173 SME owners/managers to estimate their demand for credit. These interviews took place in Greater Cairo, including the 6th October and 10th of Ramadan Cities, Alexandria, and Fayoum. These firms were randomly selected in the manufacturing, service, and trade sectors. We focused primarily on the more dynamic sub-sectors of textile-garment manufacturing, furniture-wood processing, shoe making, artisanal craft production, carpet weaving, tourism companies, hotels and restaurants, service companies, and wholesale and retail trade.

Supply of Financial Services to the SME Sector

Based on an understanding of the supply of and demand for financial services in the SME sector, appropriate intervention schemes and adequate policy reforms are proposed to assist in the development of financial markets. Results of the study indicate that despite the overwhelming prevalence (over 98%) of micro, small and medium enterprises in the Egyptian economy, commercial banks are lending relatively small percentages of their loans to these enterprises. Very rough estimates of the volumes of such lending by the sample group of banks indicates that the total SME lending by the whole banking sector is estimated to be between 5-6%. Almost all microenterprise lending by commercial banks is politically motivated, with the primary impetus for it coming from the Social Fund for Development (SFD) initiative of government. The below market interest rates passed on to micro and small borrowers through SFD discourage broader participation in SME lending by commercial banks. Bankers say that they lose money on SME loans, primarily because of the high loan loss rates and higher than normal expenses related to this type of lending. With the exception of the National Bank for Development (NBD), banks eschew microenterprise lending primarily because it is costly and risky. In addition, commercial bankers in Egypt, as in most of the rest of the world, have very little understanding of the dynamics of microlending and how to make it work. None of the sample banks, with the exception of the NBD, had the policies, procedures, personnel, systems, training and philosophy in place to be successful in microenterprise lending. This is consistent with experience elsewhere in the world.

Bank collateral policies varied considerably among the sample banks with requirements ranging from 110% to 200% of loan value. Collateral included real estate, inventories, accounts receivable, marketable securities, cash, equipment, contract and lease assignments, and bank and personal guarantees. All sample banks make uncollateralized loans. While some banks didn't think their collateral policies were more or less harsh with regard to smaller borrowers, most banks indicated that the smaller the borrower the more difficult it is for them to provide the necessary collateral either because they don't have it or because registering it is too expensive.

In general, the banking system is not sufficiently competitive because the majority of financial resources of the nation are controlled by five large government-owned banks. This concentration of power reduces competition and limits the use of more modern technology, particularly computerized internal reporting systems in branches out of Cairo, and limits the range and use of certain financial products and services (e.g. factoring, forfaiting and bankers acceptances).

Five special financial models were studied. The NGO model, as exemplified by the Alexandria Business Association (ABA), appears to be a viable model in Egypt. An expansion of the number of institutions employing the model would be beneficial to the availability of credit to SMEs. In addition, encouraging a cautious move up market by the stronger of these institutions may be warranted to reach more small and medium scale enterprises. There is some concern whether the model can be scaled up market using the current, uncollateralized lending approach, but there is reason to believe that the additional portfolio and individual borrower risks expected with larger client size can be contained with a controlled approach to expansion and with appropriate modifications to the operating systems based on experience. Institutions

experienced in the application of best practice lending guidelines should be prudent lenders at any level in the SME market.

Given the fairly widespread application of the NGO model in Egypt, and the operational maturity of international best practices in microfinance, there may be merit in encouraging the development of a microfinance industry around this model. Formalizing the model as an industry through innovative, flexible legislation would enable practitioners like ABA to access funding from commercial sources. However, although the ABA financial track record is excellent, banks may not be able to provide any significant amounts of uncollateralized lending to ABA-like foundations because of their legal status which prevents banks from taking them to court in case of default.

Special programs for micro and small enterprise lending within banks also appear to be viable. NBD has expanded its micro lending program rapidly and achieved profitability in a reasonably short period. This has been achieved through efficient operations, controlled loan losses, close performance monitoring ratio and a high effective interest rate. The program is reaching a significant number of borrowers, and has been successful enough to warrant a decision to implement it throughout the bank's branch network.

The credit guarantee model, as exemplified by the Credit Guarantee Corporation, also offers certain benefits. CGC is the only private company in Egypt issuing guarantees to banks for SME lending and has been responsible for increasing bank credit to the sector. With total guarantees outstanding of LE191 million, its has leveraged its LE94 million collateral fund two times. Claims against its guarantees have been a fraction of 1%, which is very low by international standards. On the other hand, concentration of business with a limited number of banks indicates that CGC has not been successful in its marketing activities, or that unresponsive operating habits may be limiting its business, or that only limited demand exists for its guarantees. Moreover, guarantee fees cover only a small part of CGC's expenses. The bulk of the operations are financed by income from a soft loan from government and a grant from USAID. While this does not appear to be unusual around the world, it does call into question the long term financial viability of the CGC approach unless it is able to expand its guarantee activities to a much broader market. A government SBA is not a viable alternative.

The Social Fund for Development (SFD) appears to be a well-intentioned government program targeting unemployed graduates, but its activities distort credit markets with subsidized interest rates and sub-standard repayment rates. SFD should not be expected to become a viable model for achieving a self-sustaining expansion of credit to microenterprises without a considerable shift in emphasis towards enhancing the financial incentives to, and the institutional capacity of, banks and non-bank financial institutions with regard to SME lending.

Egypt's nascent leasing industry probably offers one of the most important models for expansion of SME financing in the future. With flexible instruments which can supply nearly 100% of equipment financing requirements and can match payments to specific cash flows, leasing offers a potentially significant alternative source of SME financing in Egypt, where small entrepreneurs have limited access to term borrowing.

Demand for Financial Services in the SME Sector

The survey of SMEs generated a number of findings regarding their demand for financial services. First, the primary source of financing used by most entrepreneurs in the sample was retained earnings. Second, trade credit in the form of supplier credit and customer advances was significantly used by over half of the micro, small and medium scale enterprises. Third, informal and formal loans seemed to be substitutes for entrepreneurs depending on the size of the business. A smaller share of microentrepreneurs used formal loans than those using informal loans, while a smaller share of small and medium scale enterprises used informal loans than those using formal loans. Over half of the small and medium scale enterprises had an effective demand for bank financing over the past year. It is important to note, moreover, that the average amounts used by the entrepreneurs, across the three size categories and sectors of operation, reflects significantly higher values of formal loans compared to informal loans. Loan quantity rationing was found not to be the problem or bottle neck, contradictory to popular belief of discrimination against small businesses. The observation of entrepreneurs often self-selecting themselves out of the formal credit markets was reported to be based on their fear of inability of repayment, availability of other sources, religious beliefs, or regarding market interest rates as being too high.

Entrepreneurs in the sample were found to participate in different savings channels. Among the most common savings channels were commercial banks. On the one hand, the majority of the entrepreneurs operating small and medium scale enterprises held at least one account with one of the commercial banks in the country. On the other hand, only one third of the microentrepreneurs held an account with one of the commercial banks. “Gam’iyat” or RoSCAs were the second most widely used saving channel among the entrepreneurs in the sample. Again size of the enterprise presented significant differences. Over a third of the microentrepreneurs participated in these groups while about one fourth of the small scale entrepreneurs did, and only a few medium scale entrepreneurs were members of these groups. Finally, very few entrepreneurs reported saving money with informal collectors. The few who did reported that they held some funds with a family member.

Supply of and Demand for Financial Services in the SME Sector

Findings of the study provide valuable insights into the supply of and demand for financial services in the SME sector in Egypt. While commercial banks indicated that SME lending represents a very small share of their overall portfolio, analyses of the entrepreneurs’ demand for formal financial services indicated that over half of the small and medium scale enterprises draw on loans from banks. The disparity is largely a result of the bankers’ perception that SME lending is typically microlending. The small and medium enterprises’ demand for formal financial services is clearly different from that of microenterprises. Small and medium entrepreneurs were found to draw on significant amounts of formal loans, much higher than those typically reported by bankers when asked about the amounts borrowed by small and medium size businesses. Small and medium scale enterprises did not seem to have a binding constraint with respect to accessing bank financing. As expected, commercial banks did not engage in microlending, except through special programs and lines of credit.

NGOs and special programs, such as the SFD, provide the bulk of microlending largely to microenterprises and some small scale businesses. Enhancing the growth of such programs, based on "best practices" in microlending will undoubtedly increase the outreach and sustainability of these institutions and contribute to more credit flowing to the SME sector. These efforts, however, will only reach a small share of the vast microenterprise sector. Microentrepreneurs rely to a large extent on non-bank sources of financing, such as retained earnings, informal loas, and trade credit. A large number of small and medium scale enterprises draw upon these non-bank sources of financing as well. The extent to which bank financing is utilized by small and medium scale enterprises, however, is much more significant than the extent to which microenterprises draw upon bank or special program financing. Self-selection out of the formal financial markets by microentrepreneurs explains part of this phenomenon, contrary to the common belief of rejection of SMEs by formal institutions in general.

Recommendations

Improving the overall performance of the financial sector would benefit all enterprises, including micro, small, and medium businesses. Overall performance could be improved with the following recommendations:

- Continue and accelerate privatization of the banking system to increase the level of competition and the services provided to the SME sector.

- Privatization should be complemented by an effort to reduce the dominance of these institutions by breaking them into smaller entities to encourage competition and innovation.

- Reverse the current Central Bank position against approving the entry of additional foreign banks. The window allowing entry by purchasing the public share holdings in joint venture banks is positive, but insufficient. Many foreign banks will only enter the market if they can own 100 percent of the operating entity. In other markets, such as the rapidly advancing markets in Asia, free market entry has resulted in more modern banking practices, increased competition leading to cheaper and more readily available credit, and stronger financial institutions. Egypt is not over-banked.

- Reduce the cost of funds to financial institutions by lowering reserve requirements to prudentially required levels. Coupled with an enhanced competitive banking environment and increased banking efficiency, this would result in lower current market interest rates. Potential money supply expansion could be controlled by open market operations of the central bank.

- Eliminate government influence on the banking industry calling for lower interest rates on SME lending. Below-market interest rates reduce incentives for bankers to provide SME loans.

- Fully implement the new government regulations to require full disclosure in bank financial

reporting via detailed audited annual reports and semiannual reports according to international standards. In the free and private banking market envisioned in Egypt's future, better information will generally draw more resources to the better performing banks, and this will ultimately improve the overall availability of credit at all levels.

- Improve supervision of banks to reinforce prudence and competition in lending. Enforcement of rules for provisioning and capital adequacy will allow banks that actively find and develop good borrowers to expand faster than banks with non-performing loans.

- Continue and accelerate the process of court reform, particularly the creation of special commercial courts.

- Modify current legislation to enable more flexible, secure, and inexpensive loan collateralization.

- Reform the SFD program to use its resources to stimulate a free market in the provision of financial services to small businesses by providing financial, rather than political, reasons for banks and other institutions to participate in this market.

- Draft new, modern legislation governing NGO financial institutions such as ABA. To attract wholesale funding from commercial banks, the legislation should allow these NGO financial institutions to obtain a legal status similar to that of a joint stock company while retaining their non-profit status.

- Donors and the Government should encourage the establishment of special units within banks to stimulate both wholesale and retail SME lending through the provision of subsidies to cover start-up costs.

- Donors and the government should encourage the expansion of the private sector Credit Guarantee Corporation program rather than dilute its focus or compete with it through the establishment of a government SBA program.

- Trade liberalization policies should be accelerated to provide increased opportunities to the SME sector by increasing competition among wholesalers of raw materials supplying many entrepreneurs operating micro, small, and medium scale enterprises.

- Provide incentives to marketing and/or trading companies which would assist in marketing the finished products for SMEs in both domestic and foreign markets.

- Focus primarily on providing financial and non-financial services to small and medium scale enterprises with growth potential. Findings of the study support that small and medium scale enterprises are the growth engines of the economy rather than microenterprises which are the

typical income generation vehicles.

- Also focus on providing financial and non-financial services to young enterprises with growth potential. Young enterprises are typically those in their early stages of growth, in contrast to start-up enterprises which have a high degree of failure.

- Relax the non-financial constraints that limit enterprise growth. Tax laws, labor laws, marketing, and government bureaucratic procedures and red tape, were all suggested by entrepreneurs to present significant problems limiting their operations and growth. Improved access to input and output markets, more efficient government procedures, amended labor and tax laws that foster SME growth, would provide a more conducive environment for business development in general.

Chapter One

Study Overview

I. Objective of the Study

The objective of this study is to determine the main constraints to greater availability of credit to micro, small, and medium scale enterprises (SMEs) that have potential to grow and provide employment in Egypt and to provide policy recommendations for increasing the availability of such credit. While emphasis is placed on small and medium scale enterprises with potential to grow, the study also assesses the financing situation of informal sector microenterprises with growth potential and the experience of and constraints facing banks and non-bank financial institutions regarding microfinancing, including special donor and the Government of Egypt (GOE) sponsored programs. Various financial products of actual or potential significance to SME financing are explored, including leasing and loan guarantees. These analyses provide the basis for recommendations regarding policy, legal and regulatory reforms, and special programs which would improve the availability of credit to the SME segment of the Egyptian economy.

This chapter provides an overview of the Egyptian economy in general, and the enterprise sector in particular, and outlines the methodology adopted in the study. The second chapter, presents an overview of the financial sector, the Egyptian banking system and relevant legislation, and reports on the supply of financial services to the SME sector. Chapter three deals primarily with the demand for financial services by SMEs, detailing the characteristics of the enterprises and their demand for alternative financial services based on a survey of SMEs in the manufacturing, service and trade sectors. The fourth, and last chapter, draws together the conclusions from the supply and demand analyses, and provides policy recommendations.

II. Structure of the Economy

The Egyptian economy is struggling to sustain its large population of 58 million people, with the pressure of almost half of the population residing in cities and the other half in the 3 percent of the total area which constitutes arable land (World Bank, 1997). The heavy reliance of the Egyptian economy on agriculture has declined over the past two decades as its share in the gross domestic product (GDP) fell from about 30 percent in 1970 to about 20 percent in 1995. The agricultural sector, however, remains an important pillar of the economy as it amounts to about 20 percent of total exports (World Bank, 1997). In addition, agriculture is the primary source of livelihood for many Egyptians as it employs about 64 percent of the total rural labor force, and 9 percent of the urban labor force (Richards, 1994).

The decline in the share of the agricultural sector's contribution to GDP has been countered with an increase in the contribution of the service sector to GDP which rose from 42

percent in 1970 to 60 percent in 1995 (World Bank, 1997). Industry, however, has remained stagnant at about 20 percent of GDP over the past two decades. Changes in the structure of production reflect more closely changes in employment opportunities in both urban and rural areas. While only about 36 percent of the total rural labor force are engaged in non-farm employment, about 38 percent of the average rural household income is derived from non-farm activities (Richards, 1994). The World Bank's recent estimates indicate that three out of four non-agricultural, private sector jobs (about 3.7 million workers) are in the micro and small scale enterprise sector (World Bank, 1994). Micro and small scale enterprises, moreover, represent about 98 percent of the total private non-farm establishments in the economy.

These changes in the structure of the economy are partially the outcome of the Economic Recovery and Structural Adjustment Program (ERSAP) adopted by the GOE. From about the early 1990s the Egyptian government increasingly exposed economic activities to market forces in accordance with the structural adjustment program reforms. The structural adjustment program encompassed many reforms in key sectors of the economy including financial markets. By the mid 1990s interest rate policies were generally liberalized, credit controls eliminated, modern banking regulations introduced, treasury bill auctions offered, and the foreign exchange regime liberalized. These efforts, nonetheless, have not resulted in a competitive financial sector largely due to the predominance of state-owned banks excessively engaged in financing public sector entities.

III. Methodology

A wide variety of definitions segmenting micro, small, and medium businesses in Egypt exist. Given the objective of our study, and our focus on small and medium scale enterprises, the following breakdown was used in the interviews with managers of banks and non-bank financial institutions:

Micro	= 1- 9 employees and/or loan size of LE 500 to LE 19,000
Small	= 10- 49 employees and/or loan size of LE 20,000 to LE 99,000
Medium	= 50-100 employees and/or loan size of LE 100,000 to LE 250,000

The classification of enterprises among the three size categories based on the number of employees only was used during the SME survey. Our study of the supply of and demand for financial services in the SME sector in Egypt included the following:

- reviews of relevant literature;
- interviews with officials from the Government of Egypt and donor agencies, private and public sector financial institutions and associations for background information. These background interviews took place largely in Cairo;
- interviews with private and public sector financial institution managers that supply credit to SMEs. These interviews took place in Cairo, Alexandria, Port Said, Damietta, 6th October City, 10th of Ramadan City, and Fayoum, and included the Central Bank of Egypt, eleven commercial banks, three business and investment banks, two specialized banks and five non-bank financial institutions;

- interviews with 173 SME owners/managers to estimate the demand for credit. The interviews took place in Greater Cairo, including the 6th October and 10th of Ramadan Cities, Alexandria, and Fayoum. These firms were randomly selected in the manufacturing, service, and trade sectors. We focused primarily on the more dynamic sub-sectors of textile-garment manufacturing, furniture-wood processing, shoe making, artisanal craft production, carpet weaving, tourism companies, hotels and restaurants, service companies, and wholesale and retail trade.

Both interviews with the managers of financial institutions and the interviews with enterprise owners included questions on finance in general, and specific inquiries related to international trade in particular. Analyses of the trade related information are presented in a complementary DEPRA report entitled *Egypt: Trade Finance Reform for Small Business Development*.

Chapter Two

The Supply of Financial Services for Small Businesses

I. Overview of the Financial Sector

While long term debt capital is available to a limited extent from insurance companies and relatively few bonds placed privately and through the Cairo Stock Exchange, the Egyptian banking sector provides the great majority of credit in Egypt. The banking sector consists of the Central Bank of Egypt, 28 commercial banks, 29 business and investment banks and 6 specialized banks.

At the end of 1996[1], the system had assets of LE391 billion distributed as follows:

The Egyptian Banking Sector			
	Assets	Deposits	Credit
Commercial Banks	53%	88%	77%
Business and Investment Banks	10%	9%	13%
Specialized Banks	4%	3%	10%

Commercial banks, both private and public, control the majority of the financial assets in Egypt, hold nearly ninety percent of the deposits, and provide more than three-quarters of the credit available in the country.

Credit Facilities by Beneficiary Sector				
	6/95	3/96	6/96	2/97
Government & public business sectors	39%	38%	36%	35%
Private business sector	47%	49%	50%	51%
Households & foreign sector	14%	13%	14%	13%

For most of the past thirty-five years, the government and government-owned banks and enterprises dominated the credit markets. However, primarily due to improvements made under the ERSAP, private business borrowing accounted for more than fifty percent of the credit extended in 1996[2], as indicated above. Credit to private business grew at a rate two to three times that of government borrowing in 1996. Commercial credit tended to be largely short term, with

[1] Central Bank of Egypt, Annual Report, 1995/96. The remaining 33% of the banking system's assets are held by the Central Bank of Egypt.

[2] Ibid

nearly seventy percent having a maturity of less than one year.[3] Additional statistics regarding the structure of banking in Egypt are presented in Appendix B.

II. The Egyptian Banking System

Prior to 1961, Egypt's banking system was largely private, but in that year, twenty-seven commercial and specialized banks were nationalized. By 1964, the number of banking institutions had been reduced to four government-owned banks. In the early 1970s, a series of laws began a general economic liberalization which affected the banking industry. Law 43 of 1974 allowed the reentry of foreign banks.

As part of the Economic Reform and Structural Adjustment Program (ERSAP) that began in 1991, the Government of Egypt has initiated a set of financial reforms which include the following elements:

- Elimination of interest rate controls;
- Elimination of foreign exchange controls;
- Abolition of credit ceilings;
- Elimination of non-commercial, directed credit to public enterprises;
- Foreign banks and their branches were permitted to deal in local currency;
- Enhanced prudential regulations and bank supervision.

In general, these moves served to strengthen the banking sector. Combined with initiatives to privatize state-owned enterprises, revitalize the stock exchange, and provide better liquidity management, these elements have made greater volumes of credit available to the private sector, including small and medium enterprises. The overall macro economic environment, particularly freer markets and lower inflation, have generally benefited all enterprises.

Concentration of Financial Power in State-owned Commercial Banks

Despite the progress stimulated by the ERSAP, an analysis of the financial information available from the commercial banks and the Central Bank for fiscal years 1995 and 1996 indicates the following situation:

- The overwhelming majority of commercial bank assets, loans and deposits continue under the control of government institutions. Four government-owned commercial banks, National Bank of Egypt, Banque du Caire, Banque Misr and Bank of Alexandria, dominate the financial sector with more than half of all loans and advances outstanding. When one adds to this figure the Principal Bank for Development & Agricultural Credit (PBDAC), a government-owned

[3] El-Rafaie, Faika, 1997, "Financial Intermediation: Efficiency of the Egyptian Banking System," The Egyptian Center for Economic Studies

specialized bank, the percentage jumps to more than sixty percent. These five banks control 89% of the branch bank outlets in Egypt and 69% of the bank deposits in the country. Preliminary figures indicated that dominance of the government-owned commercial banks has not significantly dropped in 1997. However, government participation in banking sector has been reduced through the privatization of the joint venture banks.

- These government institutions continue to lag significantly behind their private sector counterparts in almost all areas of performance:

1995 Profitability Measures

	5 State Banks	Private Banks		5 State Banks	Private Banks
Return on assets	.3%	1.7%	Loans/branch	LE 42,000	LE 133,000
Return on equity	4.2%	23.2%	Loans/employee	LE 1,095	LE 2,073
Deposits/branch	LE73,000	LE164,000	Profit/branch	LE 200	LE 4,400
Deposits/employee	LE1,925	LE2,851	Profit/employee	LE 41	LE 731

LE figures are in 1,000s

In general, the public commercial banks do not appear to be progressive in offering modern services. They indulge in anti-competitive practices such as offering subsidized interest rate loans, and generally do not price their loans consistent with risk. Their dominance in the market weakens the environment of competition essential for improved customer services to borrowers as well as depositors. Their corporate culture is based on a vision of themselves as government employees following government rules regarding accepting deposits and making loans. They do not see themselves as financial intermediaries competing with each other in a market to identify new opportunities to earn higher yields with less risk for their depositors and shareholders.

- In addition, a very large portion of the non-performing assets of the financial sector appears to be concentrated in the state-owned commercial banks, and these institutions do not appear to be taking aggressive steps to purge their balance sheets of these bad loans, or enforce financial discipline on non-performing borrowers.

Privatization of the state bank ownership positions in joint venture banks, which account for about a quarter of the commercial branches in the country (excluding the PBDAC network) is a positive move, but is not yet complete. The government has announced plans to privatize the state banks themselves, but progress in this has been minimal.

Despite indications that the number of bank branches per thousand people appears to be below regional standards and the world average[4], the Central Bank of Egypt is apparently not

[4] El-Rafaie, Faika, 1997, "Financial Intermediation: Efficiency of the Egyptian Banking System," The Egyptian Center for Economic Studies. El-Rafaie's figures indicate that in Egypt there are 26,567 persons per branch, and even the major population centers, where most of the branches are located, are under banked (for example, Cairo is about

allowing additional foreign bank entry into the local market. Instead, the Central Bank favors further branching by existing banks. A number of bankers interviewed indicated that the Central Bank is far less likely to approve new branch applications from private banks as compared with state banks, or is likely to take an inordinately longer time in approving such applications. Because most of the lending to small and medium business appears to occur at the branch level, this appears to limit the credit available to small and medium business.

In short, the availability of credit to all sizes of Egyptian enterprise appears to be constrained by the fact that most of the financial assets of the nation are under performing. This appears to be the result of:

- their over-concentration in a limited number of state-owned financial institutions;
- the lack of modern managerial practices in the state-owned financial institutions and in some private institutions. For example, in none of our discussions in state-owned banks did managers refer to the output records of computerized financial reporting systems. Several mentioned that such reports were not available to them and/or their operations were not computerized;
- loan write-off policies which are inconsistent with loan performance. Some state banks appear to be rolling over delinquent loans to government business entities rather than writing them off. This practice is not uncommon in government-owned financial institutions world wide, well-known for creating economic drag on economic development;
- the lack of competition in the financial sector. Egyptian government banks appear to offering a limited range of traditional products to their customers. A highly competitive banking system would be aggressively looking for good loan opportunities and offering a wider range of services. Many of the government bankers we spoke to did not appear to have any targeted or aggressive marketing programs for their SME lending;
- limited and inconsistent financial reporting. Information stimulates competition. The financial reports of government-owned banks do not disclose much information needed for making meaningful analysis and comparisons. In addition, detailed information is important for investment decisions. Variations in the level of disclosure, and inconsistency in presentation, will ultimately affect investment decisions, particularly when state banks are privatized. Full disclosure would encourage investment and broaden the supply of funds to the banking sector.

III. Relevant Legislation

Banking Legislation. The Egyptian banking system is guided by the following legislation[5]:

18,205 persons per branch. The world average appears to be below 5,000 persons per branch. The comparable figure is 5,664 persons per branch for Lebanon (Baydas, 1996), and 9767 persons per branch for Jordan.

[5] "Banking Legislations", The Central Bank of Egypt, December, 1994 and subsequent updates

- Law No. 120 of 1975 regarding the Central Bank of Egypt and the Banking System,
- Presidential Decree No. 59 of 1993 issuing the Statutes of the Central Bank of Egypt,
- Presidential Decree No. 187 of 1993 issuing the Executive Regulations of the Banks and Credit Law,
- Presidential Decree No. 205 concerning the Law of Confidentiality of Bank Accounts,
- Law No. 97 of 1996 amending some provisions of the Banks and Credit Law issued in Law No. 163 of 1957 and Law No. 120 of 1975 regarding the Central Bank of Egypt and the Banking System.

Banking legislation governing the ownership of banks in Egypt and Central Bank authority regulating the banks was liberalized in 1974 to remove the prohibition on foreign ownership, which had a dampening effect on bank competition in Egypt. Present regulations do not appear to constrain lending except in the promulgation of normal prudential and monetary controls such as minimum reserves and single borrow limits. The reserve requirements in Egypt are 15% of deposits, and the maximum loan limit to any one borrower is 30% of a bank's capital. This limit does not apply to government banks. By comparison, the reserve requirement in the U.S. is basically 10%[6], and the single borrower limit is 10% of capital and reserves. The higher reserve requirements in Egypt increase the cost of credit to all borrowers, including micro, small and medium scale businesses. In addition, the fact that the single borrower limits are higher and do not even apply to government-owned banks, the largest providers of credit, tends to promote more concentrated and riskier loan portfolios and reduces the availability of credit to smaller enterprises since larger entrepreneurs absorb more credit than would otherwise be prudent.

There is no specific legislation that encourages banks to lend to SMEs. The removal of interest rate controls should have a positive impact on such lending in that it allows banks to price loans to SMEs at higher levels to cover the higher risk and administrative costs associated with this type of lending.

The Central Bank of Egypt indicated there are no regulations requiring banks to demand collateral on loans, except on loans in excess of one year, and there are no special regulations requiring additional provisioning for uncollateralized or "clean" lending. Therefore, there appears to be no official regulations penalizing SMEs, which generally have less collateral to offer than larger firms do.

The Central Bank, and other government entities, are said to use "moral suasion" to encourage banks to lend to SMEs. This would, on the face of it, have a positive influence on the availability of credit to the smaller enterprises. However, since the government strategy has been to offer credit to smaller firms at below market interest rates (e.g., SFD program), it is likely that the overall availability of credit to small enterprises is negatively impacted, since commercial banks would earn less on every below-market-rate loan they make to the small business segment. Banks perceive SME lending to be more risky and more expensive, and the normal economic response would be to charge higher prices to reflect the risk and cost inherent in this segment. The perception of government pressure to "under-price" SME loans leads to sub-economic returns in SME lending and inhibits the involvement of the banks in this segment, especially private banks.

[6] U.S. reserve requirements are 0% for the first $2.8 million, 3% for between $2.8 million and $48 million, and 10% above $48 million.

Legislation Governing Private Societies and Organizations. As in many other nations, much of the finance available to microenterprise in Egypt is provided by non-profit, non-government organizations (NGOs) such as the Alexandria Business Association and the Egyptian Small Enterprise Development Foundation. The limited finance available to these programs comes primarily from donor agencies. Unless they can access commercial sources of finance, the growth potential of microfinance industry worldwide is limited. However, advances in understanding of the demands and behavior of microenterprises has led to the adoption of technologies and management tools that enable success in lending to microenterprises - e.g. acceptable repayment rates, efficient operating control and self-sustaining interest/fee levels. These practices are at play in Egypt, and, as elsewhere, have opened the possibility that banks and other commercial financiers could become a major source of loan capital as the NGOs demonstrate good performance records. Unfortunately, the legal status of NGOs in Egypt appears to inhibit bank lending to these organizations in amounts significantly in excess of the collateral funds placed at the banks.

NGOs in Egypt are governed by Law No. 32 of 1964 and Presidential Decree No. 932 of 1966.[7] These statutes, as with all Napoleonic Code law, grant specific rights, privileges and responsibilities. Rights not specifically granted do not exist. Under this legislation, NGOs are licensed by the Ministry of Social Affairs (MSA) after having submitted their by-laws, lists of their directors and a specification of their intended activities to MSA. They can accept voluntary contributions and are exempt from certain taxes. However, since there is no specific authorization to borrow funds, it may be assumed they are not authorized to do so. In addition, since NGOs are licensed rather than "legal persons," there is some question whether they can successfully be sued in court. These two issues, the lack of specific authorization to borrow and the lack of a legal status, appear to be the reason why bankers are reluctant to lend significant amounts to NGOs in excess of their cash collateral. Foundation "borrowing," then, could be interpreted as the banks simply administering their funds on an collateralized overdraft basis on behalf of the foundations.

Because of this lack of legal status, banks are reluctant to lend to foundations on the basis of cash flow records, even when those records show solid, positive performance over a number of years. This is in stark contrast to the bank willingness to make cash-flow-based loans to businesses, which can be sued. This significantly limits the volume of credit which the banks could supply wholesale to the foundations for on-lending to small borrowers.

IV. Interview Findings

1. General Findings

Sample Size. The interview sample consisted of 17 financial institutions, including seven government-owned banks, comprising the four largest commercial banks, two specialized banks and one classified as a business and investment bank. Interviews at these banks included senior

[7] Law No. 32/1964 Concerning the Private Societies and Organizations with its Executive Regulations, Oct. 1996, The Middle East Library for Economic Services.

managers in the head offices and, in the case of the commercial banks, the managers of branches in outlying areas such as 6th of October City, 10th of Ramadan City, Damietta, Port Said, Alexandria and Fayoum. The sample also included ten private and/or joint venture banks located in Cairo and Alexandria, of which seven are commercial banks and three are business and investment banks. Collectively these banks represent 74% of the assets, 82% of the deposits, 87% of the loans and 86% of the branches in Egypt, most of which are controlled by the public banks.

Definitions. During the course of the interviews with bank managers, it became apparent that each of the banks had its own definition of how to classify credit business by size. The definition of micro, small and medium businesses was different with each bank, and could differ even within the same bank depending on which manager was interviewed. For example, the definitions used by senior management at the headquarters of one state-owned bank differed with that of the branch managers of the same bank outside of Cairo.

In addition, few bank managers classified businesses by employee size. Typically, they classified them by the size of loans given, but even this definition was imprecise because the same borrower might have had several loans of vastly different sizes. It could be concluded that the best classification criterion might be the "relationship size," that is, the size of the credit relationship with a customer. For example, a large customer is likely to have many loans, some of which may be significantly smaller than others. Conversely, a small business, may have one or more large loans more commonly associated with medium scale business, depending on the nature of his industry. Unfortunately, the management information systems of the banks interviewed did not seem to disaggregate loans outstanding according to business or loan size.

Most bank managers interviewed resorted to describing the breakdown of their loan portfolios by size of loan. The estimates of total volume of credit available to each of the three size categories, micro, small and medium, provided in subsequent sections, are based on these estimated breakdowns.

Data Quality. With one exception, at a private bank, none of the bank managers interviewed referred to any form of computer printout when estimating the breakdown of their loan portfolios by loan size. Therefore, the estimates of total volume of credit available to each of the three size categories can be viewed as very rough estimates. Despite the wide variation in the quality of loan data, the interviewees provided very useful information regarding their:

- attitudes toward micro and small business,
- approaches to handling it,
- views on collateral,
- constraints to making additional credit available to these firms, and
- suggestions for making additional credit available to these firms.

There was a surprising level of consistency among interviewees on many of these issues.

2. Findings: Commercial Banks

Loan Portfolio Attributes. Consistent with the banking industry as a whole, the bulk of the loans of these banks, roughly 83%, was short term lending for working capital purposes. There was a wide variation in the largest sectors of business for these banks, with manufacturing, commerce (wholesale and retail trade) and tourism being the most frequently cited. Approximately sixty percent of lending was to the private sector, versus slightly greater than fifty percent for the banking industry as a whole.

The sample group is estimated to have had approximately LE5.9 billion, 6.4% of their collective portfolios, outstanding to the SME segment of the economy at the end of 1996 distributed as follows:

	LE billions					Egyptian ------Total Sample Group----------				
	SME	Medium	Small	Micro		Credit	SME	Medium	Small	Micro
Public banks	4.3	2.5	1.2	.60		66%	81%	81%	78%	94%
Private banks	1.6	1.0	.5	.04		34%	19%	19%	22%	6%
Totals	5.9	3.5	1.7	.64	% of collective portfolio		6.4%	3.8%	1.9%	.7%

Based on the relative size of credit available from public and private institutions in the banking system, it is estimated that SME credit was approximately 5-6% of all credit extended by banks in 1996.

Micro enterprise credit was almost exclusively supplied by public banks with most of the private micro credit being provided by the National Bank for Development. However, the distribution of medium and small enterprise credit in the sample more closely approximated the overall estimated distribution of credit between public and private banks (66% vs 34%). While loan sizes ranged from LE500 to millions of pounds, many banks indicated minimum loan sizes of between LE50,000 and LE500,000.

Nine of seventeen banks reported pricing smaller loans differently from larger loans. About half reported higher rates for smaller borrowers, and about half reported lower rates. On average, respondents indicated that they were pricing term loans only .5% higher than working capital loans. Private bank interest rates were between .4% and 1.1% higher than the rates of public banks, and their fees were .4% higher on average.

Attitudes Toward SME Lending. Micro enterprise lending was primarily via the Social Fund for Development (SFD) program with the exception of the National Bank for Development (NBD). Only one other private bank in the sample indicated doing SFD lending. Public banks account for more than 87% of SFD usage, and 99% of SFD usage by banks. There is nearly unanimous agreement that the SFD business is unprofitable, and that banks would not undertake it on their own for this reason. Although the SFD indicated that ten private banks were joining their program, there were no significant new SME initiatives mentioned by the sample banks with the exception of the National Bank for Development, which is expanding its programs at its own

expense (USAID's support for the program has come to an end).

Most banks indicate that small and micro lending is more risky than medium and large lending and that the administrative costs are either the same or higher (i.e., the cost is higher per LE disbursed). All of the banks involved with SFD lending reported very high loan loss experiences (from 8% to 90%). All of the sample banks indicated that small and micro loans are less economic, and with the exception of NBD, they prefer not to do this type of lending. The fact that they are making some token small and micro enterprise loans is primarily due to political pressure, either real or perceived. In some cases it appears that residual socialist attitudes among the public bankers are contributing factors.

While most banks believe that microfinance is unprofitable, nearly half believe that their lending to small and medium enterprise is profitable or will become profitable (two-thirds of the banks). It should be assumed that, due to differences between banks as to what constitutes small and medium lending, and due to the fact that all managers interviewed provided rough verbal estimates of the size of their lending in these categories, many of these bankers were referring to loan and enterprise sizes larger than those defined in the interview questionnaire.

Government Policy Constraints. None of the banks could identify any government policy which was constraining the supply of credit to smaller borrowers, with the exception of one bank which stated that the SFD program may be distorting the market by artificially depressing interest rates. Many banks stated that the government is encouraging them to drop their rates to smaller borrowers. The government's position on subsidized lending for SMEs clearly contributes to limiting the volume of SME lending.

Internal Bank Policy/Attitudinal Constraints. The following policy or attitudinal constraints were stated as being internal to their banks:

- higher collateral requirements for smaller borrowers to cover additional risk;
- policy restricting bank to lend to larger business;
- no loans under LE50,000 are allowed;
- policy is to lend larger sums because smaller loans are unprofitable;
- credit policies dictate larger loans.

The respondents gave the following explanations why their banks do not extend more loans to smaller business:

- higher risk with smaller business exhibiting 30%-90% write-off rates at some banks;
- high administrative costs;
- meeting collateral requirements is too expensive for smaller clients;
- high cost, high risk, low or no return;
- success depends on analysis and follow-up;
- clients are not aware of what banks are looking for;

- bank does not understand this business;
- small businesses do not come to the bank.

Collateral and Guarantees. Collateral policies varied considerably among the banks. The collateral levels required, as percentage of the loans extended, ranged from 110% to 200%, with the lower percentages usually applying to domestic and international trade finance, the latter against letters of credit. Types of collateral include registered real estate, inventories, accounts receivable, marketable securities, cash, equipment, contract and lease assignments, and bank and personal guarantees. Collateralization of inventories is effected using a "two key" system in which inventory may be drawn by the entrepreneur, who holds one key, from a secure warehouse only in the presence of a representative of the bank, who holds the other key, thereby giving the bank effective control over the inventory.

All banks indicate that they did do some "clean" (uncollateralized) lending, but only eleven indicate that they provided clean loans to small business. All banks state that there were no Central Bank sanctions against clean lending.

Over three-fourths of the banks stated that their collateral policies toward smaller borrowers do not differ from those applied to larger borrowers. Those banks with policy differences, indicated that their policies were more relaxed for smaller businesses. Several banks indicated that the cost of perfecting or registering collateral, which is paid by the borrower, is high, and is a deterrent to borrowing.

All banks indicate that the court system is cumbersome, inefficient, antiquated and corrupt. They endeavor to structure their lending so as not to rely on the courts, generally through good credit analysis. They indicate that legal action can take six months to five years depending on the nature of the case, and the court and judges involved.

Almost all banks indicate that they use guarantee programs to cover small lending. Twelve said that they use the program of Credit Guarantee Corporation. One used the Export Credit Guarantee Corporation programs. Those using guarantees do so to complement a client's collateral position which is inadequate. Those that do not use guarantee programs stated the following reasons for not doing so:

- problems encountered making applications for the guarantee programs;
- cost of guarantees are a burden on the borrower;
- problems in realizing proceeds from the guarantees when borrowers default.

The views expressed by the bankers interviewed generally correspond to the findings of a recent report[8] which suggested that legal reform with respect to collateral could improve SMEs access to credit. That study identified the following difficulties related to collateral in Egypt, many of which were cited by the commercial bankers interviewed:

[8] "Report on Collateral-based Credit in Egypt," IRIS, 1997

- titles to property are difficult to verify;
- properties being pledged as collateral must be specifically identified and among those allowed in the civil code;
- state notarial offices are not centralized or computerized, making it difficult to determine whether property has been pledged or not.
- lenders must apply for a court order to seize property and sell it;
- fees for registration of collateral are very high;
- commercial mortgage must be taken on all the assets of a business, and it is not possible to lodge a claim singling out particular assets (law 11/1940);
- a pledge of movable property must entail possession by the lender. Non-possessory pledges are not supported in law.

Specialized Units, Systems and Personnel to Service SME Business. Only two of seventeen banks report separate units to handle small/medium business, and one of those units has only three people attached to it. Over three-fourths of the banks report that small/medium lending was available for all branches. In only one bank, NBD, is there a specific manager in charge of micro/small lending. None of the banks except NBD target the marketing of SME lending in any way, or offer any special products or services to the sector, and none except NBD report the presence of any of the following basic microfinance best practices[9] in servicing the SME sector:

- special microfinance products and lending technology (e.g. small loan sizes, short maturity, cost-covering interest rates, appropriate loan screening and monitoring);
- special lending technology (i.e. appropriate loan screening and monitoring);
- loan approval authority at the loan officer level;
- specialized software for SME loans that supports an efficient management information system (except NBD, which employs a special system);
- special remuneration based on performance of loan officers servicing the SME borrowers;
- special selection criteria in hiring staff for the SME.

Only one-third of the banks reported having special training for SME personnel, and only one, NBD, reported using outside technical assistance in implementing their SME program. Almost all loans in the SME category were to individual business enterprises. There were no loans to "groups" as is common in some microfinance programs.

In summary, with the exception of the NBD, none of the banks interviewed exhibit efforts to create the special "technologies" necessary for success in the SME market. Almost none are aware that SME lending can be more successful through special handling.

Suggestions for Improvement. The banks interviewed made the following suggestions

[9] Baydas, Graham and Valenzuela, 1997; Christen, Rhyne and Vogel, 1996.

for increasing the amount of credit available to the SME sector:

- expansion of branch networks;
- lending via finance companies;
- subsidized loans to banks from government and donor agencies;
- subsidize the cost of marketing and administering such loans;
- teach borrowers the needs of the banks regarding financial information;
- funding sources should share the risk (a reference to SFD);
- improved follow-up work;
- provide additional technical and financial support from government;
- lower the reserve requirements to reduce the cost of funding these small loans;
- reduce fees on collateral/guarantee registration;
- subsidize interest rates;
- create a new bank to support this type of business;
- develop a special unit within the bank;
- make small business lending profitable;
- improve small businesses to make them creditworthy;
- establish more branches, particularly in 6th of October and 10th of Ramadan cities;
- lend on raw materials, but on strict supervision;
- create special finance companies, funded via venture capital and/or bonds;
- tax incentives;
- small business must start coming to the banks.

These comments support earlier statements concerning perceived higher risks and lower returns in small enterprise lending. Most bankers feel the source of the solution is external, that is, government or some other entity ought to assume some of the risk or raise the return through subsidies or special incentives. However, several suggestions, such as increased branching, better training, improved operations and new approaches (finance companies) were aimed at expanding credit through improvements by the banks themselves.

3. Findings: Non-Bank Financial Institutions and Specialized Programs

The following non-bank financial institutions and specialized programs were included in the interview program for study as alternative models for increasing the supply of credit to small enterprises:

- Alexandria Business Association
- Special Microfinance Program of the National Bank for Development
- Credit Guarantee Corporation
- Social Fund for Development
- Orix Leasing Ltd.

Summaries of the findings from interviews related to these programs, and resulting conclusions about their efficacy as models for expanded credit to micro, small and medium business, are provided below.

a. **The NGO Model**. One alternative model to commercial bank lending, especially in micro and small enterprise lending, has been the use of NGOs or private development foundations. The NGO approach to SME lending has gained prominence worldwide,[10] and has been growing in importance in Egypt[11] through the support of a number of donors, including USAID.

Established in 1983 as the Economic Committee for Businessmen under the auspices of the Alexandria Chamber of Commerce, the Alexandria Business Association (ABA) registered with the Ministry of Social Affairs in 1988 as a private non-profit organization. In 1989, ABA signed a seven year cooperative agreement with USAID to provide financial and technical services to small and microenterprises unable to access credit from the formal banking system. The Small and Micro Enterprise Project (SMEP) was launched in 1990. The organization has evolved into one of Egypt's most successful micro lending programs with more than 15,000 customers and largely self sustaining operations designed around the best practices in microfinance. The model employed by ABA is in operation in five other similar organizations elsewhere in Egypt[12], and appears to have potential for greatly expanding the availability of credit to micro, and possibly small enterprises.

ABA is governed by a fifteen member board of elected directors and a four person executive committee. Day to day operations are the responsibility of the executive director. ABA is divided into five operating divisions: Financial, Management Information, Operations (includes the ten branches), Legal, and the Alexandria Small Business Center, a technical support facility which provides non-financial services to assist in skills training, production technology, marketing, and the technical and administrative problems of its clients. ABA also provides microfinancial consultancy services to national, regional and international agencies and institutions. ABA's total staff is currently about 220.

The Small and Micro Enterprise Project (SMEP) functions using the following arrangements with Egyptian commercial banks:

- USAID-donated funds are deposited in US$ interest bearing accounts at several commercial banks. Interest earned is reinvested in the same accounts;
- The interest bearing accounts serve as collateral at the commercial banks for SMEP

[10] Otero and Rhyne, 1994

[11] Stallard, Bagchi, and El Agouz, 1995

[12] ESED (Cairo), ASBA (Assiut), SBA (Sharkia) and SEDAP (Port Said). USAID reports that through these NGOs, including ABA, "to date (end of August, 97) 138,000 loans valued at LE 412 million were disbursed to more than 64,200 borrowers with less than a 3% default rate".

overdraft accounts in Egyptian pounds;

- SMEP identifies qualified borrowers and disburses loans using checks drawn on these overdraft accounts;
- Participating commercial banks provide ABA with daily faxes listing each loan repayment received, and this information is inputted into the ABA management information system.

This arrangement allows ABA and its clients to utilize the banks' branch networks and secure funds handling systems of participating banks without having to shoulder the expense of creating those networks and systems. The arrangement also provides SME's experience with the formal banking system, and vice versa. In addition, as banks have become familiar with the SMEP, they have begun to allow ABA to draw overdrafts in excess of collateral funds. This leverage is important to the long range growth of such programs, however, as noted earlier the legal status of NGO appears to be a limiting factor to the amount of uncollateralized credit that banks are willing to extend to NGOs.

SMEP lends only to existing enterprises and has two target customer groups:

- **Micro** enterprises with 1-5 employees make up approximately 75% of the SMEP. These entities can obtain loans of LE1,000 to LE3,000.
- **Small** enterprises with 6-15 employees make up the remaining 25% of the program. These entities can obtain loans of LE5,000 to LE25,000.

Actual loan sizes have been modified from time to time in accordance with market demand and usage. The portfolio as of May, 1997, consisted of:

- **65% manufacturing** (garments, wood products, building materials, food processing, leather, and metal, plastic, paper, glass and wax products).
- **24% commercial trade**
- **11% services**

SMEP has concentrated its activities primarily in Alexandria, which has a population of approximately 4 million. ABA estimates that it is reaching roughly 10% of the estimated 150,000 micro and small entrepreneurs in the city. It recently branched outside of Alexandria with a new program in Kafir El-Sheikh governorate.

SMEP extends more than 2,000 loans per month at flat interest rates and repayment periods of four to eighteen months. Effective interest rates, inclusive of fees, are in the 27-28% range. All loans are given on an individual, uncollateralized basis. Promotion is via ABA extension officers and through word of mouth. Extension officers operating out of nine ABA branch offices in Alexandria and one branch in Kafir El-Sheikh appraise credit needs and assist the potential borrowers to complete their applications. Applications are reviewed and approved by branch loan committees. In some exceptional cases, because of unusual size or documentation problems, loans may be referred to ABA headquarters for approval. Initial approvals take approximately two weeks from application, and repeat loan approvals take about three days.

Extension officers are remunerated with a bonus scheme which emphasizes performance, both in loan growth, new clients and repayments, with special emphasis on the latter.

New client loans are disbursed twice a month, while repeat loans are disbursed four times a month. Disbursement is by check drawn on the ABA overdraft account. Repayments are made to the same account. Borrowers are required to sign promissory notes, one for each scheduled repayment. All new borrowers receive a 45 minute briefing orientation from the relevant branch manager to ensure their understanding of how the system works and of the services ABA can provide.

ABA's management information system (MIS) contains all information on the borrower, including the status of current and previous loans. The MIS generates daily reports for ABA management and extension officers. Late payments are immediately followed up by the relevant extension officer and a letter of collection. Loans in arrears longer than one week are turned over to the ABA legal department for corrective action. ABA is currently in the process of decentralizing the MIS system so that reporting from the commercial banks will go directly to ABA branches.

ABA uses conservative loan loss provision and write off policies. Debts more than ninety days in arrears are wholly provided for. Debts are written off entirely once they have become a year past due, however, efforts are still made to collect those debts. The percentage of the portfolio at risk at any given time is between one and two percent. To date, less than one percent of the cumulative portfolio has been written off.

ABA's Small and Micro Enterprise Project

	Alexandria Governorate	Kafir El-Sheikh Governorate	Total
Cumulative Amount Lent LE	217,917,250	561,160	218,478,410
Cumulative Number of Loans	76,920	512	77,432
Average Loan Size LE	2,833	1,096	2,822
Cumulative Number of Clients	28,733	512	29,245
Active Portfolio Size LE	49,241,000	561,160	49,802,160
Loans Outstanding LE	32,835,770	561,160	33,396,930
Latest Repayment Rates %	99.19%	99.25%	

Source: Alexandria Business Association

Since 1994, approximately 24 months after commencement of operations, ABA has been covering its operating and financial costs with revenues generated from its programs, and its operating cost ratios are among the best in the microfinance world. This is well documented in ABA's audited annual and unaudited semi-annual financial statements. The ability of ABA and similar NGOs to cover all their operating and financial costs within a relatively short period has encouraged USAID to provide start up funding for an additional sixty NGO microfinance units.

The application of prudent lending practices has enabled ABA and other NGO models in Egypt to generate attractive financial track records. If these NGOs were businesses, their records would attract loan support from the commercial banking industry, support which could significantly multiply the volume of funding available to microenterprises and to small businesses if the NGOs were to adjust their lending techniques for this market (e.g. collateralized loans, etc.). Key to obtaining this support is conversion of NGOs to a legal status which banks are comfortable with, and ensuring that banks are aware of the performance of individual NGOs and that they understand how NGOs sustain their track records.

b. **The Bank Microfinance Unit Model**. The National Bank for Development (NBD), founded as a private, for-profit bank in 1980, is the most proactive private bank in the field of micro lending, and represents one possible model for increasing credit availability to these segments of the economy. Its sixty-six branches (18 offer Islamic banking) constitute the largest private banking network in Egypt, and the sixth largest overall. NBD ranks ninth in the nation in assets, deposits and credit extended, but 16th in profits and 18th in profitability.

NBD began micro lending with the Rural Small Scale Enterprise Pilot Credit project (RSSE) in four branches in 1989 with $750,000 from USAID. In 1992, NBD initiated the Small Enterprise Credit Project (SECP) in the Greater Cairo area with a grant from USAID of LE33 million which it supplemented with LE10 million of its own funds. Agreements with UNICEF, CIDA and the Ford Foundation followed. The program employees most microfinance best practices including dedicated, specially trained loan administration personnel with performance incentives, separate financial reporting systems (a Oracle-based, Alpha Misr-created program), and multiple income sources resulting in a high effective interest rate (46% without including the opportunity cost of capital)[13].

SECP has an average loan size of about LE4,000 (LE10,000 maximum). Lending amounts range from LE250 ($74) to LE 5,000 ($1475) with no additional requirements placed on the borrower. However, once the loan size exceeds LE5,000, the borrower must sign the Commercial Registry and file a tax payment form.

NBD provided no indication of its loan loss experience except a statement that its "repayment rate" was 97%. The percentage of its portfolio that was either current or less than 180 days in arrears at March, 1996, was 97.1% and a February, 1996, report to USAID indicated 96%. SECF loan loss provisions for 1995, the last year complete figures were available, were 4.6% of year end outstandings (write-offs were .2%). In addition, a 1996 evaluation showed some decline in the repayment rate as the portfolio grew with time which may indicated a repayment rate below that of the stated 97%.[14] As indicated in the following table, SECP's loan

[13] Tucker, William R., 1996, "Evaluation of the Small Enterprise Credit Project", USAID, page 14. To achieve the high effective rate of interest necessary for sustainability, NBD employs two direct (interest and transportation fees) and three indirect (savings, penalty fees paid in advance, and insurance fees) approaches to revenue generation. Starting with a base interest rate of 16% but excluding income from mandatory savings, these revenue streams result in a 46% effective rate, 18-20% higher than that of the ABA. The yield on the mandatory savings raises the rate to almost 52%.

[14] Ibid, page 31.

loss provisions are higher than those of NBD's in general.

NBD Profit & Loss Statements [15]

	Total Bank		Total Bank		SECP	
Revenue	1996		1995		1995	
Interest	305,521	60%	265,648	59%	7,003	56%
Commissions	136,496	27%	107,885	24%	2,030	16%
Investment Income	70,032	14%	73,405	16%	3,542	28%
	512,049		446,938		12,575	
Expenses						
Interest Costs	346,322	72%	299,006	71%	3,664	30%
G&A Expenses	72,805	15%	63,040	15%	6,570	54%
Loan Loss Provision	47,448	10%	51,873	12%	1,235	10%
Other	2,255	<1%	780	<1%		
Depreciation	12,331	3%	7,570	2%	733	6%
	481,161		422,269		12,202	
Profit Before Tax	30,888		24,669		373	
% of Revenues	6.0%		5.5%		3.0%	
% of Assets	0.6%		0.5%		0.6%	
% of Equity	12.7%		12.2%		1.4%	
Net Interest Margin	(40,801)		(33,358)		3,339	
G&A/Total Revenue	14.2%		14.1%		52.2%	
Provisions/Loans	1.6%		2.0%		5.6%	

By the end of 1994, NBD had achieved break-even and generated a profit on SECP activities. NBD states that its microfinance operations continue to be self-sustaining, generating a profit margin of approximately 3% of revenues (versus 5% for its commercial operations) which corresponds to a 1996 evaluation of their program.[16] As indicated in the following table, SECF generated about the same return on assets employed as the bank did in general, however, the program is more costly to administer.

At the end of 1996, NBD had LE77 million outstanding to more than 19,000 microenterprises. About 12% of these loans are to women. As of August 31, 1997, twenty NBD branches currently offer microfinance services, and a decision was recently taken to expand microfinance services to all branches. Presumably this decision was based on the success of the program to date.

NBD estimates that approximately LE300,000 is required to extend SECP to a new branch. Specialized training accounts for a meaningful portion of this cost. NBD intends to build a training center for micro lending. New SECF employees are recent college graduates hired on three year contracts. Good performers receive permanent employment.

The NBD's microfinance has grown into a sustainable program based on internationally accepted best practice in micro lending. Inaugurated with capital from USAID, SECF grew rapidly using the bank's branch network, which have afforded microfinance clients the opportunity

[15] National Bank for Development Annual Report, 1996, and Tucker, William T., "Evaluation of the Small Enterprise Credit Project", USAID , 1996.

[16] Ibid

to develop wider banking relationships. SECF is now expanding bankwide using the NBD's own resources. While the program is profitable, it is not clear whether other banks are willing to start similar programs without donor and/or government start-up assistance. Senior management in the SECF unit also questions whether the SECF model can be scaled up to small and medium sized borrowers on an uncollateralized basis.

c. **The Credit Guarantee Model**. The Credit Guarantee Corporation (CGC) was established as a private sector joint stock company in 1989 with the support of USAID. Its shareholders and directors are nine Egyptian commercial banks and one insurance company. CGC has two basic guarantee programs, the Small Scale Enterprise program (SSE) which guarantees loans to SMEs and the Health Cost Recovery Project (HCRP) which guarantees loans to health care providers.

Under the SSE program, CGC issues guarantees to banks of up to 50% of their SME loans (single loan maximum size = LE1.7 million; maximum maturity = 5 years). To initiate operations, the Ministry of International Cooperation (MIC) lent CGC LE60 million for fifty years (10 years grace on principal), disbursed in three equal tranches (1990, 1993 & 1996). These funds are held in interest bearing deposits with commercial banks as a collateral fund to pay claims under SME guarantees issued by CGC.

In 1993, USAID and CGC signed an agreement setting up a $10 million (LE33.8 million) Guarantee Facility Fund to support guarantees under the HCRP. HCRP guarantees up to 80% of bank loans to health care providers for use in starting private practices, purchasing equipment or upgrading clinics. The program is serving 2,070 health care providers, and a second loan is being considered by USAID.

Under the SSE and HCRP programs, CGC charges a fee of 1% per annum on the outstanding balance of the guarantee. This guarantee fee income averaged 18% of total revenues and 20% of total expenses during 1995 and 1996. The interest received from deposits and investments relating to the USAID and MIC provided funds averaged 66% of total revenue and 73% of total expenses in 1995 and 1996.

SSE and HCRP guarantees issued in 1996 were LE66.7 million and LE17.4 million, respectively. Since its inception through October 31, 1997, CGC has issued a total of LE462 million in loan guarantees (average size LE52,820) covering 8,745 bank loans totaling LE973 million (average size LE111,246).

Claims become eligible for payment under CGC's policy once the bank has taken legal action against the borrowers. The policy is to pay claims not later than 10 working days after receipt of the claim, if it is justified. Payments of claims as of August 31, 1997, totaled LE1.5 million, or .46% of the LE329 million in SSE guarantees issued since inception, and LE189,000, or .17% of the LE113 million HCRP guarantees issued through August 31,1997.

In 1992, CGC signed an agreement with the Social Fund for Development for a ten year, LE10 million loan available in two equal tranches with a two year grace period on interest. The

loan, repayable semi-annually, currently carries an interest rate of 7% p.a. The loan principal is placed with participating banks for on-lending to SMEs. The balance of the outstanding SME loans made by banks under this program was LE4,385,123 on December 31, 1996. The income from this program averaged 16% of total revenues and 17% of total expenses during 1995 and 1996.

Several problem areas have been identified at CGC which merit, and in some cases are already receiving, special attention:

Unresponsive Operations. Some banks have indicated that CGC has been slow in processing loan applications to be guaranteed and slow in paying claims against guarantees. In response to these complaints, an intensive analysis was undertaken by CGC which resulted in better loan administration policy.

Stagnant Growth. SSE guarantees issued declined 3.9% and .6% during 1995 and 1996, respectively. However, 1994 was an unusual year with a 75% surge in guarantees issued due to the heavy volume (50% of the total number of credits guaranteed) of SFD-program loans being submitted by banks for guarantee. In response to an unusually high default rate on the SFD loans, however, CGC cut back on this type of business in 1995 and 1996. In addition, according to CGC, a booming Cairo Stock Exchange had a dampening effect on the loan demand of small businesses during these years. Growth in CGC's core guarantee business resumed in 1997, however, with an 8.5% growth rate anticipated based on the first ten months of operation. This renewed growth is attributed in part to the administrative decentralization of CGC into six zones, consistent with many banks in Egypt.

High Total Guarantee Cost. CGC's operational cost is in the region of 4-5% of outstanding guarantees, which is low to moderate for developing countries.[17] The 1% guarantee fee is, therefore, is only possible because of subsidies equivalent to 3-4% to banks and borrowers. The subsidy, of course, originates from the MIC subsidized loan and USAID grant funds. Without these subsidies, CGC would have to expand its guarantee portfolio more than fourfold, with no increase in expenses, for the guarantee program to generate the income necessary to cover the cost of its administration. However, this does not appear to be a unique situation as pointed out by Levitsky.[18]

Concentration of Business with One Customer. One bank, the National Bank of Egypt, accounts for 64% of CGC's business. A major shift in business directed to CGC by NBE

[17] Graham Bannock and Partners Ltd, 1997, volume I, Page 58. CGC appears to be operating relatively efficiently for such an operation in the industrializing world with costs between 4-5% of guarantees outstanding as compared to Korea"s 7.1%, Indonesia"s 7.5% and Colombia"s 14.5%. The experience elsewhere would suggest that a new government entrant into the credit guarantee field is likely to increase the cost of providing this service in Egypt where cost is already a significant factor inhibiting expanded use of credit guarantees.

[18] Levitsky, Jacob, 1997, "Credit Guarantee Schemes for SMEs - An International Review," Small Enterprise Development, Vol. 8, No. 2

could have a significant negative impact on CGC's bottom line. In addition, only a small fraction of the other thirty-one banks with which it has contractual arrangements use its services. This concentration suggests that either CGC must expand its marketing efforts to satisfy unmet demand for its services or that such demand does not exist.

An agreement between USAID and the government of Egypt, signed in September 1997, proposed US$85 million for a new program in which CGC would serve as a wholesaler of loan collateral funds to existing and new organizations, including NGOs and commercial banks, which lend to small and microenterprises. US$4.2 million has been earmarked for CGC in fiscal year 1997/98 to cover operating expenses for this new program and for use in guaranteeing 100% of the SME loans made. When these new organizations become self-sustaining, the collateral funds will be granted to them. It is envisioned that 60 new units of NGOs and other organizations will be established throughout Egypt for this purpose, and CGC will replace USAID in the supervision of these activities:

In addition, CGC has been in discussion with USAID to develop the following activities:

- Guarantee export finance facilities to SMEs and emerging businesses;
- Establish a credit reporting capability;
- Guarantee leasing facilities or contracts;
- Develop factoring guarantees;
- Deliver training on the principles of trade finance, leasing and risk management for exporters and bankers.

The desire for an expanded loan guarantee program has reportedly led to high-level GOE proposals for development of an Egyptian small business administration modeled on the U.S. Small Business Administration (SBA). The SBA, created by Act of Congress in 1953, assists small business by guaranteeing bank loans. It guaranteed over $27 billion in loans to 185,000 small businesses in 1996, about 25% of the $105 billion in small commercial and industrial loans made in the US that year. Serious questions about the efficacy of SBA guarantees have been raised in the United States (e.g., Rhyne (1988) and Beam (1996)). In particular, the high operating costs of SBA, equivalent to over 4% of guarantees outstanding in 1996, do not recommend it as a cost-effective model for loan guarantees.[19] Though the SBA has had over 40 years to develop its $27 billion guaranteed loan portfolio, which should allow for significant per unit cost reductions, American taxpayers were obligated to subsidize SBA with some $852 million tax dollars last year. There is no evidence to suggest that a government credit guarantee program in Egypt would be any more cost effective. On the contrary, there is much evidence to suggest the opposite.

[19] Graham Bannock and Partners Ltd, 1997, volume I, Page 58. The direct cost of the SBA's operation (4-5%) falls toward the higher end of the cost range for programs elsewhere in the industrial world. Germany, Netherlands and Spain are between 1-2% while France and the UK are 5-6%. On the other hand, CGC, which is still in its early stages of development, appears to be operating relatively efficiently for such an operation in developing countries with costs between 4-5% of guarantees outstanding.

d. **The Government Subsidized Interest Model**. The Social Fund for Development (SFD) was established in 1990[20] to alleviate problems resulting from implementation of Egypt's economic reform and structural adjustment program (ERSAP). SFD receives much of its funding from donors. Operating in all 26 governorates, SFD administers two major programs that provide credit:

LE Millions in Credit Disbursed as of 11/96	
Enterprise Development Program (EDP)	1,125
Community Development Program (CDP)	244

SFD's EDP operates through intermediary agencies such as banks and NGOs, including business associations. NGOs receive grant funds for on-lending while the former receive funding via loans requiring repayment to SFD. These executing agencies are responsible for technical support, marketing and promotion in addition to project/credit assessments and loan monitoring. The costs of these functions are not provided by SFD. Entrepreneurs seeking SFD funds can approach SFD directly, or present his/her proposal to a participating NGO or bank.

EDP funds can be used to finance all types of activities except land reclamation. The program provides both working capital and fixed asset financing. There is no minimum loan size, but the maximum is LE50,000 per individual and LE200,000 per partnership. The criteria for eligibility are:

- Entrepreneur must reside in the geographical locale of the executing agency
- Minimum age of 21 years
- Proven record of experience and personal motivation
- Participation in project financing

In the case of fixed asset capital investment funding, repayment periods range from 18 to 48 months depending on the sector of activity and grace periods range from 6 to 18 months. For working capital financing, repayment periods range from 18 to 36 months with grace periods of 6 to 12 months. Acceptable collateral include post-dated checks and promissory notes, machinery and equipment, insurance on fixed assets, and personal guarantees.

Interest rates on new projects are 7% of declining balances, and 9% on existing projects. The SFD program allows banks a margin of 3%; banks can source SFD funds at 4% for start-ups and 6% for existing businesses. SFD is planning revisions to this interest rate structure in 1998. The rates will vary between 7% and 13% with higher rates for repeat loans and for existing and larger businesses. Bank margins will be higher for smaller business lending.

SFD prefers to focus lending on start-up firms which it believes provide more new employment than existing enterprises. Management, accounting and marketing training are

[20] By the State Act No.40 -1990.

instrumental to success and are provided by SFD in courses along with individualized counseling sessions to prepare the borrowers to apply for bank loans. Only 10% of the trainees in Cairo and large urban centers complete the training and obtain loans versus up to 100% in the governorates. Some borrowers can and do apply directly to banks.

The biggest problem appears to be getting banks to approve the loans. This may stem from poor bank experience with these loans. Bankers interviewed indicate that their loan loss experiences with SFD programs were very high, ranging from 8% to 90%. They attributed this to SFD focus on start-up businesses and to the widespread view among borrowers that SFD loans were government giveaways.

According to SFD, the organization will focus on sustainability in its second phase, which began in January, 1997, and ends in December, 2000. SFD is considering lending to larger enterprises while continuing to subsidize rates to the poor. Disbursements totaled $660 million during the five years of Phase I. Phase 2 funding will be $740 million.

SFD reports that its programs have provided loans to 65,000 enterprises. SFD's EDP works with sixteen banks, of which ten are private. However, SFD's 1996 annual report indicates that it has disbursed to only two of the private banks. The large public banks account for the vast majority of SFD disbursements as follows[21]:

National Bank of Egypt	LE 277,401	24.7%
PBDAC	213,005	18.9%
Bank du Caire	175,605	15.6%
Misr Bank	167,951	14.9%
Bank of Alexandria	146,418	13.0%
IDB	1,237	0.1%
Private Banks	4,500	0.4%
Non-bank programs	138,638	12.3%
	LE 1,124,755	

In its efforts to assist small start-up businesses, especially unemployed school graduates, the SFD has subsidized their loans. While this approach may provide net benefits to the borrowers, the policy has undermined the overall development of SME lending in the following ways:

- The focus on start-up businesses, which have a very high probability of failure everywhere in the world, has led to a high default rate on these loans. SFD maintains that the default rate is only 8%, but bankers interviewed reported much higher rates, in one case as high as 90%, and this loss experience has contributed heavily to the negative view of SME lending held by most of these bank managers.

[21] Social Fund for Development, Annual Report, 1996

- The requirement to on-lend SFD funds at below market rates at spreads insufficient to cover the additional risk and administrative costs involved with this lending has discouraged banks from expanding their SME lending beyond levels deemed politically expedient.
- The SFD interest rate subsidy policy also undermines the long term sustainability of its own programs as well as other finance programs, such as those run by NGOs.
- While SFD has attempted to reduce bank administrative costs through its training programs for the lenders, it has done little to develop the institutional capacity within the banks to better understand and manage SME lending. While the SFD has recently initiated efforts to develop such capacity through bank manager training, the effort is insufficient compared to the need for bank reform in this regard.

e. The Leasing Model. Equipment leasing, which can supply nearly 100% of the financing required and tailor lease payments to specific cash flows, offers a potentially significant alternative source of SME financing in Egypt, where small businesses are largely excluded from term borrowing. Reports prepared by the World Bank (1995), KMPG Peat Marwick Policy Economics Group for USAID (January 1996), International Finance Corporation (March 1996), and USAID (November 1996) document that up to a third of capital expenditure is being financed through leasing in other developing economies.

To take advantage of this potential financing mechanism, the International Finance Corporation (IFC) assisted the GOE to develop the recently enacted Financial Lease Law (Law 95/1995) and associated Executive Regulations, which have all the necessary elements for the development for a sound leasing industry. This law adequately addresses pertinent issues such as depreciation, taxation, registration and repossession. While leasing companies can depreciate leased assets, lease payments are tax deductible expenses for the enterprises that use the leased equipment in their business. And because title is held by the leasing companies and is registered, repossession of the leased equipment from defaulting lessees is expected to be less of a legal problem than foreclosing on a defaulting debtor. However, enforcement of lessor rights has not yet been tested in the Egyptian courts in a significant way.

In an effort to develop a "model" leasing company with strong demonstration effects for the establishment of other leasing companies, the IFC has helped to establish one of Egypt's first leasing companies in 1997. The ORIX Leasing Egypt (OLE) includes participation by the National Bank of Egypt, Commercial International Investment Company (a subsidiary of CIB, Egypt's principal private sector bank), ORIX Corporation of Japan, ORIX Leasing Pakistan Limited, and IFC. OLE began operation in the fall of 1997 in Cairo, and has plans to expand to a second location in Alexandria. According to OLE management, their leasing products will be targeted to small and medium enterprises, with an expected average lease size of around $25,000, and an unofficial minimum lease size of $10,000. With the cost of capital estimated at around 10%, leasing rates of around 16.5% are anticipated. This is expected to be quite competitive given market rates for short term bank lending of 11% - 17% and the difficulties of SMEs obtaining term loans. Typically, leases run for three years at which time title would automatically pass to the lessee without any additional payments, assuming the lessee had paid 10% down to

obtain the lease. With the normal 20% per year depreciation which is currently allowed in Egypt, this would mean that the leasing company might have a 30% paper loss when it transferred the title to the lessee at the end of the lease. Leasing companies hope to be allowed to take a more accelerated rate of depreciation and/or the tax loss at the end of the lease. However, the government and tax authorities have yet to effectively resolve this issue.

Reportedly, since the passage of the 1995 leasing law, some 25 other leasing companies have been established with a total of LE226 million invested capital.[22] While other reports suggest that over a hundred leasing companies have been formed, this is probably an indication of business intentions rather than actual investments. In addition, banks and other financial institutions are already doing some informal leasing, without being formally registered under the leasing law.

Comparative Assessment of Non-bank and Special Financing Models. The reviews of the above five models indicate that microfinance can be cost effectively delivered by both NGOs and specialized programs within banks. Both models provide collateral free lending to established enterprises. While the models have high operational costs requiring interest rate spreads about 20% and 30%, both are potentially profitable. Using internationally recognized best practices in microfinance, such as proactive outreach to micro and small entrepreneurs, staff incentives based on performance, and timely management information systems, these models have developed sustainable operations around well diversified portfolios with small loan loss ratios. With start-up support grants, including collateral funds, provided by donors or government, these programs can achieve sustainability in several years.

NGOs are limited in the amount that they can borrow from banks on the basis of their solid financial performances due to their legal status and to the fact that most bankers are not familiar with their performance records. Unless this funding constraint can be overcome, NGOs will be precluded from further expansion in the microenterprise segment of the economy and from moving up market into larger small and medium scale lending. Microfinance units within banks, while benefiting from better access to deposits and offering an easier path for borrowers to graduate to regular commercial loans, also have significantly higher overheads and higher effective retail interest rates. In addition, they often face a cool reception within banks, where incentive structures and corporate culture favor large scale commercial operations (Baydas, et. al., 1996).

Credit guarantee programs offer opportunity for overcoming the limitations of small and medium enterprises with respect to the provision of loan collateral. A general shortage of collateral and the cost of perfecting it limit access to credit by these firms, and the guarantee mechanism helps overcome these limitations. While CGC's average operating costs are within international norms, they could be reduced significantly if the guarantee program continues to expand. There is no compelling reason to support a government run SBA as an alternative.

[22] Speech by Dr. Nawal El Tatawi, Minister of MOEIC, to the Financial Leasing Seminar of the Egyptian Businessmen's Association, April 18, 1997.

Leasing offers significant potential to fill the void in term financing for small and medium scale enterprises. As with loan guarantees, one of the benefits of leasing is that it overcomes the collateral shortfalls of SMEs. In addition, leasing's interest margins of 6% to 7% and its flexible repayment structures make it very competitive with all alternative forms of SME financing. Leasing's application to microfinance is less evident.

SFD subsidized lending policies may provide net benefits to unemployed graduates and others who receive such loans, but the program has discouraged significant growth in bank financing to SMEs by removing the economic incentives for such lending. The program has also missed the opportunity to institutionally develop solid, sustainable wholesale and retail SME financing programs within banks. While SFD has apparently become increasingly aware of the need for financial sustainability in SME lending, and may pay greater attention to bank incentive structures and institutional development in the future, the effect of its programs on the availability of SME finance to date appears to have been counterproductive.

Chapter Three

The Demand for Financial Services in the Enterprise Sector

I. Introduction

1. Purpose of the Survey

This chapter reports on the small enterprise sector in Egypt. The main focus of our analysis is to examine the financial services that entrepreneurs draw upon to finance their enterprises. In addition to the services offered by formal financial institutions, banks and non-banks, entrepreneurs draw upon a complex set of informal contracts with various economic agents. These contracts are used for both savings and loan purposes. An assessment of the role and performance of formal financial institutions and special microfinance programs is not sufficient to evaluate the entrepreneurs' demand for financial services. The puzzling question is what are the preferred sources of finance that entrepreneurs use to fund their operations? Is the popular belief of formal financial markets discriminating against small scale enterprises true or is it a misconception? This assumption, often based on reported responses of entrepreneurs that finance is the main constraint they face, will be discussed in this study. The primary purpose of this chapter is to analyze the entrepreneurs' choice of the sources of funding new investments and operations of the firm and examine the determinants of the capital structure and growth of micro, small, and medium scale enterprises (SMEs) in Egypt.

This chapter deals primarily with a survey of small enterprises in the manufacturing, services, and trade sectors in Greater Cairo, Alexandria, and Fayoum. The introduction presents an overview of small enterprises in Egypt and the environment for business. The following section reports on the enterprise survey outlining, first, various economic characteristics of the enterprises and entrepreneurs and second, highlighting the significance of the existing financial channels entrepreneurs use in financing their operations. The third section examines the determinants of the entrepreneurs' use of alternative sources of finance, as well as the determinants of growth of enterprises in Egypt.

2. Small Enterprises in Egypt

The limited role of small enterprises in many African countries implies a persistent need to examine the real constraints affecting their growth. In Egypt, similar to other countries in Africa, population growth is high. World Bank projections indicate that, with an average annual growth rate of 2 percent, the 58 million Egyptians in 1995 will be competing for resources and employment with an additional 6 million Egyptians by the year 2000 and another 30 million by the year 2025[23]. The spread of small enterprise employment probably exceeds official estimates.

[23] World Development Report, 1997.

Employment figures in Egypt indicate that the 721 thousand individuals operating non-agricultural micro and small scale enterprises in 1976 increased to 1.1 million in 1986 (World Bank, 1994). The 1994 World Bank study estimates that there exist some 2 million micro and small scale enterprises representing 99 percent of Egypt's private sector non-agricultural economic units. Field assessments of the rural small scale enterprise sector conducted in 1990 conservatively estimate that there are about 906,000 small scale enterprises in the secondary and rural towns of Egypt (Gardner and Proctor, 1990). Moreover, a study of artisanal enterprises suggests that there are 150,000 artisans employing about 300,000 individuals in the non-service informal sector (Jones, 1988). Although small business activities are reported to include commerce, restaurants, hotels, personal services, manufacturing, transport, mining, construction, and repairs among others, there is a continued ignorance about the size of the various sub-sectors of the enterprise sector.

The performance of the various sectors of the Egyptian economy has varied over the past decade. While services, which comprised 59 percent of GDP in 1995, grew at a rapid rate in the 1980s, it had a slow growth rate in the 1990s (World Development Report, 1997). Agriculture, which comprised 20 percent of GDP in 1995, has been growing at a modest rate at best in the 1990s. Industry, which contributed roughly 21 percent of GDP in 1995, however, has been stagnant since the early 1990s. Manufacturing, which contributed about 12 percent of industrial output in 1980, has grown very slowly to contribute 15 percent in 1995. While Egypt's largely traditional exports have declined from about 14 percent of GDP in 1980 to about 7 percent of GDP in 1995, non-traditional exports (NTEs) or manufactures have grown from 11 percent to 33 percent of total exports in 1995[24]. Although non-traditional exports contribute only a modest share of total exports, many of these products comprise value-added manufactured goods.

This study focuses primarily on some of the more dynamic sub-sectors in the manufacturing, services, and trade sectors in our field survey in Egypt. These are textile-garment manufacturing, furniture-wood processing, shoe making, artisanal craft production, carpet weaving, tourism companies, hotels and restaurants, service companies, and wholesale and retail traders. These sub-sectors capture two important factors that affect the operations and growth of businesses in the enterprise sector. First, the consideration of these sub-sectors allows us to cut across the various size categories of enterprises, micro, small, and medium scale enterprises[25]. Second, input materials used by these enterprises are obtained from both national and foreign suppliers, and products are sold to both national and foreign customers. This implies that entrepreneurs have contracts with the domestic and offshore suppliers and buyers through import and export arrangements. These relations will allow us to examine the growth potential for non-traditional exports produced by these types of enterprises.

[24] Traditional exports are mainly petroleum and cotton, while non-traditional exports (NTEs) include ready-made garments, processed wood products, processed aluminum products, leather products, and horticultural crops, etc.

[25] The classification of the size of enterprises is based on the number of employees. Enterprises with: 1-9 employees are microenterprises; enterprises with 10-49 employees are classified as small scale enterprises; and enterprises with 50-100 employees are classified as medium scale enterprises.

3. The Environment for Business

The positive and stable economic conditions of the post ERSAP period have generated a favorable environment and many business incentives for local and foreign entrepreneurs. The trade liberalization policies have had a positive effect on the SME sector because of the abundance of imported raw materials and the competitive environment among some of their suppliers. In addition to liberalized trade policies, some of the factors affecting the environment for business at the micro level are the regulatory framework, tax policies and the role of support institutions.

The regulatory framework governing business operations and expansion has established rules which entrepreneurs generally try to avoid. Entrepreneurs seem to have found alternative means of expansion. The size of the enterprise, measured by the number of employees, is affected by regulations on business expansion and evolution. SMEs in Egypt are mostly sole proprietorships. Owners typically manage their enterprises and hire workers to help run their operations. During the field work conducted for this research, it was found that SMEs accommodate apprentices who seek training and learn by working on the job. This phenomenon offers an escape for many SMEs who do not wish to register their employees with the Social Security System and pay monthly contributions towards their pension funds, or to comply with other labor laws[26]. Moreover, occasional or temporary workers are also used to avoid social security. Social security taxes are an incentive for enterprises not to expand their formal employment but to expand their operations and output with informal labor.

Other regulatory constraints which hinder business growth include the large start-up costs firms have to pay in order to comply with business registration laws (World Bank, 1994). Businesses are supposed to go through six layers of approval, which involve licensing, incorporation, commercial registration, location registration, local-level licensing, and tax application, before they can commence their business activities. Operating in the informal sector, therefore, is a less expensive alternative for many micro and small scale enterprises. As a part of the ERSAP, new legislation provide some incentives for private sector development and introduce improvements to the regulatory system (World Bank, 1995).

In general, taxes, which reportedly reach up to 40 percent on commercial profits and personal income, seem to stifle enterprise activity and growth in Egypt (World Bank, 1994). Interestingly, even microenterprises are subject to tax liabilities, based on estimates made by tax officers, which they pay regularly. In order to encourage investments in value-added manufactured goods and non-traditional exports, firms in the new industrial cities, such as the 10th of Ramadan and 6th of October, are given an income tax exemption for a period of 10 years.

The government of Egypt and the donors have established a number of business support

[26] Under the labor law, for example, businesses with 50 or more employees which fail to establish internal labor relations and industrial safety committees, are penalized even if the company provides a more effective working environment. This could result in costly and time consuming disputes with government officials. Moreover, employee dismissal is virtually impossible, thus, hampering the development of many labor-intensive ventures (World Bank, 1994).

institutions to assist and develop small scale industries in the country. The Credit Guarantee Corporation (CGC) is a private company, initially funded by USAID, that provides guarantees for small businesses borrowing from commercial banks with little or no collateral. The Social Fund for Development (SFD) is a government supported agency which focuses on the development of micro and small scale enterprises by providing loans at subsidized interest rates. Small scale enterprises in Egypt also receive support from donor supported non-governmental organizations (NGOs), as in many other countries[27].

II. Characteristics of the Enterprise Survey

1. Overview of The Survey

To examine the alternative financial networks in the small enterprise sector in Egypt a survey of 173 micro, small, and medium scale enterprises was carried out in October of 1997. The surveyed enterprises were located in the Greater Cairo region, which included the cities of 6th of October and 10th or Ramadan, as well as in Alexandria and Fayoum. These urban and peri-urban areas were chosen because they host a large and diverse number of enterprises across various sub-sectors and size categories that could provide information about the issues in question. Given the objective of our study, that is to focus on the development of small scale enterprises, we adopted the definition that microenterprises are those enterprises which employ 9 or less workers, small scale enterprises are those with 10 to 49 employees, and medium scale enterprises are those with 50 to 100 employees.

A. Characteristics of the Enterprises

The enterprise survey covered the manufacturing, services, and trade sectors of the economy, with particular focus on the more dynamic sub-sectors. As mentioned earlier, these consisted of textile-garment manufacturing, furniture-wood processing, shoe making, artisanal craft production, carpet weaving, tourism companies, hotels and restaurants, service companies, and wholesale and retail traders. Table 1 (Appendix A) provides the breakdown of the share of enterprises in each sector in the sample. The distribution, where over half of the enterprises fall in the manufacturing sector and roughly one fifth in each of the services and trade sectors, is similar across the three size categories. Data in table 1 also show the distribution across the geographic areas in the country, where about half of the enterprises were selected in the Greater Cairo area, about one third in Alexandria, and one fifth in Fayoum. Again, this distribution allowed us to interview businesses across the three size categories, in the various sub-sectors under consideration, and in the dynamic capital Cairo, as well as in the city of Alexandria in the Delta, and the town of Fayoum in Upper Egypt.

The majority of the micro and small scale enterprises in the survey were proprietorships and about one third were partnerships. Medium scale enterprises, however, displayed the opposite pattern where two thirds were partnerships and one fourth were proprietorships. Very few

[27] The function and role of SFD, selected NGOs and donor programs are reviewed in chapter 2 of this report.

enterprises had other ownership structures, such as simple commandite[28], de-facto partnerships, limited liability, or joint stock. This pattern is consistent with the overall ownership structure for non-agricultural private establishments in the country where almost 90 percent of businesses are reported as proprietorships, while the other forms include five percent as partnerships[29].

The vast majority of the businesses across the three size categories were registered businesses which operated with licenses and possessed tax cards. The majority of the small and medium scale businesses also paid social security for all their employees or at least some of them. Not surprisingly, about half of the microenterprises, however, did not pay social security for their workers. The primary reasons reported by business owners for not complying with the social security system were that the procedures were difficult and costly. This, on the one hand, resulted in about one third of the microenterprises being classified as informal (32 percent), less than one fifth semi-formal (14 percent), and about half fully formalized businesses (54 percent)[30].

Formalization of Businesses

	Micro	Small	Medium
Formal	54%	70%	88%
Semi-Formal	14%	23%	8%
Informal	32%	7%	4%

Small and medium scale businesses, on the other hand, were largely formal businesses (70 percent and 88 percent, respectively), with some semi-formal enterprises (23 percent and 8 percent, respectively), and only very few informal (7 percent and 4 percent, respectively).

The average enterprise in the sample has been in operation for about 15 years with the interviewed managers/entrepreneurs running these businesses for an average of 11 years (Table 2). The average value of physical assets, excluding land and building, as expected varied significantly by size of the enterprise. Microenterprises had an average value of assets worth L.E. 26 thousand (with a median of L.E. 6,000), while small scale enterprises had an average value of assets worth L.E. 630 thousand (with a median of L.E. 80,000), and medium scale businesses had an average value of assets worth L.E. 3.3 million (with a median of L.E. 2.5 million).[31]

On average, microenterprises started with 4 workers and currently employ also an average of 4 workers, while small businesses started with an average of 9 employees and currently employ 21, and medium scale enterprises started with an average of 27 employees and currently employ 91. These figures imply that small and medium scale businesses in the sample have experience

[28] Simple commandite refers to the partnership with silent shareholders.

[29] Data based on CAPMAS statistics as of 1986.

[30] Businesses were classified as formal enterprises if they fulfilled all four requirements including registration, licensing, possessing a tax card, and making social security payments for all their employees; semi-formal if they fulfilled registration, licensing, possessing a tax card, and making social security payments for at least some of their employees; and informal if they did not satisfy at least one of the four requirements.

[31] The exchange rate at the time of the survey was US$ 1 = L.E. 3.4

significant growth, while microenterprises have been stagnant.[32] The average annual growth rate, based on the change in the number of employees over the life of the business, consistently reflects that small and medium scale enterprises have been growing at an average of 34 percent (with a median of 11 percent) and 38 percent (with a median of 14 percent), respectively. Moreover, average growth rates in production over the past year, as reported by the entrepreneurs during the interviews, are in line with the average annual growth rate figures. Both small and medium scale enterprises have experienced positive single digit growth rates in production over the past year, while microenterprises had a zero median growth rate in production over the past year.

Employment Profile of Businesses

	Micro	Small	Medium
# of Start-up Employees	4	9	27
# of Current Employees	4	21	91
Annual Growth Rate	7%	34%	38%

B. Characteristics of the Entrepreneurs

Small scale enterprises frequently have been characterized as consisting of many otherwise unemployed workers who operate mostly in the informal sector. In our sample, however, the majority of the entrepreneurs had registered businesses. This is not surprising given that over half of the entrepreneurs had finished at least high school level of education or higher (Table 3). The typical 45 year old male entrepreneurs, moreover, operated their enterprises as full time businesses. The majority, who were either owners or partners, did not hold any other employment. However, like some of the characteristics of the enterprise, the entrepreneur's position in business varied by size of the enterprise, particularly for medium scale enterprises. One fourth of the interviewed respondents among medium scale enterprises were managers.

C. Regional Differences

Characteristics of the enterprise varied to some extent based on the geographical location (Table 4). Enterprises in Greater Cairo and Alexandria, on the one hand, constituted about two thirds of the total sample. These were largely established businesses that had been in operation on average 16 and 17 years, respectively, employed an average 26 and 23 workers (with medians of 9 and 11), respectively, and had physical assets worth almost L.E. one million on average (with medians of L.E. 35,000 and L.E. 20,000, respectively). The town of Fayoum, that is about 100 kilometers South of Cairo in Upper Egypt, constituted our peri-urban/rural sphere. Peri-urban/rural enterprises in Fayoum, on the other hand, had been in operation for about 8 years, employed about 14 workers on average (with a median of 6) and had a total value of physical assets of about L.E. 50 thousand on average (with a median of L.E. 15,000).[33]

[32] Small scale enterprises grew from being microenterprises at start-up and medium scale enterprises grew from being small scale enterprises.

[33] The large variation between the means and medians, particularly for physical assets, illustrates a widely skewed distribution which highlights the fact that in urban areas larger enterprises exist while in peri-urban/rural areas it is less common.

The sectoral distribution of the urban and peri-urban/rural enterprises was similar across the three regions. The size distribution of these enterprises, however, varied. While the surveyed urban enterprises, in Cairo in Alexandria, were disbursed across micro, small, and medium scale enterprises, the peri-urban/rural enterprises in Fayoum were concentrated in the micro and small scale categories. This is consistent with the figures of the average value of physical assets, which re-enforces the differences in the existing concentration of micro, small, and medium scale enterprises in the urban and peri-urban/rural regions. While there is a continuum of the various size categories in the urban cities of Cairo and Alexandria, the medium scale enterprises are almost non-existent in the peri-urban/rural region of Fayoum. Finally, while the gender composition of the peri-urban/rural sample of Fayoum is about one fifth women entrepreneurs, the urban sample consists of a majority of men entrepreneurs.

D. Gender Differences

Characteristics of the enterprises varied to some extent based on the gender of the entrepreneur (Table 5).[34] The most striking difference was associated with the size of these enterprises. On the one hand, female operated enterprises on average started as micro businesses and continued operation within this size category. On the other hand, male operated enterprises started as small scale enterprises and continued operation in this size category. Again, this was consistent with the difference in the average value of physical assets which was about three quarters of a million L.E. for male operated enterprises, while reaching only L.E. 17 thousand for female operated enterprises. Another variation was the gender composition of the sample across the three sectors. The services sector was almost absolutely dominated by men, while the manufacturing and trade sectors accommodated some women entrepreneurs . This is not surprising in this typically traditional society where garment manufacturing, for example, is an appropriate women's specialty while service sub-sectors are men's professions.

E. Sector Variations

Sub-sector analysis entails examining commodity-specific sub-sectors with the objective of identifying support systems and constraints facing micro, small, and medium scale enterprises. This methodology allows for the study of the role of the various economic agents, the terms and conditions of their contracts, the linkages in their transactions and the constraints affecting the different economic units in a certain market. Thus, by considering an industry or sub-sector classification, similarities and differences among firms may be identified that explain variations in the performance of enterprises across different sub-sectors. However, prior to analyzing the differences in the contracts between entrepreneurs and their suppliers and customers and the performance of these enterprises, it is useful to quickly review the differences in the characteristics of the establishments across the three sectors under study.

[34] It should be noted that while the women entrepreneurs sub-sample is relatively small, we present some of these comparisons to gain a glimpse of gender differences.

Enterprises operating in the service sector had the largest value of physical assets followed, second, by manufacturing enterprises, and third, by trade establishments (Table 6). Traders do not utilize much machinery or tools which explains the low average value of their physical assets. Traders, however, have been in business the longest time on average (18 years). Enterprises in the manufacturing and service sectors have been operating on average for 14 and 15 years, respectively.

Industry classification is associated with the concentration of micro, small, and medium scale enterprises in certain sectors. Statistics in table 6 indicate that the majority of enterprises in the trade sector fall in the microenterprise category when they first begin their operations. Very few traders were found in the medium scale category. Similarly, based upon the number of current employees, most traders remain microenterprises. Figures in table 6, also indicate that currently most of the manufacturing and service enterprise fall in the micro and small scale size categories, with some in the medium scale category.

Growth in employment is reflected by the differences in the average number of employees the firm starts with and the current number of employees (Table 6). While traders do not seem to experience a major change in the number of employees, employment figures for the manufacturing and service enterprises indicate substantial increases over the lives of these enterprises. The annual growth rate for enterprises measured by the change in number of employees over the number of years the enterprise has been in operation indicates that services enterprises have experienced the highest growth rate followed, second, by manufacturing enterprises, and third, by traders.

2. Significance of the Existing Financial Channels

The sources of funding and the savings channels entrepreneurs draw upon are various. They fall into informal and formal networks. The informal channels that prevail in Egypt include family and friends; suppliers credit and customer advances (i.e., trade credit); "Gam'iyat" (Rotating Credit and Savings Associations, or RoSCAs); and informal collectors. Although the formal financial sector in Egypt is expanding, formal channels reported by the entrepreneurs were mostly commercial banks. Compared to the wide array of informal financial channels, formal channels were limited in their role as financial intermediaries, particularly for micro and small scale enterprises.

A. Investment Capital

For most entrepreneurs in this survey, personal savings accounted for the majority (77 percent) of the investment capital (Table 7)[35]. The second most often used source of investment capital was bank loans (19 percent). This source, however, varied significantly by the size of the enterprise. Not surprising, over a third of the medium scale enterprises reported using bank loans as a source for investment capital, while less than one third of the small scale enterprises did, and only a few of the microenterprises reported using bank loans as a source for investment capital.

[35] Investment capital refers to the latest major investment, either for expansion or start-up purposes, that the entrepreneur has undertaken.

Only a very small number of entrepreneurs reported taking informal loans from family or friends for investment capital, and only one entrepreneur used an NGO loan and another used a supplier loan for their investment purposes. These findings, not surprisingly, are similar to enterprise behavior in most developing countries. Entrepreneurs typically rely on savings to finance new business ventures or expansions, particularly in less developed capital markets where bank financing or non-bank financing sources, such as venture capital, scarcely represent the primary sources of business start-up or expansion costs.

Sources of Investment Capital

	Micro	Small	Medium
Savings	87%	69%	64%
Family & Friends	4%	3%	0%
Bank Loan	8%	27%	36%
NGO Loan	1%	0%	0%
Supplier Loan	0%	1%	0%

Figures in table 8 indicate that the source of investment capital varied slightly by sector of operation. These statistics indicate, first, that the majority of entrepreneurs in all three sectors relied heavily on personal savings as a source of financing to start or expand business ventures. Bank loans ranked as the second source of investment capital, particularly for the service and manufacturing sectors. Lastly, loans from family, friends, and suppliers assisted only a small share of entrepreneurs in the sample.

B. Contractual Relations with Suppliers and Customers

Sectoral and sub-sectoral variations imply differences in the linkages and contracts in the distribution or production of goods among the different entrepreneurs, suppliers, and customers. These variations are mainly manifested in the existing contracts between entrepreneurs and their suppliers and customers across different sub-sectors. Entrepreneurs purchasing input material on credit and/or selling products after receiving advance payments are engaged in trade credit contracts. Trade credit is one of the sources of financing working capital for many enterprises in both developing and developed capital markets. The linkage between input suppliers and entrepreneurs as well as the linkage between entrepreneurs and their customers in the enterprise sector in Egypt present a complex variety of contracts across the three sectors under study.

a) Relations with Suppliers

The majority of the entrepreneurs in the sample purchased input materials in the domestic market either from national suppliers or local agents (Tables 9 and 11). A few enterprises in the medium scale category import materials directly from off-shore suppliers. The relationship between suppliers and entrepreneurs typically influences the nature of the sale contract between these economic agents. Entrepreneurs who purchase inputs on credit typically buy from one or two suppliers. This relationship reduces transaction costs and helps resolve part of the asymmetric information problem that is often encountered between the principal-lender and the agent-borrower in credit contracts[36].

[36] See Stiglitz andWeiss (1981) for a discussion of asymmetric information problems in credit markets. Asymmetric information problems refer to the adverse selection and moral hazard behavior that the principal-lender encounters as a result of the agent-borrower"s undetermined type, i.e. good or bad borrower, and unpredictable action, i.e. repayment performance.

Form of Payment to Suppliers

	Micro	Small	Medium
Retained Earnings	62%	77%	84%
Credit	48%	53%	80%
Advance Payment	8%	23%	36%
Consignment	2%	6%	4%

The majority of the entrepreneurs in the sample purchased their major inputs in cash. Interestingly, over half of the entrepreneurs across all three size categories bought inputs on credit. The credit linkages between entrepreneurs and suppliers particularly stand out for medium scale enterprises (80 percent, table 9). In addition, more enterprises in the manufacturing and trade sectors (54 percent and 83 percent, respectively, table 11) purchase inputs on credit than enterprises in the service sector (23 percent).

The terms and conditions of the supplier trade credit contracts varied significantly depending on the size of the business (Table 10). As expected, larger enterprises (i.e., those in the medium scale category) used larger amounts of supplier credit. On average, the value of the credit reached L.E. 368 thousand per transaction, representing over half of the value of the transaction. Small scale businesses used, on average, L.E. 23 thousand per supplier credit transaction (with L.E. four thousand median), while microenterprises used L.E. 3 thousand per supplier credit transaction (median L.E. one thousand). Interestingly, the value of the supplier credit used by micro and small scale enterprises represented almost the total value of the transaction. The frequency of using supplier credit varied across the size categories as well. While small and micro enterprises used supplier credit as often as 23 and 44 times per year on average, respectively, medium scale businesses used supplier credit on average 7 times per year.

Most of the supplier credit was typically extended for an average of 3 months. Moreover, the majority of the entrepreneurs, across the three size categories (78 percent), reported getting goods on credit free of interest charge[37]. Some suppliers, depending on the particular product and market structure, charged some interest which averaged about 10 percent over the 3 months average term of the credit contract. In any case, about half of the entrepreneurs reported providing their suppliers with security in the form of a signed promissory note to pay at the end of the term. The use of security was more frequent for small and medium scale enterprises than microenterprises. This is probably due to the fact that small and medium scale entrepreneurs had larger amounts of supplier credit per contract. Lastly, the terms and conditions of the trade credit contracts did not seem to vary significantly across the three sectors in the study. The most notable finding was that the few entrepreneurs in the service sector who accessed supplier credit used on average close to L.E. half-million per transaction. This stands out in sharp comparison to entrepreneurs in the manufacturing and trade sectors who used L.E. 50 thousand and L.E. 30 thousand, respectively.

Some entrepreneurs (18 percent) in the sample reported providing advance partial payment on occasions to their suppliers to secure access to the needed types of input materials. This

[37] Interest charge on supplier credit was measured by considering the difference between the price of goods when sold on credit and the price of goods when sold in cash. The mark-up traders usually attach to the credit price, compared to the cash price, represents the implicit interest charge.

relationship was more prevalent among medium scale enterprises (36 percent), and to some extent among small scale enterprises (23 percent), than microenterprises (8 percent). Sector variations shed additional light on this relationship. Traders and manufacturing enterprises (26 percent and 18 percent, respectively) seemed to provide advances to their suppliers more often than service enterprises (10 percent). Very few entrepreneurs in the sample purchased inputs on consignment (4 percent). Those who bought on consignment, however, were largely concentrated in the trade sector (14 percent).

The supply of trade credit by suppliers of inputs is dependent on the type of commodity and the degree of competition among suppliers in the market. The higher the degree of competition, the more incentive there is for traders to offer trade credit as a marketing tool to sell their commodities. Moreover, the more perishable the commodity is, the more incentive there is for traders to offer trade credit to reduce storage period and potential damage. These factors explain why there is more trade credit offered to enterprises in certain sub-sectors than others.

b) Relations with Customers

Goods and services produced by the enterprises in the sample were largely sold in the domestic markets (Tables 13 and 15). About one fifth of the manufacturing enterprises sold in both domestic and foreign markets. Moreover, about one third of the medium scale enterprises and one fifth of the small scale enterprises sold in both domestic and foreign markets.

Form of Sales to Clients

	Micro	Small	Medium
Cash	77%	86%	88%
Credit	36%	52%	60%
Advance Payment	26%	22%	40%
Consignment	1%	6%	12%

With respect to the sale of output, the majority of the entrepreneurs sold for cash (82 percent) and about half offered credit to their customers (46 percent), while only very few sold on consignment (5 percent). Interestingly, a larger share of the medium scale entrepreneurs (40 percent) took advance payment from their customers than did micro and small scale entrepreneurs (26 percent and 22 percent, respectively). Taking sector of operation into account implied that about one third of the entrepreneurs in the manufacturing and service sectors (33 percent and 29 percent, respectively) also received advance payments, while only a few traders took advances from their customers (6 percent).

The terms and conditions of the customer advance contracts varied significantly depending on the size of the business (Tables 14 and 16). As expected larger enterprises, i.e. those in the medium scale category, took larger amounts of customer advances. The value of the credit reached on average L.E. 134 thousand per transaction, which represented about one third of the total value of the transaction. Small scale businesses used on average L.E. 17 thousand per customer advance (with L.E. four thousand median), while microenterprises took on average L.E. one thousand per customer advance transaction (with L.E. one thousand median). The frequency of using customer advances varied across the size categories as well. While small and micro enterprises took customer advances as often as 10 and 32 times on average per year, medium scale businesses used customer advances on average 4 times per year.

Most of the customer advances were typically extended for a period of one month. Most of the entrepreneurs reported providing their customers with security in the form of a signed promissory note with the amount received and the promise to deliver the product at the end of the term. The use of security was more frequent for small and medium scale enterprises than for microenterprises, due to the larger amount of advances involved. Lastly, the terms and conditions of the customer advance contracts did not seem to vary significantly across the three sectors in the study. As with the supplier credit, the most notable difference with customer advances was that the few entrepreneurs in the service and trade sectors who used customer advances reported using larger amounts than entrepreneurs in the manufacturing sector.

The nature of the product and its value directly affect the method of payment. Most of the manufacturing products, and particularly the custom-made orders, require advance payment as a guarantee and deposit to allow the entrepreneur to purchase input materials. Traders have less customer advances flowing into their enterprises because the nature of their sales are not generally customized.

C. The Demand for Informal Loans

The demand for informal loans by entrepreneurs in the sample was significant (Table 17). Differences based on the size of the enterprise, however, existed. Almost half of the microentrepreneurs in the sample had requested an informal loan at one time, while only one fourth of the entrepreneurs operating small scale businesses did, and yet less than one fifth of the entrepreneurs operating medium scale businesses reported ever requesting an informal loan. Loan quantity rationing, i.e. borrowers being rejected loans completely, was not reported save for a single case.

The source of informal loans over the past year was largely from family and friends. Only a couple of microentrepreneurs reported having borrowed from moneylenders. Informal loans were typically given in a matter of days for periods ranging from 6 to 3 months. Microentrepreneurs used smaller amounts of informal loans (L.E. 3 thousand) than entrepreneurs operating small and medium scale businesses (L.E. 16,000 and L.E. 22,000) on average. This is not surprising, given that microentrepreneurs have demand for smaller loan amounts and have a smaller capacity for repayment. Most informal loans were unsecured and provided free of interest charge except in a few cases. This is typical for informal loans as it is socially and religiously unacceptable to charge interest on these types of loans or hold collateral. Personal relations allow lenders to make judgments about the creditworthiness of their borrowers and induce borrowers to fulfill the repayment promise.

D. The Demand for Formal Loans

The demand for formal loans was found to vary significantly by size of the business (Table 18). About two thirds of the microentrepreneurs in the sample never requested formal loans, compared to about half of the entrepreneurs operating small scale businesses, and only about one third of the medium size businesses. The reason provided by the entrepreneurs for never requesting a formal loan varied again by size of the enterprise. On the one hand, one third of the micro entrepreneurs who never requested a formal loan reported their primary reason being fear of inability to repay the loan, a few others (12 percent) suggested that they had religious reasons, while some others thought that they

did not have sufficient collateral (12 percent), or that the interest was high (12 percent), or that banking procedures were difficult (16 percent). Only a few microentrepreneurs (14 percent) reported that access to other sources of finance was their reason for not requesting formal loans. On the other hand, the primary reason reported by entrepreneurs operating small and medium scale enterprises for not requesting a formal loan was the availability of other sources of finance (31 percent and 50 percent, respectively). The second most frequent reason was religious beliefs (22 percent and 25 percent, respectively), the third, was high interest rates (19 percent and 12 percent, respectively), and the fourth was difficulty of banking procedures (6 percent and 12 percent respectively). Interestingly, among the entrepreneurs who had requested a formal loan in the past, very few had their loan applications rejected, i.e. loan quantity rationed. The reasons a few entrepreneurs were rejected were because they did not have sufficient collateral or banking experience.

Consistent with the information reported on the request for loans, and the infrequent occurrence of loan rejections, the majority of the entrepreneurs operating medium scale enterprises (64 percent) reported using formal loans in the past year (Table 19). Similarly, almost half of the entrepreneurs operating small scale enterprises (44 percent) reported using formal loans in the past year, while only about one fifth of the microentrepreneurs (20 percent) had used a formal loan in the past year. These findings are similar to the results reported in the 1994 World Bank survey, where almost two thirds of the medium scale enterprises interviewed had received loans from banks, and over one third of the small scale enterprises and less than a fifth of the microenterprises reported receiving loans from banks (World Bank, 1994)[38].

Micro and small scale entrepreneurs reported using two loans on average, while medium scale entrepreneurs used four loans on average over the past year (the median of number of loans was one for all three categories). Public sector banks were the primary source of the majority of the loans obtained by micro, small, and medium scale entrepreneurs. Private bank loans were primarily focused on medium scale enterprises. Interestingly, however, half of the microenterprise loans granted were associated with a special program, such as the Social Fund for Development or an NGO, while only a few of the others had such linkages.

Most of the loans reported were working capital loans, however some were fixed assets loans. A few entrepreneurs who operated medium scale enterprises reported using domestic and foreign letters of credit, and in a couple of cases entrepreneurs even used discounts of drafts or a letter of guarantee. Interestingly, while very few entrepreneurs reported being rejected their loan applications, a few did report being loan size rationed, i.e. unable to borrow the amounts they requested. Loan size rationing was experienced more significantly by smaller enterprises, that is, more by microenterprises than by small scale enterprises, and least by medium scale enterprises. Loan approvals and disbursements were reported to take from two weeks to a month.

Average loan amounts, as expected, varied vastly by the size category of the enterprise. Microentrepreneurs reported an average loan amount of L.E. 17 thousand, while entrepreneurs operating small scale enterprises reported an average loan amount of L.E. 360 thousand, and yet

[38] The definition adopted in the World Bank study refers to businesses employing 1 to 4 workers as microenterprises, those with 5 to 9 workers as small scale enterprises, and those with 10 to 100 workers as medium scale enterprises.

entrepreneurs operating medium scale enterprises reported an average loan amount of L.E. 1.3 million. Loans were generally granted for periods ranging from one to two years at interest rates ranging from 13 percent to 16 percent[39]. Interest rates, however, varied by size of the enterprise. On the one hand, microenterprise loans, which as mentioned earlier were often associated with special programs, reported a below the market average interest rate of 13 percent. On the other hand, entrepreneurs operating small and medium scale enterprises had average interest rates of 15 percent and 16 percent, respectively, which were in line with the current market rates in the country. Most notably, however, all loans given to micro, small, and medium scale enterprises were secured by collateral with values averaging over 100 percent of the loan amount. The average value of the collateral was higher the smaller the businesses, reaching 183 percent on average for microenterprises, 148 percent for small scale enterprises, and 133 percent for medium scale enterprises. Typically more than one collateral was used to cover the total value of the security.

E. Significance of the Existing Current Sources of Financing the Business

In summary, the alternative sources of financing current operations of the business seemed to vary by size of the enterprise and sector of operation (Tables 20 and 21). First, the primary source of financing used by most entrepreneurs in the sample was retained earnings. Second, trade credit in the form of supplier credit and customer advances was the second significant source used by micro, small, and medium scale enterprises. Third, informal and formal loans seemed to be substitutes for entrepreneurs depending on the size of the business. A smaller share of microentrepreneurs were found to use formal loans than those using informal loans, while a smaller share of small and medium scale enterprises used informal loans than those using formal loans. It is important to note, however, that the average amounts used by the entrepreneurs, across the three size categories and sectors of operation, reflects significantly higher values of formal loans compared to informal loans. Loan quantity rationing was found not to be the problem or bottle neck, contradictory to popular belief of discrimination against small businesses. The observation of entrepreneurs often self-selecting themselves out of the formal credit markets was reported to be based on their fear of inability of repayment, availability of other sources, religious beliefs, or regarding market interest rates as being too high.

The sources of finance may be characterized in a ranking order starting with the most to the least frequently utilized. First is retained earnings as the overwhelming source; second are customer advances and supplier credit; third comes informal loans from family and friends or formal loans from commercial banks, depending on the size of the business. This preliminary ranking order falls in line with the pecking order theory of finance that will be tested subsequently.[40]

[39] Interest rate charges reported by entrepreneurs include fees. Entrepreneurs generally did not know how much was the interest rate and how much were the fees.

[40] The pecking order theory of finance suggests that "safety first," i.e. not losing ownership control of the firm, is the principle that is used to rank the firm's preferred sources of financing in priority order (Gurley, 1992; Donaldson, 1961, 1969; Myers, 1984). It is argued that firms choose to finance investments first from internally generated funds since this represents the safest source of financing. External sources of financing, therefore, are ranked second.

F. Significance of the Existing Saving Channels

Entrepreneurs in the sample were found to participate in various savings channels. Formal channels consisted of accounts in commercial banks. The informal channels were represented by the "gam'iyat" or RoSCAs and the informal collectors. Table 22 presents the share of entrepreneurs saving with formal institutions, informal groups and informal collectors by size of the enterprise.

Among the most common savings channels were the commercial banks. On the one hand, the majority of the entrepreneurs operating small and medium scale enterprises held at least one account with one of the commercial banks in the country. On the other hand, only one third of the microentrepreneurs held one account on average with one of the commercial banks. "Gam'iyat" or RoSCAs were the second most widely used saving channel among the entrepreneurs in the sample. Again size of the enterprise presents significant differences. Over a third of the microentrepreneurs participated in these groups while about one fourth of the small scale entrepreneurs did, and only a few medium scale entrepreneurs were members of these groups. The amounts contributed to these groups ranged from L.E. one thousand to over L.E. 20 thousand per year per member. Finally, very few entrepreneurs reported saving money with informal collectors. The few entrepreneurs who did reported that they held some funds with a family member. This is probably due to the reason that the sample enterprises were largely concentrated in urban and peri-urban areas where this phenomenon is less practiced than in rural areas.

In summary, the array of saving channels and the different concentrations of entrepreneurs by size category among these channels indicates very important findings. Monetary savings are very important to entrepreneurs. Almost every entrepreneur has used at least one savings channel to keep her/his deposits as a means to manage liquidity of the enterprise. Moreover, entrepreneurs draw upon formal channels, commercial banks in general, as well as on informal channels, such as RoSCAs, to deposit their savings.

3. Problems and Constraints

Entrepreneurs are typically perceived to face problems and constraints limiting their growth and expansion. Most of these problems are often attributed to lack of finance. Problems outside financial markets, however, represent important barriers to entrepreneurs in many environments. In our sample, first, the most significant problem reported by microentrepreneurs was weak demand, followed by domestic competition, raw materials and marketing (Table 23)[41]. Second, entrepreneurs operating small scale enterprises reported that taxes was their most significant problem, followed by marketing, weak demand, and labor problems. Third, entrepreneurs operating medium scale enterprises reported that labor problems ranked as their most significant problem, followed by marketing, taxes, and weak demand. Interestingly, finance was not presented to be the most serious constraint except by a few entrepreneurs in each size category. When asked about their second most significant problem microentrepreneurs reported taxes, raw materials and domestic competition, while small scale enterprises reported marketing, domestic competition and taxes, and medium scale

[41] Entrepreneurs were asked to list their three most significant problems in a descending order, with no suggestions offered by the interviewers.

enterprises reported raw materials and labor problems. Again, finance was reported as a second most serious problem by only a few entrepreneurs. These evaluations, although subjective and based on the entrepreneurs' initial responses, serve to highlight the point that finance is not necessarily the bottle neck as widely perceived by many small business advocates, including governments and donors.

Entrepreneurs were also asked to evaluate their growth in production over the past year. Those who did not experience any growth were asked to list the three most significant constraints limiting their growth. Microentrepreneurs largely reported weak demand and domestic competition as their primary reasons, while small scale entrepreneurs suggested weak demand and marketing, and medium scale entrepreneurs regarded weak demand and labor problems as their principal constraints (Table 24). The second reason provided by the entrepreneurs as to why they did not experience growth over the past year was either domestic competition or taxes. Again, contrary to popular belief, finance was not reported to be the major obstacle.

Lastly, the entrepreneurs were asked to rank a set of constraints, suggested by the interviewers, among three classes representing whether they have no problem with the particular issue addressed, or they have some problems, or they have a severe problem[42]. This exercise allows us to get an overall estimate through normalizing the answers of the severity of each problem to the enterprise sector[43]. The responses for each size category of enterprises were analyzed separately. With respect to microentrepreneurs, the most severe constraints were tax laws, costly bank financing, inflation, weak demand, government procedures, cost of raw materials, and competition (Table 25). With respect to small scale entrepreneurs, a similar pattern of problems was found (Table 26). The most severe constraints were tax laws, costly bank financing, inflation, producing quality products for foreign markets, government procedures, competition, and weak demand. Medium scale entrepreneurs, as well, ranked lack of technical labor, costly bank financing, tax laws, government procedures, costly raw materials, inflation, and weak demand as their major constraints (Table 27).

Interestingly, the constraints ranked most severe by small and medium scale entrepreneurs place emphasis on the same issues concerning microentrepreneurs. In addition, the majority of these constraints fall outside the financial markets except for the view that bank financing, at current market rates, is costly. These findings, again, are consistent with the results of the 1994 World Bank survey, where the level of interest rate was the most severe problem reported by all micro, small, medium, and large scale enterprises (World Bank, 1994). This is not surprising, and is the typical rhetorical response for entrepreneurs in many environments. Size of the enterprise, however, seems to influence the effective demand for bank financing. As discussed earlier, while many small and medium scale entrepreneurs have an effective demand for bank financing, at current market rates, the majority of the microentrepreneurs have a very limited demand for bank financing.

[42] Interviewers probed entrepreneurs for a response concerning each particular constraint suggested to the entrepreneur.

[43] Normalization of the entrepreneurs' responses involved estimating the weighted average of the degree of severity, with no problem 0, some problem 1, and severe problem 2, where the weights were given by the percentage of respondents for each degree. The weighted average was then normalized by 0.02. The normalization rates range from 0 to 100, where 0 represents no constraint.

III. Determinants of the Use of Financial Services and Growth Among Micro, Small and Medium Scale Enterprises in Egypt

1. Determinants of the Use of Financial Services

Despite the numerous projects and policies initiated to assist micro, small, and medium scale enterprises over the past decade, there is a lack of understanding about the entrepreneur's effective demand for alternative financial services under the circumstances found in many low income countries. Most of the literature that describes the sources of finance for micro, small, and medium scale enterprises in low income countries across various sectors is based on a descriptive rather than a diagnostic framework (e.g. Cortes et al., 1987; Levy, 1993; McLeod, 1991; Kilby et al., 1984). Descriptive studies often provide reports of field surveys of various sectors in these countries. The identification of finance as the primary obstacle to develop small scale enterprises in some of these studies, however, is highly rhetorical when based on the entrepreneurs' subjective responses (e.g. Levy). Entrepreneurs when asked about their access to formal finance typically respond by claiming "a need for credit at reasonable prices." These subjective questions are rarely specific enough to show how the entrepreneur would respond to a rigorous subset of loan terms and conditions. Under increasingly rigorous terms and conditions the demand for credit would decline.

A critical problem in the assessment of small enterprise sector studies is that they consider formal financial contracts that entrepreneurs use as being exogenously predetermined, and not a function of the overall mix of financial services entrepreneurs choose to use and the particular sectors within which they operate. An entrepreneur's use of alternative financial services is determined by a number of factors. These include characteristics of the enterprise, attributes of the entrepreneur, interest rates of alternative sources of financing, and the respective shares of these financial assets and liabilities over the production period. Size of the enterprise influences the financial behavior of the entrepreneur since larger scale affects the costs and bargaining power of accessing external financial services. Sector of operation directly impacts the physical asset composition and volatility of earnings which influence the financial structure. Furthermore, investments in physical capital, i.e. tangible assets, allow a firm to provide collateral and in turn access debt financing easier. Finally, among the characteristics of the enterprise and its external relationships, the nature of the input and output linkages found among the various economic agents--producers, traders and consumers--also affect the financial contracts that are available to an entrepreneur.

A set of entrepreneurial characteristics influence the financial behavior of the entrepreneur managing the firm. These include education level, age, risk taking attitude, and the degree to which the entrepreneur is informed. Entrepreneurs who are better informed and have completed higher levels of education, are likely to use more debt finance than their less informed counterparts. Older entrepreneurs, however, are likely to be more risk averse and less interested in using external finance. The entrepreneur's attitude towards risk suggests that risk averse entrepreneurs use less debt finance than risk taking entrepreneurs.

This section analyzes the differences found across sectors in the sources of finance used

by micro, small, and medium scale enterprises in Egypt. An examination of the entrepreneur's choices among various sources of financing will shed light on how financial contracts influence firm behavior across sectors. This analysis utilizes the sub-sector approach to demonstrate how input purchases, output sale contracts, informal sources and formal finance simultaneously determine the financial structure of the firm. The section presents a model which addresses the sources of financing of micro, small, and medium scale enterprises and presents empirical implications based on the survey in Egypt.

A. The Empirical Model

The empirical model describing the capital structure of the enterprise may be presented by considering the set of endogenous variables: cash or retained earnings (RE), trade finance from suppliers and customers (TL), non-commercial informal loans (IL) from fellow entrepreneurs, friends and relatives, and formal loans (FL) from commercial banks and other non-bank institutions such as microenterprise programs; and the set of exogenous variables: characteristics of the enterprise (Y_K), including value of physical capital (K), the profitability of the firm (P/T), where (T) is the total cost of inputs (T) and (P) is the price of output (P), size of the enterprise (Size: Micro, Small, and Medium), sector of operation (Sector: MNF, SRV, TRD), the age of the firm (YRS), interest rates associated with the financial liabilities (i_j), where (j= TL, FL), the use of bank deposit accounts (ACCT) and a set of entrepreneurial or managerial abilities (A), which included proxy variables, such as the education level (EDUC) and age (AGE) of the entrepreneur. The variables in the model are specified in table 28.

The allocations of financial assets and liabilities used to finance the firm's operating costs for a given period are jointly determined in a structural system of simultaneous equations (eqs. 1-4). The empirical model can be written as:

(1) $$(RE) = b_{10} + b_{11}(i_{TL}) + b_{12}(i_{FL}) + b_{13}(TL) + b_{14}(Y_K)$$

(2) $$(TL) = b_{20} + b_{21}(i_{TL}) + b_{22}(i_{FL}) + b_{23}(IL) + b_{24}(Y_K)$$

(3) $$(IL) = b_{30} + b_{31}(i_{TL}) + b_{32}(i_{FL}) + b_{33}(FL) + b_{34}(Y_K)$$

(4) $$(FL) = b_{40} + b_{41}(i_{TL}) + b_{42}(i_{FL}) + b_{43}(RE) + b_{44}(Y_K)$$

The objective of this model is to examine the financial structure of the firm using the structural system of simultaneous equations which accounts for the endogeneity of financial contracts in different sectors. The financial assets and liabilities on the left hand side (LHS) of equations 1-4 represent: retained earnings (RE), trade loans (TL), informal loans (IL), and formal loans (FL). These endogenous variables, which are determined simultaneously, are explained by a set of exogenous or predetermined variables on the right hand side (RHS) including: characteristics of the enterprise (Y_K)--which is described by value of physical capital (K), the profitability of the firm (P/T), size of the enterprise (Size: Micro, Small, and Medium), sector of operation (Sector: MNF, SRV, TRD), the age of the firm (YRS), and a set of entrepreneurial or managerial abilities (A), which

included proxy variables, such as the education level (EDUC) and age (AGE) of the entrepreneur--, the use of bank deposit accounts (ACCT), and interest rates associated with the financial liabilities (i_j), where (j= TL, FL). Moreover, following the safety first principal, the use of the alternative financial asset and liabilities is jointly determined, with retained earnings ranked first, trade loans second, informal loans third, and formal loans fourth.

The model tests for the entrepreneurs' use of the safety first principal of the pecking order theory and the determinants that affect the entrepreneurs' choices of the alternative sources of finance. This implies, first, that more profitable enterprises, those with larger values of physical assets, larger enterprises in the small and medium scale category, older enterprises, those run by older and more educated entrepreneurs, are expected to use safer internal sources of finance or retained earnings (RE) to a larger extent than their counterparts. Second, entrepreneurs using external sources of finance are expected to use safer and less costly sources, such as trade loans (TL) and informal loans (IL), first, and more risky sources of external finance, i.e. formal loans (FL), second. Again, more profitable enterprises, those with larger values of physical assets, larger enterprises in the small and medium scale category, older enterprises, those run by older and more educated entrepreneurs, are expected to use safer external sources of finance to a larger extent than their counterparts. The model was estimated using the log functional form[44]. The appropriate econometric technique was used to produce the most efficient results[45].

B. Results and Discussion

Table 29 presents the results of the long-term multipliers generated from the first-stage estimation of the reduced form equations. Among the significant relationships, profitability of the enterprise has a positive effect on the entrepreneur's use of retained earnings and negative effect on the entrepreneurs' use of trade credit. The coefficients for profitability indicate that more profitable enterprises use smaller amounts of supplier loans and customer advances and more retained earnings to purchase their inputs. The value of physical assets of the enterprise has a negative effect on the entrepreneurs' use of informal loans and a positive effect on the entrepreneurs' use of formal loans. This contradicts the pecking order theory, however it is in line with asymmetric information theory[46]. Physical assets are

[44] The literature does not provide any implications as to which functional form is more appropriate; however, having a set of variables derived from the marginal productivity of physical capital among the explanatory variables suggests that the log form may describe the true functional form better than the linear form. The production function is a general power function which is estimated more efficiently using the log functional form.

[45] The different financing sources that an entrepreneur may use to fund total expenditures over inputs represents some zero and non-zero amounts for the variables (RE, TL, IL, FL) on the LHS of the equations in the model. The sequential two-stage estimation technique used in the study involves, first, estimating the reduced form equations using the standard tobit model for equations with limited LHS variables. Second, we obtain the predicted values of the endogenous variables from step 1, and insert the predictors for the endogenous variables on the RHS of the equations in the structural model. Third, we estimate the structural equations using the maximum likelihood technique to generate the results of the model presented in table 30. This methodology is similar to that used in Nelson and Olson's model (1978), reviewed by Amemiya (1984) under a type 4 tobit model, which generates consistent and asymptotically normal estimates.

[46] Asymmetric information problems refer to the adverse selection and moral hazard behavior that the principal-lender encounters as a result of the agent-borrower's undetermined type, i.e. good or bad borrower, and

typically used as collateral by formal lenders or at least are a proxy for capacity of repayment in an attempt to resolve part of the asymmetric information problems. The age of the business, however, has a negative effect on the entrepreneurs' use of formal loans implying a preference for the use of other internal and less risky sources of finance in line with the pecking order theory.

Size of the enterprise seems to have an influence on the entrepreneurs' choice of the alternative financing sources. Small and medium enterprises have a positive effect on the use retained earnings, in line with the pecking order theory, implying that they use more retained earnings than microenterprises. Moreover, medium scale enterprises have a positive effect on the use of trade credit. This finding can be explained by the large amounts of trade credit flowing to medium scale enterprises compared to micro and small scale businesses.

Sector differences also have an effect on the entrepreneurs' use of the various channels of finance. Entrepreneurs operating manufacturing enterprises use more retained earnings and less informal loans than those in the other sectors. Enterprises in the service sector, similarly use more retained earnings, implying that traders use less retained earnings than entrepreneurs in other sectors. Enterprises in the service sector, however, use less trade loans than manufacturing and trade establishments. This again was expected, as trade credit is more typical for enterprises in the manufacturing and trade sectors using customer advances and supplier credit.

More educated entrepreneurs, as expected, use less formal loans than less educated entrepreneurs. This implies that while more educated entrepreneurs have more information, they seem to be more risk averse, choosing to use safer sources of finance than formal loans. Older entrepreneurs, also, seem to be rather risk averse in terms of their use of informal loans compared to younger entrepreneurs. Older entrepreneurs, however, use less retained earnings than younger entrepreneurs.

Lastly, the use of formal deposit services has a positive effect on the use of formal loans. This is not surprising given that most entrepreneurs who do not have reservations dealing with commercial banks to meet their deposit demands probably use these banks for their credit services as well. Moreover, the use of bank deposit services has a positive effect on the use of retained earning. This relation implies that entrepreneurs who use more retained earnings in financing their business operations hold deposit accounts. Interestingly, the use of retained earnings is negatively associated with the interest rate on trade loans, implying that at higher interest rates on trade credit entrepreneurs use more retained earnings. The use of trade loans, as well as informal loans, are positively associated with the interest rates on trade loans, while the use of formal loans is positively associated with the interest rate on formal loans. These results can be explained by the fact that the equations represent a market outcome and do not allow for separation between the demand and supply for the financial sources. Thus, the positive association between the financial liabilities and their respective interest rates implies a combination of demand and supply behavior and the resulting use by entrepreneurs of these financial channels.

unpredictable action, i.e. repayment performance. For further details see the literature addressing asymmetric information, e.g.,Stiglitz andWeiss (1981) and Gale (1990, 1991) among others.

Results of the second-stage estimation, presented in table 30, are similar with respect to most of the factors discussed among the long-term relationships, reflected in the first-stage estimation, in addition to some new implications. Among the additional implications of the second stage estimation are the findings that enterprises which have a larger value of physical assets and those that have been in operation for a longer period of time use more retained earnings than their counterparts. The age of the business, also implies that enterprises that have been in operation longer use less informal loans. Moreover, older entrepreneurs use less trade loans implying a risk averse behavior. Lastly, and importantly, the use of trade loans has a negative effect on the use of retained earnings. This implies that entrepreneurs who use less trade loans are using more retained earnings, which is a safer source of finance, in order with the pecking order theory of finance. In addition, the use of formal loans has a negative effect on the use of informal loans. This result implies a substitution effect between formal and informal loans, where entrepreneurs using informal loans use less formal loans and vise-versa. This inverse relationship is also in agreement with the pecking order theory as it implies these two financial liabilities are substitutes rather than complements.

C. Lessons and Implications

The results of the capital structure model provide several lessons and insights about the importance of the various financial services entrepreneurs draw upon in financing their operations. First, retained earnings are used more by profitable small and medium scale enterprises, those in the manufacturing and service sectors, younger entrepreneurs, and those who hold accounts with banks. Second, profitability, medium scale enterprises, and those enterprises operating in the service sector have a negative effect on trade loans. Third, informal loans are larger for enterprises with small value of physical assets, those in the service and trade sectors, and younger entrepreneurs. Fourth, increases in formal loans are associated with increases in the value of physical assets of the enterprise, a decrease in the age of the enterprise, less educated entrepreneurs, and those who hold accounts with banks. And finally, fifth, the effect of using trade loans is to decrease the use of retained earnings and the effect of using formal debt financing and informal loans indicates a substitutional rather than complementary relation between these sources.

2. Determinants of Enterprise Growth

The literature on the role of the entrepreneur in the dynamic theories of firm growth, reveal how incomplete research is on the relationship between growth and the capital structure and asset portfolio choice of the enterprise. Our lack of understanding of this relationship has led to many efforts to assist SMEs in low income countries with fruitless results. Empirical studies in developing countries point to the abundance of small scale enterprises as a source of income[47]. Anderson (1982) states in his discussion of entrepreneurship and small scale industries in low income countries that although there is a tremendous entrepreneurial response in regions of rapid market growth, the entrepreneurial variable cannot be regarded as an abundant or slack variable and, thus, requires adequate attention by those involved in the development process.

[47] A study of the dynamics of small scale industry in Africa reports that the majority of the African firms are small scale enterprises, located in rural areas and producing simple consumer goods (Liedholm, 1990).

Theories of firm dynamics, which are quite sparse and still at an early stage, have in different ways employed entrepreneurial skill as a principal part of their analyses. Among the entrepreneurial models, Jovanovic (1982) assumes that individuals have different managerial abilities which they are not sure of when they enter an industry, yet as they learn entrepreneurs change their operations over time. This model postulates that the growth rates and failure rates of the firm are inversely related to the age and initial size of the firm. A more recent study examining firm size and optimal growth rates follows a different approach in which, due to dissolution costs, growth rates of small and large firms follow different trends[48] (Segal and Spivak, 1989). This model considers that the choice of allocating profits between dividends and retained earnings is inclined towards the latter, which if reinvested in the firm enhances future growth and, thus, yields an endogenous growth rate. The results indicate that the growth rate of small firms tends to be higher and more variable than that of larger firms which grow at a fixed rate as advanced by Gibrat's Law. Segal and Spivak's work throws some light on the rate of growth of the firm considering the dissolution costs and the reinvestment of profits. The model, however, does not allow for external financing through any form of debt or equity.

The evolution and dynamics of small scale industries in developing countries have been explored by Michigan State University mostly with reference to changes in employment rates (Liedholm and Mead, 1990; Liedholm and Mead, 1987; Liedholm and Parker, 1989). In examining the factors that influence the growth of a small firm, Liedholm and Mead (1990) draw attention to the size and age of the firm, and agree with the inverse relationship between growth and age of the firm as well as between growth and size of the firm[49], consistent with Jovanovic's model and contrary to Gibrat's law[50]. Liedholm and Mead in their review of the state-of the-art of firm growth theories state: "Unfortunately, neither the Jovanovic nor the other evolutionary models indicate what the key determinants of this managerial ability might be or how it might be augmented." (Liedholm and Mead, 1990; p. 12).

Contemporary research has neither indicated clearly what the key determinants of managerial or entrepreneurial ability are, nor has it indicated what the key relationships might be between the operations and growth of SMEs and their capital structure and asset portfolio choice. The two issues are related in the sense that managerial ability might be one of those key determinants influencing the entrepreneur's choice of certain sources of financing and investment; however, there are more factors affecting this choice, as discussed in the previous section. The preceding studies constitute a body of literature which tackles an important dimension of the forces that bring about change and growth in small scale industries; however, these studies raise questions regarding SMEs financial strategies and operations.

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[48] Dissolution costs include largely the loss of intangibles of the firm such as reputation and organization and a subset of bankruptcy costs (Segal and Spivak, 1989).

[49] This view is in agreement with the Jovanovic theoretical model (1982). Empirical findings supporting these hypotheses are found in Evans (1987a, b).

[50] Gibrat's Law states that firm growth is independent of firm size; that is, the firm grows at a fixed rate (Gibrat, 1931).

A. The Empirical Model

The empirical model describing the growth rate of the enterprise (GRATE) takes into account, first, capital structure of the enterprise by considering the set of variables: retained earnings (RE), trade finance from suppliers and customers (TL), non-commercial informal loans (IL) from fellow entrepreneurs, friends and relatives, and formal loans (FL) from commercial banks and other non-bank institutions such as microenterprise programs. Second, the set of variables describing characteristics of the enterprise and entrepreneurs include: characteristics of the enterprise (Y_K), including value of physical capital (K), the profitability of the firm (P/T), where (T) is the total cost of inputs (T) and (P) is the price of output (P), size of the enterprise (Size: Micro, Small, and Medium), sector of operation (Sector: MNF, SRV, TRD), the age of the firm (YRS), interest rates associated with the financial liabilities (i_j), where (j= TL, FL), the use of bank deposit accounts (ACCT) and a set of entrepreneurial or managerial abilities (A), which included proxy variables, such as the education level (EDUC) and age (AGE) of the entrepreneur. The variables in the model are specified in table 31.

The objective of this model is to examine the determinants of the growth rate of the enterprise using the following equation (5):

(5)

$$(GRATE) = b_{50} + b_{51}(i_{TL}) + b_{52}(i_{FL}) + b_{53}(TL) + b_{54}(FL) + b_{56}(IL) + b_{57}(C) + b_{57}(Y_K)$$

The entrepreneurs' choices of financing, both internal and external, provide a wide array of possible capital structures. The model allows us to take the capital structure of the firm into account when examining the determinants of firm growth. This model attempts to add to the empirical research on the relationship between financial contracts and the operations and evolution of micro, small, and medium scale enterprises by considering the characteristics of the enterprise and entrepreneurs as well as their capital structure choice. It is expected, as postulated by previous theoretical and empirical work, that age and size of the enterprise are inversely related to firm growth. Profitability of the firm, the use of retained earnings, and the use of other safe sources of finance, however, is expected to have a positive effect on firm growth.

Given that some enterprises have experienced some growth while others have not, presents some zero and non-zero amounts for the (GRATE) variable on the left hand side (LHS) of the equation in the model. The standard tobit model is, therefore, the appropriate estimation technique to generate the results (Table 32)[51].

[51] The model is estimated using the log functional form. Again, having a set of variables derived from the marginal productivity of physical capital among the explanatory variables suggests that the log form may describe the true functional form better than the linear form.

B. Results and Discussion

Among the significant relationships, profitability of the enterprise has a positive effect on the growth rate of the firm. This implies, as expected, that more profitable enterprises experience more growth. Firms that have been in business longer have a lower annual growth rate compared to enterprises which have been in operation shorter periods of time. This relationship is consistent with the Jovanovic theoretical model and Liedholm and Mead empirical work, which supports the inverse relationship between growth rate and age of the enterprise. Larger enterprises, i.e. those in the small and medium scale categories, however, experience higher growth rates than microenterprises. This relationship is in line with the view that microenterprises experience less growth because they are primarily income generating businesses and do not have much growth potential. Our sample does not include large scale enterprises, but if we were to make any inferences, we could speculate that our results are also in line with the Jovanovic model as they imply that small and medium scale enterprises grow more rapidly than larger enterprises. In addition, results of the model imply that manufacturing enterprises grow more than enterprises in other sectors.

Age of the entrepreneur has a positive effect on the growth rate of the enterprise implying that older entrepreneurs experience higher growth. Lastly, with the respect to the use of the alternative financial assets and liabilities, the use of retained earnings has a negative effect on the growth rate of the enterprise, while the use of trade loans has a positive effect on the growth rate of the enterprise. These relations imply that use of internal sources of financing, holding all else constant, and being rather risk averse is inversely related to the growth rate of the enterprise, while drawing on safe external sources of finance, such as trade credit, supports a higher annual growth rate of the firm. Importantly, the use of formal sources of finance, such as bank and microfinance program loans, does not have an effect on the growth rate of the enterprise.

C. Lessons and Implications

Results of the growth rate model indicate that, first, more profitable enterprises grow more than less profitable ones. Second, older enterprises have a lower annual growth rate than younger enterprises. Third, enterprises in the manufacturing sector have higher growth rates than those in the service and trade sectors. Fourth, small and medium scale enterprises have higher growth rates than microenterprises. Fifth, older entrepreneurs operate enterprises that have higher growth rates than younger entrepreneurs. And lastly, sixth, the use of retained earnings has a negative effect on the growth rate of the enterprise, while the use of trade loans and bank deposits have a positive effect on the growth rate of the enterprise.

Chapter Four

Conclusions and Recommendations

The supply leading approach to the development of financial markets to serve micro and small scale enterprises, largely prevalent in the 1970s and early 1980s, has left researchers wary of the consequences of targeted credit and special microenterprise programs[52]. Fungibility of credit presents a critical issue in the study of the impact of loan services provided by enterprise development programs to SMEs[53]. The demand approach to the development of financial markets, which has developed since the late 1980s, has placed emphasis on the development of viable and sustainable microfinance institutions to serve the poor in general and micro and small scale enterprises in particular. The investigation of the nature of SME's demand for alternative financial services, on the one hand, yields important insights into the operations and growth of SMEs. The investigation of the nature of the supply of financial services to the SME sector, on the other hand, yields significant insights into the nature of the financial markets. Based on an understanding of supply and demand, appropriate intervention schemes and adequate policy reforms can be proposed to assist in the development of financial markets and SMEs.

I. Supply of Financial Services to the SME Sector

1. Commercial Banks

A. Despite the overwhelming prevalence (over 98%) of micro, small and medium enterprises in the Egyptian economy, commercial banks are lending relatively small percentages of their loans to these enterprises. Very rough estimates of the volumes of such lending by the sample group of banks indicates the following:

% of Bank Loan Portfolios	
Medium	3 - 4 %
Small	1 - 2 %
Micro	0 - 1%
SME Aggregate	5 - 6%

[52] The "supply leading approach" to the development of financial markets is based on the perception that the provision of cheap targeted credit to disadvantaged sectors of the economy, such as small farmers, micro and small entrepreneurs and women, would result in growth and expansion of the economic activities operated by these economic agents.

[53] See Adams and Von Pischke (1991) and Von Pischke and Adams (1983) for detailed views on the difficulty of assessing the impact of agricultural loans because of fungibility.

The total SME lending by the whole banking sector is estimated to be between 5-6%.

B. The reasons cited by commercial bankers for the relatively low level of SME lending are as follows:

- SME lending represents higher than average risk and lower than average returns for most bankers;
- SME loans are administratively more expensive than larger loans, particularly costs related to marketing and follow-up;
- Banks need a large branch network to reach SME customers effectively. Most of the banks in the country do not have such networks, particularly the private banks other than NBD;
- SME entrepreneurs are frequently incapable of preparing the information which would make them bankable. They often do not maintain the accounting records necessary to produce the financial reports on which bankers would base a cash flow analyses, and they often do not have the managerial skills and experience to develop other data necessary to support cash flow analyses (e.g. market studies);
- Small businesses often do not have the collateral normally required by banks. Their businesses may be too small or too young to have accumulated substantial collateral, or even if they have it, they have not taken the formal steps to register it, as is necessary in the case of real estate, or they are not inclined to risk losing these assets by pledging them to a bank;
- Excessive collateral requirements deter small borrowers even when they are inclined to pledge collateral. The cost of registering collateral is also high (e.g., 5% for mortgages);
- A socialist mentality among many bankers as evidenced by the often cited solution to making more credit available to SMEs - “the government needs to fund such programs at below market interest rates to enable the banks to provide low cost credit to the poor.”

C. Almost all microenterprise lending by commercial banks is politically motivated, with the primary impetus for it coming from the SFD initiative of government. With the exception of the National Bank for Development, banks eschew microenterprise lending for the reasons cited above. In addition, commercial bankers in Egypt, as in most of the rest of the world, have very little understanding of the dynamics of micro lending and how to make it work. None of the sample banks, with the exception of the NBD, had the policies, procedures, personnel, systems, training and philosophy in place to be successful in microenterprise lending. This is consistent with experience elsewhere in the world.

D. Current government policy toward micro and small business lending, implemented primarily through SFD, is counter productive because:

Subsidized credit does not resolve the problem of financial institutions" lack of active provision of financial services to the targeted exporters. This is due to the fact that subsidized credit does not enhance the capacity of the involved institutions in developing the borrower-lender

relationship, or adopting the appropriate financial technologies, and management information systems, among others, that would allow these institutions to serve this clientele after the special lines of credit are consumed.

- Subsidized credit does not provide an appropriate incentive structure for borrowers and lenders, thus intensifying adverse selection and moral hazard problems and resulting in large default rates. As with many targeted government credit programs in other parts of the world, government subsidized loans are viewed by many as a giveaway program in which *lenders* do not have to be repaid.

- Fungibility issues are a major intricacy in the face of targeted credit. Subsidized credit favoring microentrepreneurs is likely to be used for a number of productive and consumption purposes other than those targeted by the program.

- The below market interest rates passed on to SME borrowers discourage participation of commercial banks. Bankers say that they are losing money on these loans, primarily because of the high loan loss rates and higher than normal expenses related to this type of lending. But for the political force exerted, and some residual socialist thinking among bank managers, they would not do this type of business.

- In addition, the poor SFD loan recovery rates appear to have given SME lending a bad name among commercial bankers inhibiting the credibility among them of well run microfinance programs.

- The focus on recent graduates' start-up businesses greatly increases the risk of default and the cost of SFD lending by the banks.

- The high loan loss experience associated with the SFD business reinforces the negative attitudes (high risk, low or no return) of bankers toward SME finance.

E. Informal government pressure on government banks to lend to small business at lower than market interest rates discourages private banks from entering this segment. Since this type of business is more expensive to conduct, the pricing ought to be higher to reflect the greater cost. The fact that this is not the case discourages private bank lenders.

F. The banking system is not sufficiently competitive because the majority of financial resources of the nation are controlled by five large government-owned banks. This concentration of power reduces competition. This in turn limits the use of more modern technology, particularly computerized internal reporting systems in branches outside of Cairo, and limits the range and use of certain financial products and services (e.g. factoring, forfaiting and bankers acceptances).

G. Collateral policies varied considerably among the sample banks with requirements ranging

from 110% to 200% of loan value. Collateral included real estate, inventories, accounts receivable, marketable securities, cash, equipment, contract and lease assignments, and bank and personal guarantees. All sample banks make uncollateralized loans. While some banks didn't think their collateral policies were more or less harsh with regard to smaller borrowers, most banks indicated that the smaller the borrower, the more difficult it is for them to provide necessary collateral either because they don't have it or registering it is too expensive.

H. All banks indicated that the court system was slow, cumbersome, inefficient and corrupt. These responses, and responses cited in other studies, indicate that commercial court system upgrading and legal reforms with regard to collateral would have a positive effect in banks' propensity to lend. Improvements in the accuracy, ease and cost of perfecting or registering collateral, in the allowable collateral types, in the range of collateral specificity, and in the enforceability of lender's rights to foreclose in the event of default.

2. Special Financial Institution Models

A. The NGO Model

The NGO model, as exemplified by the ABA's SMEP, appears to be a viable model in Egypt. An expansion of the number of institutions employing the model would be beneficial to the availability of credit to SMEs. In addition, encouraging a cautious move up-market by the stronger of these institutions may be warranted to reach more small and medium scale enterprises. There is some concern whether the model can be scaled up-market using the current, uncollateralized lending approach, but there is reason to believe that the additional portfolio and individual borrower risks expected with larger client size can be contained with a controlled approach to expansion and with appropriate modifications to the operating systems based on experience. Institutions experienced in the application of best practice lending guidelines should be prudent lenders at any level in the SME market.

Given the fairly widespread application of this model in Egypt, and the operational maturity of international best practices in microfinance, there may be merit to encouraging the development of a small business finance industry around this model. Formalizing the model as an industry through innovative, flexible legislation would enable practitioners like ABA to access funding from commercial sources. However, two of the larger banks interviewed indicated that although the ABA financial track record was excellent, they could not do any significant amounts of uncollateralized lending to ABA-like foundations because of their legal status.

The legal status of organizations like the ABA make them difficult to take to court, and banks are reluctant to provide credit which is not cash collateralized. A modification of NGO's legal status toward something more closely approximating a joint stock company would enable the banks to lend to these entities if their financial performances otherwise warranted it. The resultant leveraging of credit resources available from commercial banks could make significantly larger pools of funds available to micro, small and medium enterprises through ABA-like entities across Egypt. Key to this are self-sustaining operations following "best practices" in microfinance, that is operations based on sound credit assessment, loan follow-up and operating controls. Commercial banks providing

financing for these associations on the strength of their balance sheets and their operating performances should be forthcoming with the improved legal status of the NGOs.

ABA has clearly demonstrated that microfinancial institutions can be financially viable once start-up costs and initial loan funds are provided, usually by donor agencies. In ABA's case operating viability appears to be based on "best practices" in microfinance. Its performance and that of several other similar institutions indicate that it may be possible to establish an "industry" of such entities, operating under special rules, which could draw funding from banks and other commercial sources.

B. The Bank Microfinance Unit Model

Special programs for micro and small enterprise lending within banks also appear to be viable. NBD has expanded its micro lending program rapidly and achieved profitability in a reasonably short period. This has been achieved through efficient operations, controlled loan losses, close performance monitoring ratio and a high effective interest rate. The program is reaching a significant number of borrowers, and has been successful enough to warrant a decision to implement it throughout the bank's branch network.

The SECF is a microfinance program, and again, there is some question whether its practices can be scaled upward for application to small and medium sized business on an uncollateralized basis. However, since NBD as a whole operates profitably, with an overall return on equity well in excess of that earned by its microfinance program, one might argue that NBD has demonstrated that it can deliver services profitably to all sizes of enterprises. As such, NBD appears to represent a model for the extension of credit to micro, small and medium scale businesses.

C. The Credit Guarantee Model

The credit guarantee model, as exemplified by the Credit Guarantee Corporation, also offers certain benefits. CGC is the only private company in Egypt issuing guarantees to banks for SME lending and has been responsible for increasing bank credit to the sector. CGC has diversified by guaranteeing the loans of medical practitioners to establish, upgrade or expand private practices and clinics. With total guarantees outstanding of LE191 million, its has leveraged its LE94 million collateral fund two times. Claims against its guarantees have been a fraction of 1%, which is very low by international standards.

On the other hand, concentration of business with a limited number of customers opens CGC to significant risk, and indicates that CGC has not been successful in its marketing activities, or that unresponsive operating habits may be limiting its business or that only limited demand exists for its guarantees. CGC appears to be taking steps to deal with its operating problems, but the addition of new responsibilities at the request of USAID will make achieving this task more challenging.

CGC's core business, guarantees, appears to be nowhere close to covering the cost of CGC's operations. The bulk of the operations are financed by income from a soft loan from the

government and a grant from USAID. While this does not appear to be unusual around the world, it does call into question the long term financial viability of the CGC approach unless it is able to expand its guarantee activities to a much broader market. Expansion into new lines of business, particularly export credit guarantees, should be considered risky. A government run guarantee program, modeled on the U.S. SBA, does not appear to be a cost effective alternative.

D. The Government Subsidized Interest Model.

SFD appears to be a well-intentioned government program targeting unemployed graduates, but its activities distort credit markets with subsidized interest rates and sub-standard repayment rates. SFD should not be expected to become a viable model for achieving a self-sustaining expansion of credit to microenterprises without a considerable shift in emphasis towards enhancing the financial incentives to, and the institutional capacity of, banks and non-bank financial institutions with regard to SME lending.

E. The Leasing Model

Egypt's nascent leasing industry probably offers one of the most important models for expansion of SME financing in the future. With flexible instruments which can supply nearly 100% of equipment financing requirements and can match payments to specific cash flows, leasing offers a potentially significant alternative source of SME financing in Egypt, where small entrepreneurs have limited access to term borrowing.

II. Demand for Financial Services in the SME Sector

The analysis of SME demand for financial services entailed examining the enterprise sector in the urban and peri-urban regions of Egypt. The main focus of our analysis was to examine the alternative financial services that entrepreneurs draw upon to finance their enterprises. In addition to the services offered by formal financial institutions, i.e. bank and non-bank intermediaries, entrepreneurs draw upon a complex set of informal contracts with various economic agents. These contracts are used for both savings and loan purposes. The demand study includes analyses of the entrepreneurs' choice of the sources of funding new investments and operations of the firm and examines the determinants of the capital structure of micro, small and medium scale enterprises, and the determinants of enterprise growth.

A survey of 173 micro, small, and medium scale manufacturing enterprises was carried out in October of 1997. The surveyed enterprises were selected in the urban areas of Greater Cairo and Alexandria, and in the peri-urban region of Fayoum. These areas were chosen because they represent the only regions in the country in which one finds a large and diverse number of enterprises across various sectors and size categories that could provide information about the issues in question. The enterprise survey focused primarily on some of the more dynamic sub-sectors in the manufacturing, services, and trade sectors. These are textile-garment manufacturing, furniture-wood processing, shoe making, artisanal craft production, carpet weaving, tourism companies, hotels and restaurants, service companies, and wholesale and retail traders.

The majority of the enterprises in the sample were proprietorships operated by middle aged male entrepreneurs. The predominance of formal enterprises in the sample, among all micro, small, and medium scale enterprises, was rather surprising and contrary to the perception that these enterprises are largely informal. It is important to note that while small and medium scale enterprises recorded fairly significant rates of growth over the life of the enterprise, microenterprises have been stagnant. This finding supports the view that microenterprises are income generating models rather than growth models.

Sources of finance for current operations included both informal and formal channels. The alternative sources of financing the current operations of the business seemed to vary by size of the enterprise and sector of operation. First, the primary source of financing used by most entrepreneurs in the sample was retained earnings. Second, trade credit in the form of supplier credit and customer advances was significantly used by over half of the micro, small and medium scale enterprises. Third, informal and formal loans were substitutes depending on the size of the entrepreneur's business. A smaller share of microentrepreneurs used formal loans than those using informal loans, while a smaller share of small and medium scale enterprises used informal loans than those using formal loans. Over half of the small and medium scale enterprises had an effective demand for bank financing over the past year. It is important to note, moreover, that the average amounts used by the entrepreneurs, across the three size categories and sectors of operation, reflects significantly higher values of formal loans compared to informal loans. Loan quantity rationing was found not to be the problem or bottle neck, contradictory to popular belief of discrimination against small businesses. The observation of entrepreneurs often self-selecting themselves out of the formal credit markets was reported to be based on their fear of inability of repayment, availability of other sources, religious beliefs, or regarding market interest rates as being too high.

The sources of finance may be characterized in a ranking order starting with the most to the least frequently utilized. First is retained earnings as the overwhelming source; second are customer advances and supplier credit; third comes informal loans from family and friends or formal loans from commercial banks, depending on the size of the business.

Entrepreneurs in the sample were found to participate in different savings channels. Formal channels consisted of accounts in commercial banks. The informal channels were represented by "gam'iyat" or RoSCAs and informal collectors. Among the most common savings channels were commercial banks. On the one hand, the majority of the entrepreneurs operating small and medium scale enterprises held at least one account with one of the commercial banks in the country. On the other hand, only one third of the microentrepreneurs held an account with one of the commercial banks. "Gam'iyat" or RoSCAs were the second most widely used saving channel among the entrepreneurs in the sample. Again size of the enterprise presented significant differences. Over a third of the microentrepreneurs participated in these groups while about one fourth of the small scale entrepreneurs did, and only a few medium scale entrepreneurs were members of these groups. Finally, very few entrepreneurs reported saving money with informal collectors. The few who did reported that they held some funds with a family member. This is probably due to the sample of the enterprises being largely concentrated in urban and peri-urban areas. This phenomenon is practiced more in rural areas.

Entrepreneurs, in addition, were asked to list the three most significant problems facing them in their operations. The most significant problem reported by microentrepreneurs was weak demand, followed by domestic competition, raw materials and marketing. Second, entrepreneurs operating small scale enterprises reported that taxes were their most significant problem, followed by marketing, weak demand, and labor problems. Third, entrepreneurs operating medium scale enterprises reported that labor problems ranked as their most significant problem, followed by marketing, taxes, and weak demand. Interestingly, finance was not presented to be the most serious constraint except by a few entrepreneurs in each size category. When asked to rank the severity of a number of binding constraints, however, tax laws, costly bank financing, inflation, producing quality products for foreign markets, government procedures, competition, and weak demand, were suggested by entrepreneurs across the three size categories. The view that bank financing is costly was not surprising, and is the typical rhetorical response of entrepreneurs in many environments. Size of the enterprise, however, seemed to influence the effective demand for bank financing. While many small and medium scale entrepreneurs have an effective demand for bank financing, at current market rates, the majority of the microentrepreneurs have a very limited demand for bank financing.

The differences found across size categories and sectors of operation and the sources of finance used by enterprises in Egypt were further tested in an empirical model examining the determinants of the entrepreneurs' choice of the alternative financial services. The analysis found that profitable enterprises rely more on the use of retained earnings and less on trade loans. Enterprises with larger value of physical assets use more formal loans in line with the asymmetric information theory, and less informal loans. In addition, enterprises that have been in operation a longer period of time use less formal loans and more trade loans. Manufacturing and service enterprises use more retained earnings than trade enterprises. Service enterprises, however, use less trade loans than manufacturing and trade enterprises. With respect to the size of the enterprise, small and medium scale enterprises use more retained earnings than microenterprises. Interestingly, size of the enterprise did not have an effect on the entrepreneurs' use of formal loans. Characteristics of the entrepreneurs implied that older entrepreneurs use less retained earnings and informal loans, and the more educated entrepreneurs use less formal loans, than their counterparts. Lastly, the use of trade loans has a negative effect on the use of retained earnings, and the use of formal loans has a negative effect on the use of informal loans.

In addition, the determinants of the growth rate of the firm, including the use of the alternative financial sources and the characteristics of the enterprise and entrepreneur, were analyzed. The results indicate that, on the one hand, more profitable enterprises, those in the manufacturing sector, small and medium enterprises and those operated by older entrepreneurs/managers experience higher growth rates than their counterparts. Older enterprises, on the other hand, grow at slower rates than younger enterprises. Moreover, the use of retained earnings has a negative effect on the growth rate of the enterprise, while the use of trade loans and bank saving accounts have a positive effect on the growth rate of the enterprise. These findings suggest that efforts aiming at providing services to enterprises in their early stages of their life cycle are appropriate[54]. These efforts, however, should not ignore the

[54] This, however, should not be confused with efforts trying to assist recent graduates with no business experience by furnishing them with business plans and subsidized loans for business start-ups.

other factors which influence firm growth, such as profitability of the business and size of the enterprise. Our results also support the view that small and medium scale enterprises have a larger potential for growth than microenterprises which seem to have limited potential for growth in comparison.

III. Supply of and Demand for Financial Services in the SME Sector

Findings of the study provide valuable insights into the supply of and demand for financial services in the SME sector in Egypt. While commercial banks indicated that SME lending represents a very small share of their overall portfolio, analyses of the entrepreneurs' demand for formal financial services indicated that over half of the small and medium scale enterprises draw on loans from banks. The disparity is largely a result of the bankers' perception that SME lending is typically microlending. The small and medium enterprises' demand for formal financial services is clearly different from that of microenterprises. Small and medium entrepreneurs were found to draw on significant amounts of formal loans, much higher than those typically reported by bankers when asked about the amounts borrowed by small and medium size businesses. Small and medium scale enterprises did not seem to face a binding constraint with respect to accessing bank financing. As expected, commercial banks did not engage in microlending, except through special programs and lines of credit.

NGOs and special programs, such as the SFD, provide the bulk of microlending largely to microenterprises and some small scale businesses. Enhancing the growth of such programs, based on "best practices" in microlending will undoubtly increase the outreach and sustainability of these institutions and contribute to more credit flowing to the SME sector. These efforts, however, will only reach a small share of the vast microenterprise sector. Microentrepreneurs rely to a large extent on non-bank sources of financing, such as retained earnings, informal loans, and trade credit. A large number of small and medium scale enterprises draw upon these non-bank sources of financing as well. The extent to which bank financing is utilized by small and medium scale enterprises, however, is much more significant than the extent to which microenterprises draw upon bank or special program financing. Self-selection out of the formal financial markets by microentrepreneurs explains part of this phenomenon, contrary to the common belief of rejection of SMEs by formal institutions in general.

IV. Recommendations

Despite numerous projects and policies initiated to assist micro, small and medium scale enterprises in low income countries, little is known about the impact of these efforts on enterprise operations and evolution in these countries. The persistent question, that is often debated, is to what extent do financial services and credit programs assist the operations and evolution of SMEs? The supply leading approach to the development of financial markets to serve micro and small scale enterprises has recorded many more failures than successes. Intervention programs focusing on distributing cheap loans are as short lived as the life of the operation that is required to allocate the funds. NGO financial institutions that do not also engage in deposit-saving mobilization incur greater moral hazard because there is limited constituency in the institutions concerned with responsible loan

evaluation practices and effective recovery problems. Successful microfinance programs, whether deposit taking or not, have to adopt appropriate organizational designs, financial technologies, management information systems, and incentive structures for their employees, among others, to achieve viability and sustainability. Furthermore, savings, whether informal or formal, are an important component of the entrepreneurs' portfolios. Programs that plan to channel financial services to entrepreneurs should attempt to mobilize their funds. However, mobilizing deposits should be subject to regulation and these institutions should be monitored by the regulatory authorities in order to ensure the safety of depositors. Perhaps some programs could choose to work with commercial banks to reach more entrepreneur savers and borrowers.

Commercial banks, also, have a role in the provision of services to the SME sector. There needs to be a strong incentive for any banking institution, however, to agree to work with an enterprise development program. Given that the financial markets in Egypt are not competitive enough, no commercial bank is forced to look for new customers at the time that it is enjoying a large share of the market. Hence, there is more incentive for the government to induce competition in financial markets by implementing policies that would increase the number of the financial institutions that would reach different classes of customers and leave the existing banks no room for exercising monopoly power. It is vital for the government, therefore, to adopt financial liberalization policies that enhance bank privatization which will lead to increased competition in the domestic markets across different sectors of the economy. The following sections outline proposed recommendations pertinent to each segment of the economy.

1. With Respect to Banking

Improving the overall performance of the financial sector would benefit all enterprises, including micro, small, and medium businesses. Overall performance could be improved by adopting the following:

A. Reverse the current Central Bank position against approving the entry of additional foreign banks. The window allowing entry by purchasing the public shareholdings in joint venture banks is positive, but insufficient. Many foreign banks will only enter the market if they can own 100 percent of the operating entity. In other markets, such as the rapidly advancing markets in Asia, free market entry has resulted in more modern banking practices, increased competition leading to cheaper and more readily available credit, and stronger financial institutions. Egypt is not over-banked.

B. Eliminate government and donor influence on the banking industry calling for lower interest rates for SME lending in general, and SFD loans in particular.

C. Continue and accelerate privatization of the banking system to increase the level of competition and the services provided to the SME sector.

D. Privatization of banks should be complemented by efforts to encourage competition. These may include requirements to reduce the size and dominance of some institutions or more access to new entrants.

E. Reduce the cost of funds to financial institutions by lowering reserve requirements to prudentially required levels. Coupled with an enhanced competitive banking environment and increased banking efficiency, this would result in lower current market interest rates. Potential money supply expansion could be controlled by open market operations of the central bank.

F. Continue with the government/IMF program to require full disclosure in bank financial reporting via detailed audited annual reports and semiannual reports according to international standards. In the free and private banking market envisioned in Egypt's future, better information will generally draw more resources to the better performing banks, and this will ultimately improve the overall efficiency of the banking system at all levels.

G. Improve supervision and regulation of banks to encourage prudent competitive performance through loan classification, provisioning for losses, and capital adequacy requirements. Banks that seek out and service good borrowers will be allowed to expand faster than banks with non-performing loans.

H. Increase the frequency and variety of training courses related to SME finance through the Bankers' Association and the Bank Training Institute at the American University of Cairo. Courses should be added which not only enhance the understanding of the special situation of SMEs, but also focus particularly on the additional hurdles they face and the risks involved.

2. With Respect to the Legal System

An efficient legal system in which commercial disputes can be settled quickly will be of positive benefit to smaller borrowers because it will reduce the overall cost of conducting business at this level.

A. Continue and accelerate the process of court reform, particularly the creation of special commercial courts.

B. Egyptian legislation relating to collateral should be modified as follows[55]:

- Non-possessory pledges of moveable collateral should be made possible;
- A central computerized registry of liens should be created. This would enable lenders to identify assets which are subject to prior claims, and would protect the secured creditor against third parties claims by prioritizing the order of claim.
- Lenders should be allowed to seize and sell collateral without court approval unless the borrowers or other creditors legally contest the seizure;
- Fees for registering collateral should be reduced to a reasonable flat charge.

[55] Based in part on reforms suggested in "Report on Collateral-based Credit in Egypt", IRIS, 1997

- Secured creditors should rank ahead of all other claims in the event of debtor insolvency;
- All creditors, not just banks authorized by the CBE, should be allowed to single out specific assets for collateralization.

The above reforms could be accomplished by an amendment to the civil code.

C. Enact new legislation for NGOs as outlined in the subsection below entitled "NGO model Reforms."

3. With Respect to Special Programs

The following recommendations are geared to encourage "organic," rather than "directed," stimulation of credit supply to the smaller borrowers. The application of market pricing, innovative services and technologies, efficient operations, and prudent banking practices, generally known as "best practices" in the microfinance industry internationally, can lead to the development of an new segment of the financial industry, populated by both banks and non-bank financial institutions, which compete to provide services to small businesses for financial reasons.

A. SFD Program Reforms

Reform the SFD program to use its resources to stimulate a free market in the provision of financial services to small businesses by providing financial, rather than political, reasons for banks and other institutions to participate in this market. Incentives could be in the form of subsidies of the cost of inaugurating special small credit programs within these institutions rather than subsidized interest rates for SME borrowers. Incentives should be structured to encourage banks to participate at both the retail and wholesale level, where in the latter case, other institutions, such as foundations, would provide the retail service.

B. NGO Model Reforms

The financial track record of ABA, that is, its widely diversified portfolio, its strict operational policies and tight financial reporting, its low loan loss experience and its financially self-sustaining operations, should merit lines of credit from formal financial similar to those extended to other businesses. However, to attract such wholesale funding from commercial banks, foundations such as ABA must be allowed to obtain a legal status similar to that of a joint stock company while retaining their non-profit advantages. The drafting of new, modern legislation governing financial institutions such as ABA is required and recommended.

The design of this new legislation should create a new category of financial institutions, perhaps called SME Finance Companies, which would:

- Cater to micro, small and medium enterprises demand for financial services;
- Initially be non-deposit taking institutions. However, the new legislation and resulting Central Bank of Egypt regulations should be drafted with enough flexibility to allow for these

institutions to evolve and mobilize deposits once the CBE has additional staff trained to supervise this new industry. Prior to achieving deposit-taking status, these institutions could provide savings services indirectly through the branches of their correspondent commercial banks;

- Be subject to a special supervisory division of the Central Bank of Egypt;
- Be required by CBE regulation to operate according to the "best practices" guidelines for microenterprise lending;
- Once they have become deposit taking, these institutions should have minimum capital requirements set at some prudent level, perhaps LE25 million;
- Be rated annually by an independent, non-governmental group, on the basis of financial performance and adherence to the "best practices" guidelines for microenterprise lending;
- Be required to publish audited annual reports and unaudited semi-annual reports according to a specific "full disclosure" format.

The new legislation should also specifically allow for the conversion of existing NGOs or foundations to the new form of institution. Accounting standards should be adjusted, if necessary, to classify grants from government, donor agencies or others as part of the equity accounts of the new institutions.

Reforms to the SFD program suggested above should conform to this new legislation in that SFD resources should be restricted to those organizations which conform to best practice guidelines and achieve above average rating standards.

C. Bank Microfinance Unit Model Reforms

Donors and the Government should encourage the establishment of special units within banks to stimulate both wholesale and retail SME lending through the provision of subsidies to cover start-up costs. A program of incentives (e.g. tax relief partial subsidy to cover start-up costs) to create SME lending units should also be considered. Wholesale lending could be directed to non-bank financial institutions following best practice guidelines, and again, the reforms to the SFD program suggested above should support these new units with SFD resources only when they conform to these guidelines.

D. Credit Guarantee Model Reforms

The donors and the government should encourage the expansion of the private sector Credit Guarantee Corporation program rather than dilute its focus or compete with it. CGC is a young company still perfecting its credit guarantee operating system. The low level of guarantees outstanding in relation to CGC's overall collateral funds, and the low level penetration among CGC's thirty-two client banks, suggest that CGC needs to market its loan guarantee products more aggressively. However, CGC is being encouraged by USAID to greatly expand its role to include issuing new types of guarantees (exports and leasing) and administering USAID's microfinance program. These diversifications will present significant organizational challenges to CGC.

Indeed, successfully integrating its new functions without jeopardizing existing business will require careful planning and resource allocation, especially in the case of USAID's microfinance program which represents a significant departure from business as usual at CGC. Successfully absorbing its new role will require special attention on the part of senior management, careful planning, and fresh training for existing and new management and staff, all of which will divert management attention from its core loan guarantee business. As with diversification in any organization, caution is highly recommended.

It is further recommended that CGC be discouraged from entering into the export credit guarantee business for two reasons. First and foremost, this is a highly specialized line of work more closely resembling the insurance industry than the credit guarantee business. Second, and as indicated in the accompanying study on trade finance reform, the Export Credit Guarantee Company of Egypt (ECGE) has found limited demand for export credit guarantees because of the low level of Egyptian exports.

The desire for an expanded loan guarantee program has reportedly led to high-level government proposals for development of an Egyptian small business administration modeled on the U.S. Small Business Administration (SBA). The need and desirability of such a new Egyptian government program is clearly in question given the serious questions about the efficacy of SBA guarantees which have been raised in the United States and the high operating costs of government run programs elsewhere in the world.[56] Clearly, a private sector managed CGC which continues to bring down its guarantee costs through expansion of its guarantee business offers the better alternative for Egypt.

D. The Leasing Model

While the new legal and regulatory environment appears to be supportive of leasing, the government will need to carefully monitor the performance of this emerging financing industry to ensure that the potential growth is realized.

4. General Recommendations

First, trade liberalization policies should be accelerated to provide increased opportunities to the SME sector. Trade liberalization has a positive impact on increasing the competition among importers and traders. Consequently, increased competition among wholesalers of raw materials supplying many entrepreneurs operating micro, small, and medium scale enterprises presents incentives for these suppliers to engage in offering trade loans as a marketing facility to encourage the sale of their commodities. On the other hand, trade liberalization encourages exports which opens new channels for sale in new expanded markets.

Second, removing the laws prohibiting foreign-owned trading companies and providing incentives to marketing and/or trading companies which would assist in marketing the finished products for SMEs in both domestic and foreign markets should be pursued. This task could involve

[56] GrahamBannock and PartnersLtd, 1997, volume I, Page 58.

organizing a larger scale of operation which would act as a middleman between local enterprises and larger scale enterprises or foreign customers and assist in brokering information and transferring customer advances to the enterprises which would serve as a source of financing for working capital.

Third, efforts should focus primarily on providing financial and non-financial services to small and medium scale enterprises with growth potential. Findings of the study support that small and medium scale enterprises are the growth engines of the economy rather than microenterprises which are more typically income generation vehicles. This does not imply that initiatives focusing on providing financial and support services to microenterprises are not worthwhile, however it is important to recognize the limitations of the expected outcome of these efforts.

Fourth, efforts should also focus on providing financial and non-financial services to young enterprises with growth potential. Young enterprises are typically those in their early stages of growth, in contrast to start-up enterprises which have a high degree of failure.

Fifth, and finally, efforts should focus on relaxing the non-financial constraints that limit enterprise growth. Tax laws, labor laws, marketing, and government bureaucratic procedures and red tape were all suggested by entrepreneurs to present significant problems limiting their operations and growth. Improved access to input and output markets, more efficient government procedures, amended labor and tax laws that foster SME growth would provide a more conducive environment for business development in general.

Appendix A

The SME Survey Tables

Table 1. Characteristics of the Firms in the Enterprise Survey.

	Micro	Small	Medium	Total Sample
Sample Size	(n=84)	(n=64)	(n=25)	(n=173)
Sectors				
Manufacturing	62%	56%	72%	62%
Services	14%	23%	16%	18%
Trade	24%	19%	12%	20%
Location				
Cairo	51%	33%	28%	41%
6th of October	1%	6%	16%	5%
10th of Ramadan	1%	6%	16%	5%
Alexandria	25%	37%	32%	31%
Fayoum	21%	17%	8%	18%
Ownership Structure				
Proprietorship	71%	55%	24%	58%
Partnership	18%	28%	60%	28%
Simple Commandite	1%	11%	12%	6%
Informal Partnership	1%	0%	0%	1%
Inheritance/ De-Facto	8%	3%	0%	5%
Limited liability/ Joint Stock	0%	3%	4%	2%
Business Possesses				
Registration	82%	95%	96%	89%
License	84%	98%	96%	91%
Tax Card	90%	98%	100%	95%
Social Security for All Employees	58%	70%	88%	67%
Social Security for Some Employees	21%	25%	12%	21%
Formalization of Business[a]				
Formal Business	54%	70%	88%	65%
Semi-Formal Business	14%	23%	8%	17%
Informal Business	32%	7%	4%	18%
Reason for not Formalizing the Business:				
Difficult Procedures	75%	70%	67%	73%
Lengthy Procedures	3%	20%	33%	10%
Costly Procedures	19%	10%	0%	15%
Nobody Complies with Procedures	3%	0%	0%	2%

Source: DEPRA Enterprise Survey, 1997.

Note a: Formal enterprises fulfilled all four requirements including registration, licensing, possessing a tax card, and making social security payments for all their employees; semi-formal businesses fulfilled registration, licensing, possessing a tax card, and making social security payments for at least some of their employees; and informal did not satisfy at least one of the four requirements.

Table 2. Profile of the Firms in the Enterprise Survey[a].

	Micro	Small	Medium	Total Sample
Establishment Profile				
Avg. Number of Years in Operation	16 (12)	14 (10)	18 (17)	15 (12)
Avg. No. of Years Entrepreneur in Business	15 (10)	13 (10)	18 (17)	11 (11)
Avg. Age of Entrepreneur	44 (42)	46 (46)	47 (48)	45 (45)
Avg. Value of Physical Assets[b]	26 (6)	630 (80)	3286 (2500)	709 (20)
Avg. Number of Start-up Employees	4 (3)	9 (7)	27 (25)	9 (5)
Avg. Number of Employees Last Year	4 (4)	19 (13)	86 (88)	21 (9)
Avg. Number of Current Employees	4 (4)	21 (15)	91 (95)	23 (10)
Avg. Annual Growth Rate[c]	7 (3)	34 (11)	38 (14)	22 (7)
Avg. Growth in Production over the last Year	55 (0)	6 (3)	6 (10)	3 (0)

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000

Note c: Annual average growth rate measured by change in number of employees over the years the enterprise has been in operation.

Table 3. Selected Characteristics of the Entrepreneurs in the Enterprise Survey.

	Micro	Small	Medium	Total Sample
Gender				
Male	92%	95%	96%	94%
Female	8%	5%	4%	6%
Education Level				
Post Graduate	0%	3%	4%	2%
University Graduate	20%	39%	52%	32%
Technical	20%	19%	8%	18%
High School	6%	8%	4%	6%
Basic Education	18%	6%	16%	13%
Read & Write	23%	23%	12%	21%
Read	4%	0%	0%	2%
Illiterate	9%	2%	4%	6%
Position in Business				
Owner	81%	70%	52%	73%
Partner	15%	19%	24%	18%
Manager	4%	11%	24%	9%
Other Employment				
Other Private Business	0%	3%	4%	2%
Private Sector Employee	2%	0%	0%	1%
Public Sector Employee	0%	0%	0%	0%
Government Employee	5%	2%	0%	3%
None	93%	95%	96%	94%

Source: DEPRA Enterprise Survey, 1997.

Table 4. Selected Characteristics of the Enterprise by location[a].

	Greater Cairo	Alexandria	Fayoum
Sample Size	(n=89)	(n=53)	(n=31)
Establishment Profile			
Average Number of Years in Operation	16 (14)	18 (17)	8 (7)
Average Number of Start-up Employees	10 (5)	11 (6)	4 (3)
Average Number of Current Employees	26 (9)	23 (11)	14 (6)
Average Value of Physical Assets[b]	816 (35)	932 (20)	49 (15)
Sector of Operation			
Manufacturing	69%	55%	55%
Services	12%	24%	22%
Trade	19%	21%	23%
Gender			
Male	95%	98%	81%
Female	5%	2%	19%
Size Categories: (No. of Employees)			
Micro: (1 - 9)	50%	40%	58%
Small: (10 - 49)	33%	45%	35%
Medium: (50 - 100)	17%	15%	6%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000

Table 5. Selected Characteristics of Enterprises by Gender[a].

	Male Entrepreneurs	Female Entrepreneurs
Sample Size	(n=162)	(n=11)
Establishment Profile		
Average Number of Years in Operation	16 (13)	9 (7)
Average Number of Start-up Employees	10 (5)	3 (3)
Average Number of Current Employees	24 (10)	14 (6)
Average Size of Physical Assets[b]	758 (25)	17 (10)
Size Categories: (No. of Employees)		
Micro: (1 - 9)	47%	64%
Small: (10 - 49)	38%	27%
Medium: (50 - 100)	15%	9%
Sector of Operation		
Manufacturing	62%	64%
Services	18%	9%
Trade	20%	27%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000

Table 6. Selected Characteristics of Enterprises by Sector of Operation[a].

	Manufacturing	Services	Trade
Sample Size	(n=107)	(n=31)	(n=35)
Establishment Profile			
Avg. No. of Years in Operation	14 (12)	15 (13)	18 (17)
Avg. No. of Start-up Employees	10 (5)	11 (5)	6 (3)
Avg. No. of Current Employees	26 (10)	25 (13)	14 (4)
Avg. Size of Physical Assets[b]	633 (23)	1530 (55)	227 (10)
Avg. Annual Growth Rate[c]	29 (7)	12 (7)	9 (7)
Avg. Growth in Production over the last Year	3 (0)	10 (5)	-14 (0)
Size Categories: (No. of Employees)			
Micro: (1 - 9)	49%	39%	57%
Small: (10 - 49)	34%	48%	34%
Medium: (50 - 100)	17%	13%	9%
Gender Composition:			
Male	94%	97%	91%
Female	6%	3 %	9%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000

Table 7. Sources of Investment Capital Reported in the Enterprise Survey by Size of Business.

	Micro	Small	Medium	Total Sample
Investment Capital				
Personal Investment from Savings	87%	69%	64%	77%
Family & Friends	4%	3%	0%	3%
Bank Loan	8%	27%	36%	19%
NGO Loan	1%	0%	0%	0.6%
Supplier Loan	0%	1%	0%	0.6%

Source: DEPRA Enterprise Survey, 1997.

Table 8. Sources of Investment Capital Reported in the Enterprise Survey by Sector of Operation.

	Manufacturing	Service	Trade	Total Sample
Investment Capital				
Personal Investment from Savings	77%	77%	77%	77%
Family & Friends	2%	0%	9%	3%
Bank Loan	19%	23%	14%	19%
NGO Loan	1%	0%	0%	0.6%
Supplier Loan	1%	0%	0%	0.6%

Source: DEPRA Enterprise Survey, 1997.

Table 9. Selected Indicators of the Relations between Entrepreneurs and Suppliers by Size of Business.

	Micro	Small	Medium	Total Sample
Contractual Relations with Suppliers				
Public National Suppliers	1%	3%	12%	3.5%
Private National Suppliers	94%	88%	40%	82%
Foreign Suppliers	0%	3%	12%	3%
More than One Supplier	4%	6%	36%	9%
Form of Payment				
Retained Earnings	62%	77%	84%	70%
Credit	48%	53%	80%	55%
Advance Payment	8%	23%	36%	18%
Consignment	2%	6%	4%	4%

Source: DEPRA Enterprise Survey, 1997.

Table 10. Selected Characteristics of the Trade Credit Relation (Credit Payment) between Entrepreneurs and Suppliers by Size of Business[a].

	Micro	Small	Medium	Total Sample
Entrepreneurs Using Supplier Credit	(n=40)	(n=34)	(n=20)	(n=95)
Ave. Value of Transaction[b]	3 (1)	37 (5)	673 (300)	16 (5)
Ave. No. of Transactions/yr.	23 (7)	44 (10)	7 (5)	27 (7)
Ave. Value of Credit[b]	3 (1)	23 (4)	368 (200)	75 (3)
Entrepreneurs charged zero interest	80%	73%	78%	75%
Avg. Interest Rate (interest >0)[c]	9 (10)	10 (4)	12 (10)	10 (8)
Avg. Duration of Credit (Days)	89 (90)	121 (90)	120 (90)	107 (90)
Use of Security	35%	50%	75%	49%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Note c: Average interest or mark-up over the transaction period was calculated for the number of entrepreneurs who were charged positive interest rates.

Table 11. Selected Indicators of the Relations between Entrepreneurs and Suppliers by Sector of Operation.

	Manufacturing	Service	Trade	Total Sample
Contractual Relations with Suppliers				
Public National Suppliers	6%	0%	0%	3.5%
Private National Suppliers	80%	94%	89%	82%
Foreign Suppliers	2%	0%	9%	3%
More than One Supplier	12%	6%	3%	9%
Form of Payment				
Retained Earnings	74%	87%	46%	70%
Credit	54%	23%	83%	55%
Advance Payment	18%	10%	26%	18%
Consignment	2%	0%	14%	4%

Source: DEPRA Enterprise Survey, 1997.

Table 12. Selected Characteristics of the Trade Credit Relation (Credit Payment) between Entrepreneurs and Suppliers by Sector of Operation[a].

	Manufacturing	Service	Trade	Total Sample
Entrepreneurs Using Supplier Credit	(n=59)	(n=7)	(n=29)	(n=95)
Ave. Value of Transaction[b]	417 (7)	514 (4)	96 (4)	16 (5)
Ave. No. of Transactions/yr.	26 (6)	35 (7)	27 (10)	27 (7)
Ave. Value of Credit[b]	51 (3)	416 (3)	31 (3)	75 (3)
Entrepreneurs charged zero interest	79%	72%	79%	75%
Ave. Interest Rate[c] (interest>0)	11 (4)	14 (14)	8 (9)	10 (8)
Ave. Duration of Credit (Days)	99 (90)	127 (90)	120 (90)	107 (90)
Use of Security	52%	28%	48%	49%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Note c: Average interest or mark-up over the transaction period was calculated for the number of entrepreneurs who were charged positive interest rates.

Table 13. Selected Indicators of the Relations between Entrepreneurs and Customers by Size of Business.

	Micro	Small	Medium	Total Sample
Contractual Relations with Customers				
Domestic Customers	92%	80%	68%	84%
Foreign Customers	0%	3%	4%	2%
Domestic & Foreign	8%	17%	28%	14%
Form of Purchase				
Cash	77%	86%	88%	82%
Credit	36%	52%	60%	46%
Advance Payment	26%	22%	40%	27%
Consignment	1%	6%	12%	5%

Source: DEPRA Enterprise Survey, 1997.

Table 14. Selected Characteristics of the Trade Credit Relation (Advance Payment) between Entrepreneurs and Customers by Size of Business[a].

	Micro	Small	Medium	Total Sample
Entrepreneurs Using Customer Advances	(n=22)	(n=15)	(n=10)	(n=47)
Ave. Value of Transaction[b]	3 (2)	39 (12)	522 (107)	127 (5)
Number of Transactions/yr.	32 (5)	10 (8)	4 (2)	19 (5)
Ave. Value of Advance[b]	1 (1)	17 (4)	134 (54)	35 (2)
Ave. Duration of Credit (Days)	30 (20)	39 (30)	53 (35)	38 (30)
Use of Security	54%	93%	91%	74%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Table 15. Selected Indicators of the Relations between Entrepreneurs and Customers by Sector of Operation.

	Manufacturing	Service	Trade	Total Sample
Contractual Relations with Customers				
Domestic Customers	77%	97%	94%	84%
Foreign Customers	2%	3%	0%	2%
Domestic & Foreign	21%	0%	6%	14%
Form of Purchase				
Cash	74%	97%	94%	82%
Credit	61%	13%	26%	46%
Advance Payment	33%	29%	6%	27%
Consignment	7%	0%	0%	5%

Source: DEPRA Enterprise Survey, 1997.

Table 16. Selected Characteristics of the Trade Credit Relation (Advance Payment) between Entrepreneurs and Customers by Sector of Operation[a].

	Manufacturing	Service	Trade	Total Sample
Entrepreneurs Using Customer Advances	(n=36)	(n=9)	(n=2)	(n=47)
Ave. Value of Transaction[b]	41 (4)	420 (26)	305 (305)	127 (5)
Number of Transactions/yr.	14 (5)	42 (10)	5 (5)	19 (5)
Ave. Value of Advance[b]	14 (2)	102 (11)	105 (105)	35 (2)
Ave. Duration of Credit (Days)	38 (30)	33 (10)	60 (60)	38 (30)
Use of Security	22%	100%	100%	74%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000

Table 17. Selected Characteristics of the Informal Loans Entrepreneurs Use by Size of Business[a].

	Micro	Small	Medium	Total Sample
Ever Requested an Informal Loan	48%	25%	16%	35%
Ever Rejected an Informal Loan	1%	0%	0%	0.6%
Used an informal loan Last Year	42%	19%	12%	29%
Ave. Number of Loans Last Year	5 (2)	4 (2)	1 (1)	4 (2)
Source of Most Significant Loan				
Friends	18%	3%	4%	10%
Family in Egypt	23%	16%	8%	18%
Money Lender	1%	0%	0%	1%
Ave. Number of Days to get Loan	5 (2)	6 (2)	2 (2)	5 (2)
Ave. Value of Loan[b]	3 (1.5)	16 (5)	22 (14)	7 (2)
Ave. Interest on Loans	1 (0)	3 (0)	0 (0)	1.6 (0)
Ave. Duration of Loan (Days)	140 (87)	216 (165)	110 (90)	157 (90)
Ave. Value of Collateral as % of Loan	0	0	0	0

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Table 18. Selected Characteristics of Entrepreneurs Demand for Formal Loans by Size of Business.

	Micro	Small	Medium	Total Sample
Never Requested a Formal Loan	68%	45%	28%	54%
Reason for Never Requesting a Loan:				
Insufficient Collateral	12%	3%	0%	8%
No Financial Statements	0%	0%	0%	0%
High Interest	12%	19%	12%	14%
Difficult Procedures	16%	6%	12%	12%
No Banking Experience	3%	3%	0%	3%
Availability of Other Sources	14%	31%	50%	23%
Religious Reasons	12%	22%	25%	16%
Fear of Inability of Repayment	30%	12%	0%	22%
Other	0%	3%	0%	0%
Request for Formal Loan Rejected	7%	3%	8%	6%
Reason for Being Rejected:				
Insufficient Collateral	2%	3%	4%	3%
No Financial Statements	1%	0%	0%	1 %
No Banking Experience	4%	0%	4%	2%

Source: DEPRA Enterprise Survey, 1997.

Table 19. Selected Characteristics of Formal Loans Entrepreneurs Used in the Past Year by Size of Business[a].

	Micro	Small	Medium	Total Sample
Used a Formal Loan in the Past	25%	52%	66%	48%
Used a Formal Loan Last Year	20%	44%	64%	35%
Characteristics of Last Year Loans:				
Ave. Number of Loans Last Year	2 (1)	2 (1)	4 (1)	2 (1)
Source of Most Significant Loan:				
Public Bank	19%	36%	44%	28%
Private/Joint Venture Bank	1%	8%	20%	7%
Loan Associated with Special Program				
Social Fund for Development	8%	3%	0%	5%
Credit Guarantee Corporation	0%	0%	4%	1%
NGO	4%	3%	0%	3%
Type of Last Year Loan:				
Working Capital Loan	15%	27%	25%	21%
Fixed Assets Loan	4%	9%	9%	6%
Domestic Letter of Credit	1%	2%	4%	2%
Foreign Letter of Credit	0%	3%	13%	3%
Discount of Drafts	0%	3%	9%	2%
Letter of Guarantee	0%	0%	4%	1%
Loan Size Rationed Borrowers as a % of Total Number of Borrowers	29%	19%	13%	20%
Ave. Number of Days to get Loan	35 (30)	41 (15)	15 (15)	33 (15)
Ave. Value of Loan[b]	17 (15)	360 (200)	1326 (1000)	509 (170)
Ave. Interest and Fees Charges (%)	13 (10)	15 (16)	16 (16)	15 (16)
Ave. Duration of Loan (months)	20 (12)	24 (15)	17 (12)	21 (12)
Ave. Value of Collateral as % of Loan	183 (100)	148 (120)	133 (120)	155 (120)
Type of Collateral:				
Real Estate	2%	2%	4%	2%
Machinery	4%	3%	4%	4%
Inventory	0%	0%	0%	0%
Bank Accounts	2%	4%	12%	4%
More than One Collateral	12%	35%	44%	25%

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Table 20. Current Funding Sources Reported in the Enterprise Survey by Size of Business[a].

	Micro	Small	Medium	Total Sample
Sources of Funds:				
Retained Earnings (Cash)	62%	77%	84%	70%
Avg. Value Last Year[b]	15 (3)	238 (45)	2256 (1020)	503 (35)
Trade Credit (Supplier/Customer)	65%	62%	84%	65%
Avg. Value Last Year[b]	25 (6)	172 (32)	1664 (390)	340 (17)
Informal Loans	42%	19%	12%	29%
Avg. Value Last Year[b]	11 (3)	81 (10)	22 (14)	28 (4)
Formal Loans	19%	44%	64%	35%
Avg. Value Last Year[b]	39 (10)	674 (200)	7606 (1500)	2319 (200)

Source: DEPRA Enterprise Survey, 1997.
Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.
Note b: L.E. 1000

Table 21. Current Funding Sources Reported in the Enterprise Survey by Sector of Operation[a].

	Manufacturing	Service	Trade	Total Sample
Sources of Funds:				
Retained Earnings (Cash)	74%	87%	46%	70%
Avg. Value Last Year[b]	637 (35)	274 (34)	239 (31)	503 (35)
Trade Credit (Supplier/Customer)	70%	45%	83%	65%
Avg. Value Last Year[b]	328 (12)	572 (50)	248 (40)	340 (17)
Informal Loans	27%	22%	40%	29%
Avg. Value Last Year[b]	25 (4)	31 (3)	35 (5)	28 (4)
Formal Loans	37%	32%	23%	35%
Avg. Value Last Year[b]	2678 (150)	767 (625)	2470 (225)	2319 (200)

Source: DEPRA Enterprise Survey, 1997.
Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.
Note b: L.E. 1000.

Table 22. Savings Channels Reported in the Enterprise Survey by Size of Business.

	Micro	Small	Medium	Total Sample
Entrepreneurs Holding Deposits in Formal Institution	30%	81%	84%	57%
Avg. Number of Current Accounts	1 (1)	1 (1)	2 (2)	1.5 (1)
Avg. Number of Savings Accounts	1 (1)	1 (1)	1 (1)	1.3 (1)
Avg. Number of Fixed Deposit Accounts	1 (1)	1 (1)	1 (1)	1 (1)
Entrepreneurs Participating in Informal Groups (Gam'iyat)	39%	25%	8%	30%
Avg. No. of Groups Participating in	2 (1)	1 (1)	1 (1)	1.7 (1)
Avg. Size of Contribution[b]	8 (1)	7 (6)	20 (20)	9 (5)
Informal Collectors				
Entrepreneur Saving with Collectors	5%	5%	0%	4%
Avg. size of Deposit[b]	3 (3)	3 (2)	0	3 (2)

Source: DEPRA Enterprise Survey, 1997.

Note a: Statistics reported present means and medians in parenthesis for the given sample. Missing information did not exceed a few observations for a given variable.

Note b: L.E. 1000.

Table 23. Selected Indicators of Constraints and Problems Facing the Entrepreneurs by Size of Business.

	Micro	Small	Medium	Total Sample
Most Significant Problem:				
Weak Demand	31%	13%	8%	21%
Marketing	11%	16%	20%	14%
Labor Problems	5%	11%	28%	10%
Raw Materials	12%	9%	4%	10%
Infrastructure	4%	2%	0%	2%
Financing Costly	0%	3%	0%	1%
Insufficient Sources of Financing	8%	6%	4%	7%
Domestic Competition	14%	8%	4%	10%
foreign Competition	0%	0%	4%	0.6%
Taxes	8%	22%	12%	14%
Government Procedures	4%	3%	8%	4%
Customs	1%	0%	0%	0.6%
Problems with Clients	1%	3%	0%	2%
Machinery & Technology	1%	0%	4%	1%
Others		3%	4%	2%
Second Most Significant Problem:				
Weak Demand	8%	7%	0%	6%
Marketing	10%	15%	5%	11%
Labor Problems	0%	3%	19%	4%
Raw Materials	16%	8%	29%	15%
Infrastructure	1%	3%	5%	2%
Financing Costly	2%	7%	5%	4%
Insufficient Sources of Financing	10%	5%	5%	7%
Insufficient Guarantees	0%	2%	0%	0.6%
Domestic Competition	13%	13%	5%	12%
Foreign Competition	0%	2%	5%	1%
Taxes	21%	12%	5%	16%
Government Procedures	9%	10%	9%	9%
Export Problems	0%	0%	5%	0.6%
Customs	0%	2%	5%	1%
Problems with Clients	8%	10%	0%	7%
Machinery & Technology	1%	2%	0%	1%

Source: DEPRA Enterprise Survey, 1997.

Table 24. Selected Indicators of Constraints and Problems Facing Entrepreneurs who did not Experience Growth in Production over the Past Year by Size of Business.

	Micro	Small	Medium	Total Sample
Number of Competitors in Market				
1-2	7%	11%	8%	9%
3-5	16%	11%	16%	14%
6-10	19%	12%	12%	15%
11+	58%	66%	64%	62%
Most Significant Problem if no Growth:				
Weak Demand	42%	31%	46%	39%
Marketing	6%	20%	15%	11%
Labor Problems	0 %	3%	15%	3%
Raw Materials	4%	3%	0%	3%
Infrastructure	1%	0%	0%	1%
Financing Costly	3%	3%	15%	4%
Insufficient Sources of Financing	14%	14%	0%	12%
Domestic Competition	18%	9%	0%	13%
Foreign Competition	0%	3%	0%	1%
Taxes	8%	6%	8%	7%
Machinery & Technology	0%	3%	0%	1%
Others	3%	6%	0%	3%
Second Most Significant Problem if no Growth:				
Weak Demand	6%	7%	0%	6%
Marketing	8%	10%	0%	8%
Labor Problems	3%	7%	11%	5%
Raw Materials	11%	3%	22%	10%
Financing Costly	2%	0%	0%	1%
Insufficient Sources of Financing	9%	10%	11%	10%
Domestic Competition	29%	31%	11%	28%
Foreign Competition	0%	3%	0%	1%
Taxes	24%	21%	22%	23%
Government Procedures	6%	3%	0%	5%
Export Problems	0%	3%	11%	2%
Customs	2%	0%	0%	1%
Others	0%	0%	11%	1%

Source: DEPRA Enterprise Survey, 1997.

Table 25. Selected Indicators of Constraints and Problems Facing Micro Entrepreneurs

	No Problem	Some Problems	Severe Problem	Normalization
Strong Competition	26%	38%	36%	55%
Weak Demand	21%	31%	48%	63%
Business Registration	87%	2%	11%	12%
Export Procedures in Foreign Markets	29%	57%	14%	42%
Quality Products for Foreign Markets	29%	57%	14%	42%
Timely Delivery of Exports	43%	57%	0%	28%
Costly Raw Materials	33%	17%	50%	58%
Lack of Raw Materials	67%	16%	16%	24%
Costly Equipment	53%	21%	25%	35%
Lack of Technical Labor	75%	9%	16%	20%
Labor Laws	80%	4%	16%	18%
Tax Laws	24%	18%	58%	67%
Government Procedures	31%	19%	49%	58%
Infrastructure	63%	13%	23%	29%
Inflation	26%	15%	60%	67%
Lack of Financing from Suppliers	61%	11%	28%	33%
Lack of Financing from Banks	52%	9%	39%	43%
Financing from Banks Costly	24%	17%	59%	67%
Insufficient Guarantees	58%	8%	35%	39%
Banking Procedures Lengthy	49%	13%	37%	43%
Client Repayment Problems	54%	24%	22%	34%
Insufficient Information	83%	11%	6%	11%
Instability of Investment Environment	70%	17%	12%	20%

Source: DEPRA Enterprise Survey, 1997.

Table 26. Selected Indicators of Constraints and Problems Facing Small Scale Entrepreneurs

	No Problem	Some Problems	Severe Problem	Normalization
Strong Competition	36%	32%	32%	48%
Weak Demand	42%	23%	35%	46%
Business Registration	92%	2%	7%	8%
Export Procedures in Foreign Markets	40%	33%	27%	43%
Quality Products for Foreign Markets	19%	50%	31%	56%
Timely Delivery of Exports	71%	29%	0%	14%
Costly Raw Materials	47%	17%	36%	44%
Lack of Raw Materials	72%	15%	12%	19%
Costly Equipment	49%	16%	34%	42%
Lack of Technical Labor	56%	13%	31%	37%
Labor Laws	61%	14%	24%	31%
Tax Laws	29%	9%	62%	66%
Government Procedures	45%	5%	50%	52%
Infrastructure	60%	3%	37%	38%
Inflation	32%	18%	50%	59%
Lack of Financing from Suppliers	59%	15%	26%	33%
Lack of Financing from Banks	63%	8%	28%	32%
Financing Costly from Banks	33%	13%	53%	59%
Insufficient Guarantees	86%	14%	0%	7%
Banking Procedures Lengthy	55%	16%	29%	37%
Client Repayment Problems	56%	21%	23%	33%
Insufficient Information	71%	11%	17%	22%
Instability of Investment Environment	61%	27%	12%	25%

Source: DEPRA Enterprise Survey, 1997.

Table 27. Selected Indicators of Constraints and Problems Facing Medium Scale Entrepreneurs.

	No Problem	Some Problems	Severe Problem	Normalization
Strong Competition	56%	16%	28%	36%
Weak Demand	40%	20%	40%	50%
Business Registration	100%	0%	0%	0%
Export Procedures in Foreign Markets	50%	50%	0%	25%
Quality Products for Foreign Markets	57%	43%	0%	21%
Timely Delivery of Exports	71%	29%	0%	14%
Costly Raw Materials	42%	8%	50%	54%
Lack of Raw Materials	67%	21%	12%	22%
Costly Equipment	48%	26%	26%	39%
Lack of Technical Labor	25%	25%	50%	62%
Labor Laws	60%	4%	36%	38%
Tax Laws	36%	16%	48%	56%
Government Procedures	33%	21%	46%	56%
Infrastructure	52%	12%	36%	42%
Inflation	37%	21%	42%	52%
Lack of Financing from Suppliers	61%	4%	35%	37%
Lack of Financing from Banks	50%	14%	36%	43%
Financing Costly from Banks	30%	13%	56%	62%
Insufficient Guarantees	86%	4%	9%	11%
Banking Procedures Lengthy	61%	17%	22%	30%
Client Repayment Problems	54%	21%	25%	35%
Insufficient Information	62%	12%	25%	31%
Instability of Investment Environment	57%	39%	4%	23%

Source: DEPRA Enterprise Survey, 1997.

Table 28. Definition of Variables in the Simultaneous Equations Model: Determinants of the Use of the Different Sources of Financing

Variables	Definition
Exogenous Variables	
K	Physical assets (L.E.);
P	Total value of output (L.E.);
T	Total cost of inputs (L.E.);
YRS	Number of years the enterprise has been in operation;
MNF	Dummy variable = 1 for manufacturing;
SRV	Dummy variable = 1 for services;
SMALL	Dummy variable = 1 for small scale enterprises;
MEDIUM	Dummy variable = 1 for medium scale enterprises;
AGE	Age of the entrepreneur (Years);
EDUC	Educational level of the entrepreneur;
ACCT	Dummy variable=1 for entrepreneurs using a bank deposit account;
ITL	Interest rate on trade loans;
IFL	Interest rate on formal loans;
Endogenous Variables	
RE	Retained Earnings;
TL	Trade Loans;
IL	Informal Loans;
FL	Formal loans.

Table 29. Results of the Reduced Form Equations of the Model: Determinants of the Use of the Different Sources of Financing (Log Functional Form).

Variables	TOBIT (RE)	TOBIT (TL)	TOBIT (IL)	TOBIT (FL)
Const.	+*	+*	+***	-
K	+	+	-*	+ ***
PT	+**	- *	+	+
YRS	+	+*	-	- **
MNF	+ **	-	- *	+
SRV	+ ***	- **	-	-
SMALL	+**	+	-	-
MEDIUM	+**	+*	-	-
AGE	-*	-	-	-
EDUC	-	+	- **	- **
ACCT	+*	+	-	+ *
ITL	-**	+*	+**	-
IFL	+	+	-	+ ***
Log-Likelihood	-408.1	-390.8	-228.6	-143.6

***, ** & * represent significance at 1, 5 and 10 percent levels, respectively.

Table 30. Results of the Second-Stage Estimation of the Model: Determinants of the Use of the Different Sources of Financing (Log Functional Form).

Variables	TOBIT (RE)	TOBIT (TL)	TOBIT (IL)	TOBIT (FL)
Const.	3.9 (2.2)**	3.6 (3.2)	5.69 (1.8)***	-2.24 (2.36)
PT	0..05 (0.13)	-0.14 (0.09)*	0.05 (0.12)	0.17 (0.21)
K	0.09 (0.05)*	0.01 (0.07)	-0.05 (0.68)	0.34 (0.09)***
YR	0.23 (0.13)*	0.12 (0.14)	-0.19 (0.12)*	-0.34 (0.16)**
MNF	0.24 (0.27)	-0.31 (0.29)	-0.44 (0.27)*	0.08 (0.42)
SRV	-0.41 (0.50)	-0.79 (0.32)**	-0.41 (0.35)	-0.08 (0.57)
SMALL	0.50 (0.22)**	0.07 (0.23)	-0.10 (0.26)	-0.29 (0.44)
MEDIUM	1.27 (0.51)	0.56 (0.35)*	-0.05 (0.45)	-0.12 (0.66)
AGE	-1.1 (0.54)	-0.77 (0.60)*	-1.19 (0.51)**	-0.56 (0.66)
EDUC	0.05 (0.22)	0.09 (0.23)	-0.30 (0.25)	-0.72 (0.31)**
ACCT	0.46 (0.22)**	0.06 (0.22)	-0.08 (0.25)	0.69 (0.45)*
ITL		0.22 (0.17)*		
IFL				1.88 (0.16)***
CHAT				-0.01 (0.11)
TLHAT	-0.22 (0.13)*			
ILHAT		-0.08 (0.15)		
FLHAT			-0.035 (0.02)*	
Log-Likelihood	-409.18	-390.84	-229.44	-143.58

Asymptotic standard errors are reported in parentheses.
***, ** & * represent significance at 1, 5 and 10 percent levels, respectively.

Table 31. Definition of Variables in the Growth Model.

Variables	Definition
GRATE	Annual growth rate measured by change in number of employees over the years the enterprise has been in operation.
K	Physical assets (L.E.);
P	Total value of output (L.E.);
T	Total cost of inputs (L.E.);
YRS	Number of years the enterprise has been in operation;
MNF	Dummy variable = 1 for manufacturing;
SRV	Dummy variable = 1 for services;
SMALL	Dummy variable = 1 for small scale enterprises;
MEDIUM	Dummy variable = 1 for medium scale enterprises;
AGE	Age of the entrepreneur (Years);
EDUC	Educational level of the entrepreneur;
ACCT	Dummy variable=1 for entrepreneurs using a bank deposit account;
ITL	Interest rate on trade loans;
IFL	Interest rate on formal loans;
RE	Retained Earnings;
TL	Trade Loans;
IH	Informal Holdings in RoSCAs;
IL	Informal Loans;
FL	Formal loans.

Table 32. Estimation Results of the Growth Rate Model (Log Functional Form).

Variables	TOBIT (GRATE)
Const.	-2.0 (1.7)
	0.16 (0.1)*
K	
YR	-0.28 (0.11)***
	0.39 (0.23)*
SRV	
SMALL	1.08 (0.23)***
	1.41 (0.37)***
AGE	
EDUC	0.24 (0.21)
	-0.04 (0.02)**
IL	
TL	0.03 (0.02)*
	0.01 (0.05)
IH	
ITL	0.04 (0.12)
	-0.19 (0.19)
ACCT	
Log- Likelihood	-262.2

***, ** & * represent significance at 1, 5 and 10 percent levels, respectively.

Appendix B

Egyptian Banking System: 1996

Assets of the Egyptian Banking System

	(LE millions)
Central Bank of Egypt	129,811
Commercial Banks	208,467
Business and Investment Banks	37,348
Specialized Banks	15,303
Total	390,929

Credit Granted by Banks in Egypt

	(LE millions)	Relative Importance	Change from '95
Local Currency Facilities	99,907	78%	20%
Foreign Currency Facilities	28,919	22%	24%
Total	128,826	100%	21%

Credit Granted by Sector in Egypt

(LE millions)	Commercial Banks	Bus. & Inv. Banks	Specialized Banks	Relative Importance	Change from '95
Local Currency	78,444	9,463	12,000	78%	20%
Foreign Currency	21,047	7,240	632	22%	24%
Total Credit	99,491	16,703	12,632	100%	21%
Government sector	13,049	2,418	2,813	14%	10%
Public business sector	27,578	655	3	22%	14%
Private business sector	48,954	12,353	3,605	**50%**	30%
Household sector	8,674	1,184	6,211	12%	19%
Foreign sector	1,236	93	0	1%	-24%
Relative Importance	77%	13%	10%		

Loans & Advances Egyptian Banks by Maturity

(LE millions)	Commercial Banks	Bus. & Inv. Banks	Specialized Banks	Relative Importance	Change from '95
One year or less	*71%*	*74%*	*47%*	*69%*	
In local currency	54,276	5,848	5,849	75%	19%
In foreign currency	15,775	6,291	34	25%	25%
More than one year	*29%*	*26%*	*53%*	*31%*	
In local currency	23,951	3,566	6,152	84%	21%
In foreign currency	5,164	793	597	16%	20%
Relative Importance	77%	13%	10%		

Deposits Held by Banks in Egypt

(LE millions)	Commercial Banks	Bus. & Inv. Banks	Specialized Banks	Relative Importance	Change from '95
Local currency deposits	110,424	8,460	5,840	72%	15%
Foreign currency deposits	42,593	6,809	20	28%	3%
Total Deposits	153,017	15,269	5,860	100%	11%
Demand deposits	18,013	1,031	1,933	12%	3%
Savings deposits	125,177	12,697	3,897	81%	12%
Blocked deposits	9,827	1,541	30	7%	16%
Relative Importance	88%	9%	3%		

Source: Central Bank of Egypt - Annual Report: 1995/96

Banks in Egypt

I. Commercial Banks(28)

A. Public Sector Banks(4)

Bank of Alexandria
Banque Misr
Banque du Caire
National Bank of Egypt

B. Banks Established Under the Investment Law (Private & JV Banks)(23)

Al Watany Bank of Egypt
Alexandria Commercial & Maritime Bank
Bank of Commerce and Development
Banque du Caire et De Paris
Cairo Far East Bank
Commercial Egyptian Bank
Commercial International Bank
Delta International Bank
Egyptian American Bank
Egyptian British Bank
Egyptian Gulf Bank
Egyptian Saudi Finance Bank
Egyptian Workers Bank
Misr America International Bank
Misr Exterior Bank
Misr International Bank
Misr Romanian Bank
Mohandes Bank
National Bank for Development
P. Said National Bank for Development
Suez Canal Bank
The Nile Bank
United Bank of Egypt

C. Banks Established Under Private Laws (1) Faisal Islamic Bank of Egypt

II. Investment and Business Banks(29)

A. Joint Stock Companies (8)

Banque Du Caire Barclays International
Credit International d'Egypte
Egypt Arab African Bank
Housing and Development Bank
Islamic International Bank for Investment & Development
Misr Iran Development Bank
National Societe Generale Bank
Societe Arab International de Banque

B. Banks Established Under Private Laws (4)

Arab African International Bank
Arab Investment Bank
Export Development Bank of Egypt
Union Arab Bank for Development & Investment

C. Foreign Bank Branches (17, excluding those in the process of closure)

American Express Bank Ltd.
Arab Bank
Bank of Nova Scotia
Banque Paribas
Citibank
Credit Suisse First Boston
Credit Lyonnais
Jammal Trust Bank
Mashreq Bank
Middle East Bank
National Bank of Abu Dhabi
National Bank of Greece
National Bank of Oman
National Bank of Pakistan
National Bank of Sudan
Rafidain Bank

III. Specialized Banks (6)

Arab Land Bank
Credit Foncier Egyptien
Industrial Development Bank of Egypt
Naser Social Bank
National Investment Bank
The Prinicpal Bank for Development & Agricultural Credit

Source "Banks Registered with the Central Bank of Egypt in October 1997," Central Bank of Egypt

Appendix C

Scope of Work

Financial Reforms for Small Business Development in Egypt

Development Economic Policy Reform Analysis Project (DEPRA)

Cairo, Egypt

(Task Order 15 - Contract No. 263-C-00-96-00001-00)

August 29, 1997

1. BACKGROUND

As part of Egypt's Economic Reform and Structural Adjustment Program (ERSAP), the financial sector has undergone extensive liberalization since 1991. Credit controls have been eliminated, interest rates have been liberalized, modern banking regulations have been introduced requiring banks to conform to capital adequacy requirements and risk classifications in line with international practice, treasury bill auctions have been introduced to manage liquidity, the foreign exchange regime has been liberalized, and the stock market has been revitalized. However, a considerable amount of further financial development is needed. The financial sector remains dominated by public sector banks, pension and insurance companies with very weak performance allocating saving to productive investments. Private saving is excessively used to finance public sector debt. The remaining formal sector credit is almost exclusively directed to large private sector firms. While small and medium-scale and informal micro enterprises (SMEs) generate the bulk of the value added and employment, the sector is largely excluded from formal financial institution financing, and therefore relies primarily on high-cost informal financing. Extensive donor-subsidized SME financing programs cover less than 5 percent of the sector's needs. Given the priority given to increasing the economy's growth rate and providing expanding employment opportunities to reduce widespread unemployment and underemployment, the Ministry of Economy (MOE) has proposed that DEPRA conduct a financial reform study that focuses on how to make credit more readily available to SMEs.

While there already are a number of GOE and donor special SME financing programs which are supported by extensive research efforts, the lack of SME formal sector financing appears to remain a significant constraint to SME development. Even if there is no actual shortage of SME finance, the issue of such finance is very much on the policy agenda. There is much interest in both the GOE and donor community to expand special programs to overcome the perceived credit shortage. Furthermore, much of the research that has been conducted to date has not been widely distributed, including the excellent unpublished work by the World Bank in 1995 and a number of internal consulting reports prepared for USAID. Hence, a MOE sponsored DEPRA study that was endorsed by the MOE and widely distributed within the GOE and donor community could generate significant dialogue for needed policy reforms. Freshly generated reform proposals from a credible MOE/RIS - DEPRA study could lead to broader understanding and acceptance of the reforms, especially given the current policy environment which is

more supportive of needed reforms than existed prior to the change of government in 1996.

The study will contribute to current knowledge about how credit practices may have changed in recent years in light of expanded financial markets, the advent of leasing companies, and other developments.

The policy recommendations of the proposed study would rest on empirical and theoretical analyses of the constraints and issues relevant to SME development and financing. In particular, the study would evaluate a number of testable hypotheses, such as the following:

1. SMEs have significant potential for growth and employment generation in Egypt, especially small and medium scale enterprises which could capture economies of scale and adopt modern technologies and expand exports.

2. SME growth could be significantly accelerated by increased access to finance.

3. SME financing is constrained by the high cost of providing such credit due to the need to engage in intensive outreach marketing and high loan appraisal and supervision costs.

4. Limited competition in the banking sector (due to such factors as government ownership of commercial banks, controls limiting number of banks, etc.) constrains the provision of credit to SMEs.

5. The proliferation of GOE and donor funded SME programs with subsidized interest rates tends to crowd out the commercial banking sector from SME lending.

6. The difficulties of SMEs providing bankable collateral and the prohibitive cost of collateral recovery through the judicial system disproportionately hampers lending to SMEs, especially smaller SMEs.

7. Bank financing for SMEs will be delayed until the banking sector is further reformed, including the privatization of commercial banks and increased free market competition amongst banks.

8. There is potential for bank lending to SMEs that could provide collateral, documented cash flows and credit histories. Bank lending is not feasible for informal micro enterprises unable to document their creditworthiness.

9. SME financing through leasing, loan guarantees and other informal sector financing products offer the most potential for SME financing in the near term.

10. Some SME special lending programs have demonstrated that they can be replicated commercially, including uncollateralized SME lending, loan guarantees, and leasing.

2. OBJECTIVES

This study is intended to determine the main constraints to providing credit to SMEs that have a potential to grow and provide needed employment in Egypt. Hypotheses regarding SME

development and financing will be tested against empirical evidence and form the basis for policy recommendations. While emphasis will be placed on small and medium enterprises which could capture economies of scale, adopt modern technologies, and/or expand into export markets with improved access to financial sector services, the study would also assess the financing situation of informal sector micro enterprises with growth potential. In addition, the study will focus on the experience of and constraints facing formal and informal financial institutions with SME financing, including special donor and GOE sponsored programs. Various financial products of actual or potential significance to SME financing would be explored, including leasing, loan guarantees, factoring, etc. These analyses would generate recommendations for policy, legal and regulatory reforms and special programs needed to accelerate needed reforms.

3. TASKS

A joint MOE/RIS - DEPRA study team will carry out the following tasks in conducting the study:

Task 1. Review the literature on SMEs and formal and informal financial institutions providing or potentially providing SME financing in Egypt, emphasizing small-scale non-agricultural enterprises that could expand with financing for plant and equipment investments and/or exporting.

Task 2. Review the experience in other countries with extending financial services to serve SMEs, with emphasis on leasing, loan guarantees, and long-term financing.

Task 3. Interview GOE, donor and private sector officials and experts in Egypt on the issues facing the development of SMEs and meeting their financial needs. In particular, obtain the views of officials and experts of the MOE, Central Bank, World Bank, IMF, UNDP, USAID, Egyptian Exporters Association, academic and private think-tanks, etc. A small group of interested public-private sector stake-holders will be invited by DEPRA to serve on a Study Advisory Group. The study team will consult and interact with the Advisory Group to the maximum extent feasible.

Task 4. Develop questionnaires for interviews with SMEs and Banks. Include in the SME questionnaire questions about SME financing needs and experience with banks and other financial institutions. Confer with the World Bank staff about earlier SME questionnaires. Develop a second questionnaire for interviewing banks and other financial institutions about their experience with SME financing.

Task 5. Translate the questionnaire/s into Arabic.

Task 6. Develop a sampling methodology for selecting the SMEs and Banks to be interviewed.

Task 7. Field test and refine the questionnaires.

Task 8. Interview at least 75 representative SMEs in three large urban centers (Cairo, Alexandria, and one other center) and non-farm SMEs in two rural communities to determine

the proportion of their sources and uses of funds and the particular constraints they face in remitting and receiving remittances, obtaining short and long term credit, and managing their financial resources over the different seasons. In particular, explore the extent to which they secure informal and formal finance through trade credit, accounts receivable finance, discounted instruments etc., the terms and conditions under which financing is available, and the impact of this finance on investment, exports, and employment. Prepare analyses of the SME interview data, focusing on SME demand for financing, problems of obtaining credit, and impacts of removing financial and other major constraints to SME growth. Discussions with many professionals suggest that a larger number (e.g., 200) of SME interviews would be desirable to allow more rigorous data analysis. This will be explored and implemented to the extent feasible.

Task 9. Interview managers of major donor and GOE sponsored special SME financing programs, including those providing uncollateralized loans to informal micro enterprises, loan guarantees, leasing, and trade financing to determine the feasibility of commercially replicating these programs in the formal or informal financial sectors and/or linking them with formal financial institutions. Based upon these interviews and earlier research of programs in Egypt and other countries, prepare analyses of major special finance programs.

Task 10. Interview a representative sample of managers of banks and other financial institutions. At least 20 institutions in the above five geographical areas would be interviewed, including providers and potential providers of financial services to SMEs, about their experience in providing such financial services and the difficulties they experience, particularly on account of institutional, policy and regulatory constraints. Determine how adequate collateral could be provided by SMEs, how it could be efficiently recovered through the judicial system in the event of default, and how other credit documentation could be improved. Based upon these interviews and other relevant research, prepare analyses of the problems and capacity of banks and other financial institutions to provide SME financial services.

Task 11. Determine the extent to which urban SME transactions, including exports and imports, are constrained by lack of access to formal financial institutions, and the potential of innovative financial instruments to relax those constraints.

Task 12. Provide a prioritized set of policy and regulatory reforms that the GOE could implement to facilitate increased SME access to financial services. Particular attention will be paid to cross-cutting effects on the prudential soundness of the financial system and other economic priorities of the GOE.

Task 13. Prepare a draft report of findings, conclusions, and recommendations for review by and discussion with officials of the GOE, USAID, other donors, and private sector groups in Egypt.

Task 14. Produce a Final Report incorporating the study's final findings, conclusions, and recommendations to the GOE and donors for improving SME financing and growth in Egypt.

After the study is completed, it is expected that the Final Report would be presented at a Conference on Financial Sector Reforms and SME Development in Egypt. Follow-up discussions

with GOE and donor officials on implementation of recommended reforms are also anticipated.

4. METHODOLOGY

The Team Leader should propose to the DEPRA study coordinator a detailed Work Plan for the study. It is anticipated that the joint DEPRA - MOE/RIS team would work mostly in Cairo, reviewing relevant literature and interviewing GOE, donor, private sector, and financial sector officials and SME owners/managers. However, the team would also need to travel to several other urban centers and rural communities in Egypt for interviews with formal and informal financial institution managers and SME owners/managers.

The interviews of SME owners/managers will require the development of an interview form. Interviews of this sort have been successfully conducted on a qualitative basis in many commercial centers and their interview forms can be used to develop the interview for this study. See for example Benedict's 1962 study of Tehran's bazaar merchants, the recent Asian Development Bank sponsored surveys in five Asian Countries, the World Bank 1993/94 survey of private enterprises in Egypt, and the 1995 interviews of Egyptian rural enterprises by Nagy and Adams.

Interviews with financial sector managers will also be based upon an interview form. While this may draw on the form developed by Nagy and Adams (above), it will necessarily be much more of a guide for open ended discussions of SME financing issues with financial institution managers.

This SME finance study will benefit from the opportunity to collaborate with another more focused, DEPRA study on Trade Finance Reforms for Small Enterprise Development in Egypt (see attached SOW). The latter study includes interviews with financial institutions and SME export-oriented enterprises and analyses of trade finance constraints and policy issues. While it focuses on trade finance, it will facilitate and complement the more general SME domestic finance study. The overall effectiveness and synergy of both studies would be increased if they are implemented in tandem.

5. DELIVERABLES

1. A detailed Work Plan within one week of beginning the study.

2. Questionnaires to be used for interviewing SMEs and banks/other financial institutions, within 3 weeks from commencement of the study.

3. A Draft Report with findings, conclusions, and tentative recommendations for review by and discussion with GOE officials, USAID staff, Study Advisory Group, and other representatives of financial institutions and the business community in Egypt at least one week prior to team departure from Cairo.

4. Meetings and presentations to the above groups to obtain their review and comments.

5. A Final Report, incorporating review and comments, completed before team departure from Cairo.

The Draft and Final Reports shall be written in English with an executive summary translated into Arabic. The Final Report will also be submitted on a computer diskette, with Word Perfect or MS World for text files and Excel or Lotus 1-2-3 tables and graphs.

6. LEVEL OF EFFORT AND STAFFING REQUIREMENTS

The study will require five experts, three Egyptians and two expatriates, working over 3.5 months. The Egyptian expert consultants will be contracted for 2 person months each. They should have graduate training in economics or business administration, be familiar with the workings of the financial sector and SMEs in Egypt, and have experience conducting the sort of SME and financial sector interviews envisioned.

One of the expatriates will serve as team leader and be contracted for up to 3 person months. The other expatriate will be contracted for up to 2.5 person months. The consulting time in Egypt will be broken into 2 three to six week periods separated by up to one month off. The expatriates should have graduate level training in economics or business administration, experience with SMEs and financial services for them in a wide variety of countries, and particularly experience with expanding access to formal financial institutions. They should also have some background in the debates on financial development and repression and its relation to overall development. At least one of the expatriates should have experience with interviews of private sector enterprises.

Four MOE/RIS staff economists capable conducting interviews in Arabic, translating for the expatriate experts, and computer processing the interview forms and other data analyses will be required for two months full-time. They will be provided by RIS without charge to the study. The study team will be supported on a part-time basis by one DEPRA Egyptian long-term economist.

The study will reserve funding for contractor(s) who may be required to assist with the proposed survey of SMEs. If and when such contractor(s) are identified, written approval from the COTR will be requested before issuing contract(s). It is anticipated that the contract(s) would be in the form of purchase/work order(s) for survey deliverables.

7. START AND COMPLETION DATES

The study would begin on or about September 7 and be completed by December 19. The Final Report would be presented at a MOE/RIS - DEPRA sponsored Conference on Financial Sector Reforms for SME Development after the study is completed.

8. LOCATION OF WORK

Unless otherwise agreed to by the Study Coordinator, all work will be done in Egypt, except for up to 4 days work on the questionnaire that may be done in the USA by the team leader working with counterparts at the World Bank. While most of the work in Egypt will be done in or around Cairo, the team will need to travel to other locations in Egypt to conduct interviews.

9. REPORTING PROCEDURES AND OTHER CONDIITONS

The team leader shall report to the DEPRA study coordinator. The consultants will collaborate with and contribute to the DEPRA Trade Finance Reform for Small Business Development study. The team leader will be in charge of both study teams. The consultants shall work closely such GOE officials, USAID/Egypt staff, and representatives of the financial and business community. In particular, the consultants shall work with Dr. Farouk Shakweer, First Undersecretary, MOE/RIS, and/or others designated by him.

A six day work week is authorized for expatriate short-term consultants for work performed outside the United States. The DEPRA Project shall provide necessary in-country logistical support, including transportation, office space, access to telephones, essential photo-copying, and basic secretarial support. A printer in the DEPRA office will be available for printing computer files. However, the consultants would need to provide their own personal computers. The Egyptian team members, in addition to their professional duties, shall be expected to act as translators and interpreters as needed for interviews, essential documents and reports, and to facilitate the activities of the expatriate consultants or study coordinator as needed.

Appendix D

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Appendix E

List of Organizations Contacted

Al Watany Bank of Egypt
Alexandria Business Association
Alexandria Commercial and Maritime Bank
Arab Management Association
Arab Investment Bank
Bank of Alexandria
Banque Misr
Banque du Caire
Central Bank of Egypt
Commercial International Investment Co.
Credit International D'Egypte
Credit Guarantee Company
DEPRA Project (MOTS)
DEPRA Project (MOE)
Egyptian Exporters Association
Egyptian Center for Economic Studies
Export Development Bank of Egypt
Export Credit Guarantee Co. of Egypt
Industrial Development Bank of Egypt
International Finance Corporation
Ministry of Economy
Ministry of Trade & Supply
Misr International Bank
Mohandes Bank
National Bank of Egypt
National Bank for Development
Nile Clothing Co.
Nile Bank
Nile Agricultural Development Company
ORIX Leasing Egypt S.A.E.
Societe Arabe Internationale de Banque
Suez Canal Bank
U.S. Agency for International Development
United Company for Oriental Sweets
United Securities Stockbrokers
World Bank
World Trading Company (Egypt)

الإصلاح المالى من اجل تنمية المشروعات الصغيرة فى مصر

معد لأجل

حكومة جمهورية مصر العربية

مقدم الى

الوكالة الامريكية للتنمية الدولية

مقدم من

مؤسسة ناثان (Nathan Associates Inc.)

عقد رقم

٢٦٣-C-٠٠-١٦-٠٠٠٠١-٠٠

ديسمبر ١٩٩٧

الملخص التنفيذى

يشهد القطاع المالى فى مصر تحريراً شاملاً منذ عام ١٩٩١. فقد تمت إزالة القيود الائتمانية، وتحرير سعر الفائدة ونظم اسعار الصرف، وكذلك تطبيق تنظيمات ولوائح مصرفية حديثة، بالاضافة الى استخدام عطاءات أذون الخزانة، واعادة الحياة الى سوق الاوراق المالية. ومع ذلك، لازال القطاع المالى يخضع لسيطرة المؤسسات الحكومية ذات الاداء المنخفض جداً، التى تقوم بتخصيص نسبة كبيرة جداً من المدخرات الخاصة لتمويل ديون القطاع العام. يضاف الى ذلك، ان الشطر الاعظم من ائتمان القطاع الرسمى يتم توجيهه الى الشركات الكبيرة. أما المشروعات الصغيرة والمتوسطة الحجم، متضمنة الورش الحرفية الصغيرة جداً فى القطاع غير الرسمى، والتى تولد معظم القيمة المضافة، والتوظف فى الدولة. تبدو مستبعدة من تمويل المؤسسات المالية الرسمية، الامر الذى جعلها تعتمد الى حد كبير على التمويل غير الرسمى والتمويل الذاتى.

وفيما يتعلق ببرامج الائتمان المدعم للمشروعات الصغيرة والمتوسطة، نجد انها تغطى جزءاً ضئيلاً من الطلب على التمويل من جانب هذه المشروعات. وحيث يعد هذا الامر قصوراً فى توفير الائتمان لأكثر الاجزاء ديناميكية فى الاقتصاد المصرى، نجد ان الامور تسير بشكل معاكس لما وضعته الحكومة من اولويات من اجل زيادة معدل النمو الاقتصادى، وتوسيع فرص التوظف، الامر الذى دعى وزارة الاقتصاد الى طلب إجراء هذه الدراسة بهدف التركيز على كيفية توفير الائتمان للمشروعات الصغيرة والمتوسطة.

وتهدف هذه الدراسة الى تحديد القيود الرئيسية التى تحول دون توفير الائتمان للورش الحرفية والمشروعات الصغيرة والمتوسطة، التى تتمتع بإمكانات النمو وزيادة فرص التوظف فى مصر، وكذلك لتقديم توصيات للسياسة من اجل زيادة القدر المتاح من هذا النوع من الائتمان. وعلى حين انصب التركيز على المشروعات صغيرة ومتوسطة النطاق التى تمتلك مقومات النمو، فقد قامت الدراسة ايضاً بتقييم الوضع التمويلى للورش الحرفية الصغيرة جداً التى تنتمى الى القطاع غير الرسمى، والتى تتوافر لديها امكانات النمو، وكذلك الخبرة والقيود التى تواجه المصارف والمؤسسات غير المصرفية عند تمويل هذه الورش الحرفية، ويتضمن ذلك برامج التمويل من جهات مانحة خاصة، والبرامج التى ترعاها الحكومة المصرية. كما قامت الدراسة بتناول الاشكال المتنوعة من التمويل، سواء الراهنة او المرتقبة، كما تم استعراض الاهمية المحتملة لتمويل المشروعات الصغيرة والمتوسطة، والتى تشتمل على التأجير، وضمانات القروض. ويقدم هذا التحليل الاساسى الذى يمكن من خلاله تقديم التوصيات الخاصة بالسياسات، والاصلاحات القانونية والتنظيمية، والبرامج الخاصة التى تستهدف تحسين درجة توافر الائتمان لقطاع المشروعات الصغيرة والمتوسطة فى الاقتصاد المصرى.

وتضمنت هذه الدراسة بداءة اختباراً لعرض وطلب الخدمات المالية المقدمة لقطاع المشروعات الصغيرة والمتوسطة فى مصر. وقد اشتمل ذلك من ناحية على مقابلات مع مدراء المؤسسات المالية سواء فى القطاع الخاص او العام، والتى تقوم بعرض الائتمان للمشروعات الصغيرة والمتوسطة. وقد غطت المقابلات

الشخصية فى هذه الدراسة مناطق القاهرة، الاسكندرية، بورسعيد، دمياط، مدينة السادس من أكتوبر، مدينة العاشر من رمضان، الفيوم، كما اشتملت على مقابلات مع المسؤلين فى البنك المركزى المصرى، واحد عشر مصرفاً تجارياً، وثلاثة من مصارف الاعمال والاستثمار، واثنين من المصارف المتخصصة، وكذلك خمس من مؤسسات التمويل غير المصرفية. ومن ناحية اخرى، اشتمل بحث جانب الطلب على مقابلات شخصية مع عدد (١٧٣) من اصحاب ومدراء هذه المشروعات بقصد تقدير الطلب على الائتمان. وقد تم اجراء تلك المقابلات فى مدينة القاهرة الكبرى مشتملة على مدينتى السادس من أكتوبر، والعاشر من رمضان. بالاضافة الى مدن الاسكندرية، والفيوم. وقد تم اختيار الشركات التى تم استقصائها بشكل عشوائى من قطاع السلع المصنوعة، والخدمات، وقطاعات التجارة. ولقد تم التركيز بداءة على القطاعات الفرعية الاكثر ديناميكية فى مجال المنسوجات والملابس، تصنيع الاثاث الخشبى، صناعة الاحذية، المنتجات الحرفية، وصناعة السجاد، وشركات السياحة، الفنادق والمطاعم، شركات الخدمات، وتجارة الجملة والتجزئة.

عرض خدمات التمويل لقطاع المشروعات الصغيرة والمتوسطة:

بناء على فهم آليات عرض وطلب خدمات التمويل لقطاع المشروعات الصغيرة والمتوسطة، تم اقتراح خطط التدخل الملائمة، والاصلاحات الكافية للسياسات، وذلك للمساعدة فى تطوير الاسواق المالية. وقد اوضحت نتائج الدراسة انه بالرغم من الهيمنة الكاملة (مايزيد على٩٨%) للمشروعات الصغيرة والمتوسطة والورش الحرفية فى الاقتصاد المصرى، فان قروض البنوك التجارية لهذه المشروعات تمثل نسبة ضئيلة نسبياً من اجمالى الاقراض. وتشير التقديرات الى ان حجم هذا النوع من الاقراض الذى تقدمه مجموعة البنوك الداخلة فى العينة الى المشروعات الصغيرة والمتوسطة يتراوح بين ٥%، ٦% من اجمالى الاقراض. ونجد ان كل الاقراض الموجه الى الصناعات الحرفية الصغيرة تقريباً، والذى مصدره البنوك التجارية يكون مدفوعاً بمبادرات سياسية، وتأتى قوته الدافعة المبدئية من "الصندوق الاجتماعى للتنمية". الذى يمثل مبادرة الحكومة فى هذا الصدد.

ويؤدى سعر الفائدة الذى يقوم الصندوق الاجتماعى للتنمية—وهو يقل عن سعر الفائدة السوقى—بالاقراض على اساسة للمشروعات الحرفية وصغار المقترضين الى إعاقة عملية المشاركة الواسعة من جانب البنوك التجارية فى إقراض للمشروعات الصغيرة والمتوسطة. ويقول رجال البنوك انهم يخسرون فى عمليات إقراض هذه المشروعات بسبب ارتفاع معدلات فقدان هذه القروض، والنفقات التى ترتفع عن النفقات العادية والتى تصاحب هذا النوع من الاقراض. وباستثناء البنك الوطنى للتنمية، تتهرب المصارف من إقراض المشروعات الصغيرة والورش الحرفية بسبب ارتفاع التكلفة والمخاطرة. يضاف الى ذلك، ان المصارف التجارية فى مصر، مثلها فى ذلك مثل معظم دول العالم، ليس لديها الفهم الكافى لآليات اقراض مثل هذه المشروعات، وكيفية العمل على انجاحه. وقد اظهرت الدراسة عدم وجود اى بنك—باستثناء البنك الوطنى للتنمية—لديه سياسات، وإجراءات، وافراد، ونظم، وتدريب وفلسفة، من اجل النجاح فى اقراض المشروعات الصغيرة والورش الحرفية. ويتسق هذا الامر مع ما هو موجود فى كل مكان بالعالم.

وسياسات الضمانات المصرفية، تتفاوت بشكل كبير فيما بين المصارف الداخلة فى عينة الدراسة. من حيث متطلباتها التى تتراوح بين ١١٠%. ٢٠٠% من قيمة القرض. وتشتمل هذه الضمانات على العقارات. البضائع. الحسابات المقبولة. اوراق مالية قابلة للتداول، أرصدة نقدية، معدات، عقود التنازل. والضمانات المصرفية والشخصية. وجميع المصارف التى تم تناولها فى العينة قامت بتقديم قروض بدون ضمانات.

وعلى حين لا تعتقد بعض المصارف ان سياسات الضمانات التى تقدم على اساسها القروض ليست قاسية بالنسبة لصغار المقترضين، فقد اوضحت معظم المصارف انه كلما كان حجم المقترض صغيراً. كلما صعب عليه تقديم الضمانات الضرورية، ويرجع ذلك الى عدم ملكيته إياها، أوبسبب الارتفاع الكبير فى تكلفة التسجيل.

وبصفة عامة، يمكن القول بأن النظام المصرفى ليس تنافسياً بدرجة كافية، وذلك لأن غالبية الموارد التمويلية فى الدولة تتحكم فيها المصارف الحكومية الخمسة الكبرى. وهذا التركز فى القوة يقلل من المنافسة، ويقيد استخدام التكنولوجيا الحديثة. وعلى وجه الخصوص نظم التقارير الداخلية المبرمجة على الحاسب الآلى فى الفروع خارج القاهرة، وتقييد النطاق الذى تستخدم فيه خدمات مالية معينة (مثال ذلك: الوساطة التجارية، الرهن التجارى، القبول المصرفى).

وقد تمت دراسة خمسة نماذج مالية خاصة. ونموذج المنظمات غير الحكومية NGO كما توضحه جمعية رجال اعمال الاسكندرية، يبدو قابلاً للتطبيق فى مصر. ان توسع عدد المؤسسات التى تستخدم هذا النموذج يمكن ان يكون مفيداً فى توفير الائتمان للمشروعات الصغيرة والمتوسطة. يضاف الى ذلك، أن تشجيع التحرك الحذر فى السوق، من جانب المؤسسات القوية يكون مبرراً للوصول الى المزيد من المشروعات الصغيرة والمتوسطة. وهناك بعض القلق يتعلق بامكانية توسيع استخدام هذا النموذج فى السوق، باستخدام منهج الاقراض الراهن غير القائم على الضمانات، ولكن هناك سبباً للاعتقاد بأن وجود محفظة اضافية، ومخاطر الاقتراض الفردى المتوقعة مع وجود حجم أكبر من العملاء، يمكن احتواءها من خلال منهج التحكم فى التوسع، مع ادخال بعض التحسينات على نظم التشغيل، تكون مبنية على الخبرة. فالمؤسسات ذات الخبرة فى تطبيق أفضل ممارسة لارشادات الاقراض، يجب أن تكون مقرضاً واعياً عند أى مستوى فى سوق المشروعات الصغيرة والمتوسطة.

وبافتراض الانتشار المعقول لتطبيق نموذج المنظمات غير الحكومية NGO فى مصر، والنضج التطبيقى لأحسن التطبيقات الدولية فى تمويل المشروعات الحرفية الصغيرة جداً فقد يستحق الأمر تشجيع تطوير صناعة اقراض المشروعات الحرفية من خلال هذا النموذج. إن تقديم هذا النموذج بشكل رسمى كصناعة، ومن خلال الابتكار، ووجود تشريع يتسم بالمرونة، يمكن ان يساعد الجهات التى تطبق هذا النموذج مثل جمعية رجال أعمال الاسكندرية على الوصول الى مصادر التمويل التجارى ومن ناحية أخرى، وعلى الرغم من السجل المالى الممتاز لجمعية رجال اعمال الاسكندرية، فقد لا تكون المصارف قادرة على تقديم مقادير كافية من الاقراض بدون ضمانات الى مثل هذه الجمعية لأن وضعها القانونى يمنع المصارف من رفع دعاوى قضائية ضدها بالمحاكم فى حالة الفشل فى السداد.

إن وجود برامج خاصة لاقراض المشروعات الحرفية والصغيرة داخل المصارف يبدو أمراً قابلا للتطبيق. فالبنك الوطني للتنمية قام بالتوسع في برنامج إقراض المشروعات الحرفية بشكل سريع، وحقق الربحية في فترة زمنية قصيرة. وقد تحقق هذا الأمر عن طريق القيام بعمليات تتسم بكفاءة مرتفعة، والتحكم في خسائر القروض، والمتابعة الوثيقة لنسب الاداء، ومعدل فائدة فعلي مرتفع. وقد استطاع البرنامج الوصول الى عدد كبير من المقترضين، وحقق درجة معقولة من النجاح بشكل يبرر تنفيذه من خلال شبكة فروع البنك.

ونموذج ضمان الائتمان، كما توضحه وثيقة شركة ضمان الائتمان يقدم أيضاً منافع معينة. وشركة ضمان الائتمان هي الشركة الخاصة الوحيدة في مصر، التي تقوم باصدار الضمانات للمصارف من اجل اقراض المشروعات الصغيرة والمتوسطة، وكانت هي المسؤلة عن زيادة حجم الائتمان المصرفي لهذا القطاع. ومع وجود حجم ضمانات قائم مقداره (١٩١) مليون جنيه مصري، أمكن مضاعفة الاموال التي تبلغ (٩٤) مليون جنيه مرتين. وكانت المطالبات في مواجهة الضمانات تبلغ نسبة ضئيلة مقدارها ١% والتي تعد نسبة منخفضة جداً بالمعايير الدولية. ومن ناحية اخرى، فان تركز النشاط التجاري لدى عدد محدود من المصارف، يوضح ان شركة ضمان الائتمان لم تكن ناجحة في تسويق انشطتها، أو ان عادات التشغيل ضعيفة الاستجابة، وقد أدت الى تقييد نشاطها، أو ان هناك طلباً محدوداً على ضماناتها. علاوة على ذلك، نجد ان رسوم الضمان تغطي جزءا صغيراً فقط من نفقات شركة ضمان الائتمان. ويتم تمويل الشطر الاكبر من العمليات بالدخل المتولد من القرض الميسر من الحكومة، ومنحة الوكالة الأمريكية للتنمية الدولية USAID. وعلى حين لا يبدو هذا الامر غير عادي عبر العالم، فالامر يدعو الى طرح سؤال يتعلق بمدى استمرارية التمويل طويل الاجل لمنهج شركة ضمان الائتمان، ما لم يكن قادراً على توسيع نطاق أنشطة الضمان الى سوق أكثر اتساعاً. ووجود وحدة حكومية لإدارة المشروعات الصغيرة تعتبر بديلاً غير قابل للاستمرار.

ويعتبر الصندوق الاجتماعي للتنمية برنامج حكومي محمود القصد، يستهدف العاطلين من خريجي الجامعات، ولكن الانشطة التي يقوم بها تؤدي الى حدوث تشوهات في اسواق الائتمان، بسبب معدلات الفائدة المدعمة ومعدلات إعادة السداد التي تختلف عن المعايير المعتادة. ولاينبغي النظر الى نموذج الصندوق الاجتماعي للتنمية على انه قابل للاستمرار لتحقيق توسع في الائتمان ينمو ذاتياً ويوجه للمشروعات الحرفية الصغيرة، دون حدوث تحول كبير في الاهتمام تجاه تحسين الحوافز المالية، والقدرة المؤسسية للمصارف والمؤسسات غير المصرفية، فيما يتعلق باقراض المشروعات الصغيرة والمتوسطة.

وفيما يتعلق بصناعة التأجير المصرية الناشئة، فهي ربما تقدم احد أهم النماذج لتوسع تمويل المشروعات الصغيرة والمتوسطة في المستقبل. فمن خلال ادواتها المرنة، تستطيع تقديم ما يقرب من ١٠٠% من التمويل اللازم للمعدات، وتستطيع الربط بين المدفوعات وبين تدفقات نقدية معينة، فان صناعة التأجير من المحتمل ان تكون بمثابة أحد المصادر البديلة لتمويل المشروعات الصغيرة والمتوسطة في مصر،حيث يواجه صغار المنظمين صعوبات في شروط الاقراض.

الطلب على خدمات التمويل فى قطاع المشروعات الصغيرة والمتوسطة:

أظهر مسح المشروعات الصغيرة والمتوسطة عددا من النتائج تتعلق بطلب هذه المشروعات على خدمات التمويل، تتمثل فى الآتى:

أولا: المصدر المبدئى للتمويل المستخدم من جانب معظم المنظمين الذين اشتملت عليهم عينة البحث. كان يتمثل فى الايرادات المحتجزة.

ثانيا: الائتمان التجارى الذى يأخذ شكل ائتمان موردين، والدفعات النقدية المدفوعة مقدما من جانب العملاء. استخدمها بشكل كبير ما يزيد على نصف عدد المشروعات الحرفية، والصغيرة، والمتوسطة.

ثالثا: تعتبر القروض الرسمية وغير الرسمية بدائل امام المنظمين،تعتمد على حجم المشروع.

وقد استخدمت نسبة صغيرة من المشروعات الحرفية القروض الرسمية قياسا الى تلك المشروعات التى استخدمت القروض غير الرسمية، بينما استخدمت نسبة اصغر من المشروعات الصغيرة والمتوسطة القروض غير الرسمية قياسا الى تلك التى تستخدم القروض الرسمية.

وما يزيد عن نصف عدد المشروعات الصغيرة والمتوسطة كان لديه طلبا فعالا على التمويل المصرفى خلال العام الماضى. علاوة على ذلك، فمن الامور الهامة ان نلاحظ ان متوسط المقادير التى استخدمها المنظمون فى المستويات الثلاثة من المشروعات (الحرفية، الصغيرة، المتوسطة) تعكس بدرجة كبيرة ارتفاع قيمة القروض الرسمية بالقياس الى القروض غير الرسمية. ولم تظهر الدراسة ان الترشيد الكمى للقروض يمثل مشكلة او عنق زجاجة، الامر الذى يتعارض مع الاعتقاد الشائع بوجود تمييز ضد المشروعات الصغيرة. وملاحظة هؤلاء المنظمين توضح قيامهم بشكل اختيارى بالابتعاد عن اسواق الائتمان الرسمية، ويرجع ذلك الى خوفهم من عدم القدرة على اعادة السداد، والى وجود مصادر اخرى بديلة، والى المعتقدات الدينية والنظر الى معدلات الفائدة السوقية باعتبارها مرتفعة جدا.

وقد لوحظ ان المنظمين الذين اشتملت عليهم عينة البحث يشاركون فى قنوات إدخارية مختلفة. ومن ضمن أكثر قنوات الادخار شيوعا نجد البنوك التجارية. فمن ناحية، نجد ان غالبية المنظمين الذين يديرون مشروعات صغيرة أو متوسطة لديهم على الاقل حساب واحد مع أحد البنوك التجارية فى الدولة. ومن ناحية أخرى، نجد ان حوالى ثلث اصحاب الورش الحرفية لديهم حساب مع أحد البنوك التجارية. كما ان نظام الجمعيات (وهو نظام ادخار جماعى دورى) كان هو ثانى أهم قنوات الادخار التى استخدمها المنظمون الداخلون فى عينة البحث. ونؤكد مرة اخرى ان حجم المشروع يؤدى الى وجود فروق هامة. فما يزيد عن ثلث عدد المشروعات الحرفية الصغيرة شارك فى مثل هذه الجمعيات الادخارية، بينما نجد ان حوالى الربع من المشروعات الصغيرة قد شارك، أما بالنسبة للمشروعات متوسطة الحجم، فنجد ان عددا قليلا منها شارك فى هذه الجمعيات. واخيرا، لوحظ ان عددا قليلا جدا من المنظمون قاموا بادخار اموالهم لدى شركات غير رسمية لتجميع المدخرات، وهذه القلة أشارت الى احتفاظها ببعض الاموال لدى احد اعضاء الاسرة.

عرض وطلب خدمات التمويل فى قطاع المشروعات الصغيرة والمتوسطة:

تقدم نتائج الدراسة رؤى ثمينة لعرض وطلب خدمات التمويل فى قطاع المشروعات الصغيرة والمتوسطة فى مصر. وعلى حين اشارت البنوك التجارية ان اقراض المشروعات الصغيرة والمتوسطة يمثل نسبة صغيرة جدا من المحفظة الشاملة. فان تحليل طلب المنظمين على خدمات التمويل الرسمى يبين ان ما يزيد على نصف عدد المشروعات الصغيرة والمتوسطة الحجم يسحبون قروضا من البنوك. وينتج التباين والاختلاف بدرجة كبيرة من نظرة رجال البنوك التى تعتبر ان اقراض المشروعات الصغيرة والمتوسطة مماثل تماما لإقراض المشروعات الحرفية الصغيرة جدا. إن طلب المشروعات الصغيرة والمتوسطة على الخدمات المالية الرسمية يختلف بوضوح عن طلب المشروعات الحرفية الصغيرة جدا. وقد لوحظ ان اصحاب المشروعات الصغيرة والمتوسطة يسحبون مقادير كبيرة من القروض الرسمية، وهى مقادير أعلى كثيرا مما اشار اليها رجال البنوك عند سؤالهم عن حجم اقتراض المشروعات الصغيرة والمتوسطة. ولا يبدو ان المشروعات الصغيرة والمتوسطة الحجم تواجه قيدا معوقا فيما يتعلق بقدرتها على الوصول الى التمويل المصرفى. وكما هو متوقع، لم تقدم البنوك التجارية على تمويل المشروعات الحرفية الصغيرة إلا من خلال برامج وخطوط ائتمانية خاصة.

إن المنظمات غير الحكومية NGOs وغيرها من البرامج الخاصة مثل الصندوق الاجتماعى للتنمية، تقدم الشطر الاعظم من اقراض المشروعات الحرفية الصغيرة، وبعض المشروعات الصغيرة. إن تدعيم نمو مثل هذه البرامج، المبنية على "افضل الممارسات" فى اقراض المشروعات الحرفية سوف يؤدى دون شك الى امتداد واستمرارية هذه المؤسسات، ويسهم فى تقديم المزيد من التدفق الائتمانى الى قطاع المشروعات الصغيرة والمتوسطة. وهذه الجهود، سوف تصل فقط الى نسبة صغيرة من قطاع المشروعات الحرفية الصغيرة الهائل. فأصحاب المشروعات الحرفية يعتمدون الى حد كبير على المصادر غير المصرفية للتمويل مثل الايرادات المحتجزة، القروض غير الرسمية، الائتمان التجارى. وعدد كبير من المشروعات الصغيرة والمتوسطة يسحبون أيضاً من هذه المؤسسات غير المصرفية. إن المدى الذى يتم من خلاله استخدام التمويل المصرفى من جانب المشروعات الصغيرة والمتوسطة يكون أكثر اهمية من المدى الذى من خلاله تقوم المشروعات الحرفية بالسحب من البنوك أو من برامج التمويل الخاصة. فالابتعاد الاختيارى عن اسواق التمويل الرسمية من جانب المشروعات الحرفية الصغيرة يفسر جزءاً من هذه الظاهرة،وهو عكس الاعتقاد الشائع برفض المشروعات الصغيرة والمتوسطة من جانب المؤسسات الرسمية بشكل عام.

التوصيات:

إن تحسين الاداء الشامل لقطاع التمويل سوف يعود بالفائدة على كافة المشروعات، متضمنة المشروعات الحرفية، والمشروعات الصغيرة والمتوسطة ويمكن تحسين الاداء الشامل من خلال التوصيات التالية:

- الاستمرار والاسراع فى عمليات خصخصة النظام المصرفى من أجل رفع مستوى المنافسة، وزيادة الخدمات المقدمة لقطاع المشروعات الصغيرة والمتوسطة.

- ينبغى استكمال الخصخصة بجهود تستهدف تقليل درجة هيمنة هذه المؤسسات عن طريق تجزئتها الى كيانات أصغر من أجل تشجيع المنافسة والابتكار.

- مراجعة الموقف الحالى للبنك المركزى المصرى الرافض للموافقة على السماح بدخول بنوك أجنبية جديدة. إن نافذة السماح بالدخول عن طريق شراء حصص الدولة فى البنوك المشتركة تعتبر أمرا ايجابيا، وإن كانت غير كافية. فالبنوك الأجنبية تستطيع دخول السوق فقط فى حالة امتلاكها للكيان العامل بنسبة ١٠٠%. وتشير تجربة الاسواق سريعة التقدم فى آسيا، الى ان حرية دخول السوق نتجت عنها ممارسات مصرفية حديثة. وزادت درجة المنافسة، الامر الذى أدى الى توافر الائتمان بتكلفة أرخص وأكثر استقراراً، ووجود مؤسسات مالية أكثر قوة. فالاقتصاد المصرى لايزال غير متخم من الناحية المصرفية.

- تقليل تكلفة الاموال للمؤسسات المصرفية عن طريق تخفيض عن طريق تخفيض متطلبات الاحتياطى الى المستويات الواعية المطلوبة. فإذا صاحب ذلك زيادة التنافسية فى البيئة المصرفية، وزيادة كفاءة البنوك، سوف ينتج عن ذلك تخفيض معدلات الفائدة السوقية الحالية. ويمكن التحكم فى التوسع المحتمل للمعروض النقدى من خلال عمليات السوق المفتوحة التى يقوم بها البنك المركزى.

- إلغاء التأثير الحكومى على الصناعة المصرفية عن طريق المكالبة بمعدلات فائدة منخفضة على القروض الموجهة للمشروعات الصغيرة والمتوسطة. فمعدلات الفائدة الاقل من المعدلات السوقية للفائدة تقلل من حوافز البنوك لتقديم القروض للمشروعات الصغيرة والمتوسطة.

- التنفيذ الكامل للتعليمات الحكومية التى تتطلب الافصاح الكامل للتقارير المالية للبنوك، عن طريق تقارير المراجعة السنوية ونصف السنوية طبقاً للمعايير الدولية. إن وجود سوق مصرفى خاص حر نتصور وجوده فى مصر مستقبلاً، فان المعلومات الافضل سوف تساعد على سحب المزيد من الموارد الى البنوك ذات الاداء الافضل، ويؤدى ذلك فى النهاية الى تحسين التوافر الشامل للائتمان، على كافة المستويات.

- تحسين الاشراف على البنوك من أجل الالتزام بالحرص والمنافسة عند الاقراض. إن الالتزام بتنفيذ القواعد الخاصة بالاحتياطى وكفاية رأس المال سوف يسمح للبنوك التى تبحث بشكل فعال عن مقترضين يتمتعون بالسمعة الطيبة، بأن تتوسع بشكل أسرع من البنوك التى تقدم قروضا لا تتسم بحسن الاداء.

- الاستمرار والاسراع فى عملية إصلاح نظام المحاكم، وعلى وجه الخصوص، إنشاء محاكم تجارية خاصة.

- تحديث التشريعات الحالية بحيث تؤدى الى وجود نظام لضمانات القروض أكثر مرونة، وأكثر أمنا، وغير مكلف.

- إدخال إصلاحات على برنامج الصندوق الاجتماعى للتنمية بحيث يتم استخدام موارده بشكل يشجع على وجود السوق الحرة فى تقديم الخدمات المالية الى المشروعات الصغيرة، وذلك استنادا الى الاسباب المالية وليس السياسية، عندما تقوم البنوك وغيرها من المؤسسات الاخرى بالمشاركة فى هذه السوق.

- وضع تشريع جديد وحديث ينظم نشاط المؤسسات المالية من المنظمات غير الحكومية NGO مثل جمعية رجال اعمال الاسكندرية. ولكى يتم اجتذاب عمليات تمويل الجملة من البنوك، يجب على هذا التشريع ان يسمح لهذه المنظمات غير الحكومية بالحصول على وضع قانونى يشبه ذلك الذى تتمتع به الشركات المشتركة عندما تحافظ على وضعها فى حالة عدم تحقيق ربح.

- يجب على الجهات المانحة والحكومة ان تشجع على إقامة وحدات خاصة داخل البنوك لتشجيع عمليات الجملة والتجزئة لإقراض المشروعات الصغيرة والمتوسطة، من خلال تقديم الدعم لتغطية نفقات إنشاء وبدء نشاط هذه الوحدات.

- ينبغى على الجهات المانحة والحكومة أن تشجع على توسع شركة ضمان الائتمان التابعة للقطاع الخاص، وذلك بدلا من تخفيف التركيز عليها أو التنافس معها من خلال إنشاء برنامج حكومى لإدارة المشروعات الصغيرة.

- العمل على الاسراع بسياسات تحرير التجارة لكى تقدم فرصا متزايدة لقطاع المشروعات الصغيرة والمتوسطة. والعمل على زيادة المنافسة بين تجار الجملة الذين يقدمون المواد الخام للعديد من المنظمين فى المشروعات الصغيرة والمتوسطة والورش الحرفية.

- العمل على تقديم الحوافز لشركات التجارة والتسويق التى يجب أن تساعد فى تسويق المنتجات تامة الصنع من انتاج المشروعات الصغيرة والمتوسطة، سواء فى السوق المحلى أو الاسواق الخارجية.

- التركيز بشكل مبدئى على تقديم الخدمات المالية وغير المالية للمشروعات الصغيرة والمتوسطة ذات امكانات النمو. وتشير نتائج الدراسة الى ان مثل هذه المشروعات تعتبر بمثابة محركات النمو فى الاقتصاد أكثر من المشروعات الحرفية الصغيرة التى تعتبر بمثابة عربات توليد الدخل.

- التركيز ايضا على تقديم الخدمات المالية وغير المالية للمشروعات الشابة ذات امكانات النمو المرتفعة. ويقصد بالمشروعات الشابة تلك المشروعات التى فى مراحل نموها الاولى، بعكس المشروعات البادئة والتى تتضمن درجة عالية من احتمالات الفشل.

- تخفيف القيود غير المالية التى تعوق نمو المشروعات. فقوانين الضرائب، وقوانين العمل، والتسويق. والاجراءات الحكومية الروتينية والمحظورات، حددها المنظمون الذين تم استقصائهم كمشـــاكل هامـــة حالية تقيد عملياتهم وآفاق نموها.

- تحسين الوصول الى اسواق المدخلات، واسواق المنتجات. والاجراءات الحكومية الاكثر كفاءة. وتعديل قوانين الضرائب والعمل التى تدعم نمو المشروعات الصغيرة والمتوسطة، سوف يؤدى الى وجود بيئة أكثر صلاحية لتنمية النشاط الاقتصادى بصفة عامة.